

**ETHICS IN FEDERAL INCOME TAX LEGISLATION:  
EXPECTATIONS VS. REALITY FOR LOW-INCOME  
TAXPAYERS**

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**Abstract**

Federal income tax laws often provide potential tax benefits for various groups of taxpayers based on specific social or economic policies. Some of these benefits are targeted specifically at low-income taxpayers while other benefits are targeted more generally but can still apply to low-income taxpayers. In certain cases the benefits actually available to low-income taxpayers may be less than expected when the legislation was passed. This paper discusses some tax benefits that presume to benefit low-income taxpayers. Discussion of these specific tax benefits will lead to discussion of ethical issues that may arise for those who legislate these tax provisions. Legislators might be deceptively creating discrepancies in a complicated tax code to appear to provide benefits for low-income taxpayers when, in fact, they know these benefits are limited or nonexistent. In the alternative, the ethics of competence in

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understanding the tax laws legislated is relevant: legislators may be voting on legislation they do not really understand.

## INTRODUCTION

Federal income tax laws often provide potential tax benefits for various groups of taxpayers based on specific social or economic policies. Some of these benefits are targeted specifically at low-income taxpayers. An example of this type of benefit is the earned income tax credit which provides a tax benefit for working taxpayers with low incomes. Other tax benefits are targeted more generally but can still apply to low-income taxpayers. An example of this type of benefit is the child tax credit.

In some cases the benefits actually available to low-income taxpayers may be less than what taxpayers are led to expect when the legislation was passed. Discrepancies can arise because of (1) specific qualifications and limitations within certain tax provisions, (2) evolution of tax laws over time which change the available benefits, (3) complications in coordinating multiple potential tax benefits, and (4) mistakes or errors in the law because of the legislative process. Some of the results can be quite counterintuitive.

This paper will first introduce and discuss selected tax benefits that are potentially available for low-income taxpayers. The benefits discussed will include the dependent care credit and exclusion, the child tax credit, the adoption tax credit and exclusion, and the retirement savings contribution credit. These examples will lead to a discussion of the ethical issues that may arise for those who legislate these tax provisions. Legislators might deceptively create discrepancies in a complicated tax code to appear to provide benefits for low-income taxpayers when, in fact, they know these benefits are limited or nonexistent. In the alternative, the ethics of competence in legislating tax laws may be applicable. For example, (1) in some cases, inadequate calculations have been performed to determine the actual effects of

tax laws on taxpayers with various income levels; or (2) legislators may be voting on legislation they do not really understand. This type of issue focuses on individual competence. However, another type of competence is also relevant--systemic competence. This is the competence of the entire legislative process related to tax legislation. The ethics of systemic competence will also be discussed.

Although social, economic, and political viewpoints are important to policy decisions, the paper will not include a discussion of these different viewpoints as to whether tax benefits targeted for the poor are appropriate. Instead, the focus will be on the ethical issues related to legislation of tax laws which may seem to benefit low-income taxpayers when they do not necessarily provide the claimed benefits.

### **TAX BENEFITS**

Federal income tax benefits potentially available for individuals include exclusions, deductions, exemptions, and credits. Generally, all income is taxable, but an exclusion is an income item which is specifically excluded from taxation by law. Deductions are expenses, either business or personal, that the law allows a taxpayer to subtract in calculating taxable income. An exemption is an amount set by law that the taxpayer is allowed to subtract in calculating taxable income even though the exemption is not directly related to an expense incurred by the taxpayer.

Generally, taxpayers are allowed a personal exemption (and one for the spouse as appropriate) plus another exemption for each person who qualifies as a dependent. These three tax benefits reduce taxable income, either by being excluded or by being subtracted from gross income. Taxable income is then used, applying the tax rates, to determine the amount of tax owed.

A tax credit is a reduction of the taxes otherwise owed rather than an amount used in calculating taxable income. Most personal tax credits are nonrefundable, meaning they can reduce an individual's tax liability down to, but not below, zero. A few personal tax credits are refundable, meaning they can reduce the

tax liability down to zero with any excess being paid to the taxpayer by the government. An example of a refundable credit is the earned income tax credit (EITC). “The structure of the EITC makes it clearly targeted at lower-income individuals. Specifically, the EITC is refundable and available to taxpayers with earnings below a threshold that varies based on family size and marital status.”<sup>1</sup>

Because the EITC is a nonrefundable credit, it can be very beneficial to low-income taxpayers. Some of the nonrefundable credits and the exclusions available to individual taxpayers may also seem particularly helpful to low-income taxpayers. However, some anomalies exist which limit the actual benefit which can be claimed by these taxpayers.

### **Dependent Care Credit and Exclusion**

The Internal Revenue Code provides two related tax benefits for people who need to pay for dependent care to allow them to work. One is a nonrefundable child care credit of up to 35 percent of the first \$6,000 (\$3,000 if only one child) a taxpayer pays for dependent care.<sup>2</sup> The second is an exclusion from income of up to \$5,000 of dependent care costs paid by the employer (or by the employee using a salary reduction agreement through an employer=s plan).<sup>3</sup>

The same expenses cannot qualify for both the exclusion and the credit. One potential problem for very low-income taxpayers such as those on a low hourly wage is that they are more likely to work for employers who offer no dependent care assistance plans. Therefore, these individuals will not be able to take the exclusion and will have to rely on whatever benefit they can obtain from the credit.

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<sup>1</sup> Stacy Dickert-Conlin, Katie Fitzpatrick, and Andrew Hanson, *National Tax Journal*, Volume 58, Number 4, December 2005, pp. 743-85 at 747.

<sup>2</sup> Internal Revenue Code (IRC) section 21.

<sup>3</sup> IRC section 129.

The amount of the credit is equal to the percentage applicable to the taxpayer=s adjusted gross income (AGI) multiplied by the dependent care expenses paid by the taxpayer during the year (reduced by any amounts received through an employer=s plan that are excluded from income). The percentage for the credit ranges from 35 percent of expenses for those with AGI under \$15,000 to 20 percent of expenses for those with AGI over \$43,000. The percentage is reduced by one percentage point for each \$2,000 of AGI, or fraction thereof, in excess of \$15,000.

Exhibit 1 shows the applicable percentages for the credit for different AGI levels and the maximum potential credit for each of these AGI ranges, assuming taxpayers have two qualifying children for the dependent care credit and will spend at least \$6,000 on child care during 2007. Because the credit is nonrefundable and some taxpayers will not have a tax liability large enough to absorb their potential dependent care credit, the maximum effective credit for taxpayers in the lowest AGI ranges is less than the maximum potential credit calculated using statutory limits.

Two different scenarios are illustrated in the exhibit. The first assumes a taxpayer filing as head of household with two children but who cannot claim the dependency exemption for his/her children because the exemptions will be taken by an ex-spouse. This scenario is illustrated because it represents the situation where the taxpayer is most likely (at smaller income levels) to have a tax liability against which to use the credit. Notice that under this scenario, the maximum effective credit is smaller than the maximum potential credit until the taxpayer=s AGI is in the \$25,001 - \$27,000 bracket.

The actual amount where the maximum effective credit and the maximum potential credit are first equal mathematically is \$26,583. The effective credit percentage (out of \$6,000 of expenses) is less than the applicable percentage credit until this level of AGI is reached and the effective credit percentage is only 29 percent.

The second scenario assumes a married couple filing jointly with four exemptions (taxpayer, spouse, and two children). While this might be a common situation, no effective credit is available until the taxpayers' AGI reaches \$24,300. Even then, the maximum effective credit does not match the maximum potential credit until the taxpayers have \$38,100 of AGI. Thus, the effective percentage (out of \$6,000) does not equal the applicable percentage in the tax code until the percentage drops to 23 percent. Thus, no taxpayer can ever get a dependent care credit even approaching the 35 percent credit promised by the tax code and perhaps expected by those who do not know otherwise. The maximum percent credit (for taxpayers with \$6,000 of dependent care expenses) is 29 percent in an extreme case and 23 percent in a reasonably likely case.

Even for taxpayers who do have an employer dependent care assistance plan that allows them to pay through a salary reduction option on a pre-tax basis, the choice between the exclusion and credit is not obvious. Black and Smith<sup>4</sup> illustrate how, depending on the AGI level, different taxpayers may be better off with one option versus the other, but taxpayers have no advance knowledge as to which might be better for them.

In addition, an employer's plan can only qualify for the exclusion if it meets certain nondiscrimination tests such that the contributions or benefits provided under the plan do not discriminate in favor of employees who are highly compensated. Thus, low-income taxpayers who may unknowingly be better off with the credit may be encouraged to participate in the employer plan because of the nondiscrimination rules that must be met in order for highly paid employees to qualify for the exclusion. Further, Smith and Black<sup>5</sup> show how some low-income taxpayers

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<sup>4</sup> Katherine D. Black and Sheldon R. Smith, "Dependent Care Tax Benefits: A Sham and a Scam," *Tax Notes*, Volume 113, Number 2, October 9, 2006, pp. 175-80.

<sup>5</sup> Sheldon R. Smith and Katherine D. Black, "Dependent Care Tax Benefits: A Second Look," *Tax Notes*, Volume 117, Number 7, November 12, 2007, pp. 718-722.

may actually be better off claiming no dependent care tax benefit than claiming the exclusion. Realistically, once taxpayers have decided on the child care exclusion through an employer, they are probably not going to calculate the effects, at year end, of their choice. Thus, taxpayers may never know they were worse off taking the exclusion than they would have been claiming no dependent care tax benefit.

### **Child Tax Credit**

The tax code provides a taxpayer with a credit for 2007 of up to \$1,000 for each qualifying child (under age 17).<sup>6</sup> This credit is generally nonrefundable, but part or all of it can actually become refundable as an Additional child tax credit<sup>7</sup> under certain conditions. Under the original legislation which provided for this credit, any or all of it could be refundable only for taxpayers who had three or more qualifying children, and the amount refundable was limited to a taxpayer's social security taxes in excess of his/her earned income credit. However, the refundability was later liberalized so that for 2007, taxpayers with fewer than three children might qualify to the extent of 15 percent of earned income in excess of \$11,750. Taxpayers with three or more qualifying children can claim a refundable credit based on the more favorable of these two limitations.<sup>7</sup>

Exhibit 2 shows the amount of income needed to fully claim the child tax credit for married taxpayers filing a joint tax return who have one to six qualifying children. The bottom row of the exhibit indicates the minimum level of income needed to fully

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<sup>6</sup> IRC section 24.

<sup>7</sup> Congressional committee reports make it clear that taxpayers are still supposed to be able to use the greater of these two limitations. The 2006 tax forms prepared by the IRS also reflect this committee intent. However, as noted later in the paper, because of a "technical correction" which was made contrary to the committee intent, the actual wording of the tax code now limits the refundability for taxpayers with three or more children to the social security taxes minus earned income credit test.

claim the credit as a combination of both the nonrefundable and refundable portions. Taxpayers who, for other reasons, do not have any tax liability at these income levels and need to take the entire credit as a refundable credit would need more income in five of the six cases as shown. It is certainly feasible that low-income taxpayers may earn less than these amounts and thus lose some of the child tax credit that they may have been expecting. Furthermore, the assumptions used for the exhibit were conservative. If the parents have additional dependents who are not qualifying children for the child tax credit or if they itemize deductions, the income numbers needed to fully claim the credit would increase.

### **Adoption Tax Credit and Exclusion**

The tax code also has potential tax benefits to help taxpayers who adopt a child. An adoption tax credit is available of up to \$11,390 per adoption.<sup>8</sup> A related exclusion of up to \$11,390 per adoption also exists for employer adoption assistance payments.<sup>9</sup> However, the situation for the exclusion for the lowest-income taxpayers may be the same as it is for dependent care benefits. Those with very low paying jobs are less likely to have employer adoption assistance plans available.

For those taxpayers who have adoption assistance available from an employer, the choice between the exclusion and the credit is far from straightforward. In some cases the optimal coordination of these benefits is extremely complicated or even impossible, even for a tax expert, partially because of the uncertainty of the timing of adoption payments and adoption finalization.<sup>10</sup>

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<sup>8</sup> IRC section 23.

<sup>9</sup> IRC section 137.

<sup>10</sup> Sheldon R. Smith and Glade K. Tew, "The Adoption Exclusion: Complications for Employees," *Tax Notes*, Volume 90, Number 5, January 29, 2001, pp. 659-664 and Sheldon R. Smith, "Adoption Tax Benefits: Emphasizing the Exclusion Before the Credit," *Journal of Accounting, Ethics & Public Policy*, Volume 4, Number. 4, Fall 2004, pp. 299-321.

The adoption tax credit is nonrefundable but can be carried forward for up to five years beyond the year of the original claim, perhaps because of the potentially large dollar amount of this particular credit. The option to carry the credit forward to future years provides a greater probability that taxpayers will be able to claim more of the credit. However, even with this provision, some low-income taxpayers will lose some or all of the credit because it will expire before it is used. Even if a taxpayer can fully use the credit, it may take up to six years, a significant amount of time, to claim a credit that taxpayers may have thought they would be able to claim almost immediately. The value of money over time may be significant if the credit must be taken over an extended period.

Exhibit 3 shows how much income taxpayers would need to be able to fully use the adoption tax credit over a six-year period for one, two, or three adoptions. For one adoption, the income needed is \$38,772. Obviously, the amount goes up for adoptions of two or three children which may occur if a sibling group is adopted. For two children the amount of income needed is \$54,828, and for three children the amount of income needed is \$70,883.

Similar calculations show what income level is needed to fully use the adoption tax credit in just one year for adoptions of either one or two children. For one adoption, the income level needed would be \$95,070. For two adoptions, the income level needed would be \$144,030. Obviously, these amounts would not be considered low incomes. However, even the amounts required in Exhibit 3 to take the full credit over six years may be more than what low-income taxpayers might make.

#### **Retirement Savings Contribution Credit**

The Internal Revenue Code also has a provision to encourage some low- and medium- income taxpayers to contribute to a retirement savings plan. The retirement savings contributions credit is a nonrefundable credit of up to 50 percent of the first \$2,000 contributed to a qualifying retirement savings plan (\$4,000

for a married couple filing jointly).<sup>11</sup> For taxpayers filing jointly, the credit is 50 percent for those with income between \$0 and \$31,000. It drops to 20 percent for those with income between \$31,001 and \$34,000 and drops again to 10 percent for those with income between \$34,001 and \$52,000. The credit is not available for taxpayers filing jointly if their income is above \$52,000.

Exhibit 4 shows the income needed to claim the full potential credit in each of the income brackets. Interestingly, those whose income is less than \$31,000 and who are therefore in the income bracket to claim a 50 percent credit, would need \$36,050 of AGI to have a tax liability large enough to get the \$2,000 credit. Thus, it is mathematically impossible for anyone to get the full 50 percent credit. The maximum credit that could be used for taxpayers with income equal to \$31,000 is \$1,350 (\$650 less than the statutory credit). A similar situation exists for those filing singly or as head or household. Taxpayers with incomes in the \$31,001 to \$52,000 brackets can possibly use the entire credit, but the credit is much less to start with because the percentage is only 20 percent or 10 percent rather than 50 percent.

If taxpayers have additional dependency exemptions above the two assumed in the table calculations or if they itemize deductions rather than claiming the standard deduction, the availability of this credit would be reduced or eliminated. Also, it is unlikely that taxpayers in the lowest income range shown above will be financially able to make \$4,000 of contribution to retirement savings plans.

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<sup>11</sup> IRC section 25B.

### **Multiple Tax Credits and Progressivity of Tax Structure**

The tax benefits discussed above have been examined in isolation. Some taxpayers may qualify for more than one of the nonrefundable credits discussed above. In addition, several other nonrefundable personal tax credits exist that have not been specifically discussed.<sup>12</sup> If taxpayers are eligible to claim multiple nonrefundable tax credits, the income level necessary to claim all of the credits is even higher than what has been illustrated with each credit in isolation.

As an example, Smith and Black<sup>13</sup> illustrate that the choice between the dependent care credit and the dependent care exclusion is complicated by other tax benefits that likely relate to low-income taxpayers who can claim the dependent care tax benefits. Since these taxpayers will also likely qualify for the child tax credit and the earned income credit, the choice becomes even more ambiguous. In fact, since dependent care expenses excludable from income through an employer's dependent care assistance program are also excluded from social security taxes, the social security savings also enters into the appropriate calculations to compare the benefits of the credit versus the exclusion.

Also, the progressive nature of the federal income tax rate structure makes it more difficult for low-income taxpayers to benefit from nonrefundable tax credits. Information from the Congressional Budget Office indicates that income tax rates for

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<sup>12</sup> See Aviva Aron-Dine, "Making Higher Education Tax Credits More Available to Low- and Moderate-Income Students: How and Why," Center on Budget and Policy Priorities, May 10, 2007 for an explanation that the two federal tax credits for higher education expenses—the Hope Credit and the Lifetime Learning Credit—are largely unavailable to low-income taxpayers, mostly because they are nonrefundable.

<sup>13</sup> Sheldon R. Smith and Katherine D. Black, "Dependent Care Tax Benefits: A Second Look, *Tax Notes*, Volume 117, Number 7, November 12, 2007, pp. 718-722.

low-income taxpayers are negative.<sup>14</sup> For 2003, the lowest quintile has a -5.9 percent tax rate and the second quintile has a -1.1 percent tax rate. Because many low-income taxpayers already have a negative tax due to refundable credits, it is even more difficult to legislate nonrefundable credits that can help this type of taxpayer. However, this is not an excuse to legislate credits that claim to help these individuals when they do not.

While it is true that an argument can be made that taxpayers do not deserve tax credits that will reduce their tax liability below zero, the point is that taxpayers may not get all of the tax benefits they are led to believe they may receive. Thus, ethical issues exist for those who are involved in the process of legislating these tax laws. Some of these issues will be discussed in the next section.

## **ETHICAL ISSUES IN TAX LEGISLATION**

Ethics reform seems to be the watchword on Capitol Hill these days. Fingers are pointed whenever there is a breach of ethical or moral conduct. Perhaps it is time to scrutinize not only the obvious moral and ethical lapses, but also the accepted, standard moral and ethical lapses that have become pervasive. Is it possible that legislators pass tax legislation, either knowingly or unknowingly, that seems to provide tax benefits for low-income taxpayers when, in fact, it does not? If this is done knowingly, then the ethics of deception are relevant. If it is done unknowingly, then the ethics of competence are relevant.

### **Ethics of Deception**

Tax laws which do not accomplish what they purport to accomplish or which do not benefit the taxpayers groups they seemingly target are deceptive. If legislators pass tax laws that they

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<sup>14</sup> Historical Effective Federal Tax Rates: 1979-2003, December 2005, Congressional Budget Office, accessed at <http://www.cbo.gov/ftpdoc.cfm?index=7000&type=1> on February 6, 2007.

know will not accomplish what they seem to do, have they breached an ethical duty? Might they gain politically by passing legislation that seems to benefit certain parties such as low-income taxpayers when the real effect of the legislation is different than it seems?

### **Ethics of Competence**

Competence in tax legislation can refer to individual competence. Do legislators read and understand the tax legislation they are voting on? Most of our Senators and Representatives have no specific training in accounting and taxation. Many likely do not prepare their own tax returns. Most likely have not read much, if any, of the tax code. The tax code is extremely complex. Even the Atax experts@ have commented on the complexity.

The distressingly complex and confusing nature of the provisions of subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years of experience in the tax field. . . . Surely, a statute has not achieved Asimplicity@ when its complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries.<sup>15</sup>

Even though this quotation comes from a 1964 tax court case, it seems relevant to the current tax code. Despite calls for simplification, the code seems to only become more complex over time. Since the tax code is complex and tax legislation which adds to or changes it is also complex, do the legislators really know what the ramifications are of proposed tax legislation? Do we

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<sup>15</sup> Foxman v. Commissioner 42 T.C. 535, 551 n. 9 (1964).

really believe that all the legislators carefully work their way through every tax act?

Competence in tax legislation can also refer to systemic competence. Does the legislative process work such that tax legislation is drafted and passed appropriately to achieve stated and/or intended results? Are errors made in the legislative process which result in tax legislation that is not consistent with intent?

### **Examples of Deception or Incompetence**

It may be difficult to distinguish problems with tax legislation that are a result of deception from those that are a result of incompetence. However, regardless of the reason, problems exist. These problems can relate specifically to misunderstanding by low-income taxpayers or others.

As mentioned earlier in this paper relating to the dependent care tax benefits and the adoption tax benefits, the difficulties for taxpayers in knowing whether to take the credit or the exclusion is not straightforward. What seems to be an obvious choice for one benefit over the other may counterintuitively become suboptimal. In addition, taxpayers, as a group, are not very sophisticated in their knowledge of the tax code. Low-income taxpayers cannot be expected to be any more sophisticated than other taxpayers, let alone more sophisticated than their legislators. Thus, any expectation that low-income taxpayers would even know there is a non-obvious choice to be made may be inappropriate.

It is one thing when qualifications and limitations on certain tax benefits make it unlikely for low-income taxpayers to get full advantage of them, especially when multiple tax benefits are involved. It is quite another thing when, as illustrated earlier in this paper, for the dependent care credit and the retirement savings contribution credit, it is mathematically impossible for any taxpayer to get the full statutory benefit of a tax credit. The calculations to determine the ability of a specific credit to provide the statutory benefit are not difficult but are either sometimes not performed or are ignored if performed.

Because of the evolution of tax law, tax code limitations which may have made sense may no longer make sense. As discussed previously, the child tax credit can be partially or fully refundable in some circumstances, but the limitations on refundability have changed over time.

The limit on refundability originally existed only for taxpayers with three or more qualifying children. These taxpayers could qualify for a refundable tax credit to the extent their social security taxes exceeded their earned income credit. To provide greater refundability, the limit was changed so that all taxpayers could claim a refundable credit to the extent of 10 percent of their earned income in excess of \$10,000 (taxpayers with three or more children were allowed to use the greater of this test or the original social security taxes in excess of earned income credit test). Over time, the refundability was liberalized even more by changing the 10 percent test to a 15 percent test. In addition, the \$10,000 amount has been indexed. For 2007, this amount is \$11,750.

By changing the 10 percent test to a 15 percent test, Congress has made the original social security test obsolete. Chart 1<sup>16</sup> illustrates what happens in 2007 for a married couple filing jointly. The social security taxes do not equal the earned income credit until earned income reaches \$29,183. However, by this income level, 15 percent of earned income in excess of \$11,750 is already greater than the social security taxes. For any higher levels of earned income, the 15 percent test exceeds the social security taxes test, so the social security taxes test is moot.

Another problem with the refundable portion of the child tax credit exists because of a slight wording change in the tax law which makes the tax code inconsistent with the Congressional committee intent.<sup>17</sup> It is unclear whether the wording change was

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<sup>16</sup> Updated from Katherine D. Black and Sheldon R. Smith, "The Refundable Child Tax Credit: Now You See It, Now You Don't," *Tax Notes*, Volume 113, Number 11, December 11, 2006, p. 1018.

<sup>17</sup> See Katherine D. Black and Sheldon R. Smith, "The Refundable Child Tax Credit: Now You See It, Now You Don't," *Tax Notes*, Volume 113, Number 11,

an intentional attempt to change the tax law or simply an ill-advised attempt to clarify the wording. However, the result of the change in wording is that the 15 percent test on refundability was removed for taxpayers with three or more qualifying children, thus meaning these taxpayers have a smaller portion of refundable child tax credit than do other taxpayers.

The wording problem just discussed is the result of legislation of the Gulf Opportunity Zone Act of 2005.<sup>18</sup> These changes were billed as Atechnical corrections.@ Technical corrections are intended to conform wording of a tax code section to its intended meaning as expressed in legislative committee reports or to coordinate among the myriad, complex tax code sections.

However, tax technical corrections are often passed as part of other large bills and are often added at the last minute. It is also likely that some of the technical corrections included in the Gulf Opportunity Zone Act affected the 2005 tax reporting year, so these Acorrections@ may have been hurriedly added to a bill so they could be passed before the Congressional holiday break at the end of 2005. This bill was passed and signed late in December.

Because technical corrections are supposed to correct prior errors and are not intended to change tax policy, this type of tax bill probably receives even less scrutiny by Senators and Representatives and their aids than other tax bills. However, it seems that, because of the way these technical corrections are made law, it is again an opportunity for either deception or incompetence to creep into the legislative process without much oversight.

## CONCLUSION

Discrepancies between expected and actual tax benefits for low-income taxpayers can arise for a number of reasons: (1)

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December 11, 2006, pp. 1015-1020 for an explanation and discussion of the change.

<sup>18</sup> P.L. 109-135.

specific qualifications and limitations of certain tax provisions; (2) evolution of tax laws over time which change the available benefits; (3) complications in coordinating multiple potential tax benefits; and (4) mistakes or errors in the law because of problems with the legislative process—individual or systemic, intentional or unintentional. The problems with misunderstanding the tax law and having false expectations of what it will provide are not unique to low-income taxpayers; other taxpayers can encounter problems as well.

There is a difference between incompetently passing legislation that does not work and deliberately passing legislation that does not work. However, either scenario still harms the public and deteriorates the integrity and efficacy of Congress. The ethics of deception and competence with respect to the legislative process for tax laws should be reviewed and improved.

Exhibit 1 <sup>19</sup> Maximum Effective Dependent Care Credit <sup>B</sup> 2007 Two Qualifying Individuals						
Adjusted Gross Income	Applicable Percentage	Maximum Potential Credit	Head of Household <sup>B</sup> Maximum Effective Credit		Married Filing Jointly <sup>B</sup> Maximum Effective Credit	
			Amount	Percent	Amount	Percent
\$11,250 or less	35%	\$2,100	\$0	0%	\$0	0%
\$11,251 - 15,000	35%	\$2,100	\$375	6.3%	\$0	0%
\$15,001 - 17,000	34%	\$2,040	\$575	9.6%	\$0	0%
\$17,001 - 19,000	33%	\$1,980	\$775	12.9%	\$0	0%
\$19,001 - 21,000	32%	\$1,920	\$975	16.3%	\$0	0%
\$21,001 - 23,000	31%	\$1,860	\$1,203	20.0%	\$0	0%
\$23,001 - 25,000	30%	\$1,800	\$1,503	25.0%	\$70	1.2%
\$25,001 - 27,000	29%	\$1,740	\$1,740	29%	\$270	4.5%
\$27,001 - 29,000	28%	\$1,680	\$1,680	28%	\$470	7.8%
\$29,001 - 31,000	27%	\$1,620	\$1,620	27%	\$670	11.2%
\$31,001 - 33,000	26%	\$1,560	\$1,560	26%	\$870	14.5%
\$33,001 - 35,000	25%	\$1,500	\$1,500	25%	\$1,070	17.8%

<sup>19</sup> Updated from Katherine D. Black and Sheldon R. Smith, "Dependent Care Tax Benefits: A Sham and a Scam," *Tax Notes*, Volume 113, Number 2, October 9, 2006, pp. 175-180.

\$35,001 - 37,000	24%	\$1,440	\$1,440	24%	\$1,270	21.2%
\$37,001 - 39,000	23%	\$1,380	\$1,380	23%	\$1,380	23%
\$39,001 - 41,000	22%	\$1,320	\$1,320	22%	\$1,320	22%
\$41,001 - 43,000	21%	\$1,260	\$1,260	21%	\$1,260	21%
\$43,001 and over	20%	\$1,200	\$1,200	20%	\$1,200	20%

Calculations in which the maximum effective credit is less than the maximum potential credit were made assuming the top level of income within each bracket. The maximum effective credit is the smaller of the tax liability or the maximum potential credit, and the maximum effective credit percent assumes \$6,000 of qualifying dependent care expenses. For head of household, a standard deduction of \$7,850 (2007) and one personal exemption of \$3,400 (2007) was used for a total of \$11,250. For married filing jointly, a standard deduction of \$10,700 (2007) with four exemptions at \$3,400 were used for a total of \$24,300. 2007 tax rates were used. For the head of household example, the maximum effective credit equals the maximum potential credit starting at an AGI level of \$26,583. For the married filing jointly example, the maximum effective credit equals the maximum potential credit starting at an AGI level of \$38,100.

Exhibit 2 2007 Income Needed to Fully Claim Child Tax Credit (CTC) (based on 2007 standard deduction and exemption amount and the 2007 tax rate schedule for a married couple filing a joint return)						
Number of Children	1	2	3	4	5	6
Potential Credit	\$1,000	\$2,000	\$3,000	\$4,000	\$5,000	\$6,000
Income Needed to Fully Claim CTC as Nonrefundable	\$30,900	\$42,850	\$52,917	\$62,983	\$73,050	\$83,117
Income Needed to Fully Claim CTC as Refundable	\$18,417	\$25,083	\$31,750	\$38,417	\$45,083	\$51,750
Income Needed to Fully Claim CTC as a Combination of Nonrefundable and Refundable Credits	\$18,417	\$24,770	\$30,130	\$34,590	\$40,850	\$46,210
Assumes all income is earned income, taxpayers have no other exemptions besides the parents and the children who qualify for the credit, taxpayers have no other nonrefundable tax credits, and the taxpayers do not itemize deductions.						

Exhibit 3 <sup>20</sup>						
2007 Adjusted Gross Income Levels Needed to Take Advantage of a Full \$11,390, \$22,780, or \$34,170 Adoption Tax Credit Over Six Years* (based on 2007 standard deduction and exemption amounts and the 2007 tax rate schedule for a married couple filing a joint return)						
	One child adopted/No other children		Two children adopted/ No other children		Three children adopted/ No other children	
Total Potential Adoption Tax Credit (ATC)	\$11,390		\$22,780		\$34,170	
Tax Liability Needed to Take 1/6 of the ATC	\$1,898		\$3,797		\$5,695	
Split between tax brackets	\$1,565	\$333	\$1,565	\$2,232	\$1,565	\$4,130
Divided by Tax Rates	0.10	0.15	0.10	0.15	0.10	0.15
Taxable Income Needed (Sum)	\$17,872		\$30,528		\$43,183	
Add: Standard Deduction	\$10,700		\$10,700		\$10,700	
Add: \$3,400 per Exemption	\$10,200		\$13,600		\$17,000	
Adjusted Gross Income Needed	\$38,772		\$54,828		\$70,883	
* Table works backwards from the tax liability needed to take full advantage of one-sixth of the ATC to arrive at the AGI necessary to reach this tax liability.						

<sup>20</sup> Adapted and updated from Sheldon R. Smith and Glade K. Tew, "Ironies of the Adoption Tax Credit," *Tax Notes*, Volume 85, Number 1, October 4, 1999, pp. 83-89 at 85 and Sheldon R. Smith, "The Adoption Tax Credit: Problematic Implications for Low-Income Taxpayers," *Journal of Accounting, Ethics & Public Policy*, Volume 7, Number 3, 2007, pp. 329-349. The child tax credit is not included in this exhibit because of more generous rules about the refundability of the child tax credit which now exist. However, the child tax credit could still be an issue in some cases.

Exhibit 4 2007 Adjusted Gross Income Needed to Take Advantage of Maximum Retirement Savings Contribution Credits At Various Levels* (based on 2007 standard deduction and exemption amounts and the 2007 tax rate schedule for a married couple filing a joint return)			
Income Range	\$0C31,000	\$31,001C34,000	\$34,001C52,000
Total Potential Contribution	\$4,000	\$4,000	\$4,000
Applicable Rate for Credit	50%	20%	10%
Maximum Credit (Tax Liability Needed)	\$2,000	\$800	\$400
Split between tax brackets	\$1,565	\$435	\$800
Divided by Tax Rates	.10	.15	.10
Taxable Income Needed (Sum)	\$18,550	\$8,000	\$4,000
Add: Standard Deduction	\$10,700	\$10,700	\$10,700
Add: \$3,400 per Exemption	\$6,800	\$6,800	\$6,800
Adjusted Gross Income Needed	\$36,050	\$25,500	\$21,500
Upper Income Limit Allowed for Applicable Credit	\$31,000	\$34,000	\$52,000
*Table works backwards from the tax liability to take full advantage, if possible, of the credit to arrive at the AGI necessary to reach this tax liability. No credit is available if AGI exceeds \$52,000. This assumes that there are no additional personal exemptions other than the filers.			

