Office of Chief Counsel
Internal Revenue Service
memorandum

CC:DOM:IT&A:2
SAIskow - COR-113066-98

date: JUL 14 1998

to: Taxpayer Advocate C:TA

from: Assistant Chief Counsel (Income Tax & Accounting)

subject: [redacted] b(6)

This responds to your memorandum dated June 10, 1998, forwarding an inquiry from Senator Reid concerning a constituent, b(6) [redacted] [redacted] requests information about the purpose for the standard deduction and personal exemptions, and the original formulas used to compute them. We recommend that your reply to Senator Reid substantially incorporate the following material.

The Standard Deduction:

Section 63 of the Internal Revenue Code allows an individual who does not itemize deductions to deduct the standard deduction from adjusted gross income to arrive at taxable income. The standard deduction was enacted by Congress in 1944, shortly after the base of the federal income tax was expanded to include most of the nation's wage earners. Section 9 of the Individual Tax Act of 1944, Pub. L. No. 78-315, 58 Stat. 231, 236. The initial standard deduction was set at 10 percent of adjusted gross income, not to exceed $500.

The standard deduction was described in H.R. Doc. No. 78-655, at 8 (1944) as follows:

> Generally speaking the standard deduction is a device to allow every taxpayer, regardless of his source of income, approximately 10 percent of his adjusted gross income (that is total income after business deductions) but not in excess of $500, in lieu of itemizing certain nonbusiness or personal deductions and credits. Any taxpayer may, if he chooses, itemize his actual deductions.

Over the years Congress has raised the standard deduction. For example, in 1988 the basic standard deduction was $5,000 for married taxpayers filing jointly and $3,000 for single filers. For years beginning after 1988, Congress amended § 63 to provide for an adjustment for inflation. Tax Reform Act of 1986, § 102, 1986-3 (Vol. 1) C.B. 17 (the 1986 Act). Further, Congress set forth the method for calculating the adjustment. Section 101 of the 1986 Act.

The current provisions relating to the adjustment for the standard deduction are contained in §§ 63(c)(4) and 1(f)(3). In summary, the standard deduction for any calendar year is computed by multiplying the amounts set by Congress in § 63(c)(2) by the cost-of-living adjustment. The cost-of-living adjustment is the percentage (if any) by which the consumer price index for the preceding calendar year exceeds the consumer price index for the calendar year 1987. The standard deduction is currently $7,100 for joint returns and $4,250 for single filers. These amounts are set forth in § 3.04 of Rev. Proc. 97-57, 1997-52 I.R.B. 20 (copy attached).

Personal Exemptions:

Section 151 generally allows a deduction from federal income tax for personal exemptions. This exemption is available for each taxpayer and dependent. The federal income tax system has included some form of personal exemption since its inception in 1862. Personal exemptions serve three major purposes: (1) to exempt from income tax individuals and families with the smallest incomes and to provide all taxpayers with a deduction for essential living expenses; (2) to differentiate tax liability according to family size; and (3) to limit the total number of filed returns to a manageable proportion and to exclude the number of taxpayers with a tax liability lower than the cost of collection. Generally, Congress legislates the level of exemption to reflect these objectives.

Originally, the exemption was set at a high level to ensure that an income tax was properly levied only on income exceeding necessary living expenses. Congress has periodically adjusted the exemption amount in response to revenue needs. For example, the level of personal exemption was lowered to help finance World Wars I and II. Congress later raised the personal exemption, attempting to eliminate federal income tax on taxpayers with incomes below the poverty level.

Like the standard deduction, Congress subjects the personal exemption to a cost-of-living adjustment to protect the value of the exemption from inflationary erosion. Sections 151(d)(4) and 1(f)(3). The current exemption amount is $2,000. See § 3.08 of Rev. Proc. 97-57.

Taxpayer Advocate C:TA

We hope this information will be helpful to you in responding to Senator Reid. If you have any further questions, please contact Sheldon Iskow of my office at 202-622-4920.

By (signed) Robert A. Berkovsky
Robert A. Berkovsky
Chief, Branch 2

Enclosure:
Rev. Proc. 97-57