V

Excise Taxes

COMMUNICATIONS TAX REPEAL

Present Law

Amounts paid for certain communication services are subject to a communications excise tax. The rate of this tax for 1978 is 4 percent. The tax is being phased out by reducing the rate by one percentage point a year. As of January 1, 1982 the tax will be repealed.

Services subject to tax are local telephone service, long distance toll telephone service including WATS, and teletypewriter exchange service. Private communication services which are charged for separately are exempted from the tax.

Reasons for Change

In the Excise Tax Reduction Act of 1965, Congress instituted a comprehensive overhaul of the excise tax system. The only uncompleted step in this overhaul is repeal of the communications tax.

In addition to completing the overhaul of the excise tax system planned in 1965, repeal of the communications tax will help to reduce inflation. Repeal of the tax will reduce the cost of living both directly and by lowering business costs. As the resulting reductions in business costs are passed through in the form of price cuts, they will reduce inflation through lower consumer prices and through the effect of these lower prices on cost-of-living adjustments in wages. Repeal of the communications tax will be particularly beneficial to lower and middle income persons, who bear a disproportionately heavy share of the tax.

Between 40 and 50 percent of this tax reduction will be reflected in lower prices of communications services paid by business firms. The rest will be reflected in lower prices paid by individual telephone users.

General Explanation

The Administration proposes to repeal the communications tax as of October 1, 1978. Repeal will be effective for service for which bills are first rendered on or after such date, except that the tax will continue to apply to services supplied before August 1, 1978 even though a bill is first rendered on or after October 1.

Revenue Estimate

Change In Tax Liability

($ millions)

Calendar Years					
1978	1979	1980	1981	1982	1983
-355	-1,200	-900	-500	--	--

UNEMPLOYMENT TAX RATE REDUCTION

Present Law

The unemployment compensation program is financed by a combination of Federal and State employer payroll taxes. In general, the Federal tax effectively is equal to 0.7 percent of the first $6,000 of each worker's annual earnings. The nominal Federal tax rate is 3.4 percent; it is generally offset by a credit of 2.7 percent for State unemployment tax payments.

Unemployment benefits can be provided for up to 65 weeks. The first 26 weeks is referred to as "regular coverage," the next 13 weeks is referred to as "extended benefit coverage," and the final 26 weeks is referred to as "supplemental benefit coverage." State unemployment taxes are used to finance the regular coverage plus half of the extended benefit coverage. The Federal government through the Federal Unemployment Insurance Fund ("FUIF") finances the other half of extended benefit coverage plus all of the supplemental benefit coverage. In addition, States which have run out of money to pay unemployment benefits may borrow from the FUIF.

Federal unemployment taxes are deposited in the FUIF. Federal general revenues are loaned to the FUIF to the extent it does not otherwise have sufficient funds to meet its obligations.

Reasons for Change

The 1974-1975 recession had a severe impact on the unemployment insurance system. As shown in the following table, as of December 1977 the Trust Fund had borrowed about $8.9 billion from general revenues to finance those unemployment benefits which are a Federal responsibility.

Table VB-1

	Federal UI Costs			Costs Met By	
	Extended Benefits	Federal Supplemental Benefits ($ millions)	Total	Payroll Tax	Loans from General Revenue
Prior to CY 1975	661		661		661
CY 1975	1,306	2,271	3,577	130	3,447
CY 1976	1,237	2,946	4,183	160	4,023
CY 1977 Estimate	946	620	1,566	750	816
	4,150	5,837	9,987	1,040	8,947

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Office of Tax Analysis

Moreover, about half the States have exhausted their insurance reserves and have borrowed an additional $4.4 billion from the Trust Fund. The Trust Fund in turn has borrowed this money from the general revenues. Further, between 1979 and 1981, Federal unemployment tax revenues are expected to fall short of outlays by $600 million.

Congress has taken two steps in response to this extraordinary financing problem. The rate of Federal unemployment tax was effectively increased from 0.5 to 0.7 percent as of January 1, 1977. This increased rate is scheduled to remain in effect until the FUIF has repaid all general revenue advances other than those which financed loans to the States. Also, costs of the Federal supplemental benefit program incurred after April 1, 1977, are being funded directly out of general revenues.

The January 1977 increase in the rate of Federal unemployment tax has raised business costs, thereby increasing inflationary pressures. The Administration is committed to financing normal unemployment benefits out of employer payroll taxes. However, the Administration believes it is inappropriate for the extraordinary expenses resulting from the severe 1974-1975 recession and the continuing rate of high unemployment to be financed solely out of payroll taxes.

General Explanation

The Administration proposes to restore the Federal unemployment payroll tax to its normal effective rate of 0.5 percent, a reduction of 0.2 percentage points.

In addition, the Administration plans to consider whether further use of general revenues is necessary to strengthen the present financial position of the FUIF, or to ensure the financial strength of the FUIF for the future.

Analysis of Impact

The reduction in the effective rate of Federal unemployment tax will assist in reducing inflation. As the resulting reductions in employer wage costs are passed through in the form of price cuts, they will reduce inflation directly through lower consumer prices and, indirectly, as the lower prices result in lower cost-of-living wage adjustments. (As the employer cost reductions are passed through in the form of price cuts, the reduction in wage costs will eventually translate into a reduction in the GNP deflator of approximately 0.1 percent.)

The impact of the rate reduction, in terms of percentage of wages, will be greatest for costs associated with the employment of low-wage workers. Thus, the reduction will partially offset the increased employer costs associated with recent minimum wage legislation and will increase the demand for low-skilled labor.

Effective Date

The reduction in the rate of Federal unemployment tax will be effective as of January 1, 1979.

Revenue Estimate

Change in Tax Liability
($ millions)

Calendar Years					
1978	1979	1980	1981	1982	1983
--	-850	-900	-950	-1,000	-1,050

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