

Heller and Pechman have elaborated. In general, the CED desires to enable and encourage the States and localities to provide more adequately those services which they traditionally and efficiently perform, with as little Federal control as is necessary to assure that result, and with a system of financing which is in general equitable.

I think the point at issue here relates to the effectiveness of the alternative plans in achieving this general objective that we all share.

My main point is that the probable consequences of the tax credit which CED and others have proposed are the opposite of the usual expectations.

I think the credit will result in a larger increase of State and local expenditures, and in more reliance on income taxes than will unconditional grants from the Federal Government to the States.

While I shall in my statement devote some attention to a comparison between the credit plan and the unconditional grant plan, I should say I don't do that as an enemy of the unconditional grant plan which I do regard as one of the four or five best plans now under consideration in this general field. In fact, it has seemed to me that we might take advantage of the opportunity provided by our federal system to experiment with the Heller-Pechman plan west of the Mississippi and the credit plan east of the Mississippi.

There are some reasons that might not be a good scientific test.

Anyway, let me explain the credit plan.

As you know, individuals paying Federal income tax may deduct State income taxes paid, like most other State and local taxes, from their gross income in arriving at the taxable income which determines the amount of Federal income tax they have to pay. The credit proposal would leave this deduction undisturbed. It would give the Federal taxpayer in addition a credit to be subtracted from the Federal tax he would otherwise have to pay; the amount of the credit being based on the amount of his State income tax. This credit might be calculated in any one of several ways. One credit system described in the CED statement would give the taxpayer a credit equal to a flat percentage of the net cost to him of his State income tax after taking account of the value of the deduction. Thus, suppose that the taxpayer is in a 40-percent Federal income tax bracket. The net cost to him of \$1,000 of State income tax is only \$600, because the \$1,000 deduction reduces his Federal tax by \$400. The suggested credit would be based on the \$600, rather than on the \$1,000. CED used an illustrative credit of 25 percent in describing this plan. In this case his credit would be \$150, which is 25 percent of \$600, and he would deduct the \$150 from the Federal tax he owes. Since the net cost of State income taxes, after taking account of deductibility, is about 80 percent of the gross cost, on the average, a 25-percent credit on the net cost would equal 20 percent of gross cost on the average, but it would be a bigger percent of the gross cost for low-bracket taxpayers than for high-bracket taxpayers. The computation of the credit under this plan is illustrated in exhibit A and the effects in different tax brackets are shown in exhibit B.

In my statement the exhibits explain how it works in greater detail, but the details are not of great significance for today's discussion.

This particular plan would give everyone a credit in proportion to what State income taxes actually cost him. Moreover, it would permit the credit to be set at any desired height without running into a