

*Paying Dividends
To American Residents
From Carbon Fee Revenue*

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About the Author

Allen H. Lerman served as an economist in the Office of Tax Analysis of the United States Treasury Department for over 42 years before retiring in 2014. He specialized in Federal income taxation of individuals, social security taxation, and Federal employment taxes. He analyzed, developed, and recommended tax policies, and he provided expert advice to policymakers. He has worked on every major tax reform legislation and administrative reform undertaken during his tenure at Treasury.

The author worked closely and extensively with the Internal Revenue Service on the implementation of tax policies to help assure that tax policy considerations were properly reflected in administrative procedures and on income tax forms, especially after major tax revisions. As Tax Policy's sole representative on the IRS Tax Products (Forms) Coordinating Committee, the author played a major role in the development and implementation of major changes to Federal individual income tax forms, including being the primary developer and content designer of the Form 1040-EZ. On behalf of the Treasury Department, the author coordinated and supervised the implementation of the 2003 and 2008 tax rebate programs for individual taxpayers. He was a core member of the Treasury-IRS group that developed new methodology for measuring taxpayers' compliance burden and estimating the changes in compliance burden due to administrative and legislative changes.

The author was responsible for the withholding system for individual income taxes. He developed major changes to the withholding system to make withholding more accurate. He developed annual income tax withholding tables. On several occasions he developed special procedures to adjust withholding to account for intra-year tax law changes designed to provide economic stimulus (such as the withholding changes necessary for the Making Work Pay credit for 2009 and 2010), and he developed procedures for issuing direct economic stimulus payments to many millions of taxpayers. He developed the methods for indexing tax provisions for the effects of inflation and prepared the indexed values annually.

The author's other areas of analysis and development of policy proposals included: analyzing how some high income taxpayers are able to pay little or no income tax; tax amnesties; tax benefits for adoption; taxation and compliance of self-employed workers ("independent contractors"), including methods for comparing whether employee or independent contractor status would be more beneficial without regard to tax compliance; the alternative minimum tax; measurement of tax gaps; the tax collection side of the Federal employment tax system; taxation of social security benefits; taxpayer privacy and disclosure; use and coordination of taxpayer information for other government programs; and the measurement of effective marginal tax rates.

Paying Dividends from Carbon Fee Revenue

Introduction

The Citizens' Climate Lobby (CCL) has proposed the enactment of a fee on use of carbon-based fossil fuels (a Carbon Fee) in order to internalize the costs to society of burning such fuels, thereby reducing their use. All of the net Fee receipts would be paid to American residents in the form of a monthly Dividend. The Dividend would be the same amount for each adult. Up to two children per family would also be entitled to Dividends, generally 50 percent of the adult Dividend.

This paper addresses the implementation of the Dividend portion of the CCL proposal. The paper presents two possible methods of paying out the Dividend and the relative merits of each method. The paper also explores several of the potential problems in collecting the Carbon Fee and paying the Dividend.

Section 1 presents the Citizens' Climate Lobby's proposal for a fee on the use of carbon-based fossil fuels together with a rebate of 100 percent of the net revenue from the Fee to all residents in equal monthly Dividend payments.

Section 2 describes how the amount of the monthly Dividend from the Carbon Fee would be determined at the beginning of the program (and periodically thereafter).

Sections 3, 4, and 5 describe two general methods for disbursing the Dividend. This paper presents the method of paying the Dividend from the carbon fee by direct monthly payments to each entitled individual or family. The paper also describes how the Dividend could be paid through a new program of reverse withholding on wages and other periodic payments but supplemented by direct payments for those not receiving periodic payments. Because of significant limitations of the reverse withholding method, the paper concludes that the direct payment method is both simpler and preferable.

Section 6 explores how the Carbon Dividend payment system might be simplified and have less administrative burden if certain provisions of the original CCL proposal were modified. It includes rough estimates of how monthly benefits for families of different sizes might change under a modified Dividend structure. Administrative systems are compromises between simplicity and specific goals. Simpler systems provide less ability to meet goals precisely.

Section 7 discusses some issues from the income taxation of Dividends.

Section 8 discusses some issues that are common to various payment methods.

Finally, Section 9 presents some general conclusions.

Appendix A summarizes the major decisions that would need to be made prior to implementation, the options available, and where applicable, the option recommended by CCL.

Appendix B summarize the differences between the Citizens' Climate Lobby proposal as modified by the simplifications mentioned in Section 6 and the proposal by the Climate Leadership Council to pay an equal monthly benefit to all residents through the Social Security system. The comparison points out some potential administrative problems that the Climate Leadership Council's proposal does not seem to address.

1. The Citizens' Climate Lobby Carbon Fee and Dividend Proposal

The Citizens' Climate Lobby (CCL) has proposed the enactment of a fee on use of carbon-based fossil fuels (a Carbon Fee) in order to internalize the costs to society of burning such fuels, thereby reducing their use. The Carbon Fee is a proxy for the hidden costs of climate change. Since the goal of the Carbon Fee is to reduce usage and not to raise revenue, all of the net revenue from the Carbon Fee would be paid back in the form of a monthly lump-sum Dividend to American residents. The Dividend would be treated as income for income tax purposes but not for purposes of non-income tax means-tested programs.¹

The CCL proposal calls for a Carbon Fee on all fossil fuels and other greenhouse gases at the point where they first enter the economy. The fee, to be collected by the Treasury Department, initially would be \$15 per ton of CO₂ equivalent emissions. Each year, the Fee would increase by \$10 per ton of CO₂-equivalent until total U.S. CO₂-equivalent emissions have been reduced to 10 percent of U.S. CO₂-equivalent emissions in 1990.

All Fees would be placed in the Carbon Fee Trust Fund, and 100 percent of the Fee receipts (excluding the expenses of Fee collection and Dividend payment) would be paid to American residents in the form of a monthly Dividend.

The Dividend would be the same amount for each adult. Up to two dependent children per family would also be entitled to Dividends.² If the dependent child were under age 19, the child's Dividend would be one half of the adult amount; if the dependent child were age 19 or older (generally only full-time students), that dependent's Dividend would be the full adult amount.³ Self-supporting residents under age 19 who are not eligible to be claimed as the dependents of their parents would be entitled to full adult Dividends.⁴

Under the CCL proposal, the Dividends would be taxable for income tax purposes but would not be treated as income for other purposes, such as federal and federally-supported social programs.

Eligibility for Dividends would be determined by the resident's status on the final day of each month. A child born or adopted during the month would be entitled to a child's Dividend for that month. A child who reaches age 19 (or age 24 for full-time student dependents) during the month and becomes eligible for an adult Dividend for the month on his or her own account might permit a younger child in families with three or more children to become eligible for a child's Dividend for the month.

¹ Legislation creating the carbon fee and dividend (rebate) programs would specify that the Dividends would only be considered to be taxable income for Federal income tax purposes. Except for social programs enacted pursuant to Federal law, states and localities could not be prevented from treating Dividends as income for their own programs, including state and local income taxes.

² Since information about families and dependents would be based on current Internal Revenue Code definitions, not more than one child would be eligible for a Dividend when married couples file separate rather than joint income tax returns (or the equivalent form necessary for Dividend payments for non-filers).

³ The ages of under 19 (and under 24 for dependent full-time students) were selected as the thresholds for Dividends in order to be consistent with the ages specified in the Internal Revenue Code. Such consistency would reduce complexity both for the IRS and for residents.

⁴ Non-child dependents would be entitled to the full adult Dividend, just as if they were not dependents.

It is estimated that the Dividend payment initially would be about \$20 per month per adult and \$10 per month for each eligible child.⁵ The Dividend would increase each year as the Fee per ton of CO₂-equivalent emissions increased, although the additional revenue from the fee increase would be mitigated by any reduction in nationwide fossil fuel usage. Over a twenty year period, the monthly Dividend payments are estimated to increase to nearly \$130 per adult and \$65 per eligible child.⁶

⁵ These initial monthly Dividend amounts are after excluding about \$2 per month per adult for the costs of collecting the Fee and paying the Dividend.

⁶ Based on interpolation of Figure 3.18 in the REMI report, with the initial year adjusted to reflect the final proposal's initial Carbon Fee of \$15 per ton of CO₂. Not adjusted for inflation after 2012. Regional Economic Models, Inc. (REMI) and Synapse Energy Economics, Inc., *The Economic, Climate, Fiscal, Power, and Demographic Impact of a National Fee and Dividend Carbon Tax*. Prepared for Citizens' Climate Lobby, June, 2014.

2. Determining the Size of the Per Person Monthly Dividend from the Carbon Fee

CCL proposes that 100 percent of net Carbon Fee revenue be paid back to residents contemporaneously with revenue collection. Contemporaneous payment requires that the amount of the Dividend be determined before actual data about Carbon Fee receipts are known. Thus, the per capita payment amount would need to be based on estimates.

Determining the monthly per capita Dividend requires estimates of the following information.

1. Numbers of adults and children eligible to receive Dividends. Data would be from the Census Bureau combined, perhaps, with information about tax filing units and children per filing unit from the Internal Revenue Service.
2. The total number of eligible units would be the number of eligible adults plus 50 percent of the number of eligible dependent children under age 19 and 100 percent of the number of eligible dependent children ages 19 through 23.
3. Gross Carbon Fee revenue for the year, as estimated for budgetary purposes.
4. The expenses of Fee collection and Dividend program operation. These expenses would be deducted from gross Carbon Fee revenue to determine the net Carbon Fee revenue.
5. After the initial year, the amount of any previous aggregate overpayment or underpayment of Carbon Fee revenue via the Dividend program.
6. Determine net Carbon Fee revenue available for the year by combining #3, #4, and #5.
7. Determine the per capita annual adult Dividend by dividing #6 by #2.
8. Determine the per capita monthly adult Dividend by dividing #7 by 12.

Adjustments for prior year over- or under-payment of Dividends are essential in fulfilling the commitment to pay back all net Carbon Fee revenue through equal per capita Dividend payments. Adjustments would be required due to differences between estimated and actual Carbon Fee receipts and expenses and differences between estimated eligible residents, actual eligible residents, and residents actually claiming Dividend payments. Adjustments for the discrepancies from any year may be necessary in ever-smaller amounts for several succeeding years, as more actual data become available.

3. Distributing Carbon Fee Revenue to Residents

All Fee receipts (excluding the expenses of Fee collection and Dividend payment) would be paid to American residents in the form of a monthly Dividend.

The Dividend would be the same amount for each adult. Up to two children per family would also be entitled to Dividends.⁷ If the dependent child were under age 19, the child's Dividend would be one half of the adult amount; if the dependent child were age 19 or older (generally only full-time students), that dependent's Dividend would be the full adult amount and will be included in the Dividend payment to the tax-filing parent or guardian.⁸ Self-supporting residents under age 19 who are not eligible to be claimed as the dependents of their parents would be entitled to full adult Dividends.⁹ Non-child dependents would be entitled to the full adult Dividend, just as if they were not dependents.

Dividends could be paid by either of two different methods, one direct and the other indirect. The direct method would be simpler and more efficient, but indirect payment is possible

The preferred method would distribute Dividends by direct monthly payments from the federal government to each eligible family and individual. Payments would be by electronic funds transfer for the vast majority with bank accounts and by adding funds to government-provided debit cards for most other recipients.

The indirect, and more problematic, alternative distribution method would make most payments by increasing net wage, salary, and other periodic income payments (such as Social Security payments) for the majority of residents who have income from those sources. Essentially, this would be reverse withholding. Indirect payments would have to be supplemented by direct Dividend payments from the federal government for residents who did not receive periodic payments of income. For employees, net wage and salary would be increased by the amount of the Dividend appropriate to the length of the payroll period. Residents who were not employed but who received other periodic payments would receive their Dividends through increases in those periodic payments. Covered periodic payments would include social security, Railroad Retirement, federal, state, local, and private retirement programs, unemployment insurance, and even other federal or state programs (such as food stamps) that make periodic payments. Self-employed residents would reduce their quarterly payments of estimated income tax by the amount of the Dividend. For residents who do not receive any of the above-mentioned periodic payments and are not self-employed, Dividends would be received via direct government payments.

⁷ Since information about families and dependents will be based on current Internal Revenue Code definitions, not more than one child will be eligible for a Dividend when married couples file separate rather than joint income tax returns or the equivalent form necessary for Dividend payments for non-filers.

⁸ The ages of under 19 (and under 24 for dependent full-time students) were selected as the thresholds for dependent status in order to be consistent with the ages specified in the Internal Revenue Code. Such consistency would reduce complexity both for the IRS and for residents.

⁹ Some minors are neither dependents of another person nor are providing their own support. Typically, such minors, including those in foster care, would be supported by governmental (or non-profit) organizations. The extent, if any, to which Dividends would be paid on behalf of such minors is subject to further discussion.

Some individuals or married couples have more than one job; some with jobs may also receive other periodic payments; and some receive wages or other periodic payments for only part of a year. As a result, some residents might receive duplicate Dividends currently, while others would not receive Dividends currently for at least parts of year. Since the goal of the Carbon Fee and Dividend proposal is that every eligible resident should receive Dividend payments but no resident should receive and keep more than one Dividend payment, the indirect payment method would need to include provisions minimizing the number of duplicate payments, the refunding of duplicate payments, and making direct payments when Dividends had not been received from employment or retirement benefits.

Under the indirect payment method, the funds used to make the Dividend payments would mostly be from the amounts that payors withheld from payees for income, social security, and Medicare taxes and from employers' matching shares of social security and Medicare withholding. Where these amounts were insufficient, payors would have to be permitted or required to make immediate withdrawals from the Carbon Fee Trust Fund to pay the shortfall.

Under either payment system, eligibility for Dividend payments would be determined monthly, based on each individual's status on the last day of the calendar month. (That is similar to eligibility for social security and Medicare benefits.) New-born or newly adopted children would be eligible for Dividends in the month of birth or adoption. Newly married couples would receive Dividends (with child Dividends limited to a total two children) beginning in the month of marriage. A deceased person's estate or heirs would not be eligible for a Dividend for the month of death.

Any Dividend payment method would impose some costs and burdens on recipients, the government, its contractors, and any intermediary payors such as employers and pension payors. Development, startup, and recurring annual complexities, burdens, and costs would differ by payment method but would be substantial under all possible payment and reconciliation methods. However, even substantial one-time costs would be only a small percentage of aggregate Carbon Fee revenue and Dividends. Continuing costs for payors would be relatively modest. However, costs and burdens for Dividend recipients could be substantial from the administrative aspects of paying income taxes on Dividends and, especially, arranging appropriate levels of income tax withholding necessary because of Dividends. It is beyond the scope of this analysis to estimate the absolute costs and burdens.

It would be simpler for the Dividends to be paid to entire family units rather than to individuals.

Under the indirect, largely payroll-based method, the payments would have to be made to the worker or income recipient on behalf of the family unit. Under the direct method, paying Dividends to family units reduces the number of payments, eliminates the need to determine which two children actually are entitled to Dividends in families with three or more children, and simplifies adjusting for changes in eligible children. At an administrative level, family-based payments would greatly reduce the number of monthly payments and also the number of transactions due to family eligibility changes and for adjustments due to underpayments or overpayments. Conversely, separate payments to each eligible individual might enable – under the direct payment method – some Dividend payments to be combined with other monthly payments from the governments, such as social security benefit payments.

Under either payment method, a small percentage of actual payments – which could still be a large absolute number – in any particular month would differ from the amount to which the family or individual were actually entitled. Most discrepancies would probably be due to delays in reporting eligibility changes or implementing the reported changes. Other discrepancies would be due to administrative or computational errors that are inevitable when payments are being made to 150 million to 200 million family or individual units.

As a result of possible discrepancies, systems for reconciling actual payments with correct payments would be necessary. Many corrections would be made by standardized or automated systems, but inevitably some corrections would require expensive, labor-intensive, manual processing. In order to minimize the number of individual correction payments, provisions for making a single set of reconciliations for an entire year should be available. Except where equity from large discrepancies required rapid retroactive reconciliation, correction payments in reconciliation should be made annually, probably via a new form to be filed as an attachment to the annual federal income tax return. Combining the reconciliation with the income tax return (and tax payment or tax refund) would minimize costs and administrative burdens for both Dividend recipients and the government.

Regardless of the distribution method selected, full implementation would not be immediate. **In fact, under the direct payment method full implementation might take two years – or even longer. If Dividend payments from the Carbon Fee must begin very quickly, some temporary and less than perfect method might have to be used during an extended start-up period.**

4. Dividend Distribution via Direct Monthly Government Payments

The federal government would pay the Dividend directly to each eligible U.S. resident family or individual. CCL proposes monthly payments, but the structure of the direct payment system would permit different payment frequencies. For example, **in the early years of the Carbon Fee, when monthly Dividend payments would be small, less frequent payments, such as quarterly or semi-annually, might be less costly administratively and also be preferred by recipients.**

If initially payments were quarterly or semi-annually, the payments could be staggered, that is, spread out, so that each month only one-third or one-sixth of residents received a Dividend payment. Since inquiries and complaints tend to cluster just after payments are received; spread out payments would smooth out the number of telephone calls and letters more evenly during the year. That would reduce the need for government staff handling inquiries, complaints, and changes in eligibility. As the size of Dividend payments increased, payments could be made more frequently, eventually monthly. By that point, start-up issues should have been handled, and the numbers of contacts with recipients would be expected to decline.

Making payments less frequently than monthly could cause financial hardship, especially for lower income residents, as their current expenses increased due to the Carbon Fee but the compensating Dividend payments were delayed. Paying the Dividends at the beginning rather than the end of a longer payment period could mitigate this problem.¹⁰ However, since eligibility would be based on end-of-month status, prepaying the Dividend could create over- and underpayments with the consequent reconciliation issues and compliance problems.

A. Information to Determine Payment Amounts

Much of the information required to determine eligibility for Dividend payments and for making those payments is currently included on Federal individual income tax returns (that is, Forms 1040, 1040A, and 1040EZ) that most residents file annually. In order to prevent residents having to provide the same information a second time for purposes of the Carbon Dividend, the IRS information should be shared with the agency actually determining Dividend payments. Similarly, any information necessary for correction and reconciliation of Carbon payments should be submitted to the IRS as part of income tax returns for transmission by the IRS to the paying agency. Residents who do not ordinarily file income tax returns would have to provide the information needed to determine Carbon payments on separate forms.

¹⁰ **Paying at the beginning of each period might mean that Dividends were paid before sufficient funds were available from the Carbon Fee. Under such a scenario, the Carbon Fee Trust Fund might have to take a permanent loan from the General Fund.** That would be analogous to “tax anticipation” borrowing by some state and local governments.

“Tax anticipation” borrowing would be necessary only temporarily if the initial month’s payment were made at the beginning of the month in which Carbon Fees were first imposed but both the initial month’s payment and monthly Dividend payments for the next 1, 3, or 5 years were reduced so that the initial loan could be repaid and sufficient funds could be accumulated to enable beginning-of-the-month payments as the per resident Dividend payment increased each year. This type of this type of advance payment would raise equity issues because aggregate Dividend payments during the transition months or years would be less than net Carbon Fee revenue.

The persons eligible to receive monthly Dividend payments during a calendar year initially would be determined by the number of adults (one, but two on “joint returns”) and dependent children (up to two children) shown on the family’s or individual’s federal income tax return for the second preceding year.¹¹ The tax return information would be used to make Dividend payments beginning for the January after the tax return was filed. For example, the number of eligible children on the 2019 tax return, which is generally filed in the spring of 2020, would provide the default for monthly Dividend payments beginning for January, 2021.

Once the system were working smoothly, it might become possible to implement any default changes earlier than the following January. Such a change in implementation date would be made administratively, depending largely on the data being available earlier.¹² A possible downside to earlier implementation is confusion because residents are used to most annual changes being made on a calendar year basis.

However, if after filing their annual income tax returns, family composition or the number of eligible dependents changed, residents would be able to initiate a Dividend change. The updated information would override the default from the tax return and begin to be used before the following January.

Since the CCL proposal would make the Dividends taxable for income tax purposes, provisions for withholding related to the Dividends would be necessary so that residents would not be underwithheld at the end of the year and have to make unexpected tax payments and, possibly, pay penalties for being underwithheld. Residents would have to provide the paying agency with information about the amount, or percentage, of the Dividend to be withheld for income tax. There are several possible ways of transmitting that information. Once the system were working, it might be possible to expand income tax returns to include information about desired withholding, although that would increase IRS involvement in the Dividend program. Alternatively, residents would have to file a separate form with the information about their desired withholding (including changes to previous withholding requests). The special form would be short. If the tax return provided an annual opportunity to elect the level of withholding, the special form would be used much less frequently than if it were the only way for residents to request withholding. Figure 1 shows the draft of a Carbon Fee Dividend Withholding Certificate (Form CFD-4) that could be used by residents transmit their desired level of withholding, including no withholding at all.

¹¹ Dividends for dependents other than children (such as dependent parents) could be handled by using would be to use the dependency information (after 2017, tax credit information) from the income tax return for the information necessary to pay the Dividend for such dependents. Under this procedure, the Dividend payment for the non-child dependent would be included with the Dividend payment for the family (tax-filing unit). Alternatively, the Dividend for non-child dependents would be to require each such dependent to file separate claims for the Dividend, just as non-dependent residents who do not file their own income tax forms would be required to do.

¹² It is more probably that earlier implementation would be possible for taxpayers who filed their tax by the statutory filing date of April 15. It would be less likely for taxpayers who used the statutory option to file their returns as late as October 15. As many as 10 percent of filers avail themselves of an “automatic extension” to file later than April 15.

Figure 1: Carbon Fee Dividend Withholding Certificate

Form CFD-4 Department of the xxxxxx Carbon Administration		Carbon Fee Dividend Withholding Certificate for Residents to request income tax withholding on their Carbon Fee Dividends		20XX
Your first name and initial		Last name		OMB No. 8888-xxxx Your social security number
Home address (number and street). If you have a P.O. box, see instructions				
City, town or post office, state, and ZIP code.				
<p>Federal income tax WITHHOLDING:</p> <p><input type="checkbox"/> I do NOT want federal income tax withheld from my Carbon Fee Dividend payments.</p> <p><input type="checkbox"/> I want federal income tax withheld from my Dividend payments at the rate of (check one):</p> <p style="text-align: center;">7% <input type="checkbox"/> 10% <input type="checkbox"/> 15% <input type="checkbox"/> 25% <input type="checkbox"/></p>				
Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.				
Resident's signature				Date

Form CFD-4 (20xx)

B. Providing Information to the IRS by Current Non-filers

Individuals or families that had not filed an income tax return would have to provide the IRS with family size and composition information in order to begin receiving Dividend payments. The filing of the necessary information might or might not be on a traditional income tax return (Form 1040, 1040A, or 1040EZ). The group of lower-income residents required to supply such information might be overwhelmed by the complexity of filing even the simplest version of a federal income tax return for the first time. Others may be frightened or otherwise resistant to begin sharing any information with a government agency, especially the IRS, or discouraged by the perceived cost of obtaining help to file. Some would employ a paid preparer; some would use the services of tax filing clinics for lower-income residents; but some (hopefully, a very small number) would fail to file and forego receiving the Dividend. A combination of outreach programs would have to be implemented immediately and would have to be continued permanently at a more modest level.

Some of the fear and burden could be mitigated by providing a new and different form for affected residents to file. The different form would require much less information, and the form would not include any information about income. It could, or could not, look like a traditional tax return. To overcome fears about dealing with the IRS, the different form could be filed with an agency other than the IRS. However, for simplicity in administration and to prevent duplication of payments of the Dividend, the information from the different form would have to be merged with traditional income tax information from IRS files.

Currently, virtually all federal income tax returns prepared by paid preparers and a very large percentage of those self-prepared by taxpayers are prepared using special tax preparation software. Many developers of tax preparation software also provide options where the tax return can be prepared “online” at special websites. Lower income tax filers can generally use the online software without any fees or other costs. It can reasonably be expected that if the Dividend payment system requires filings by current non-filers, free software for such filings would be available.

Thus, the necessary information for receiving the Dividend could be supplied by non-income tax filers in one or more of four slightly different ways:

- Option 1: File the special form with the IRS.
- Option 2: File the special form with a different (perhaps, a new) government agency.
- Option 3: File the special form with a private company under contract to the government.
- Option 4: File a modified version of Form 1040-A or Form 1040-EZ with the IRS. The modified form would be identical to the Forms 1040-A and 1040-EZ except that everything would be shaded out except the few items required for purposes of the Dividend.

The advantage of such a modified Form 1040-A or Form 1040-EZ is that such a form definitely could be processed by the IRS using the same input processing software as the regular tax forms. At the outset of the Dividend program, that could shorten the lead time for the IRS to begin processing Dividend request submissions. The disadvantages are (1) that any tax form would have to be filed with the IRS, thereby raising the concerns of some residents about having to interface with the IRS and (2) a tax form would not include space for the residents to elect withholding. Thus, if a traditional tax form were used, residents would also have to file separate Form CFD-4 for withholding purposes.¹³

For calendar year 2015, over 150 million federal individual income tax returns were filed. Those returns included taxpayer or dependent exemptions for 292 million people.¹⁴ Since total United States population was about 317 million¹⁵, about 25 million residents would have to file a form with their identifying information in order to begin receiving Dividend payments. Some of those residents would be married and others would be dependent children; thus, only about 10 to 15 million new information forms would have been filed.

¹³ In 2008, as part of the one-time economic stimulus payments (advance income tax rebates) paid to most residents, those who had not filed an income tax return for 2007 were required to file a tax return and provide a minimal amount of information. The IRS suggested using a regular Form 1040A, but the IRS provided instructions and a graphic which highlighted the small portion of the form that had to be completed for purposes of the one-time payment.

¹⁴ *Statistics of Income: 2015 Individual Income Tax Returns*, Internal Revenue Service Washington, D.C., Table 2.3.

¹⁵ U.S. Census Bureau, American Fact Finder. Estimates of Resident Population, online table. factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=PEP_2016_PEPANNRES&src=pt The population numbers vary by as much as 3 percent depending on the definition used for the U.S. population.

Figure 2 contains a draft of a form, Claim for Carbon Dividend (Form CFD-1), that could be used to initiate Dividend payments by residents who do not file income tax returns. If Dividends for non-child dependents were not paid to the tax filing unit on which they were claimed as dependents, they would also use Form CFD-1 to claim their Dividends. The Form CFD-1 would have to be filed annually.

Line 8 of the CFD-1 would be used to help adjust future Dividend payments for discrepancies in payments during the previous year. In the first year of the Dividend program, the line 8 check-box would not be included. In subsequent years, the line 8 check-box would indicate that a discrepancy between entitlements and payments actually received needed to be reconciled. A similar check-box item would have to be added to all of the traditional IRS tax forms in order to eliminate the need for residents to file additional forms if such a reconciliation were required.

Line 9 of the CFD-1 would provide information about the desired level, if any, of withholding on Dividend payments. Inclusion of line 9 on the CFD-1 would eliminate the need for residents to file a separate Form CFD-4 to set their withholding level.

If Dividends were not subject to income tax, the CFD-1 would never need to include line 9, and in the initial year of the program, line 8 would also not be included. Thus, if Dividends were not taxable, the Form CFD-1 might be able to be reformatted to make it similar enough to then-current income tax forms that it might be able to be processed using the same software that IRS uses for Form 1040A. Use of the Form 1040-A software would enable the IRS to begin processing sooner at the startup of the program when filing would be absolutely necessary to begin receiving Dividend payments.

C. Processing of Dividend Payment Information

The information for each eligible resident, family, or individual would have to be processed annually (and in each month during a year for which there was new information) to determine the actual Dividend payments to be disbursed.

The Internal Revenue Service already has the eligibility data for about 292 million residents from Federal income tax returns. It also has the necessary information (based on shared Social Security Administration data) to make adjustments for children whose eligibility changes when they or one of their siblings who are also dependents reach age 19 (or dependent full-time students reach age 24).¹⁶ The IRS, another government agency, or a private contractor would have similar information (or could obtain it from IRS or SSA) for current non-filers who would become eligible only after filing a tax return or Form CFD-1. Withholding would be based on the information on Forms CFD-4 and CFD-1.

¹⁶ The paying agency might need current information for dependents who reach age 19 and thus begin receiving full adult Dividends, but who continue being dependents because they are full-time students.

Figure 2: Claim for Dividend from Carbon Fee

Department of the XXXXXXXXXX - Carbon Administration		Claim for Carbon Fee Dividend		20XX
Form CFD-1		for Residents Not Required to File an Income Tax Return		Do not write or staple in this space
Your first name and initial		Last name		OMB No. 8888-xxxx
If a joint return, spouse's name and initial		Last name		Your social security number
Home address (number and street). If you have a P.O. box, see instructions			Apt no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below (see instructions).				
Foreign country name		Foreign province/state/country	Foreign postal code	
Filing Status <small>Check only one box.</small>	<input type="checkbox"/> 1 Single		<input type="checkbox"/> 4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter the child's name here. ► _____	
	<input type="checkbox"/> 2 Married filing jointly (even if only one had income)		<input type="checkbox"/> 5 Qualifying Widow(er) with dependent child (see instructions)	
	<input type="checkbox"/> 3 Married filing separately. Enter spouse's SSN above and full name here. ► _____			
Exemptions	6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a.			Boxes checked on 6a and 6b _____
	b <input type="checkbox"/> Spouse			
	c Dependents:		(2) Dependent's social security number	(3) Dependent's relationship to you
	(1) First Name Last Name			
d Total number of exemptions claimed.				Boxes checked on 6c for child dependents _____ Add numbers on lines above _____
Your Bank Account	7 Your bank account for direct deposit of your Carbon Fee Dividend			
	a Routing number	<input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/>	➔	b Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
	c Account number	<input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/>		
Carbon Fee Dividend	8 Is a Form CFD-5 (Carbon Fee Dividend Reconciliation) attached? <input type="checkbox"/> Yes <input type="checkbox"/> No			
Federal Income Tax Withholding	9 Federal Income Tax Withholding from my Carbon Fee Dividend payments.			
	<input type="checkbox"/> I do NOT want federal income tax withheld from my Carbon Fee Dividend payments.			
	<input type="checkbox"/> I want withholding at the rate of (check one): 7% <input type="checkbox"/> 10% <input type="checkbox"/> 15% <input type="checkbox"/> 25% <input type="checkbox"/>			
Third Party Designee	Do you want to allow another person to discuss this return with the IRS (see page xx)? <input type="checkbox"/> Yes. Complete the following <input type="checkbox"/> No			
	Designee's Name >>	Phone Number >>	Personal identification <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/> <input type="text" value=""/>	
Sign Here	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. I also declare that except for the Carbon Fee Dividend, I am not required to file a Federal income tax return. Declaration of preparer (other than tax payer) is based on all information of which preparer has any knowledge.			
	Your signature	Date	Your occupation	Daytime telephone number
	Spouse's signature. If a joint return, both must sign.		Date	Spouse's occupation
Paid Preparer's Use Only	Preparer's Signature >>		Date	Preparer's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code >>		Check if self-employed <input type="checkbox"/>	EIN
			Phone no.	

In practice, there would be instances each month in which the information from the IRS and from Forms CFD-1 and CFD-4 would not be sufficient to calculate the proper Dividend payment. In those cases, proper payment could be determined only with additional information from affected residents. One obvious situation would be the birth or adoption of a child. Unless the parent initiated a change, monthly Dividend payments would not be adjusted until many months after the parent filed a tax return the following spring. A child reaching age 19 and thus eligible for a full adult Dividend, but continuing to be a dependent only because of student status is another situation, since additional information would have to be submitted to claim student status.

The intermediary agency or private contractor responsible for processing Dividend payments would have to be empowered to determine payments for each eligible resident based on data from the IRS and the special information forms, receive and resolve inquiries and complaints from residents (such as incorrect payment amounts and missing or misdirected payments) and process both government-initiated and resident-initiated changes, including changes in recipients' bank accounts and changes from births, adoptions, marriages, divorces, and deaths. Significant staffing would be required to perform the variety of necessary functions. One or more "call centers" and, perhaps, even some local offices would have to be provided.

Changes due to children attaining age 19 (or dependent full-time students attaining age 24) and deaths would mostly be handled automatically based on IRS and social security records, respectively. However, there could be some delays in adjustments for deaths that would require repayments of Dividends paid for periods after the death of an individual. There could be similar delays and required repayments when a former dependent was no longer a student and, thus, no longer a dependent.

Even though intra-year changes from an eligible child reaching age 19 (or age 24 for dependent full-time students) could be largely automatic, such changes could be complicated and would require several separate steps. (a) The child aging out would stop receiving the child Dividend. (b) A child reaching age 19 but remaining a dependent (as a full-time student) would have his or her monthly Dividend increased to the adult amount. (c) A separate account would have to be prepared for the new adult so that he or she could begin receiving the adult Dividend. (d) The new adult would have to be informed about the requirement to file income tax returns (or information forms) in order to receive future Dividend payments. (e) A determination would have to be made about new eligibility of other children in the family who might become eligible for Dividend payments after the formerly-eligible child aged out.

Most other types of changes would have to be initiated by families. These include newly eligible dependents due to birth, adoption, marriage or divorce of parents. Determinations would be required about if or when foster children or children under guardianship became dependents and, thus, potentially eligible for the child Dividend. All types of inquiries or requests for assistance would also be initiated by, or on behalf of residents.

The intermediary would process all of these inquiries or change requests, would make the appropriate determinations (including processing and determining appeals through a separate,

independent unit), and would calculate the adjusted future monthly payments (and perhaps, some retroactive adjustments when underpayments were due to agency errors).

Each month, a list of payees and payment amounts would have to be created and provided to the agency responsible for making the payments.

Possible candidates for intermediary include:

- Option 1: The Internal Revenue Service. These responsibilities could be handled by the IRS. However, given the IRS' wide range of responsibilities, limited resources, widespread taxpayer trepidation about contacting and dealing with the IRS, and even political concerns about IRS' efficiency and fairness, assigning these responsibilities to the IRS might not be prudent.
- Option 2: Currently, the Social Security Administration ("SSA") handles similar types of issues for the large number of social security beneficiaries. Given SSA's experience working with individual members of the public, consideration should be given to expanding the SSA to handle similar issues for the Dividend.
- Option 3: A completely new – and possibly independent – government agency could be created to act as intermediary.
- Option 4: Employ one or more contractors to perform the required tasks. This would be similar to (although somewhat simpler than) the system used to process claims, make determinations, and actually pay out Medicare benefits. Since the inception of Medicare, all of these functions have been provided by contractors. Typically, the contracts are on a state-by-state basis, although a contractor can win the contract for more than one state.

Given the vast responsibilities of the IRS and the Social Security Administration, their large staffs, but their very limited resources relative to their needs, little would be gained by adding a completely new and large program with its own potential issues to their responsibilities. (Even if the IRS were not the intermediary, it would still have additional burdens from collecting and transmitting the extra information needed for the Dividend.) If the IRS or the SSA were assigned the intermediary tasks, a completely new sub-agency would have to be developed. Thus, there would be little potential benefit and possibly adverse impacts on other programs from using Options 1 or 2.

Option 3 would require the creation of a large new agency or sub-agency of an existing government department. A new independent agency not part of an existing government department could also be created.

Option 4 might be particularly attractive to those who accept the need for a carbon fee, but also insist on a smaller federal government, a smaller federal workforce, and less bureaucracy. They might be more comfortable with, and more willing to support, the Carbon Fee and Dividend proposals if administration were handled largely by contractors rather than government employees. In particular, use of private contractors might overcome their concerns about adding a large number of new federal employees.

It should be noted, however, that use of private contractors would not eliminate the need for all government involvement. A government agency would still have to hire the contractor or contractors, supervise their work, and provide oversight, guidance, and general rules and procedures about how the contractors decide various types of situations. The IRS would be involved by having to share the family structure information it already collects. The government would also have to develop and promulgate necessary regulations, as provided by the enabling legislation for the program.

Even if handled by the IRS or the SSA, a completely separate staff and completely separate accounting, recordkeeping, and computer systems would be necessary for the Dividend payments. That system would have to interface annually with the IRS for family status and size and with either the IRS or the SSA for age information.

The information required from the IRS or which will pass through IRS is subject to strict nondisclosure requirements. By law, the IRS generally is not permitted to disclose any information about taxpayers or their tax returns. Moreover, information in the IRS files which is received by the IRS from other agencies also becomes non-disclosable. These non-disclosure requirements are included in section 6103 of the Internal Revenue Code. However, there are currently many government programs that require otherwise non-disclosable IRS data. For each such program, the Congress has enacted legislation (included in subsections of section 6103) so that those programs can obtain the IRS data. The legislation and the associated regulations promulgated by the Treasury Department are specific about what information may be disclosed and to whom it may be disclosed.

The enabling legislation for the Dividend program would need to include the appropriate amendments to section 6103 (and possibly other sections) to permit the relevant government agencies and contractors to have access to the IRS data that they will need to implement the Carbon Fee and the Dividend. It would also have to impose the same non-disclosure and re-disclosure requirements on all of the agencies or contractors who handled that information, as well as on each of their employees. Similar disclosure authority would be necessary for any information from the Social Security Administration.

D. Administrative Costs

Significant new staffing and funding would have to be provided for the intermediary, both for setting it up or expanding it and for continuing annual operation. Some additional funding also would be needed for the IRS to cover its costs for providing the relevant tax return information to the intermediary. (IRS funding could also be via a reimbursable contact from the intermediary.)

Although determining even the approximate costs for administering the Dividend program is beyond the scope of this analysis, it is possible to make some general observations. Initiating a program, developing systems and software, and developing procedures would require one-time costs that would not vary significantly based the number of Dividend recipients. **The up-front costs would be very substantial.**

Annual expenses for employees, office space, facilities, communications, and so forth would be partially fixed and partially dependent on the numbers of transactions per year. Other annual

costs would be closely related to transactions. The per transaction costs of automated transactions is very low. Per transaction costs of handling inquiries and, especially, resolving errors can range from \$5 to \$25 (or even more) depending on the complexity of the problem and the employee time necessary to resolve the problem. For the most part, the number of errors (and even inquiries) would be related to the number of adjustments to payment amounts to residents, especially adjustments due to changes in the numbers of eligible persons. Generally, the total number of such changes per year would not be related to the frequency of payments (e.g., monthly or quarterly). In fact, if payments were made infrequently, residents might actually tend to inquire more because they would “forget” about relevant features of the system. **Since automated payment costs are very low, the extra cost of monthly versus bi-monthly or quarterly payments may be offset by reduced direct contact costs.**

It is possible that replacing direct monthly payments with a single annual payment made by the IRS through larger income tax refunds (or smaller balances due) might reduce government costs. However, if payments were still based on the end-of-month status of each eligible resident, the number of manual adjustments would not decline by much, and because residents would tend to initiate changes later (or retroactively), they would tend to have reduced recall of events and dates. As a result, the costs of adjustments might increase, and peak load problems would be exacerbated. If the IRS were the agency handling inquiries and adjustments, and if the peak time for Dividend adjustment requests coincided with the tax filing season, there could be significant problems for residents and taxpayers as IRS resources were overloaded. There would definitely be adverse optics for the IRS.

If the single annual Dividend payment were based on the year-end status of each resident for a previous year, a large share of the resident initiated adjustments would be eliminated. In that scenario, paying the Dividend annually as part of the federal income tax payment and refund process would reduce both upfront and ongoing costs for the Dividend program. The impacts from changing to an annual eligibility determination are discussed more fully in section 6.

A direct payment system could accommodate intra-year changes to the per capita monthly Dividend amount, if such changes were desired or required because of major discrepancies due to updates in estimates based on newer information. **Such Dividend level changes would be relatively straight-forward under a direct payment system, but because the required recalculations and the lead time between payment determinations and actual payments, there could be a one or two month (or more) delay in implementing such changes**

Government agencies that currently perform similar operations and/or provide similar services undoubtedly have developed information about per transaction costs and system development costs. Unfortunately, that information is generally not disclosed, although it might be disclosable under the Freedom of Information Act if the appropriate information were requested precisely and the party making the request were willing to pay for the search costs.

Simple comparisons to the Internal Revenue Service and the Social Security Administration should provide upper bounds for – indeed, a substantial over-estimate of – the funding and the number of employees required for the direct Dividend payment program. **Since both the IRS and the SSA perform a wider and more complicated range of functions than the Dividend payment agency will have to provide, the cost of administering the Dividend program should be substantially lower than for those agencies. The Social Security Administration has about**

64,000 employees, or about 81,000 including those working on disability determinations. The SSA has a budget of about \$12.0 billion.¹⁷ The Internal Revenue Service employs about 82,000 workers and has a budget of about \$12.0 billion.¹⁸

If the administrative costs of collecting the Carbon Fee and paying the Dividend directly were as much as half of the IRS' or the SSA's recent budgets, those costs would be about \$6 billion a year, including an allowance for significant start-up costs that would be amortized over a number of years.

While administrative costs as high as \$6 billion a year are significant, they may not seem as large when compared to the total revenue from the Carbon Fee. Even in the initial year of the Carbon Fee, revenue from the Fee would be about \$80 billion, and in each subsequent year, Carbon Fee revenue would increase by \$50 billion or more. Thus, in the first year, administrative costs would be about 7.5 percent (\$6 billion / \$80 billion) of Carbon Fee revenue, but the percentage would decline quickly in later years. In the second year, costs would be 4.6 percent (\$6 billion / \$130 billion) of receipts; in the fifth year, administrative costs would be 2.1 percent (\$6 billion / \$280 billion) of receipts; and by the tenth year, costs would be only 1.1 percent (\$6 billion / \$530 billion) of receipts. The Administrative costs as a percentage of Carbon Fee receipts would continue to decrease thereafter.

E. Actual Disbursement Methods

The vast majority of payments would be made by an automated clearing house (ACH) electronic funds transfer (EFT) to the family's bank account, either checking account or savings account. For most families without bank accounts, the payment would be made by adding funds to a debit card account that would be set up for the resident or family by the government. In instances where banks could not process EFTs (or debit cards) because of closed accounts, incorrect account numbers, lost debit cards, divorces, deaths, or any other usual or unusual situation, payments would be made by paper checks. Paper check payments would always delay the receipt of the Dividend by the resident or family.

The federal government has been largely successful in mandating that beneficiaries of federal programs, contractors, and other recipients of recurring federal payments supply bank account information so that payments can be made by EFT. Almost all social security payments to domestic recipients are made by EFT. To date, the Internal Revenue Service has not mandated that individuals provide bank account information in order to receive tax refunds. Despite the lack of any mandate, the vast majority of the one-time economic stimulus payments (advance income tax rebates) paid in 2008 were paid by EFT.¹⁹ Each year, the percentage of tax returns prepared or prepared and filed electronically has increased, with virtually all refunds related to those tax returns being made by EFT. Over 90 percent of tax returns are prepared with electronic software.

¹⁷ www.ssa.gov/budget/FY16Files/2016BO.pdf Enacted budget for Fiscal Year 2015. Social Security Administration, FY 2016 Budget Overview.

¹⁸ www.irs.gov/PUP/newsroom/IRS%20Budget%20in%20Brief%20FY%202016.pdf Enacted budget for Fiscal Year 2015. Internal Revenue Service, Program Summary by Appropriations Account and Budget Activity.

¹⁹ Economic Stimulus Act of 2008, P.L. 110-185, 122 Stat. 613, enacted February 13, 2008.

According to a study commissioned by the Federal Deposit Insurance Corporation, in 2013 about 7.7 percent of households (or about 9.6 million households) did not have a bank account (were “unbanked”).²⁰ Note that 9.6 million households may translate in a somewhat larger number of income tax filing units. Over 40 percent of the unbanked previously had a bank account, and the loss of a bank account was often related to loss of employment. With a vibrant economy and more workers employed, fewer than 10 million debit card payments would be required. With an economy in recession, as many as 12 to 13 million debit card payments could be necessary.

Most government payments are made by the Treasury Department’s Bureau of the Fiscal Service. Other government agencies may determine and authorize payments, but generally they forward the payment information to the Fiscal Service to make the actual payment. There are, however, instances where government payments are handled differently. The situation that is most relevant for the Dividend is the handling of Medicare payments which are actually disbursed by Medicare’s private intermediary contractors who also receive claims and determine appropriate payments. Payments to individual beneficiaries are made by paper checks drawn on the private bank accounts of the intermediaries. (Presumably, larger payments to Medicare providers are made electronically.)

Three options for Dividend disbursement are:

- Option 1: Have the Treasury Department make the payments based on information supplied by the Dividend intermediary. Make the Dividend payment separately.
- Option 2: The same as Option 1, except that, where feasible, the Dividend payment would be combined with monthly social security or other government pension payments and disbursed as a single payment.
- Option 3: Have the Dividend intermediary make the payments directly, with the aggregate payment amount being provided from the Carbon Fee Trust Fund.

Currently, combined disbursements as provided under Option 2 are used little, if at all, for payments, but a very similar system is used to offset (reduce) government payments to an individual from one program or agency by certain unpaid debts to other government agencies. There has been increasing use of such offsets to collect debts that would otherwise be more expensive or difficult to collect. The offset program has expanded to include not only debts owed to the federal government but also unpaid child support and unpaid state tax liabilities.

Conceptually, it seems that under Option 2 monthly Dividend payments could be combined with recurring monthly payments under other large programs into a single monthly disbursement, thereby reducing the number of payment transactions. Candidates for combining payments would include at least recurring monthly social security and federal retirement benefits. These programs make large numbers of payee payments monthly. Social security alone has nearly 60 million monthly disbursements. Combined payments might be conceptually feasible even if all Dividend decision-making and processing were provided by a contractor. It seems all that would be necessary would be for the contractor to provide a list of payees and amounts to the Bureau of the Fiscal Service for actual disbursement.

²⁰ <https://www.fdic.gov/householdsurvey/> and Federal Deposit Insurance Corporation, *2013 National Survey of Unbanked and Underbanked Households*, 2014.

However, because of underlying program differences, creating combined payments would not be a simple matter of merging two payment lists. One basic difference is that, as currently envisaged, Dividend payments are by family. Each family gets one and only one payment even if two adults and up to two children are eligible. In contrast, social security payments are made to individual payees. For husbands and wives, the Social Security Administration makes separate payments even if both payments are based on the same earnings history. (That is, even if one of the payments is for spousal benefits.) Thus, when families were involved, there would be different payees under the Dividend and social security programs. In such circumstances, combining payments would not be possible. This type of problem would not prohibit combining payments when the payees were identical.

On a more practical level, given the extremely low cost of making EFT payments, even where combining payments were feasible, it might not be cost-effective to do. The extra cost of combining payments might approximate (or even exceed) the government's costs in making two separate payments. Costs would also increase because use of combined payments might require that the content of each combined payment be stated explicitly to each recipient routinely (either monthly or annually) or whenever the payment amount changed. There would also be extra costs from recipient inquiries or complaints about the accuracy of the combined payments. When payments under separate programs are made separately, the recipient automatically knows the agency to contact with questions or problems. If, however, single payments were received for a combination of programs, recipients would not know the source of real or perceived discrepancies and would not know the agency to contact. That could be remedied only by providing a separate explanatory mailing to each recipient each time the payment changed from the preceding month's payment, or by creating another separate agency to triage inquiries for directing recipients to the correct agency. The additional mailings would be expensive. Adding a triage agency would be costly but even more importantly would add to recipients' burdens.

Even if a combined payment system were feasible, it might be prudent to make separate payments. In fact, if a contractor were used as the intermediary, direct payments by the contractor (rather than by the Treasury Department) might be nearly as efficient and provide more citizen support for the Carbon Fee program.

If it is decided to have disbursements handled by the Treasury Department, it might be prudent to give the Treasury Department the authority to decide whether some payments should be combined, based on facts such as relative costs and past experiences with the handling of errors and inquiries. Under such a scenario, some payments might be combined while others remained separate.

Finally, and perhaps most importantly, combining Dividend payments with social security or other government payments would diminish the visibility of the Dividend payment. That visibility may be an important component of support for the entire Carbon Fee program.

F. Reconciling Dividends Received during the Year with Correct Amounts

As described above, many types of intra-year adjustments in eligibility, or corrections to eligibility information or payments, would have to be initiated by, or on behalf of, affected residents. Requests for corrections could be initiated only after incorrect payments were

received, and residents might not initiate requests for changes immediately. In most instances, determinations by the intermediary in these fact-specific changes in eligibility would require time, perhaps some months. Once determinations became final, the system could (1) make retroactive correction payments, (2) adjust future monthly Dividend payments including any retroactive amount, or (3) delay making the additional payments or collecting any overpayments until the end of the year as part of a comprehensive annual reconciliation to be included (and paid) as part of the income tax return filing process for the year.

Given the factual complexity of making and adjusting payments to over 150 million resident families and individuals, it is likely that all three types of adjustments would be useful. Making retroactive payments or adjusting future monthly payments including retroactive over- or under-payments would be straightforward. It would be accomplished by the intermediary and paid in one of the ways described above. Providing for a single annual reconciliation and then making or receiving payment for discrepancies discovered during the reconciliation is more complicated. Under any payment adjustment method, each adjustment to Dividends would have to be attributed to a particular month, and the recipients would have to be provided with that information.

Annual reconciliation would be on a form to be attached to the annual federal income tax returns filed on Forms 1040, 1040A, or 1040EZ or on the information Form CFD-1 filed by non-filers. The reconciliation form would calculate total annual Dividend entitlement based on the month-by-month eligibility of each member of the tax filing unit. The total eligible Dividend amounts calculated would be compared to the Dividends payments actually received.²¹ If overpaid, the family would have to pay back the overpayment along with the income tax return. If underpaid, the underpayment would create or increase the tax refund or future Dividend payments.

Figures 3 and 4 show possible forms for Carbon Fee Dividend Reconciliation (Form CFD-5) that could be used to reconcile actual with correct payments for an entire calendar year, but based on month-by-month eligibility and actual payments.

Even though not more than two children in a family would be eligible for the child Dividend in any given month, both versions of Form CFD-5 include columns (columns d, e, and f) for three children under age 19. The third column covers situations in which different children would be eligible in different months of the year. Typically, that would occur when one eligible child reached age 19 (or age 24, if a full-time student) and a previously ineligible younger child became eligible. The forms include separate columns for dependent children age 19 through 23 who remain dependents because they are full-time students. Separate columns are necessary because the older child dependents are entitled to an adult Dividend rather than a child Dividend.

Column i in Figure 3 would be for non-child dependents. It would be included only if Dividends for non-child dependents are paid to the family unit.

Columns k and l in Figure 3 would allow for the possibility that the per capita Dividend amount varies by month; that is, it allows for intra-year changes in the per capita Dividend.

²¹ The new “schedule” would be structurally similar to, although simpler than, the current Form 8962 (Premium Tax Credit) which is required for taxpayers eligible to receive a tax credit for medical insurance.

The version of the form shown in Figure 4 is slightly simpler because it requires (1) that non-child dependents file separate claims for their Dividends and (2) that the per capita Dividend amounts be the same for all months of the calendar year.

If there were a discrepancy to be reconciled, the completed Form CFD-5 would be attached to, and submitted with, the resident's federal income tax form or, for non-filers, Form CFD-1. The social security number of each eligible dependent is not required on Form CFD-5 because that would duplicate the requirement for including the dependent's social security number on the income tax return or Form CFD-1 to which the Form CFD-5 would be attached.

Providers of income tax preparation software almost certainly would include the option of preparing Form CFD-5, so that after entering a limited amount of information, the remainder of the form would be calculated automatically and submitted (generally electronically) with an income tax return or with Form CFD-1.

G. Transition and Implementation

If the direct payment method is used to disburse Dividend payments but quicker implementation is necessary, a temporary, transitional system could be used.

A temporary payment system could use the IRS' information about family composition to make annual or semi-annual direct payments until such time as the permanent direct payment system could be fully implemented. Such temporary payments would be similar to the one-time economic stimulus payments (advance income tax rebates) paid in 2008. It is likely that such payments could begin in about three months and then, given the high percentage of tax returns for which the IRS has bank account information from the tax return, could be paid out over the following three months, or less.

A transitional system initially would not provide Dividend payments to residents who had not filed income tax returns for the preceding year. Such residents would receive both retroactive and prospective Dividend payments during the transition period beginning soon after they filed an income tax return or a Form CFD-1 to provide the information necessary for Dividend payments. The transitional system might be slightly less accurate and, in some instances, might not be able to handle resolution of discrepancies between the transitional Dividend payments and actual entitlement. Thus, when overpayments were made, the transitional Dividend payments might have to be treated as final payments. Moreover, the transitional system would not include provisions for income tax withholding from Dividends.

Figure 3: Reconciliation of Dividend from Carbon Fee with Changing Dividend

Form CFD-5		Carbon Fee Dividend Reconciliation					OMB No. 8888-XXXX
Department of the xxxxxx Carbon Administration		(to reconcile dividends received during the year with correct amounts)					20XX
Your first name and initial		Last name					Your social security number
If joint return, spouse's first name and initial		Last name					Spouse's social security number

1	2	3	4	5	6	7	8	9	10	11	12	Eligible Dependent Children (do NOT check more than 2 children for any month)				Add amounts checked (add col (b) through col (i))	Adult Carbon Fee Dividend for Month col (k)	Total Carbon Fee Dividend for Month (multiply col (l) by col (k))		
												Under Age 19		Age 19 to 23 (Full Time Students only)					Other Dependents	
												col (a)	col (b)	col (c)	col (d)				col (e)	col (f)
January	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
February	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
March	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
April	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
May	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
June	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
July	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
August	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
September	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
October	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
November	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
December	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		

13	Add the amounts in rows 1 through 12 of col (l)	
14	Enter the total amount of Carbon Fee Dividends you actually received during the year	

IF line 13 is more than line 14, CONTINUE on line 15. OTHERWISE skip to line 16.

15	Subtract line 14 from line 13. Enter the amount here and on Form 1040, line uu; Form 1040A, line line xx, Form 1040EZ, line yy; or Form CFD-1, line zz. Your "tax refund" will be reduced by this amount.	
16	Subtract line 13 from line 14. Enter the amount here and on Form 1040, line uv; Form 1040A, line line xy, Form 1040EZ, line yz; or Form CFD-1, line zw. Your "tax refund" will be increased by this amount.	

ATTACH completed Form CFD-5 to your Form 1040, 1040A, 1040EZ, or CFD-1.

Figure 4: Reconciliation of Dividend from Carbon Fee with Unchanged Dividend

Form CFD-5 Department of the xxxxxx Carbon Administration	Carbon Fee Dividend Reconciliation (to reconcile dividends received during year with correct amounts)	OMB No. 8888-xxxx 20XX
Your first name and initial	Last name	Your social security number
f joint return, spouse's first name and initial		
Last name		
Spouse's social security number		

Month	col (a)	col (b)	col (c)	Eligible Dependent Children (do NOT check more than 2 children for any month)				col (f)	col (g)	col (h)	col (i)		
				Your Spouse (if applicable)		Under Age 19						Age 19 to 23 (Full Time Students only)	
				name	name	name	name					name	name
1	January	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
2	February	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
3	March	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
4	April	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
5	May	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
6	June	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
7	July	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
8	August	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
9	September	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
10	October	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
11	November	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
12	December	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 0.5	<input type="checkbox"/> 1	<input type="checkbox"/> 1	<input type="checkbox"/> 1			
13	Add the numbers in rows 1 through 12 of col (i) and multiply the total by \$20.												
14	Enter total amount of Carbon Fee Dividends you actually received during the year (from CFD-1099s).....												
IF line 13 is more than line 14, CONTINUE on line 15. OTHERWISE skip to line 16.													
15	Subtract line 14 from line 13. Enter the amount here and on Form 1040, line uu; Form 1040A, line line xx, Form 1040EZ, line yy; or Form CFD-1, line zz. Your "tax refund" will be reduced by this amount.												
16	Subtract line 13 from line 14. Enter the amount here and on Form 1040, line uv; Form 1040A, line line xy, Form 1040EZ, line yz; or Form CFD-1, line zw. Your "tax refund" will be increased by this amount.												

ATTACH completed Form CFD-5 to your Form 1040, 1040A, 1040EZ, or CFD-1.

H. Conclusion

The direct payment method is the simpler payment method because it covers all eligible residents and does not require different payment systems for different segments of the population. All payments would come from a single source. Only the residents themselves and the government would be involved. Employers and others who make income payments to residents would not be involved at all.

Figure 5 summarizes the five possible actions required of residents (both tax filers and non-filers) in order to obtain and, if necessary, reconcile Dividend payments. Except for how residents claim Dividends and request withholding, the first step, the actions required of tax filers and non-filers would be the same.

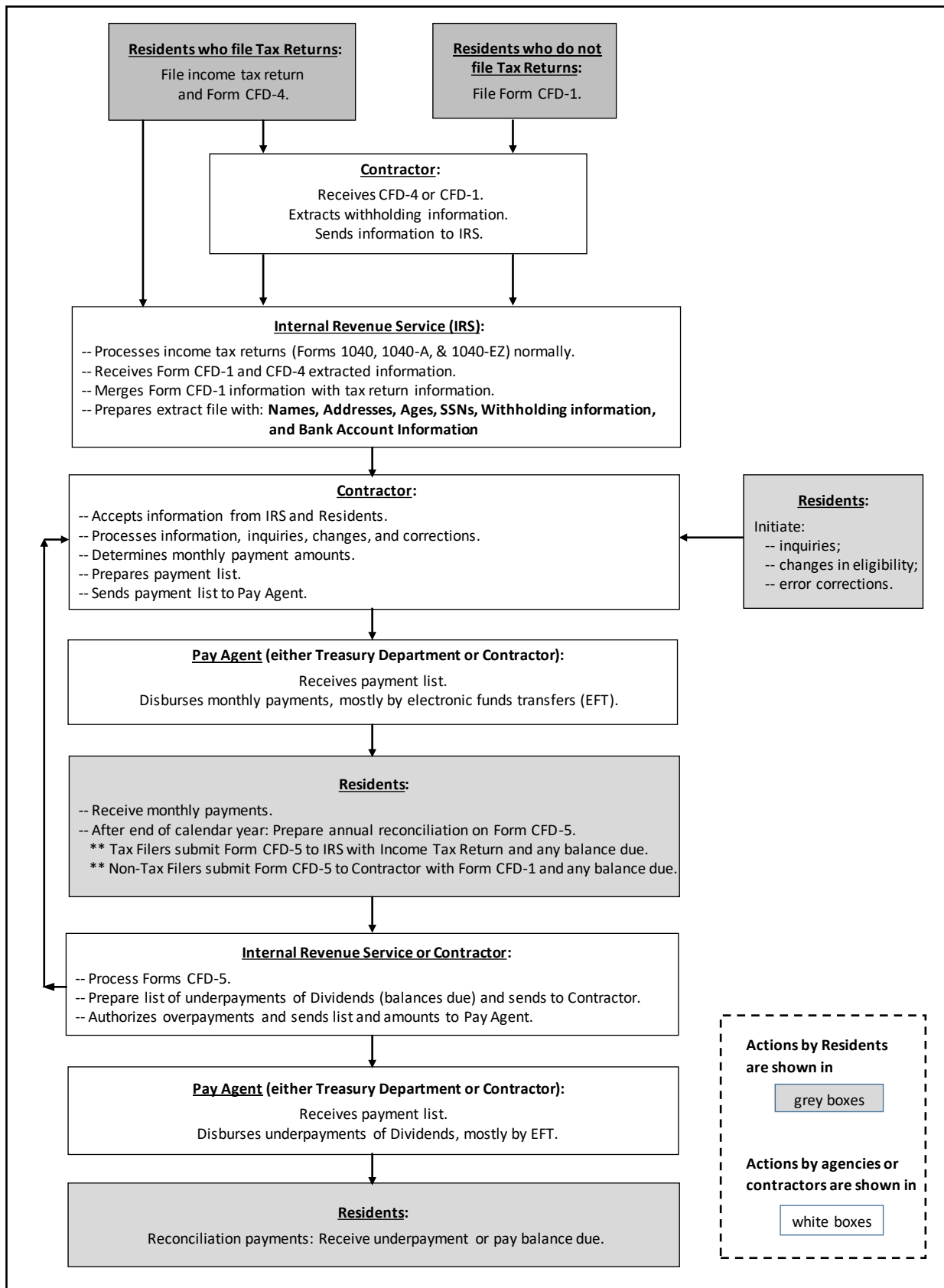
Figure 5: Summary of Actions by Residents – Direct Dividend Payment

Tax Return Filers	Non-filers
File: Income Tax Return <i>and</i> Dividend Withholding Certificate (Form CFD-4).	File: Claim for Carbon Fee Dividend (Form CFD-1).
If necessary, initiate inquiries, changes, and corrections.	If necessary, initiate inquiries, changes, and corrections.
Receive Monthly Dividend payments.	Receive Monthly Dividend payments.
If necessary, file Carbon Fee Dividend Reconciliation (Form CFD-5).	If necessary, file Carbon Fee Dividend Reconciliation (Form CFD-5).
If necessary, receive or pay reconciliation amount.	If necessary, receive or pay reconciliation amount.

Figure 6 shows the flows of information between, and the responsibility of, Dividend recipients and the administering agencies under the direct payment method. The intermediaries labeled as “Contractor A” and “Contractor B” could be either private contractors or government agencies. Contractors A and B could also be the same organization. Because of political considerations and limits on their resources, it would be preferable that the intermediary or intermediaries not be the IRS or the Social Security Administration.

The main disadvantage of the direct payment method is the time it would take to implement. Given the tasks involved, the vast number of residents covered, and the over 1 billion monthly payments required each year, implementing the system would require substantial lead time. For example, implementing the taxpayer-specific features of the Patient Protection and Affordable Care Act (“ACA”) took well over three years. Thus, a simpler and less accurate transitional system, as described in section 4G, might be required.

Figure 6: Flows of Information and Payments under the Direct Payment Method



5. Payment of the Dividend via Increased Net Wages and Other Periodic Payments

A. Introduction

It is often assumed that payments for programs such as the Dividend from the Carbon Fee could be made most efficiently through the Federal payroll tax system (“withholding system”), with only modest modifications to current practices. However, at best, the Federal payroll tax system would be complicated, burdensome, and inefficient and still would provide only partial coverage. Since not all residents or families receive income subject to the payroll tax system, other means would have to be used to cover the remaining residents. Under such a multi-part payment system, it would difficult to avoid duplicating payments to some. Overall, using the payroll tax system supplemented by other means would be far less attractive than paying the Dividend by direct monthly payments to each resident or family.

Despite the above-mentioned issues, the payroll tax system could be expanded to pay the Dividend to residents who receive wages or other periodic income payments.

This section explains the several reasons why distributing the Dividend through the payroll tax system would be complicated, inefficient, and burdensome. It begins by reviewing the structure of the withholding systems for wages and salaries and the slightly different system for other periodic payments. It then outlines how these systems would have to be modified substantially and supplemented by other payment mechanisms. (Readers familiar with the withholding systems can go directly to section 4D.)

B. Current Federal Withholding for Wages and Salaries: A Primer

Under current law, three separate federal payroll taxes are typically withheld from wages and salaries and almost immediately paid by employers to the Federal government:

1. Withholding for Federal income tax;
2. Withholding for social security; and
3. Withholding for Medicare Part A (Hospital Insurance).

i. Income Tax Withholding

Income tax withholding is a highly simplified mirror of the individual income tax system. The system described in this paper is applicable through 2018 but may change in 2019.

The Tax Cuts and Jobs Act (P.L. 115-97), signed into law on December 22, 2017, enacted changes in the individual income taxes that may result in substantial changes to income tax withholding. Although many of the relevant changes in the income tax itself is effective for 2018 through 2019, PL 115-97 delays changes in withholding until 2019. Those changes will be made administratively, probably in mid- to late-2018. The major changes in taxes that are likely to affect withholding are: (1) elimination of personal exemptions, (2) expansion of the child tax

credit and the additional child tax credit for dependents under age 18; (3) the provision of a personal tax credit for other dependents; and (4) expansion of the standard deduction.

Through 2018, for withholding purposes, gross wages are reduced by amounts that reflect an employee's personal exemptions and, optionally, itemized deductions in excess of the employee's so-called standard deduction as well as various tax credits. Employees have various options for adjusting for further reducing their wages subject to withholding to reflect exclusions, itemized deductions, and tax credits. Withholding on the reduced wage is then calculated from a progressive withholding rate schedule which reflected both income tax rates and the standard deduction.²²

All withholding adjustments including those for the personal exemptions are given to employers in the form of a number of "withholding allowances" (each of which is equivalent in size to one personal exemption).²³ That prevents employers from knowing the reasons for the number of allowances claimed.²⁴ The limit on the information provided by employees to their employers is intentional, both to reduce complexity and to prevent employer access to more than necessary personal information from adversely affecting the relative bargaining positions of employees.

Before 2011, employees could also have their income tax withholding reduced to obtain a portion of the benefits of the Earned Income Tax Credit. Since Advance EITC payments were based on only one eligible child, claiming of the Advance EITC provided employers only with the information that the worker had at least one dependent child.²⁵

Given its structure, the income tax withholding system can automatically reflect with reasonable accuracy some tax credits or deductions that are based on income and/or a worker's status as single or married.²⁶ It is also reasonably accurate if a worker has only one job at a time or if a married couple has only one job. Even if workers use optional adjustments, the accuracy of wage withholding is problematic when there is more than one job. Depending on the number of jobs and the divisions of earnings between jobs, there can be substantial overwithholding or underwithholding.

²² For 2018, the various deductions provided for withholding purposes are available to taxpayers as if PL 115-97 had not been enacted.

²³ Employees can request fixed dollar amount increases in the amount withheld each pay period; however, all requests to *reduce* withholding must be denominated in "withholding allowances."

²⁴ In addition, the employer is told whether to use the withholding rate schedule for married taxpayers or single taxpayers, but the employer is not told the actual marital status. In limited circumstances, the employee may also claim exemption from withholding, but doing so only tells the employer that the worker did not have tax liability in the preceding year and expects none in the current year.

²⁵ The Advance EITC was repealed because of low utilization by workers and concerns about its possible misuse.

²⁶ In 2009 and 2010, withholding was reduced to reflect the Making Work Pay Tax Credit. The reduction was accurate for most single taxpayers, except that when income tax withholding was zero or less than the amount of the Making Work Pay Tax Credit, some or all of the Making Work Pay Credit was not paid currently. Because withholding does not distinguish between one-earner and two-earner married couples, only an average amount of the Making Work Pay Credit was reflected in the withholding reduction. Thus, the reduction was too small for one-earner couples but too large for two-earner couples because they received the reduction on both jobs.

ii. Social Security and Medicare Withholding

Both social security and Medicare withholding are based on withholding fixed percentages of gross salary (with an annual maximum for social security withholding). The current withholding rates are 6.2 percent for social security and 1.45 percent for Medicare.²⁷ Employers must match the amount of social security and Medicare taxes withheld from employees.

iii. Remitting Payroll Taxes to the Federal Government

Withheld amounts and employers' matching amounts of social security and Medicare withholding must be paid to the government on a schedule determined by the amounts that the employer holds. Amounts over \$100,000 are payable to the Federal government the next day, smaller amounts are generally payable twice weekly, and very small amounts are paid monthly or quarterly.²⁸ Initially, all three types of payroll tax are deposited as an aggregate amount and not stated separately. Separate identification of the amount of each tax is stated for the first time on a tax return filed by the employer after the end of each calendar quarter.

C. Current Federal Withholding for Pension and Certain Other Periodic Payments

Pension, social security, unemployment insurance benefits, and certain other periodic payments are subject to income tax withholding, generally at the option of the beneficiary. For some types of payments, federal income tax withholding parallels the withholding on wages and salaries. For others, withholding is a flat percentage of the gross payment, with the percentage (within limits) selected by the beneficiary.

Unlike wages and salaries, these other periodic payments are not subject to social security and Medicare withholding.

D. Payment by Adjusting Social Security and Medicare Withholding

A seemingly simple way of disbursing the Dividend through the payroll tax system would be to avoid using the more complicated income tax withholding system and instead decrease or eliminate the social security and/or the Medicare tax rates, but for withholding purposes only.²⁹ The Dividend would be paid by increasing workers' net wages by some or all of the social security and Medicare Part A taxes that would ordinarily be withheld. Workers' social security accounts would continue to be credited with wages, just as if the taxes were actually being withheld. The social security and Medicare Part A trust funds would be held harmless by transferring the reduced revenue from the Carbon Fee Trust Funds.

²⁷ For social security, the annual amount of covered wages per worker is limited. For 2018, the limit is \$128,400 resulting in social security withholding of 7,960.80 or less. Wages above \$128,400 paid to a worker by an employer are not subject to any withholding for social security. A worker who has been employed by more than one employer during a calendar year may have additional amounts withheld. However, amounts in excess of \$7,960.8 are refunded to workers when they file their annual federal income tax returns.

²⁸ The detailed rules for payroll tax payments are explained in Section 11 of IRS Publication 15, Employer's Tax Guide (Circular E). The latest version is dated Jan 25, 2018, but the payroll tax payment rules do not change annually.

²⁹ Similar reductions in the social security withholding rate have been proposed in the past as methods of stimulating the economy.

Unfortunately, reducing or eliminating withholding for social security (and/or) Medicare would not be consistent with a fundamental principle of the Dividend proposal, which is to provide the same amount of Dividends to every resident regardless of a resident's income. Since the amounts withheld for social security and Medicare are directly proportional to covered wages (aside from the social security earnings limit), reducing that withholding would provide a larger than intended Dividend to higher-income workers, a lower than intended Dividend to lower-income workers, and no Dividend to those not employed or whose wages are not covered by social security. A somewhat more complicated system might require employers to reduce social security withholding in fixed dollar amounts based on family size information provided by each worker. That method would still not provide Dividends currently to lower-wage workers, especially as the size of the Dividend increased over time.

Any Dividend payment system based on direct changes in social security and/or Medicare withholding – whether reduced rates or fixed dollar amount reductions - would require detailed accounting and reconciliation to assure that the exact amounts of reduced withholding were charged against the Carbon Fee Trust Fund but still credited to the social security trust funds. The accounting for those transactions would not be transparent and, thus, the general public might not have complete confidence that either the Carbon Fee Trust Fund or the social security trust funds, or both, were being treated fairly. In particular, this type of payment program might raise doubt that 100 percent of net Carbon Fees were being returned to residents as Dividends.

E. Paying the Carbon Fee Dividend via a Modified Payroll Tax System

With only the limited family information that the current income tax withholding system provides to employers, the current system cannot reflect payments (such as the Dividend) that vary based on the number of children in the family. Paying the Dividend through modification to income tax withholding would require, at minimum, that employers be told the number of adults and children for which the employee wanted to receive the Dividend.

For all of the reasons mentioned above, it would not be possible to disburse the Dividend from the Carbon Fee by adjusting current federally mandated withholding from periodic payments. For the Dividend payments to be made through payroll systems, there would need to be both fundamental changes in the information given to employers and other payors and (b) a new, separate accounting system.

If a political decision were made to require employees and other recipients of periodic payments to share more personal information with payors (which could tilt wage negotiations in favor of employers), payors could disburse the Dividend by directly increasing net payments by the amount of the Dividend without altering withholding under any of the three current withholding systems. Increasing net payments to disburse the Dividend would effectively be building a new system on top of the three current payroll tax systems.

Paying the Dividend via a system of increased net wage and other periodic payments would impose new costs and burdens on employers who already incur burdens from the current withholding system for income tax, social security tax, and the Medicare tax. Employers, other payors, and their representatives would strongly oppose adding the additional burdens and costs, as well as the Carbon Fee which is the basis for the Dividends. Thus, to the extent possible, it is

important that the Dividend payment system minimize the additional costs and burdens for payors.

In order to receive Dividend payments from employers or other payors of periodic income, a resident would submit a form to a payor requesting the payor to make the Dividend payments, telling the payor about the number of eligible residents and, if desired, the rate of withholding. If a worker had more than one job at the same time or if there was more than one earner in the family, the worker or family would have to select the employer from which the Dividend would be disbursed. The mechanics of providing the information to an employer are discussed in section 5F, below.

Unless a resident made a request and supplied the appropriate information about the eligible residents, the resident would not receive Dividend payments on a current basis. Essentially, residents would have to opt-in order to receive Dividends currently.

One aspect of limiting the new burdens for payors/employers would be to restrict changes in the per capita Dividend amount to one time per year, preferably in January when employers, payroll providers, and payroll software providers already must modify their systems to accommodate annual changes in withholding for the income tax and social security.³⁰

To the extent possible, the funds for paying the Dividend to residents would come from the amounts withheld by that payor for the other federal payroll taxes and the payor's matching shares. Where those funds were insufficient, the shortfall would have to be made up by permitting payors to make immediate and unverified withdrawals from the Treasury Department's Carbon Fee Trust Fund.

In the early years of the Dividend, the vast majority of employers would have sufficient withheld funds to make full payment of Dividends. Even just the withheld social security and Medicare taxes (together with the employers' matching shares) typically would provide sufficient revenue to pay the Dividends. Shortfalls would occur only for those employing mostly low wage and part-time workers. For typical mixes of workers, any shortfalls would be unusual for the first five or more years of the program, until the per capita Dividend increased sufficiently, but shortfalls would become increasingly common over time.³¹ Pension-type payors would not have the cushion from social security and Medicare withholding. Depending on the average pension

³⁰ Technically, employers could accommodate Dividend changes at other than the beginning of the calendar year, but such changes would increase payor costs and, based on experience, might not be implemented immediately – or at the same time by all payors. Different implementation dates would increase the number of discrepancies between actual Dividend payments and correct payments.

³¹ By the tenth year of the Dividend program, the level of the per capita Dividend would be nearly \$100 per month. In that year, an unmarried worker without any dependents would have to be employed at least 19 hours per week at \$8 per hour in order to generate sufficient withholding to fully pay the Dividend. (At that wage level, there would not be any income tax withholding, but the combined employee and employer shares of social security and Medicare contributions would equal the Dividend.) A four-person family with one earner would not generate sufficient withholding to pay the Dividend even working 40 hours per week at \$8 an hour. That worker would have to earn at least \$11.31 per hour and work an average for 40 hours a week for the entire year in order to generate sufficient withholding to pay the full amount of the Dividend. These examples highlight that the lower-income workers could not receive the full amount of their Dividend just from the revenue from their own withholding. (These calculations are based on 2018 Federal withholding rate schedules.)

they paid out and the extent to which recipients requested income tax withholding, some payors would have shortfalls beginning in the first year.

If full payout of the Dividend through increased net wage and other payments is important, it would be crucial to permit payors to make immediate withdrawals from the Carbon Fee Trust Fund. Such permission would be needed by some – especially pension payors – as soon as Dividend payments were initiated. As the Dividend increased annually, such permission would be used by an ever-larger share of payors. Such largely unverifiable withdrawals would provide a vehicle for fraud and would require significant levels of enforcement activity by the government. Even with strict enforcement, substantial and continuing revenue losses would be expected.

Since the Dividends are subject to income taxation, payment via employers and other periodic payors would require withholding of income tax by the payors. The necessary withholding on the Dividends could be achieved by combining Dividends and other wages subject to income tax withholding and applying the current income tax withholding system. This would add some complexity to payroll systems since the Dividends would be treated as income for income tax withholding purposes but not for social security and Medicare withholding.

F. Universal Coverage for Dividend Payments

Since not all residents are employees (or their spouses) or do not receive other periodic pension-type payments, paying the Dividend by increasing periodic wage and other payments would not provide a complete solution. Residents who are not employed, not receiving periodic pension-type payments, and not owing sufficient estimated income tax payments would not be receiving Dividend payments currently. Thus, a system that provided Dividend payments through increases in existing period payments would not be a comprehensive Dividend disbursement method.

To achieve virtually 100 percent coverage for Dividend distribution, a supplementary direct payment system would have to be provided for residents not receiving their Dividends through increased net periodic payments. The required direct payment add-on system would be an opt-in program under which the resident would file the same form as mentioned above for those receiving their Dividends from social security, etc. They would file with a federal agency, possibly the Social Security Administration, or a contractor, following which monthly payments would be made directly to them by electronic funds transfer, debit cards, or even paper checks. The structure of this add-on system would be virtually identical to the structure of the direct payment method, as explained in section 4, above.

Even if a direct payment component were added to payments via employers and pension-type payors, it would be difficult to achieve 100 percent coverage of eligible residents. As workers changed jobs, shifted from employment to retirement, or simply failed to request current payment of the Dividend, there could be some periods for which Dividend payments were not received currently. Also, as a practical matter, some residents who do not receive periodic income payments would fail to apply for direct payment of Dividends.

As a practical administrative matter, residents requesting payment from two or more sources simultaneously would create problems, burdens, and revenue losses from duplication of

payments. For example, spouses might each claim the same Dividend, a worker with two or more jobs might claim Dividends from more than one employer, or a still employed retiree might claim from an employer and from social security. Since lower-income workers tend to change jobs more frequently or have more than one part-time job at a time, such workers would probably be affected disproportionately. Recovering overpayments of Dividends from such residents would be especially difficult and problematic under any system based on adding Dividends to net recurrent payments.

G. Additional Personal Information to Employers and Other Payors

In order to make Dividend payments through the payroll tax system, employers and other payors would have to be provided with the information about whether the worker was claiming Dividends for himself or herself, for a spouse, for the family's eligible dependent children, and for the family's non-child dependents (if the Dividend payment for non-child dependents were paid through the tax-filing unit) The resident would also have to certify under penalties of perjury that he or she was not claiming the Dividend payments from another payor. This increase in required personal information would represent a fundamental conceptual change in the information provided to employers, but administratively the change would be simple.

The Employee's Withholding Certificate (Form W-4) which employees currently use to give their withholding information to their employers could be expanded to include the number of eligible children and, possibly, non-child dependents for whom the resident was claiming the Dividend and whether a working spouse was also claiming the adult and/or child portions of the Dividend at his or her place of employment. Although an expanded Form W-4 could be used for this purpose, the current Form W-4 and its accompanying instructions are sufficiently complicated that their length and complexity reduces their use below what is optimal, even under current law. Thus, it would be prudent not to alter the current Form W-4. Rather, the additional eligibility information for Dividends should be on a separate form. In that scenario, both a Form W-4 and the new form would have to be submitted to employers or other payors. Two simpler forms, however, are preferable to one more complicated form.

Figure 7 shows the draft of a possible new form, Carbon Fee Dividend Payment Certificate (Form CFD-9), for providing Carbon Fee Dividend eligibility information to a payor.³² Based on the Form CFD-9 information from the employee, employers would increase net wage payments by the amount of the Dividend. The sizes of the adult and child payments would be adjusted to the length of each employer's payroll period. For example, for workers receiving their pay weekly (that is, 52 times a year), the Dividend payment included in each pay would be one-fifty-second of the annual amount.

To assure that periodic payments more closely match final eligibility, employees would be required to refile Forms CFD-9 if there were any changes in the number of eligible children or if the spouse started or stopped claiming any of the Dividend separately. Since it is generally accepted that most workers do not refile Forms W-4 when changes in family status require it (other than when they begin a new job), it can be expected that there would be only partial

³² The draft Form CFD-9 shown in Figure 7 does not cover claiming the Dividend for non-child dependents. To do so, the text for line 2b would have to be expanded: "Eligible Children over age 19 but under age 24 (but only if full-time students) AND non-child dependents."

compliance with the mandatory refiling requirement of Forms CFD-9, leading to incorrect Dividend payments.

Since many workers would fail to file a new Form CFD-9 when there are changes in eligible persons, in order to minimize continuing discrepancies, Form CFD-9 would have to be refilled periodically (probably annually) even if there were no changes. Some workers, however, would not comply with even periodic mandatory refiling in a timely manner. That failure would result in the termination of their Dividend payments until they did refile. At best, this would delay payment of the Dividend to those workers.

Figure 7: Certificate for Claiming the Dividend from the Carbon Fee

Form CFD-9 Department of the xxxxxx Carbon Administration		Carbon Fee Dividend Payment Certificate for Workers to Provide Information to their Employers		20XX	
Your first name and initial		Last name		OMB No. 8888-xxxx Your social security number	
Home address (number and street). If you have a P.O. box, see instructions					
City, town or post office, state, and ZIP code.					
I claim Carbon Fee Dividend payments for the following members of my family:					
1 Adults: Myself:		<input type="checkbox"/>	Enter number to boxes checked in Box 1 >>>>		<input type="checkbox"/>
My spouse:		<input type="checkbox"/>			
2 Children: Enter number of eligible children, but NOT more than 2:					
a. Eligible Children under age 19.				<input type="checkbox"/>
b. Eligible Children over age 19 but under age 24.				<input type="checkbox"/>
(Must be full-time students)					
Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.					
Employee's signature				Date	

Form CFD-9 (20xx)

Payment of the Dividend from the specific amounts withheld for a particular worker (including the employer's matching shares of social security and Medicare) is not practical. Rather, Dividends would be paid from the aggregate amount withheld and matched by an employer.

Even initially but increasingly over time as the per person Dividend increased, the total amount that an employer had to pay Dividends would not be sufficient to pay the Dividend to all workers. As mentioned above, the additional funds required to pay the Dividend currently would be obtained by permitting payors to make immediate withdrawals from the Carbon Fee Trust Fund to cover the shortfall.

H. Direct Payments Required for Some Residents

Direct payments would be necessary for residents who could not receive their Dividend payments from employers or pension-type payors. Direct payments might also be necessary for self-employed workers whose estimated income tax payments could not be reduced enough to provide the full amount of the Dividend for the worker or the worker and eligible family members.

The direct payment system would be similar, but not identical, to the system described in section 4 pertaining to the general direct payment method. In order to begin to receive (and, in subsequent years, continuing to receive) direct payments, the resident individual or family would have to file both a Carbon Fee Withholding Certificate (Form CFD-4), as shown in Figure 1, and a Claim for Dividend from Carbon Fee (Form CFD-1), as shown in Figure 2. Initially, both forms would be filed with the appropriate government agency or contractor. The information from the two forms would be shared with the IRS, so that IRS could create a record for the resident to be used later for reconciliation purposes. To prevent undue confusion, the agency which received such submissions should NOT be the Internal Revenue Service. The receiving agency would process the two forms, make determinations, handle inquiries and complaints, determine the correct Dividend payment, and disburse the Dividend payment as described in more detail above in the discussion of the general direct payment method.

I. Reconciling Dividends Received during the Year with Correct Amounts

Under any payment system that provides for disbursing Dividends via several million employers and other payors and supplemented by a direct payment system, there would be a non-trivial percentage recipients whose actual payments would vary from the correct amounts. Accuracy under this payment method would depend on immediate filing of the Form CFD-9 when family eligibility changed, immediate implementation of changes by payors, employment during every pay period of the calendar year, non-duplication of claims by spouses or at more than one employer, and always making legitimate claims. There would also be payment gaps when workers changed jobs or shifted between employment, unemployment, and retirement. In many of these instances, it is theoretically possible that discrepancies could be corrected by subsequent payments from the same payor during the calendar year; however, that would place additional burdens on employers, and making such adjustments mandatory might not be practical or politically feasible.

As described above under the direct payment method, an annual reconciliation would be required between payments actually received during the year and the total amount to which the resident or family was entitled for the full year. Reconciliation would be on a Form CFD-5, Carbon Fee Dividend Reconciliation, (see Figures 3 and 4) which would be attached to the annual federal income tax return on Form 1040, 1040A, or 1040EZ or information Form CFD-1. Thus, residents who were over- or underpaid would have to file an income tax return or a Form CFD-1 annually, even if it were not otherwise required. The Form CFD-5 would guide residents through the calculation of total annual Dividends based on the month-by-month eligibility of each member of the tax filing unit. That would be compared to the Dividend payments actually received. If Dividends were overpaid, the family would have to pay back the overpayment along with the income tax return. If underpaid, the underpayment would be treated as an additional tax

refund. Depending on policy decisions, the additional refund could either be combined with the income tax refund or be made separately.

In order to provide residents with the information necessary for an annual reconciliation, each payor would have to supply each resident payee with information about the amount of Dividends actually paid to the resident during the calendar year. Employers would include the information in a new box on IRS Form W-2 (Wage and Tax Statement) that employers currently must provide to every worker. Similarly, pension payors, the Social Security Administration, etc., would include the same information in a new box on IRS Form 1099-R (Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.) or similar forms, such as the version used by the Social Security Administration. Thus, the amounts shown in the current boxes of the Form W-2 or Form 1099-R for income tax, social security, and Medicare withholding, etc., would remain unchanged from current law. The Dividend payment would be shown completely separately.

J. Transition and Implementation

The shorter implementation time for a system of Dividend payments through increased net wage and pension payments might eliminate the need for a separate transition system. However, if an even faster implementation were deemed to be essential, annual or semi-annual payments (as described above in section 4G) and similar to the 2008 stimulus payments could be used.

K. Conclusion

A Dividend payment system based predominantly on increases in net wages and salaries and pension-type payments could be implemented reasonably quickly, probably in three to four months, although actual implementation dates would vary somewhat from payor to payor. In the past, the IRS has not expended efforts to assure employer implementation by a required date. It is believed, however, that payors strive to meet required dates so that their payees have only the correct amounts withheld. Under an employer-based Dividend payment program, it can be expected similar compliance would be the norm.

Under this type of mixed method Dividend payment system (increased net wage or other income payments, reduced estimated taxes by self-employed workers, and direct monthly payments) receiving Dividend payments currently would depend on residents taking specific action. For example, if an employee did not submit a Form CFD-9 (Carbon Fee Dividend Payment Certificate), he or she would only receive Dividends after filing an income tax return after the end of the year. Moreover, employees who did not otherwise file an income tax return would not receive their Dividends unless they filed a special form, Form CFD-1 (Claim for Carbon Fee Dividend).

Figure 8 summarizes the five different actions that residents might have take under the combination of the payroll-based system and direct payments for residents who do not receive periodic payments. Required resident actions would be similar whether they receive their Dividends from their employer or other payor or directly from the government. The main differences are in the entities with which residents interact: employers or other payors for those subject to withholding; or a government agency or contractor for residents without withholding. This summary does not specifically include self-employed workers (and their families). As

mentioned above, they would receive their Dividends either by reducing their quarterly estimated income tax payment or by direct payment, as if they were neither self-employed nor subject to withholding.

Figure 8: Summary of Actions by Residents – Indirect Dividend Payment

Some Income Subject to Withholding	No Income Subject to Withholding
<ul style="list-style-type: none"> • Submit Dividend Payment Certificate (Form CFD-9) to EMPLOYER. • If necessary, initiate inquiries, changes, and corrections with EMPLOYER. • Receive Dividend payments as part of SALARY or PENSION. • If necessary, file Carbon Fee Dividend Reconciliation (Form CFD-5) with government. • If necessary, receive or pay reconciliation amount. 	<ul style="list-style-type: none"> • File Claim for Carbon Fee Dividend (Form CFD-1) with GOVERNMENT. • If necessary, initiate inquiries, changes, and corrections with GOVERNMENT. • Receive Monthly Dividend payments from GOVERNMENT. • If necessary, file Carbon Fee Dividend Reconciliation (Form CFD-5) with government. • If necessary, receive or pay reconciliation amount.

A Dividend payment system based predominantly on increases in net wages and salaries and pension-type payments would be viable so long as most employers did not have to draw funds from the federal government in order to pay their workers the full amount of their Dividends. If (or when) the per capita Dividend increased sufficiently so that a large percentage (or even a large number) of employers had to make electronic withdrawals routinely, compliance issues would make continued use of this payment method very problematic. Incorrect actions, or lack of actions, could lead to less than 100 percent of eligibles receiving any or all of the correct Dividend payment on a current basis. Substantial and widespread underpayments could have an adverse impact on the economy since not all of the Carbon Fee revenue were being returned immediately in the form of Dividends. Year-end reconciliation would be expected for a larger fraction of eligible recipients, and the reconciliation amounts would tend to be larger. Widespread, substantial overpayments would tend to be burdensome, especially for lower-income recipients. Some repayments – both anticipated and unanticipated, but especially unanticipated – would cause financial hardship. Some overpayments would not be repaid immediately, requiring enforcement actions. And, even then, some overpayments would never be repaid, resulting in loss of revenue.

A payment system based on employer and other periodic payors would impose new and significant burdens on those employers and payors. The initial burden would be from modifying their payroll tax systems and instituting methods for drawing needed funds directly from the federal government. There would be ongoing burdens from processing the Dividend payments and, especially, from having to make withdrawals from the federal government to make Dividend payments to employees. Since most employers and other payors use automated payroll

systems, the additional processing burden would be very modest. Based on current, ongoing issues of employers making payments of withheld taxes to the federal government and the resulting substantial penalties, similar issues could be expected under an employer-based Dividend payment system. The resulting penalties might be the largest costs and burden for employers.

Under the indirect system that paid most Dividends via increasing net wages (and other periodic payments) supplemented by direct government payments for residents not receiving periodic income payments, government costs would be less than under the direct payment system. However, when employer costs were included, it is not clear whether combined administrative costs for the government and employers would be more or less than administrative costs under the direct payment system.

There would be modest additional burdens on the Dividend recipients and on the IRS from developing and processing the annual reconciliation forms submitted with income tax returns and from dealing with additional incorrect deposits of withheld taxes and incorrect withdrawals by employers.

6. Simplification of the Carbon Fee Dividend Payment System

The direct payment Carbon Fee Dividend payment system presented in section 4 could be simplified if certain specific provisions of the Citizens' Climate Lobby's original proposal were modified. Administrative systems are compromises between simplicity and fully implementing the policy goals. Greater simplicity typically reduces the ability to meet particular goals. This section explores five possible simplifications that, separately or in combination, could make a Dividend payment system less costly and less burdensome administratively without having major adverse impacts on the program's goals.

While retaining direct monthly (or other periodic) dividend payments, the simplifications would:

- 1. Provide a Dividend for all children, rather than only the first two, in a family.**
- 2. Increase the per child Dividend from 50 percent to 100 percent of the adult Dividend.**
- 3. Keep the per capita monthly Dividend amount unchanged within a calendar year.**
4. Have annual rather than monthly Dividend eligibility determinations.
5. Exclude Carbon Fee Dividends from income taxation.

Each of these possible changes could alter to a lesser or greater extent the net amount of Dividends received by many families. The policy questions to be considered are whether the benefits of a simplified Dividend program would outweigh any possible adverse impacts on recipients and whether a simplified system would continue to promote the goals of the original Citizens' Climate Lobby proposal.

Implementation of the Carbon Fee Dividend, either as proposed by CCL or as modified, would not add to the burden of determining which parent or other adult would be eligible to receive the Dividend payment for children. Such determinations would continue to be made by the Internal Revenue Service, as under current law. However, as the monthly Dividend amount increased over several years, there would tend to be greater dollar amounts at stake and, hence, more administrative tension from the resolution of uncertainty or disputes about who is eligible to claim exemptions for dependents. It would not, however, alter the criteria for deciding eligibility. Particularly with the larger dollar amounts involved, annual eligibility determinations would greatly reduce the number of disputes and the number of factually based determinations that separate eligibility for each calendar month would require.

A. Uniform Benefits for all Residents including Children

Providing the Carbon Dividend for all children and providing the same Dividend amount for children as for adults would simplify the system both for administrators and for some recipients.

The amount of the per person Dividend is determined by dividing the aggregate net amount of Carbon Fee revenue by the number of persons eligible to receive Dividends (adjusted, if

appropriate, for the differing Dividend amounts for adults and children). Thus, each of these proposals would reduce the per capita Carbon Dividend amount.

i. Providing Dividends for All Children

Providing the benefit of the carbon tax rebate for all children would not have a major impact on the size of the per capita benefit because only a relatively small percentage of American families have large numbers of dependent children. Although exact distributions of the numbers of children by the same of families is not readily available, some approximations can be derived from a Pew Research Center Study and from Census Bureau data.³³

The Pew Research Center surveyed women between the ages of 40 and 44, which is close to the end of their child-bearing years.³⁴ The survey found that only 12 percent of the survey group had ever had four or more children and that 15 percent never had children, 18 percent had only one child, 35 percent had two children, and 20 percent had three children. Since not all of a woman’s children will always be dependents at the same time, the percentage of family unit with four or more children will be even lower.

Using Census Bureau data on the percentages of children under age 18 in families with differing numbers of children shows that only 6 percent of families with 14 percent of children are in families with four or more dependent children. Thus, the Census data and the Pew Survey show extremely similar results. The Census data also show that only one percent of families with two percent of children are in families of six or more children. The Census data are summarized in Figure 9.

Figure 9: Distribution of Families and Children by Family Size

Approximate Percentages of Families and Children in Families with Children

Number of Dependent Children in Family Unit	Percentage of Families	Percentage of Children
1 Child	46%	25%
2 Children	35%	39%
3 Children	13%	22%
4 Children	4%	9%
5 Children	1%	3%
6 or More Children	1%	2%

³³ Federal income tax returns generally require the listing of the names and relationship of each dependent claimed by a family. IRS could use these data to develop a table of the distribution of returns by the number of child dependents, but the IRS Statistics of Income Division does not publish such a table.

³⁴ Gretchen Livingston, “Childlessness Falls, Family Size Grows Among Highly Educated Women.” Pew Research Center, Washington, D.C.: 2015.

The available data indicate that providing a Dividend for an unlimited number of dependent children would reduce the per capita Dividend by only 2.4 percent. The dollar magnitude of a 2.4 percent Dividend reduction can be illustrated in relation to the size of the Dividend some 15 to 20 years after implementation when the per adult Dividend level would be about \$1,200 per year (\$100 per month) under the unmodified CCL proposal. At that time, this modification would reduce the Dividend from \$1,200 to \$1,171.

Providing the same Dividend for all children would simplify the system by eliminating an incentive to structure families to obtain larger total Dividend payments. In particular, it would eliminate the incentive for two adults, each with children, to cohabit rather than get married.

ii. Providing the Same Carbon Dividend Amount for Adults and Children

Providing children with the same monthly Dividend as adults (but still limiting Dividends to two children per family) would reduce the adult Dividend by about 12 percent. That is, in the situation in which the adult Dividend under the CCL proposal would be \$1,200, this modification would reduce the Dividend to \$1,057.

This change would have some simplification benefits because there would not be any need to track the ages of child dependents so that the Dividend amount would be adjusted when a dependent reached age 19.

iii. Impact of These Modifications

Both of these modifications could be applied together. Doing so would have cumulative impact on the size of the per capita Dividend. The hypothetical \$1,200 per capita Dividend would be reduced by over 15 percent to \$1,013.

Extending the Dividend to more than two children and providing the same Dividend level for all residents each shift aggregate benefits toward larger families while, in most cases, slightly reducing Dividends for single persons, couples without children, and families with one or two children. If the economies of scale from children and larger families are modest, the CCL plan would tend to undercompensate children and larger families for the hidden costs of climate change and for the Carbon Fees that they would be paying, directly and indirectly. Conversely, to the extent that there are large economies of scale for larger families, the Dividends under these simplified proposals would tend toward overcompensating larger families for those costs and Carbon Fees and could fail to fully compensate single residents or couples without children for the costs of Carbon Fees. Under-compensation of those groups could be particularly problematic for lower-income retirees on fixed incomes and could increase opposition to the Carbon Fee and Dividend proposal.

Providing the Carbon Dividend for all family members and with the same Dividend amount for adults and children would *not* significantly change the actual information that current tax filers provide on their annual income tax Forms 1040 or 1040A nor the similar information that non-filers would have to provide the IRS. It would, however, reduce the number of changes that residents and the paying agency would have to process as children reach age 19 (or age 25 for dependent full-time students). Some paperwork and burden reduction would stem from

simplification of the form that residents would have to file to reconcile the amount of payments that the family actually received with the amount for which the family is actually eligible.

Figure 10 summarizes the impact on family units of different sizes and compositions of three different simplifications: extending child benefits to all children rather than limiting benefits to a maximum of two children in a family; providing each eligible child with the same benefit amount that an adult receives; and both simplifications implemented together.³⁵

Figure 10: Carbon Fee Dividend under Various Proposals for Child Dividends

**Carbon Fee Dividend under Various Proposals for Child Dividends
(By Size and Composition of Family Unit)**

Family Unit	CCL Proposal: 50% of Adult Dividend for Children Dividend Limited to Two Children		Modified CCL Proposal: 50% of Adult Dividend for Children Dividend for All Children		Modified CCL Proposal: 100% of Adult Dividend for Children Dividend Limited to Two Children		Modified CCL Proposal: 100% of Adult Dividend for Children Dividend for All Children	
	Dividend Amount	Change from CCL Proposal (%)	Dividend Amount	Change from CCL Proposal (%)	Dividend Amount	Change from CCL Proposal (%)	Dividend Amount	Change from CCL Proposal (%)
Single Adult	\$1,200	0%	\$1,171	-2.4%	\$1,057	-11.9%	\$1,013	-15.6%
Couple, No Children	\$2,400	0%	\$2,343	-2.4%	\$2,114	-11.9%	\$2,027	-15.6%
1 Adult and 1 Child	\$1,800	0%	\$1,757	-2.4%	\$2,114	17.4%	\$2,027	12.6%
1 Adult and 2 Children	\$2,400	0%	\$2,343	-2.4%	\$3,171	32.1%	\$3,040	26.7%
1 Adult and 3 Children	\$2,400	0%	\$2,928	22.0%	\$3,171	32.1%	\$4,053	68.9%
1 Adult and 4 Children	\$2,400	0%	\$3,514	46.4%	\$3,171	32.1%	\$5,067	111.1%
Couple and 1 Child	\$3,000	0%	\$2,928	-2.4%	\$3,171	5.7%	\$3,040	1.3%
Couple and 2 Children	\$3,600	0%	\$3,514	-2.4%	\$4,228	17.4%	\$4,053	12.6%
Couple and 3 Children	\$3,600	0%	\$4,100	13.9%	\$4,228	17.4%	\$5,067	40.7%
Couple and 4 Children	\$3,600	0%	\$4,686	30.2%	\$4,228	17.4%	\$6,080	68.9%
Couple and 5 Children	\$3,600	0%	\$5,271	46.4%	\$4,228	17.4%	\$7,093	97.0%

Again, for purposes of illustrating the dollar magnitude of the Dividend change from each or both of these modifications, Figure 10 reflects the future time at which the per adult Dividend level would be \$1,200 per year (\$100 per month) under the unmodified CCL proposal. The Figure 10 shows the annual Dividend levels for families of different sizes under the original CCL proposal and under each of the three possible simplifications. The Figure also shows the percentage change in Dividends for each-size family under each modified proposal as compared to the original CCL proposal.

The left-most bank of data shows the Dividend by family type and size under the unmodified CCL proposal.

The second bank of data from the left shows the Dividend by family type and size if *all* children were eligible for a Dividend of 50 percent of the adult Dividend.

³⁵ The number of adults and children reflected on income tax returns is from: U.S. Internal Revenue Service, *Individual Income Tax Returns 2014 Publication 1304*, Table 2.4. The number of residents not reflected on income tax returns was developed from: U.S. Census Bureau, Population Division, “Annual Estimates of the Resident Population for the United States (NST-EST2016-01)”, Table 1. The numbers of child dependents under and over age 19 and the numbers of dependents who would receive full adult Carbon Fee Dividends, half Dividends, and no Dividends was developed from: U.S. Census Bureau, Current Population Survey, “2015 Annual Social and Economic Supplement”, Table FINC-06.

Since, as discussed above, only a relatively small percentage of family units have more than two children, allowing a Dividend for all children (rather than limiting it to two children) would reduce the adult Dividend by only about 2.4 percent so that a \$1,200 Dividend under the original CCL proposal would be \$1,171 under this modification. As a result, single persons and family units with no children or with one or two children would receive smaller benefits, but family units with 3 or more children would receive very much larger Dividends.

Single persons and couples without children would receive 2.4 percent less in Dividends. A single adult with one or two children would receive, 2.4 percent less in benefits. However, a single parent with 3 children would receive a 22.0 percent larger Dividend, and with 4 children, the Dividend would be 46.4 percent larger. Couples with one or two children would have their Dividends lowered by 2.4 percent. ; Couples with 3 or more children would receive larger Dividends: 13.9 percent more with 3 children; 30.2 percent more with 4 children; 46.4 percent more with five children, etc.

The third bank of data from the left shows the Dividend by family type and size if only two children were eligible for a Dividend but the Dividend for each eligible child were 100 percent of the adult Dividend.

Providing the full adult Dividend to up to two children per family (but no Dividend for additional children) would result in the Dividend for single persons and family units without any children being lower by 11.9 percent, but would increase benefits for all families with dependent children. An unmarried adult with one child would receive 17.4 percent higher Dividends; with two or more children, the Dividends would be 32.1 percent larger. For married couples with one child, the Dividend would be 5.7 percent larger; with two or more children, the Dividend would be 17.4 percent larger.

The right-most bank of data shows the Dividend by family type and size if all children were entitled to the same Dividend as adults. Implementing both the larger Dividend per child and providing that Dividend for an unlimited number of children would result in somewhat larger changes from the original CCL proposal.

Dividends would be 15.6 percent lower than under the CCL proposal for single persons and family units without any children, but Dividends would be larger for all filing units with children. Dividends would be larger by 12.6 percent for single adults with one child, 26.7 percent larger with two children, 68.9 percent larger with 3 or more children, and 111.1 percent larger with four children. For married couples, Dividends would be larger by 1.3 percent with one child; 12.6 percent larger with 2 children; 40.7 percent larger with three children; 68.9 percent larger with 4 children; and by even larger percentages with 5 or more children.

In deciding whether it would be appropriate to provide Dividends as modified by either or both of these simplifications for child Dividends, the policy issue that needs to be addressed is whether simplification tightens or loosens the relationship by family size between Dividends and the hidden costs of climate change and the Carbon Fees that they would be paying, whether such a change is deemed to be appropriate, and whether the resulting Dividend payments are deemed to be fair for families of different sizes.

B. Annual Rather Than Monthly Dividend Changes

The CCL proposal leaves open the possibility that the amount of the per resident Dividend could be changed either at the beginning of a calendar year or during a calendar year. Two versions of the Carbon Fee Dividend Reconciliation (Form CFD-5) for end-of-year reconciliation of Dividends for which the resident or family were eligible with the amounts actually received are shown in Figures 3 and 4. The version for the system which would **not** permit intra-year changes in the monthly Dividend amount is simpler, although not simple.

Since the per person monthly Dividend would be based on estimates of future Carbon Fee receipts, those estimates could be made for a full calendar year rather than for part of a calendar year or for a non-calendar fiscal year. Any changes in the per person Dividend amount stemming from revised estimates or actual Dividend Fee receipts would be reflected in adjustments to the per person Dividend in a subsequent year or years. Permitting intra-year changes in the per person Dividend would increase complexity without a corresponding improvement in meeting the goals of the Carbon Fee and Dividend proposal. Hence, the per person Dividend should remain constant for entire calendar years.

C. Annual Dividend Eligibility Determination

Previous sections of this paper have provided that eligibility to receive a Dividend would be determined monthly, as of the end of the month. Monthly determination, however, was not mentioned specifically in the CCL proposal, and annual determination would not be inconsistent with that proposal. The Citizens' Climate Lobby proposal envisages only that the Dividend from the Carbon Fee would be **paid** monthly.

Some simplification could be obtained by determining eligibility on an annual basis while retaining monthly payments. However, annual eligibility determination would increase the average lag in changing payments to match actual changes in eligibility.³⁶

A priori annual determination could accelerate the initial implementation of the Carbon Dividend program because – at least for tax filers whose tax returns cover 85 percent or more of the population – IRS would already have much or all of the information necessary to determine eligibility based on already-filed income tax returns.

If eligibility were determined for an entire calendar year, the volume of communications between residents and the government agency (or contractor) responsible for processing eligibility and determining actual monthly disbursements to residents would be reduced. In addition, there would be less stress on the rapid acquisition and processing of data about births, adoptions, deaths, and changes in living arrangements for children or other dependents. The need for rapid correction – indeed, for any correction – for other reasons that produced over- or underpayments in previous months would be virtually eliminated.

³⁶ Annual eligibility determination could be used initially to accelerate the implementation of Dividend payments. More frequent eligibility determination could be implemented later, after the start-up problems and burdens of the Dividend payment system have been reduced or eliminated.

The current Earned Income Tax Credit (EITC) is precedent for annual Carbon Fee Dividend determination. Under both systems, eligibility would be determined for an entire calendar year. The only significant difference is that the Carbon Fee Dividend eligibility would be determined in advance whereas EITC eligibility is determined after the end of the year. Note that while the Carbon Fee Dividend would be paid monthly, the EITC is generally paid well after the end of the calendar year, some weeks after the appropriate income tax return is filed.

Annual determination would enable a major simplification through the complete elimination of the need to file an annual form, such as Form CFD-5, to reconcile eligibility and actual receipts of Dividends, either monthly or annually. Such forms would be burdensome for residents, and the communication and paperwork required in addressing the inevitable errors in completing such forms would compound burdens and costs.

If Dividend eligibility were determined annually, the exemption information for taxpayers and dependents provided by taxpayers on their income tax returns would be used to determine the number of persons eligible to receive Dividends.³⁷ (Residents who did not file income tax returns would, as under the original proposal, have to file Form CFD-1, Claim for Carbon Fee Dividend, to list the eligible members of their families.)

A downside of annual determination is that it might be viewed as being inequitable by treating two children differently because one was born shortly before the end of a calendar year and the other was born just after the beginning of the following calendar year.³⁸ In fact, however, over their entire childhood, they would receive dependent Dividend benefits for the same number of years. The child born at the end of the year would begin receiving benefits one year earlier, but that child's eligibility would end one year sooner.

Annual eligibility determinations would greatly reduce the number of disputes and the number of factually based determinations that separate eligibility for each calendar month would require. Annual eligibility would eliminate the need to make separate determinations for each month. As a result, the Internal Revenue Service could use the same determinations for the Dividend that it already must make for other purposes, such as eligibility for dependent exemptions, the child tax credit, and the earned income tax credit.

Payments for an entire calendar year would be based on tax return or Claim for Carbon Fee Dividend (Form CFD-1) information. If a person were listed as either a taxpayer or as eligible for the child credit on a 2018 tax return, for example, the IRS would obtain that information and process it after the 2018 tax return was filed, generally in the spring of 2019. That 2018 tax return information would then determine actual Dividend payments for every month of calendar year 2020. Eligibility would be redetermined based on the 2019 tax return and would apply to payments for calendar year 2021. That process would be repeated for each subsequent year.

³⁷ Under the Tax Cuts and Jobs Act, PL 115-97, signed into law on December 22, 2017, personal exemptions are eliminated for taxable years 2018 through 2025. However, tax returns will include information about taxpayers and the newly expanded child tax credit. That information should substitute for the exemption information shown on tax returns for years before 2018.

³⁸ This treatment would be virtually identical to the longstanding treatment of personal exemptions (and now to be replaced by the expanded child tax credit) for children born just before or just after the end of a calendar year.

The advance determination method would work reasonably well in most situations, but might need to be supplemented for births, adoptions, and deaths. As described above, a child born in 2018 would first be reported on the 2018 income tax return filed in the spring of 2019, and the monthly Dividend would not be adjusted automatically until the beginning of 2020. Thus, without some additional provisions, the new child would not receive Dividends for all of 2019. Similarly, a death in 2018 would result in continued Dividends for all of 2019. Since such long delays are not appropriate, some additional provisions would be necessary.

The first appearance of a newborn (or newly adopted) child first on a tax return, say for 2018, should trigger an immediate Dividend adjustment and future payment for the child for 2019. Shortly after the 2018 tax return were filed, the monthly Dividend payment to the family would be increased for the future months of 2019. For prior months, a “refund-type” direct payment would have to be paid directly.

In general, deaths could be handled in a similar – but reversed – manner. When the 2018 death is reported on the income tax return filed in the spring of 2019, monthly Dividends for the deceased individual could be stopped immediately, and any Dividends paid for the earlier months of 2019 would have to be repaid to the government. However, the need for repayments would be reduced substantially if there were coordination with deaths reported to the Social Security Administration. Most individuals who die have been receiving Social Security or other government payments. Existing systems stop monthly payments almost immediately. That information could be transmitted to the agency authorizing Dividend payments and used to stop Dividend payments at the beginning of the next calendar year. Thus, when a person dies in 2018, the Social Security information would be used to stop Dividend payments at the beginning of 2019.

Annual eligibility determined in advance of the year would reduce benefits for newborn children by between 1 and 11 months, but would increase Dividend payments by a similar time period for dependents who “age out” of eligibility for Dividends as children and for residents who die during a year. Thus, children born during a year would lose an average of 6 months worth of Dividends for the year of their birth. Conversely, children who age out and the estates of persons who die during a year would receive an average of 6 months more of Dividends.

Because there are more births than deaths, annual determination would decrease the aggregate number of months of eligibility for all residents by about 0.22 percent. With a slightly smaller number of eligibles, the dollar amount of the monthly Dividend would be larger than otherwise by about 0.22 percent.

Figure 11 compares for family units of different sizes the Dividends under the original CCL proposal and a modified proposal which would permit (a) Dividends for all children, (b) the same Dividend amount for children as for adults, and (c) annual determination for Dividend eligibility. Figure 11 shows the percentage changes in Dividends and the absolute dollar changes for an assumed \$1,200 Dividend under the original CCL proposal.³⁹

³⁹ The entries in Table 11 for the Modified CCL proposal are equal to the similar entries in the two right-most column of Table 10 multiplied by 1.0022.

When all three modifications are combined, the per person Dividend would be reduced by 15.4 percent, as compared with the Dividend in the original CCL proposal. If the per person Dividend were \$1,200 per year under the original CCL proposal, the per person Dividend would be \$1,016 under the simplified proposal. As shown in Table 11, Dividends would decrease for single residents and couples without children. All single residents and families with children would receive larger Dividend payments.

Figure 11: Simplified Carbon Fee Rebate vs Original CCL Proposal

**Simplified Carbon Fee Dividend vs Original CCL Proposal
(By Size and Composition of Family Unit)**

Family Unit	CCL Proposal: 50% of Adult Rebate for Children Rebate Limited to Two Children Eligibility Determined Monthly		Modified CCL Proposal: 100% of Adult Rebate for Children Rebate for All Children Eligibility Determined Annually	
	Dividend Amount	Change from CCL Proposal (%)	Dividend Amount	Change from CCL Proposal (%)
Single Adult	\$1,200	0%	\$1,016	-15.4%
Couple, No Children	\$2,400	0%	\$2,031	-15.4%
1 Adult and 1 Child	\$1,800	0%	\$2,031	12.8%
1 Adult and 2 Children	\$2,400	0%	\$3,047	26.9%
1 Adult and 3 Children	\$2,400	0%	\$4,062	69.3%
1 Adult and 4 Children	\$2,400	0%	\$5,078	111.6%
Couple and 1 Child	\$3,000	0%	\$3,047	1.6%
Couple and 2 Children	\$3,600	0%	\$4,062	12.8%
Couple and 3 Children	\$3,600	0%	\$5,078	41.1%
Couple and 4 Children	\$3,600	0%	\$6,093	69.3%
Couple and 5 Children	\$3,600	0%	\$7,109	97.5%

D. Taxation of Dividends from the Carbon Fee

In order to limit the complexity and the possible inequity from very high effective tax rates on Dividend payments for some residents of modest means, the CCL proposal includes Dividends as income only for income tax purposes but excludes them from income for various means-tested programs. Nevertheless, as discussed in section 7, even with that limited inclusion, due to various phase-in and phase-out provisions of the income tax system, some residents will receive very much reduced net benefits from Carbon Fee Dividends. **The Carbon Fee Dividend system would be simpler if Dividends were not subject to income tax.** The implications, impacts, and the complexity of the taxation of the Carbon Fee Dividends are discussed in section 7.

The Federal individual income tax is generally progressive, meaning that overall the effective tax rate on Dividends either increases (or, at least, does not decrease) as income from other sources increases. As a result of income taxation, a larger share of net, after-tax benefits from the

Dividend would be payable to lower-income residents. Non-taxation of Dividends would tilt a larger share of net after-tax benefits to residents with higher incomes. However, as explained in section 7, various special income tax provisions and “phase-ins” and “phase-outs” could override the general progressivity of the income tax system. Depending on each person’s views about the proper role of government in the redistribution of income, either taxation or non-taxation of Dividends might be perceived as being more equitable. This a classic situation of the tension between simplicity and the perceived equity of income redistribution.

Even though taxation of Dividends would have an actual impact on federal budget deficits or surpluses, **whether or not to tax Dividends from the Carbon Fee should be treated as income for income tax purposes is mainly a policy choice.**

E. Summary

This section explains how the system for paying Dividends proposed by the Citizens’ Climate Lobby could be simplified without doing major violence to the intent of the original proposal. Simplification could be achieved by: increasing the per child Dividend from 50 percent to 100 percent of the adult Dividend; providing Dividends for all children in a family, rather than only the first two; keeping the monthly Dividend amount constant throughout each calendar year; and having Dividend eligibility determined annually rather than monthly. If these four changes were made, the per person Dividend would decrease by about 15.4 percent from the level in the original CCL proposal. Dividends for family units with two or fewer children would decrease, and Dividends for family units with 3 or more children would increase with the increases being greater the more children in the family unit.

Additional simplification could be achieved by exempting Dividends from the Federal income tax. Exemption, however, would tilt net benefits from the Dividend toward higher income family units.

It is beyond the scope of this paper to attempt to estimate the amount that each of these simplifications might reduce costs for the government and burdens on residents. However, simplifications that reduce the number of inquiries would be reduce government costs and residents’ burdens. Simplifying the treatment of children and changing the per person Dividend amount only once a year should reduce inquiries. Annual determination of Dividend eligibility could reduce inquiries because it would be similar to annual eligibility determination of dependency status for income tax purposes. Conversely, the delays in eligibility changes from annual determination might cause confusion and increase resident inquiries, especially in the earlier years of the Dividend program. Finally, eliminating taxability of Dividends and the withholding on Dividends that taxability would require would reduce costs and burdens for residents, employers who would act as intermediaries, and the government. The costs for government and employers of reconciling errors and dealing with “collection” issues can be substantial.

7. Taxability of Dividends

The CCL is proposing that Dividends from the Carbon Fee be subject to income taxes, but the CCL recognizes that there are arguments for and against taxation of Dividends.

A fundamental element of the CCL proposal is that 100 percent of Carbon Fee revenue be paid out as Dividends to residents. Another fundamental element of the Carbon Fee and Dividend proposal is that it should be revenue neutral. There is tension between a 100 percent payout of Fees and revenue neutrality, both neutrality for legal budget scoring purposes and actual neutrality. Taxation of those payouts (the Dividends) increases the tension.

The CCL proposal mandates that Dividends would be treated as income for Federal income tax purposes but would *not* be treated as income for other purposes, especially federal and federally supported social programs. This is a compromise position that increases the net amount of Dividends to be received by residents while still reducing the adverse budgetary impact from taxation of Dividends.⁴⁰

The exclusion of Dividends from being considered as income under social programs is intended to prevent Dividends from causing large benefit reductions under means-tested programs. When combined with income taxes, reductions in benefits from social programs could result in the combined effective reduction in income from Dividends from being close to, or even exceeding, 100 percent. That would result in the after-tax and after-benefit incomes of some lower and middle-income individuals and families from being lower as the result of receiving Dividends.

In addition to reducing the after-tax Dividends, there are also conceptual, equitable, pragmatic and – especially – complexity issues stemming from taxing the Dividends.

A. Legal Issues

One of the goals of CCL's Carbon Fee and Dividend proposal is federal budget neutrality – that is, not to increase the federal budget deficit. Carbon Fees imposed on businesses would reduce taxable income for federal income tax purposes and, hence, federal income taxes. That income tax reduction would increase budget deficits.

Under the terms of the Statutory Pay-As-You-Go Act of 2010 (PL 111-139, signed February 12, 2010) and related budgetary statutes, any new proposals such as the Carbon Fee that would increase the budget deficit are required to include offsetting changes (in either spending or taxation) would make the overall proposal revenue neutral. According to the interpretation of these statutes by the Congressional Budget Office, paying out Carbon Fee revenue in the form of taxable payments (the Dividend) to residents would fulfill the offset requirement,

⁴⁰ As explained in footnote 1, the legislation creating the Carbon Fee and Dividend programs would specifically limit the treatment of Dividends as income to Federal income tax purposes. That would prevent its consideration as income for most social programs because of their full or partial funding by the federal government. It is uncertain, however, that such a limitation could prevent states and localities from counting Dividends as income for their own programs (including state and local income taxes) which were not federally supported.

yielding the necessary budget neutrality for scoring purposes.⁴¹ Thus, for scoring purposes, taxation of Dividends would achieve neutrality even though average marginal tax rates are lower for individuals than for business.

This required budget neutrality under the Pay-As-You-Go is cited as the reason why the original CCL proposal would tax Dividends.

Even if current budgetary law at the time of enactment would effectively require that Dividends be taxable, the legislation enacting a Carbon Fee and Dividend could specifically exclude such Dividends from income subject to income taxation. The enabling legislation could, and would have to, override the Pay-As-You-Go and any applicable budget-related provisions that would otherwise require the Dividends to be taxable and would have to amend the Internal Revenue Code to specify that the Dividends were not taxable.

There is some precedent for excluding Dividends from income taxation. The Economic Stimulus Act of 2008 (PL 110-185, signed February 13, 2008) enacted “recovery rebates” for most persons in the United States (including similar payments to citizens in U.S. Possessions) to stimulate the economy. The recovery rebates were nontaxable because they were enacted as a refundable tax credit. Under appropriate legislation, Dividends from the Carbon Fee could be treated similarly.

In fact, it is not certain that taxation of Dividends would produce the statutorily required full budgetary offset. Would the previous Congressional Budget Office interpretation continue to apply permit the taxation of Dividends at an average individual tax rate of about 12 percent to be treated as a full offset of the revenue loss from Fees reducing business taxes at a 25 percent tax rate?⁴²

For purposes of this paper, it has been assumed that the aggregate Dividends paid to residents would be 100 percent of Carbon Tax Fees, net of the modest costs of Fee collection and Dividend payment. That is, Dividends would be less than Fee collections by the amount of the costs of collecting Fees and paying Dividends. It remains to be determined whether or not that difference would cause the CCL proposal to violate the neutrality requirements of the Pay-As-You-Go Act. Whether that difference is a problem and whether circumventing such a problem is accomplished by statutorily waiving some or all of the Pay-As-You-Go Act provisions or otherwise is not addressed in this paper. Similarly, if it were decided to make Dividends nontaxable for income tax purposes, it is assumed that that could be accomplished, but how it might be accomplished is not relevant for purposes of this paper.

⁴¹ Congressional Budget Office. *Economic and Budget Issue Brief: The Role of the 25 Percent Revenue Offset in Estimating the Budgetary Effects of Legislation*. Washington, D.C., January, 2009.

⁴² The average tax rate for taxable returns (tax as a percentage of income) for tax returns with some income tax liability was about 15 percent. That suggests that when nontaxable returns and persons who did not file tax returns are included, the average tax rate would be somewhat lower, probably about 12 percent. Various tables in *Statistics of Income—2015 Individual Income Tax Returns*. Internal Revenue Service Washington, D.C. September, 2017. Although both business and individual tax rates were changed substantially, beginning for 2018 by the Tax Cuts and Jobs Act (PL 115-97), enacted in December, 2017, a substantial differential remains.

B. Conceptual Issues

Possible double-taxation is the primary conceptual issue, mostly for businesses, in deciding whether the Dividends should be taxable. To the extent that the Carbon Fees are paid from after-tax dollars, the return of those fees in the form of Dividends would be the recovery of previously-taxed income and, hence, should not be taxable a second time.

Some Carbon Fees imposed on consumers directly at the retail level would be paid from after-tax dollars. These include purchases of gasoline and related fuels, electricity, natural gas, and heating oil by consumers. Typically, government-imposed taxes and fees on such goods are passed on directly to consumers. Sometimes they are even stated separately. Such Carbon Fees would be paid in after-tax dollars even if they were imposed for administrative simplicity at the wholesale level or earlier but were directly passed on to the ultimate consumers.⁴³

Consumers would also be paying Carbon Fees indirectly, to the extent that those Fees are embedded in the cost of various goods and services that they purchase. However, the portion of Dividends paid from those Fees would not constitute double taxation. These embedded Fees would have been paid directly or indirectly by taxable businesses in the course of regular activities and would have been deductible in calculating net income subject to tax.

In addition, some of the Carbon Fees would be paid directly or indirectly by governments at the federal, state, and local levels and by non-for-profit organizations, such as universities. The portion of those Fees that was not passed through via purchases from taxable businesses would also not be tax deductible for business tax purposes.

Determining the share of Carbon Fees that would not be tax deductible for business tax purposes is beyond the scope of this paper. For purposes of illustration, it is assumed that non-deductible Carbon Fees are one-fifth (20 percent) of all Carbon Fee collections. Given the sizes of the government and the not for profit sectors of the economy, both of which are not taxable, the 20 percent assumption may be conservative. Under this assumption, potential double taxation is relevant for about 20 percent of Carbon Dividends.

C. Federal Revenues and Budgetary Impact

The actual budget impact may differ from the scoring of the change under the Pay-As-You-Go Act provisions.

Gross Carbon Fee revenue is estimated to be about \$80 billion in the initial year of the program. After deducting the roughly estimated, upper-bound of \$6 billion of expenses for administering the Fee and Dividend programs under the direct payment method, net revenue would be about \$74 billion – which is the amount that would be distributed in Carbon Dividends.⁴⁴ Each subsequent year, gross receipts would increase by about \$50 billion, with the amount of the

⁴³ Gasoline taxes are imposed at the refinery or distribution level but are passed through to the final purchasers. Various utility taxes are passed through to purchasers.

⁴⁴ Administrative costs for the government might be less if most Dividends were paid by increasing net wage and pensions payments. However, employers' tax deductible costs would reduce tax receipts.

increase dependent on reductions in fossil fuel use and the annually higher Fee per ton of emissions. The costs of administration, however, would change very little in real dollars.

Imposition of the Carbon Fee would reduce the income of taxable entities that pay the Carbon Fee. Over time, the reduction in taxable business income would depend on the extent, if any, to which prices increase as the result of the Carbon Fee. For budget estimating purposes, it is assumed that prices do not change. As a result of this assumption, the lower taxable income of businesses would reduce Federal income tax revenue as the Carbon Fees were deducted in calculating taxable income subject to income tax. The size of the impact would depend on (a) the percentage of Fees that are imposed on taxable businesses and (b) the average marginal income tax rate applicable to business income, generally assumed by federal revenue estimators to be 25 percent.⁴⁵ Under the previously-mentioned assumptions that four-fifths (80 percent) of the Fees would be paid by taxable businesses and that the average marginal tax rate is 25 percent, imposition of the Fee would reduce federal income tax collections in the first year of the Fee by about \$16 billion ($\$80 \text{ billion} \times 80\% \times 25\%$).

However, taxing Carbon Dividends under the federal income tax would partially offset the business income tax reduction. Fee revenue of about \$74 billion ($\$80 \text{ billion gross less } \$6 \text{ billion of expenses}$) would be disbursed as Dividends and taxed at an assumed average marginal tax rate of about 12 percent, thereby yielding additional income tax revenue due to Dividends of \$8.88 billion ($\$74 \text{ billion} \times 12\%$).

The loss of income tax revenue from businesses of \$16 billion together with the increase in personal income tax revenue of \$8.88 billion would result in a net adverse budgetary impact (revenue loss) of about \$7.12 billion. Thus, in the first year, taxation of Dividends would reduce the adverse budgetary loss by 55 percent ($\$8.88 \text{ billion} / \16 billion). In subsequent years as both Carbon Fee revenue and Dividend distributions increased but administrative costs were essentially constant, taxability of Dividends would reduce any adverse budgetary impact by a slowly increasing percentage of the gross revenue loss.

Different assumptions about the share of Carbon Fees paid by taxable businesses could increase or decrease budgetary impact; however, reasonable assumptions about the share of Fees paid by taxable businesses would all lead to a net revenue loss.

D. Practical and Administrative Issues

Taxability of Dividends raises three separate issues: (i) additional complexity for taxpayers; (ii) the equity of the disparate effective marginal tax rates on taxable Dividends for various residents; and (iii) the method or methods by which those taxes would be paid.

i. Additional Complexity

Adding the Dividend as an item of income would increase the complexity and administrative burden of income tax preparation by a modest amount, but the additional burden would be

⁴⁵ The Tax Cuts and Jobs Act (P.L. 115-97), signed into law on December 22, 2017, reduced tax rates on most business income beginning in 2018. As a result, the current assumption of a 25 percent average marginal tax rate for business income may be changed in the future.

mitigated by the facts that (1) the amount of Dividends actually received would be shown on Forms W-2 and 1099-R and (2) most individual income tax returns are prepared using software. That software would handle all computations automatically once the Dividend eligibility information was entered directly or transferred from the Carbon Fee Dividend Reconciliation for (Form CFD-5).

As discussed below, there would be both burden and complexity from adjusting current tax payments (that is, either withholding or quarterly payments of estimated taxes) to account for the income from Dividends.

Perhaps the greatest addition to taxpayer burden would fall on those whose incomes currently are so low that they are not required to file federal income tax returns, but whose incomes when the Dividends were included would be large enough to require them to file tax returns routinely. Those affected the most would tend to be residents without dependents, either single residents or married couples. Currently, if they are not taxable, they are not required to file tax returns, although some may do so in order to receive refunds of withheld taxes from employment. Nontaxable individuals or families with dependents would be affected less because, even if they are not taxable, they generally file tax returns to receive the benefits of the earned income tax credit and/or the refundable portion of the child credit.

In practice, much of the complexity and possible inequity of the taxation of Dividends would depend on the extent of Dividend overpayments in one year that would have to be paid back in the following year. Repayments in the following year has a precedent in repayments of Social Security benefits. Repayments of Social Security benefits in a later year do not simply reduce the amount of taxable Social Security benefits in that later year. Rather, repayments are deductible but only as part of so-called “miscellaneous itemized deductions” and then only to the extent that total miscellaneous itemized deductions exceed two percent of income in that later year. As a result, many persons, especially taxpayers who use the so-called “standard deduction” do not receive any tax benefit from repayments of benefits and are taxed on income that they must return to the Social Security Administration. This inequity results from some attempts at simplification of the current tax system.

Given the larger and more frequent repayments of Dividends that could be required under the Carbon Fee and Dividend proposal, more residents would be affected by the inability to receive tax benefit from paying back previously taxed Dividends. The Tax Cuts and Jobs Act further substantially increases this inequity by greatly reducing the percentage of taxpayers who itemized deductions and, therefore, could receive tax benefits from required repayments of Dividends. This impact is caused by the Act’s increase in the size of the standard deduction.

ii. Effective Marginal Rates

Statutory marginal federal income tax rates for individuals range from zero percent to 37 percent. The statutory marginal rates are generally progressive, so that rates tend to increase along with incomes. Effective marginal federal income tax rates, however, have even greater variation and do not necessarily increase as income increases. Some taxpayers with low or modest incomes pay very high effective marginal tax rates because of various “phase-ins” and “phase-outs” provided under the Internal Revenue Code. These and similar provisions produce very wide disparity in the effective marginal income tax rates that would apply to Dividends. These tax

provisions make it difficult to assure that even low income residents would receive Dividends that, after taxation, are at least as much as the Carbon Fees that they pay directly and indirectly.

Both the partial taxability of social security benefits and the Earned Income Tax Credit have fairly wide applicability and are the two major provisions of the current Federal income tax system that can cause high effective marginal tax rates for taxpayers with low-to-moderate incomes.

Over the income-related phase-in range for the taxation of social security benefits, each additional \$1.00 of non-social security income causes an additional \$0.50 or \$0.85 of social security benefits to become taxable.⁴⁶ In most situations, the ordinary income tax rate in the phase-in range is 10 percent; however, at some income levels, the rate is 12 percent.⁴⁷ Thus, \$1.00 of non-social security income – including income from the Dividend – will be taxed at effective marginal rates of 15 percent, 18 percent, 18.5 percent, or 22.2 percent.

For recipients with incomes above certain threshold levels, the amount of the Earned Income Tax Credit phases-out (i.e. is reduced) by a percentage of the amount by which the recipient's income exceeds the threshold. For recipients with one eligible child, the phase-out rate is 15.98 percent; for taxpayers with two or more eligible children, the phase-out rate is 21.06 percent. For tax year 2018, for married taxpayers (filing jointly), the phase-out begins at income of \$24,400.⁴⁸

In addition to the effective marginal income tax rates at the federal level, residents would typically face additional marginal rates from state (and, possibly, local) income taxes and other state-level programs. Even at modest income levels, state income tax rates and, where applicable, the phase-outs of the states' own earned income tax credits can reduce the after-tax benefit of Dividend payments considerably. Especially, beginning in 2018 under the provisions of the Tax Cuts and Jobs Act, only a very small percentage of lower- and middle-income taxpayers will itemize their tax deductions. Thus, none of these additional state income tax rates would be offset by reduced federal taxes from itemizing.

Figure 12 shows three examples of potential marginal tax rates due to taxation of the Dividend. In these examples, the taxpayers are affected by one or both of the income related phase-in of the taxation of social security benefits and the phase-out of the earned income tax credit. Figure 12 also shows the impact of the state income taxes under the assumption that states would elect to tax Dividends. In these examples, the Maryland state income tax and its associated county income tax are used to show the impact of state income taxation.

⁴⁶ The phase-in at a 50 percent rate begins at \$25,000 for unmarried taxpayers, \$32,000 for married taxpayers filing jointly, and \$0 for certain married taxpayers filing separately. The phase-in at an 85 percent rate begins at \$34,000 for unmarried taxpayers, \$44,000 for married taxpayers filing jointly, and \$0 for certain married taxpayers filing separately. For the purposes of this computation, income generally consists of non-social security income included in Adjusted Gross Income (AGI) plus tax exempt state and local bond interest plus 50 percent of social security benefits.

⁴⁷ These are the tax rates beginning for taxable year 2018 under the Tax Cuts and Jobs Act. For 2017 and earlier, the applicable tax rates were 10 percent and 15 percent.

⁴⁸ For unmarried taxpayers, for tax year 2018, the EITC phase-out begins at income of \$18,700.

Figure 12: Examples of Effective Marginal Income Tax Rates from the Dividend

	Example 1 Married Couple over Age 65 with No Dependents		Example 2 Married Couple under Age 65 with Two Dependent Children		Example 3 Married Couple over Age 65 with Two Dependent Children	
Non-Social Security Income	38,000		47,500		38,000	
Social Security Benefits	12,000		0		12,000	
	Without Taxable Dividend	With Taxable Dividend	Without Taxable Dividend	With Taxable Dividend	Without Taxable Dividend	With Taxable Dividend
<i>Total Social Security Benefits</i>	\$12,000	\$12,000	\$0	\$0	\$12,000	\$12,000
Taxable Social Security Benefits	\$6,000	\$7,346	\$0	\$0	\$6,000	\$8,020
Ordinary non-Social Security Income (Note 1)	\$38,000	\$38,000	\$47,500	\$47,500	\$38,000	\$38,000
Carbon Dividend	\$0	\$1,584	\$0	\$2,376	\$0	\$2,376
Adjusted Gross Income	\$44,000	\$46,930	\$47,500	\$49,876	\$44,000	\$48,396
Less: Standard Deduction	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000
Less: Additional Standard Deduction for Age	\$2,600	\$2,600	\$0	\$0	\$2,600	\$2,600
Less: Personal Exemptions	\$0	\$0			\$0	\$0
Taxable Income	\$17,400	\$20,330	\$23,500	\$25,876	\$17,400	\$21,796
Federal Income Tax Before Credits	\$1,740	\$2,059	\$2,439	\$2,724	\$1,740	\$2,234
Less: Child Credit	\$0	\$0	\$2,439	\$2,724	\$1,740	\$2,234
Less: Additional Child Credit			\$1,561	\$1,276	\$2,260	\$1,766
Less: Earned Income Tax Credit	\$0	\$0	\$863	\$363	\$1,600	\$675
Federal Income Tax After Credits	\$1,740	\$2,059	-\$2,424	-\$1,639	-\$3,860	-\$2,440
<i>After Tax Income from Dividend:</i>						
<i>Amount</i>		\$1,265		\$1,590		\$956
<i>Percent of Dividend</i>		79.88%		66.94%		40.23%
<i>Tax Change from Dividend</i>						
<i>Amount</i>		319		786		1,420
<i>Effective Marginal Tax Rate</i>		20.12%		33.06%		59.77%
Typical Marginal State Income Taxes (Note 2)						
State (and Local) income taxes		7.76%		7.87%		7.87%
State (and Local) earned income credit phase-outs		0.00%		17.26%		32.03%
Total Effective Marginal Rates including other taxes		27.88%		58.19%		99.67%

Citizens' Climate Education

Note 1: The specific sources of the ordinary non-Social Security generally relevant only for purposes of the Additional Child Tax Credit and the Earned Income Tax Credit. In these examples, taxpayers need sufficient earned income to be eligible for the maximum amount of the additional child credit for which they may otherwise be eligible (at least \$8,750 of earned income for Example 2 and \$13,670 for Example 3). The Earned Income Tax Credit is not allowed if the aggregate amount of certain investment income exceeds \$3,500.

Note 2: Average State and local income tax rates are based on Maryland law (as of February, 2018).

Assumptions: 2018 Federal Income Tax law and parameters (as of February, 2018).

The Carbon Fee Dividend is \$66 per month per adult and \$33 per month per eligible child.

Example 1 in Figure 12 shows the tax computation for a couple over age 65 with \$38,000 of income from earnings or pensions and \$12,000 of social security benefits. Based on that income, the tax rate schedule shows that their marginal tax rate would be 10 percent. However, the addition of \$1,584 of taxable Dividends from the Carbon Fee causes more of their social security benefits to become taxable, and their marginal tax rate due to the Dividends is 20.12 percent, so that after paying their income tax, the couple is left with only 79.88 percent of their gross Dividend. After considering the marginal state income tax of 7.76 percent, the couple would have a combined marginal tax on the Dividend of 27.88 percent and be able to retain only 72.12 percent of the Dividend they received.

Example 2 in Figure 12 shows a case in which a four-person family with \$47,500 of income is affected the combination of the income tax and the phase-out of the earned income tax credit. reduces the family's after-tax income from the Dividend to only 63.94 percent of their gross Dividend. At the Federal level, the marginal tax and loss of EITC benefits is 33.06 percent of their Dividend. However, the combination of state income tax and the phase-out of the state's EITC adds 25.13 percent tax. The total of the Federal and state taxes take 58.19 percent of the family's Dividend, leaving the family with only 41.88 percent of its Dividend.

There are less common – but not highly unusual – circumstances when a family can be affected by both the social security phase-in and the EITC phase-out and the effective marginal income tax rate would be much, much higher. The married couple shown in Example 3 are both over age 65, have two dependent children or grandchildren, have earnings or pension benefits of \$38,000, and receive \$12,000 of social security benefits. Because the family is affected by the social security phase-in and the EITC phase-out, its effective Federal marginal income tax rate alone is 59.77 percent. In addition, effective state and local income tax rate is 39.90 percent. The family's combined effective tax rate is 99.67 percent. Thus, after paying their income tax, the family is left with 0.33 percent their Dividend, or \$8 out of their \$2,376 Dividend.

Although Example 3 probably represents an extreme level of taxation on Dividends that is likely to be unusual, the example highlights how residents can be adversely affected by taxation of Dividends. The after tax \$8 that the Example 3 family is able to retain from the Dividend is certainly less than the Carbon Fees that the family would have paid directly or directly. The example shows how modest income families – not only higher income families – could be made worse off financially by the Carbon Fee coupled with the Dividend.

Income taxes are not the only government programs that might reduce residents' Dividends.

State programs such as property tax and rent credits are often administered through state income tax returns. The phase outs of these programs could also effectively reduce Dividends. Similarly, eligibility for both federal and private financial aid could be reduced as income reported on income tax returns increases.

Perhaps most importantly for lower income residents, the benefits under various means-tested programs such as Medicaid and food stamps (SNAP) can be reduced significantly as reported income increases.

When all of these programs and taxes are considered, marginal rates on Dividends for lower income families can be well over 50 percent and, in some instances, even exceed 100 percent.

Given the possibilities of very high total effective marginal tax rates for these and other low- to middle-income residents, one can question the horizontal equity of making Dividend payments taxable. Because of these potentially exceedingly high marginal rates, the CCL proposal excludes Dividends from being treated as income under federal programs other than the Federal income tax.

iii. Paying Taxes on Dividends

Given the wide variation in taxpayer situations and effective marginal tax rates that taxpayers may face, anticipating the extra income tax due to the Dividends would not be simple and in some cases might be quite complex. It would be beyond the ability of many taxpayers (especially lower-income and less-educated taxpayers) to estimate their tax in advance.

Generally, the income tax law requires that income taxes be paid as income is received, rather than after the close of the year when income tax returns are filed. There is a modest tolerance for underpayments, but when there is less current payment than required by the tolerances, a penalty (equivalent to non-deductible interest) is imposed.

For most taxpayers, current income tax payments are made through withholding. Some taxpayers whose liabilities are not paid fully, or at all, through withholding are required to make quarterly payments of the estimated amount of their tax liability. Withholding on wages and salaries is mandatory and generally mirrors the income tax rate structure so that when a family or individual has only one job, the amount withheld will be reasonably close to final tax liability. When a family has more than one job and/or has investment income, they usually have to make use of optional withholding provisions to increase their withholding and/or make quarterly estimated tax payments.

Taxpayers receiving pension income may request withholding under rules similar to those that apply to wages and salaries. Taxpayers receiving other types of income such as social security, distributions from IRAs or 401(k) plans have the option of requesting withholding, but only as fixed percentages of the gross payments.

If Dividends were disbursed by increasing net wage and other payments which currently subject to withholding, for many taxpayers the automatic withholding on those payments would serve as the method for paying income taxes on a current basis and would greatly minimize underwithholding issues. If Dividends were disbursed by direct payment from the federal government, residents who file a Claim for Carbon Fee Dividend (Form CFD-1) to obtain their Dividends (because they do not file income tax returns) would be advised to specify their desired withholding on line 9 of that form CFD-1. Those who do file income tax returns would be advised to file a Carbon Fee Dividend Withholding Certificate (Form CFD-4) to specify their withholding.

In order to select their withholding rate on a Form CFD-4, residents would still have to estimate their tax liabilities in advance. A system that automatically applied a fixed positive withholding rate to all direct Dividend payments unless a resident submitted a Form CFD-4 specifying no withholding or a different positive withholding rate would reduce underwithholding and would

reduce administrative burdens on some residents. It would, however, result in overwithholding for some residents, thereby causing a delay in receiving their Dividend.

Even if Dividends were subject to mandatory or optional withholding, over time as the size of annual Dividend payments increase, due to the wide variation in effective marginal rates, more and more taxpayers would have discrepancies at the end of the year. Some would be underwithheld, including some who would not meet the underpayment tolerances and would be subject to penalties. Some who were underwithheld would not have the resources to pay their balances due and would require IRS to expend enforcement resources. Others would be overpaid and receive refunds of the withholding. Those with excessive withholding would not have the use of the Dividend income currently.

Taxability of Dividends, withholding on Dividend payments, the year-end reconciliations (firstly, of gross Dividends versus eligible amounts and secondly, of tax attributable to the Dividends and the tax over- or underpayments) would enforce the idea that far less than 100 percent of Carbon Fees collected were being returned to residents in the form of Dividends.

8. Issues Common to Both Payment Methods

A. Minimal Involvement of the Internal Revenue Service

Under either Dividend distribution method, some IRS involvement would be required. Avoiding such involvement would require every resident family and individual to supply virtually identical demographic information to a different government agency or contractor to the information that he or she currently provides to the IRS on the annual income tax return. Such duplication would be expensive for all parties and would only increase the public's resentment of large, inefficient government.

Under the direct payment method, IRS involvement could be limited to sharing a very limited amount of taxpayer information with the agencies or contractors that process payments, handle changes and errors, and reconcile discrepancies. This limited sharing would eliminate residents having to provide the same information twice. Basically, IRS would have to share only: names and social security numbers of taxpayers and dependent children, addresses, and bank account information from income tax returns; and information about the amounts of Dividends actually paid out during the calendar year, from Forms W-2 and 1099. IRS might also be tasked to receive and process the Carbon Fee Dividend Reconciliation form (Form CFD-5), because having IRS process the Form CFD-5 as part of income tax return process and payment of refunds would be less burdensome for residents. Even for that task, the IRS involvement would be limited to processing information. It would not necessarily be involved in error correction, compliance, or enforcement.

If Dividends were paid via increased wage and pension-type payments, IRS would have a major role. IRS would have to handle the reconciliation of the combination of employer disbursements of the Dividends and current payroll taxes. Employer-initiated withdrawals of government funds needed to pay Dividends would also be included in the reconciliation. Based on current experience with payroll taxes, IRS would have to devote significant resources to enforcement and collection activities for employer underpayment of the net of employment taxes and Dividends. After the end of each year, IRS would be responsible for maintaining the additional information on Wage and Tax Statements (Form W-2) sent by employers to every employee.

Under this method, the IRS would have a central role in collecting income taxes attributable to Dividends, but that could be accomplished with only a very modest expansion of its current tax return processing function. Given the probability that even with withholding on Dividend payments, there would be many instances of unintended underwithholding, IRS follow-up to collect shortfalls would be required, ranging from notices to taxpayers to more aggressive enforcement and collection actions.

B. Marriage Penalty Issues

Limiting the Dividend for the Carbon Fee to the first two children in a family may result in smaller total Dividends for a married couple than two adult residents would receive if they remain unmarried but together they have more than two eligible children. Under the Dividend

for the Carbon Fee, the problem would occur only if the two adults have a total of three or more children between them.

When married couples file separate rather than joint income tax returns, only one eligible child would be permitted on each return. That limit would prevent married couples with more than two children from filing separate tax returns just to receive additional child Dividends.

When the per child Dividend payments were small, the impact of any marriage penalty would also be small, but 15 to 20 years into the Fee program when the per child Dividend would be about \$800 per year, the limitation to two children could have an impact on actual marital behavior and/or compliance with the rules for claiming dependents. There would be sufficient financial incentives for some families to attempt to restructure (either actually to avoid taxes or illegally to evade taxes) into two heads of households so that three or four children could receive Dividend payments.

The Citizens' Climate Lobby (CCL) proposal limits Dividends to a family's first two children because the Dividend's main purpose is to internalize the externalities from fossil fuel use. Since there tend to be economies of scale (relative to family size) in fossil fuel use, limiting the Dividend to the first two children tends to approximate the intended purpose.

As discussed in section 6, smaller families have become the norm, with only about 20 percent of families having more than two dependent children. Removing the two child limit would not have a large impact on the size of the monthly Dividend but would reduce complexity and marriage penalties from the Dividend.

C. Self-Supporting Children under Age 19 and Dependent Adults

The CCL proposal for the Carbon Fee Dividend seems to have been written with the most common family structures in mind. However, family structures are diverse, and the CCL proposal may be seen as being less than equitable for some situations. The Dividend proposal is simply another instance of trade-offs between equity (real or perceived) and the relative simplicity of a system necessary for administrative purposes.

For federal income tax purposes, a family is defined as an individual or married couple plus their dependents. For income tax purposes, dependents generally include (1) children under age 19 (as of the end of the year), (2) children under age 24 (as of the end of the year) who are full-time students, and (3) others (mostly related by family) at least half of whose support comes from the person claiming them as a dependent but whose own annual income is less than \$4,150 (for 2018).⁴⁹ There are many other rules and qualifiers, but they can be ignored for purposes of this discussion.

⁴⁹ The Tax Cuts and Jobs Act eliminated deduction for personal and dependent exemptions beginning for taxable year 2018. The tax benefit for dependent exemptions was changed to a tax credit for children, with substantially larger benefits for children under age 17. It appears as if rules for whether a child credit can be claimed are similar to the dependency rules. The difference between the cutoffs at ages 17 and 19 for the two provisions may cause some confusion, but the underlying qualification rules have not changed.

Some persons under age 19 may have sufficient income to support themselves. Some, but not all, may have their own households, may be married, and/or may have children of their own. Thus, they file their own tax returns, and their parents are prohibited from claiming dependency exemptions for them. As separate households, they will be entitled to adult Dividends after filing either an income tax return or a Form CFD-1.

D. Actual “Ownership” of Family Dividend Payments

Each individual’s ownership of the portion of combined payments to a family might require specification or clarification. This issue would generally arise in the context of overpayments which must be recovered through various enforcement actions. For example, if there were overpayments attributable to children who subsequently were found to be ineligible (especially if the parents later became divorced), who would be (or should be) liable for the repayment? One parent? Both parents? The ineligible child? Or would there be joint and several liability with the consequent factual determinations?

The underlying law and the rules for family payments to social security beneficiaries may provide precedent and might be used via a simple legislative cross-reference in enabling legislation. However, recent attempts to recover from current adults payments on their behalf made many years previously to their parents have highlighted a possible inequity in the social security provisions.

E. Incarcerated Residents

Incarcerated residents themselves generally do not incur the costs associated with climate change and do not pay the higher costs due to the Carbon Fee. Those costs are borne by the level of government incarcerating the residents.

However, the factual situations may be more complicated. A few jurisdictions may, in fact, require inmates to pay some or all of the costs of maintaining them. If inmates were eligible for Dividends, more jurisdictions might charge inmates so that the benefit of the Dividend would go to the incarcerating agency. Any federal legislation prohibiting such a pass-through of Dividends would not be enforceable because fees on incarcerated residents could be characterized as being for other purposes.

Married inmates may file joint income tax returns with their non-inmate spouses. If the inmate were not eligible for Dividends, who would be responsible for refunding the improper payment based on the tax return information? This would be more of a problem under the direct payment method under which the inmate would automatically be considered eligible for the Dividend based on the joint income tax filing. Under the employer and pension-type payor method, at least the non-incarcerated spouse would have to make an improper, affirmative claim on Form CFD-4 in order to have received the Dividend for the incarcerated spouse.

The IRS has had perennial problems with inmates filing false tax returns in order to obtain tax refunds. Despite expending significant resources on this problem, the IRS still cannot identify all such returns; that type of false tax return has not been eliminated; and not all of the refunds that have been paid have been able to be recovered.

Similar false claim problems would occur if incarcerated residents were not eligible for the Dividend from the Carbon Fee.

The CCL proposal which envisages inmate eligibility for the Dividend would eliminate most of practical and compliance issues.

F. Citizens and Residents of United States Possessions

Enabling legislation for the Dividend from the Carbon Fee would have to specifically provide for the eligibility and/or the size of Dividend payments to residents of the five U.S. Possessions: the Commonwealth of Puerto Rico; the United States Virgin Islands; Guam; the Commonwealth of the Northern Mariana Islands; and American Samoa.

Typical incomes in the Possessions are much lower than in the United States so that the potential Dividend payments in later years often would exceed the other income of many or most residents, especially in the three possessions in the Pacific. Thus, Dividend payments could provide a major incentive for residents to withdraw from the labor force, with the consequent changes in social systems, tax revenues, and the ability of the Possession governments to finance or provide services.

On a practical level, payment of Dividends to residents of Possessions could not be based on information from the United States Internal Revenue Service on family composition and dependents. Each of the Possessions has its own tax system. The structure of those systems is roughly comparable, but not identical, to the structure of the federal income tax system. The shares of the population who actually file tax returns, the quality of the information on those tax returns, and the ability of each Possession's tax authorities to verify information on those tax returns and enforce compliance are typically much lower than in the 50 states. In at least one Possession, even mail delivery systems are problematic. Despite such limitations, at least one or two of the Possessions do have the skilled resources to make rapid changes in tax systems.

In 2009, the Secretary of the Treasury reached separate, individualized agreements with each of the Possessions about how to handle the Making Work Pay Credit enacted as part of the American Recovery and Reinvestment Act of 2009. Under those agreements, implementation was somewhat different than in the 50 states.

A threshold decision about Dividend eligibility depends on whether the Carbon Fee would apply to the Possessions. Even if it did not apply directly, there would be indirect effects through higher prices for many items and services purchased from within the United States.

For paying Dividends from the Carbon Fee, three separate decisions would be required:

1. Would residents of the Possession be eligible to receive Dividends from the Carbon Fee?
2. If they were entitled to Dividends, would the level of payments be the same?
3. How would each Possession distribute or pay the Dividends?

The CCL believes that a reasonable and workable solution to paying Dividends to residents of the Possessions would be to legislatively and administratively provide a lump-sum payment to each Possession in the estimated aggregate amount to which its residents were entitled. Then, the government of each Possession would be required to develop its own distribution plan and enforcement methods, so long as the payments to each eligible adult were the same (with half-payments to each of the first two eligible children). Each Possession government would be required to return any undistributed funds to the Carbon Fee Trust Fund. The Secretary of the Treasury or other authority would have to approve the distribution plans before any funds could be released from the Carbon Fee Trust Fund.

G. Citizens and Resident Aliens Living Abroad

Under the Carbon Fee proposal, citizens who are not residents of the United States would not be eligible for Dividends. However, if nonresident citizens have substantial U.S.-source income, equity may suggest granting them at least part of the Dividend from the Carbon Fee, since their buying power may be reduced because of the Carbon Fee.

Presumably, U.S. citizens (and resident aliens) who live abroad and, thus, would not be subject to the Carbon Fee should not receive the Dividend. Such a position could be reinforced by the fact that besides not paying the Carbon Fee non-resident citizens would actually benefit from lower pre-Fee prices induced by lower demand for fossil fuels resulting from the Carbon Fee.

Some, but not all, citizens who are not resident in the United States could be identified from the special forms (Forms 2255 or 2255-EZ, Foreign Earned Income) that they file as part of their federal individual income tax returns. However, the only people who file Forms 2255 or 2255-EZ are those who are employed abroad and are eligible to exclude part or all of their foreign earnings from U.S. taxation. Identified persons could be required to repay any Dividends that they had received during the year (and could not file for direct payment of the Dividend). Compliance with repayment would be problematic and would be difficult to enforce when the taxpayers were not in the United States. Foreign residence cannot be determined from the mailing address shown on tax returns, since many of the returns of foreign residents show a domestic mailing address.

IRS data on use of the foreign earned income exclusion are only reported every five years in an article in the *IRS Statistics of Income Bulletin*. Such data were last reported for 2011.⁵⁰ For 2011, the data show that the foreign earned income exclusion was claimed on 449,000 tax returns, or 0.30 percent of the 147.4 million individual income tax returns filed. Based on these data, even though the mix between single and married filing returns and the number of child dependents on these returns has not been reported, assuming that these tax returns are otherwise similar to tax returns overall, there are fewer than 700,000 adults and about 500,000 children who would not be eligible for the Dividend from the Carbon Fee for some or all of each year. (At 2018 levels, these numbers might be a few percent larger.)

⁵⁰ Scott Hollenbeck and Maureen Keenan Kahr, "Individual Foreign-Earned Income and Foreign Tax Credit, 2011". *IRS Statistics of Income Bulletin*, Vol. 33, No. 4, Spring 2014.

Without implementing an entirely new system of tracking movements out of, and into, the United States by citizens, there is not a perfect system for identifying nonresident citizens and the periods they actually reside abroad.⁵¹

The CCL proposal is silent on the treatment of U.S. citizens and permanent residents who reside abroad for at least part of a year. This issue requires additional consideration. Any solution is likely to be arbitrary and result in at least some inequities.

H. Assuring That All Residents Receive Dividends from the Carbon Fee

Under any Dividend payment method, including the two developed in this paper, ensuring that all eligible residents actually receive the Dividend payments to which they are entitled would be very difficult to impossible.

In practice, living arrangements are diverse and sometimes complicated, especially for the portion of residents (about 15 percent) who do not file federal income tax returns or are not shown as dependents on tax returns. Under a direct payment plan, some non-filers would receive Dividend payments because they already receive payments from payors, such as the Social Security Administration or state agencies administering the supplemental nutrition assistance program, but those payment programs are not comprehensive.

All other non-filers would have to take action to actually apply for Dividends. Outreach efforts would be necessary, initially at a high level but continuing permanently at a lower level, but some residents would not respond. Outreach efforts would not be entirely effective. There are many possible reasons that eligible residents would not apply for Dividends, such as a desire to remain “outside the system”, uncertainty about eligibility or how to apply, inability to cope with application, and so forth.

All current programs that benefit residents have less than 100 percent “take-up rates”, and expectations are that experience would be similar under a Dividend from the Carbon Fee.

⁵¹ In theory, Department of Homeland Security information could develop a system of tracking departures and entries to the United States from information from passports and passport cards that are required for entry to the United States. The extent that such information currently is recorded initially or retained is not known. Similarly, the extent to which departure information is recorded and retained also is not known. Even if such information were used to develop a comprehensive database of movements by U.S. residents to and from the United States, that database would be tracking mostly movements for temporary business or vacation travel. Only a small portion would apply to residents who work or live overseas. Moreover, complete information about the movements of those who actually reside abroad would require a multi-year database. In addition, residents who do not travel back to the United States would not be included in the database. Hence, it would be inefficient and not fully effective to use such an entry and exit database to determine physical presence outside of the United State.

9. Conclusions

For Dividend payments which are expected to be made for many years, paying the Dividend by direct monthly transfers to every eligible resident or family has the advantages of relative simplicity, stability, and of not involving millions of employers and other payors. By using information already submitted by residents on their annual federal income tax returns, the direct payment system would eliminate the need for most residents to submit duplicate information in order to obtain Dividends. Although larger in number, direct payments would be virtually identical to the monthly payments currently made to millions of beneficiaries by the Social Security Administration. The direct payment system would have the ability to change the size of the Dividend payments more frequently than annually and at other than the beginning of calendar years. Another benefit of the direct payment system is its inherent ability to enforce compliance by deducting overpayments from future direct monthly Dividend payments. As a result of being a single payor system, a large share of overpayments and underpayments could be corrected routinely, reducing the amount of expensive manual intervention and increasing the overall level of accuracy and compliance.

A disadvantage of the direct payment method is the substantial lead time that might be necessary for full implementation. Lengthy lead time might require the use of a less accurate interim payment method, with the additional costs, burdens, and confusion from having to implement an interim system followed by a change to a permanent direct payment system. Another disadvantage of the direct payment system is that residents would have to submit information so that income tax withholding on the Dividends would be reasonably accurate. Other weaknesses of the direct payment system are the need for a good-size government agency or private contractor to handle the processing of the information necessary to determine, adjust, and correct monthly payments. A major component of those costs would be for direct interaction with residents for the handling of resident-initiated changes. The Carbon Fee Trust Fund would incur significant costs, both startup and ongoing, for the intermediary agency or contractor.

The major strength of paying Dividends through increasing net wage and salary and pension-type payments is the speed with which it could be implemented. Implementing the employer-based payment system would require only modest modification to current payroll systems and could be implemented fully in under a year, with many employers being able to implement within six months. Another benefit for the Carbon Fee Trust Fund would be lower administrative costs for the government, since this payment method would involve a much smaller government agency or private contractor. Rather than being borne by the Carbon Fee Trust Fund, much of the administrative cost would be imposed on employers and pension-type payors. Since withholding for Dividend payments would be based on the current withholding systems for wages, salaries, and other periodic payment, implementation of income tax withholding on the Dividend payments would be nearly automatic. It would not, however, necessarily be very accurate.

Payment of Dividends through employers and pension-type payors would raise some other major problems. Most importantly, to the extent that income tax, social security, and Medicare withholding did not provide sufficient funds to pay the Dividend through increased net wages or pensions, the system would have to allow for, or require, very rapid and unverified – virtually

automatic – employer and pension payor withdrawals from the Carbon Fee Trust Fund to cover the shortfall from withheld amounts. Such withdrawals would be another burden on employers and, more importantly, would provide a huge opportunity for improper or fraudulent withdrawals resulting in very significant revenue loss to the Carbon Fee Trust Fund.

Because recurrent payment systems do not cover all residents, use of a payroll-based Dividend payment system would still require a separate direct payment system, although very much smaller in scope than under the direct payment method. Even with such an add-on direct payment system, there could be less than 100 percent coverage when workers did not file for Dividend payments through the payroll system, or they were temporarily unemployed and did not elect to participate in the direct payment system.

There would be many cases of duplicate monthly payments as the same Dividend was claimed at more than one job or by both spouses or via direct payment after a person became employed. Under an employer or pension payor system, correcting and recovering overpayments would not be automatic. Employers and other payors could not be expected to be enforcement agents for the government, and they would not have the authority to make deductions from wages and other periodic payments to recover previous overpayments. A separate repayment system would be necessary so that overpaid residents could make their repayments to the government rather than to their employers. When residents did not repay overpayments voluntarily, the government would be responsible for recapturing those overpayments. Lengthy legal processes would have to be followed before the government through its own enforcement agency could essentially “take” some income to recover the overpayments.

The weaknesses associated with paying Dividends by increasing net wage and pension payments, including the need for having a backup direct payment method, the higher level of both overpayments and underpayments, the need for employers to make unverified withdrawals of government funds, and the greater difficulty and complexity of enforcement all suggest that this payment method is less desirable than the direct payment method.

Appendix A. Summary of Major Issues, Possible Options, and Preliminary Suggestions

In deciding on the administration of a system for paying Dividends from the Carbon Fee, at least eleven different decisions are necessary. Each of these issues has been discussed in greater or lesser detail throughout this paper. This appendix summarizes the decisions that are required, the major options that are available, and the option that CCL recommends, at least tentatively pending further consideration or receipt of additional information.

A. Payment Method

There are two general vehicles for distributing the Dividend to residents.

1. By making direct payments by, or on behalf of, the government.
2. Including the Dividend in net wage and other periodic payments.

Figure A1 summarizes the major strength and weaknesses of the two Dividend payment methods.

CCL's Suggestion: Implement the direct payment method. If necessary, use a simpler and less accurate method during the transition period.

B. Transitional Payment System

A direct payment method may take up to two years to implement. Payment via increasing net wages and other periodic payments could be implemented more quickly.

CCL's Suggestion: If Dividend payments need to begin soon after the initiation of the Carbon Fee, the transitional system should use annual or semi-annual payments of the type made as economic stimulus payments in 2008. The transition period should be as short as possible.

C. Dates for Adjusting Default Eligibility

Generally, under the direct payment method, eligibility would be determined from the tax return filed for the second preceding year. For example, the calendar year return for 2018, which is generally filed in the spring of 2019, would determine payments beginning for January, 2020. An alternative would be to use the 2018 tax data beginning as early as October or November, 2019, if the necessary data were available.

Adjusting payments at the beginning of a calendar year would be cleaner and would result in Dividend payments being the same for every month of the calendar year, unless residents initiated changes sooner.

CCL's Suggestion: This decision should be left to administrators of the Dividend program, basing their decisions on what would minimize the combined burdens and costs for administrators and residents, including minimizing the numbers and sizes of year-end

reconciliations. It is expected that administrators would decide to change the per-resident Dividend only at the end of calendar years.

Figure A1: Major Strengths and Weaknesses of Two Dividend Payment Methods

Direct Payment	Payment via Increased Net Wages and Pensions Supplemented with Direct Payments
<p><i>Strengths</i></p> <ul style="list-style-type: none"> • Relatively simple single payor system. • Burdens only on government and residents. • Does not involve employers, etc. • Minimal IRS involvement, especially for enforcement. • Enforcement by directly reducing future payments. Simple. Highly effective. • Level of per capita Dividend could be changed more frequently than once a year. • Changes in per capita Dividend could be implemented very quickly. <p><i>Weaknesses</i></p> <ul style="list-style-type: none"> • Would take a long time to implement. Might require a different payment system during an extended transition. • Requires a new large agency or contractor as intermediary. • Large startup costs for government. • Significant annual costs for government. • Withholding on Dividend payments would not be automatic and would require requests by residents. 	<p><i>Strengths</i></p> <ul style="list-style-type: none"> • Can be started quickly. • Usable as part of a transition to a permanent direct payment method. • Most Dividend payment would automatically be subject to withholding without additional action by residents. <p><i>Weaknesses</i></p> <ul style="list-style-type: none"> • Complicated system involving (1) employers, (2) pension-type payors, and (3) a separate agency for those not receiving period income payments. • Residents would have to take action in order to receive Dividends. • Complex system. Would still require a single payor direct payment program for those not receiving income payments periodically. • Imposes costs/burdens on employer and pension-type payors – especially handling recipient-initiated changes. • Requires employees to give employers more personal information. • Permitting employers to make immediate unverified withdrawals of government funds. Opens door to large compliance losses. • Given multiple payors, more difficult to obtain 100% coverage without duplicated payments. Even then might not get 100% coverage. • Enforcement and collection of overpayments difficult because cannot require automatic repayment via offsets against future Dividends.

D. Making Reconciliation Payments

Under both Dividend payment methods, Dividend payments actually received by some individuals and families during the year would differ from their entitlements. Some differences would be discovered or determined during the year when resident-initiated requests for changes were made and/or actually implemented. Others would not be determined until the annual Carbon Fee Dividend Reconciliation form (Form CFD-5) was prepared and filed.

The issue is how and when these overpayments and underpayments should be adjusted. Discrepancies due to intra-year changes could be handled (a) immediately by making a retroactive payment (or asking residents to make an immediate retroactive refund), (b) corrected immediately but only prospectively, or (c) delayed until after the year-end reconciliation form is filed.

CCL's Suggestion: To the extent possible, large underpayments to residents discovered during the year should be resolved immediately including a retroactive payment. Recovering overpayments to residents may be more troublesome. To the extent that such payments are a result of residents delaying requests for adjustments and are large (with large to be determined by administrators), immediate repayment should be requested, because recovery may be more problematic if delayed. Smaller overpayments to residents should be resolved as part of the annual reconciliation. Obviously, discrepancies discovered as part of the annual reconciliation should, as appropriate, be paid by residents with the annual tax return or CFD-1 filing or paid to residents in the same manner as income tax refunds.

E. Frequency of Dividend Payments under the Direct Payment Method

Dividend payments could be made monthly, quarterly, or semi-annually.

CCL's Suggestion: Especially over time as the monthly per capita Dividend amount became larger, payments should be made as frequently as practical – that is, monthly – so that residents have the Dividend funds available to them. In the early years of the program, monthly payments may either be impractical or may be overly costly relative to the size of the per capita monthly Dividend. The decision of whether to begin with less frequent payment and, if so, when to switch to monthly payments should be made by administrators based on administrative feasibility and costs, with doubt being decided in favor of making monthly payments.

F. Intermediary for Processing Dividend Payments, Changes, and Adjustments

At least four groups could act as the intermediary for Dividend processing.

- The Internal Revenue Service
- The Social Security Administration
- Another (probably new) government agency or sub-agency
- A private contractor or contractors

CCL's Suggestion: Neither the IRS nor the SSA should serve as intermediary under the direct payment disbursement method, although the IRS necessarily would have some responsibility for Dividend administration through sharing tax return information with the intermediary and possibly handling some aspects of the annual reconciliation as part of tax return filing.

Under the distribution method based on increased net payments of wages and other periodic payments, IRS would have to play a central role, at least in collecting and processing payment data. To the extent that other functions are necessary, they should be performed by either a separate government agency or a private contractor.

Both IRS and SSA are very large agencies with very large and diverse responsibilities but with fewer resources than ideal to handle even their current responsibilities. They should not be assigned more of a role in the Carbon Fee Dividend than is absolutely necessary. Moreover, political considerations may suggest that the Dividend program not be handled by the tax-collecting agency.

The choice between a new government agency and a private contractor should be made on the basis of cost, efficiency, and the time required to become operational. If there are essentially no differences between using a government agency or contractor, political considerations about increasing the number of government employees might suggest using a contractor.

G. Filing the Special Form for Non-Filers

Residents who would not otherwise file tax returns will be required to file a Claim for Carbon Fee Dividend (Form CFD-1) in order to begin receiving Dividend payments, and to file that form annually thereafter.

The issue is whether the Form CFD-1 should be filed with the IRS or with different agency or contractor.

CCL's Suggestion: The choice should be made on the basis of cost, the time required to become operational, and possibly the need to maintain as much separation as possible between the Dividend program and the federal tax system.

H. Dividend Disbursements

Dividends could be disbursed by the Treasury Department's Bureau of the Fiscal Service, as are most other government payments. If the intermediary is a contractor, that contractor could make the disbursement directly. If paid by the Treasury Department, the Dividend amount could either be paid separately or combined in a single payment with other monthly payments to the same resident or family.

CCL's Suggestion: If the intermediary is a contractor, a decision about direct disbursement by the contractor or through the Treasury Department should be made on the basis of cost. If the intermediary is a government agency, disbursement should be by the Treasury Department.

If visibility of Dividend payments is considered to be crucial by policymakers, Dividend payments should be made separately from other government disbursements. Otherwise, the

choice between separate and combined payments should be made by administrators on the basis of cost to the government and actual or perceived burdens on resident recipients. The decision could be to combine only some payments where the benefits are clear and substantial.

I. Family Payments or Separate Payments

This is an issue only for family units of more than one eligible individual. In such cases, Dividend payments could be made separately to each eligible member of a family (that is, one or two adults and up to two children) or in a single combined payment. Each method has benefits and issues. Family payments reduce the number of transactions and eliminate (or, at least, obscure) some issues about actual ownership of Dividend payment to dependent minors.

Separate payments show decisions about actual ownership at the time of the Dividend disbursement but may require some difficult decisions about ownership beforehand.

A single combined payment for each family unit would be consistent with the federal income tax system. Combined payment would effectively be required under the payment method based on increasing net wage and other periodic payments. Under the direct payment method, either payment system would work.

***CCL's Suggestion:* Given the CCL's proposal to limit child Dividends to the first two children in each family, single combined payments are advisable.**

J. Children and Other Dependents Under and Over Age 19

The CCL proposal is not specific about how self-supporting children (persons) under age 19 should be treated.

CCL's Suggestion: Since the intent of the proposal is to provide a Dividend to every household, a taxpayer who files his or her own tax return (or a joint tax return with a spouse) and cannot be claimed as a dependent on the tax return of another person should be treated as a separate household regardless of his or her age and should be entitled to an adult Dividend for the taxpayer and, if relevant, the spouse.⁵² They should also be entitled to child-level Dividend payments for the first two of their children. Although it is increasingly less common in recent years, some persons under age 19 are completely independent and live on their own. They may or may not be married and may or may not have children of their own, but they have all the characteristics of separate households.

⁵² “A taxpayer who files his or her own tax return (or a joint tax return with a spouse) and cannot be claimed as a dependent on the tax return of another person” is intended to have the same meaning as claiming an exemption for himself (or herself) on his or her tax return” would have meant under pre-2018 law. This clarification is necessary because the Tax Cuts and Jobs Act eliminated personal exemptions beginning for taxable year 2018.

K. Taxability of Dividends from the Carbon Fee

The pros and cons of taxing Dividends from the Carbon Fee have been discussed in section 7 of this paper. There are three possibilities:

- Dividends would not be treated as income.
- Dividends would be treated as income for purposes of income taxes but be excluded from income for purposes of non-tax means-tested benefits.
- Dividends would be treated as income for all purposes and programs.

CCL's Suggestion: Dividends should be treated as income for income tax purposes but excluded from income for purposes of non-tax means-tested programs. Permitting Dividends to be treated as income under means-tested programs could result in very high combined effective marginal reductions in benefits and increases in taxes, including some exceeding 100 percent. Such large marginal changes could adversely affect low income residents and, thereby, partially undermine the Dividend program.

Appendix B. The Climate Leadership Council Proposal: A Comparison

In February, 2017, the Climate Leadership Council (CLC) proposed a carbon fee and dividend plan as part of a broader proposal that would also essentially terminate most regulation of carbon emissions.⁵³ A Conservative Case for Carbon Dividends also calls for ending significant regulation, and authority for regulation, of carbon emissions. **The fee and dividend portion of the CLC plan is similar to the CCL plan, aside from the size of the fee and rate of annual increase.**⁵⁴ Also, under the CLC plan, the dividends would not be subject to federal income taxation.

If the CLC plan is compared with the CCL plan as modified per some of the suggestions in section 6 of this paper, *structurally* the plans differ mainly in how they would be administered. **The main structural difference between the CLC proposal and the simplified CCL Dividend proposal are that under the CLC plan, eligibility for dividend payments would be based only on having a valid social security number, and the program would be administered by the Social Security Administration (SSA).**

Despite complexity and possible inequities from very high effective marginal tax rates for some lower- and middle-income residents caused largely by phase-ins and phase-outs of various income tax provisions, federal income taxation plays an important role in the redistribution of the benefits of any per person benefit programs such as both the CLC and the CCL dividends from carbon fees. Taxation of benefits also affects the net budgetary impact of these programs and, unless waived by statute, interacts with the provisions of the Statutory Pay-As-You-Go Act of 2010 (PL 111-139, signed February 12, 2010). Even after considerations of complexity, redistribution, and budgetary impacts, taxation of dividend payments from carbon fees is ultimately a matter of public policy.

As explained in previous sections of this paper, adding the burden of a dividend payment program to the already overburdened Social Security Administration might overly stretch the ability of the Social Security Administration to perform its primary functions of administering the social security retirement and disability programs and partially administering Medicare eligibility and enrollment. **The Social Security Administration currently has all of the necessary information to process dividend changes due to births and deaths, but it does not have any information about the payment of dividends to dependent minors.** Payments for minors would be directed to their parents or guardians, but there are a significant percentage of cases in which the eligibility of the parents or guardians changes during the year, even monthly, and the determination of such eligibility is fact specific, requiring extensive and labor intensive examination. Placing such responsibilities on the Social Security Administration would require residents to supply information to the SSA that duplicates information they already give the IRS on income tax returns or otherwise supply to the IRS for making virtually identical decisions about eligibility to claim dependency exemptions.

⁵³ www.clcouncil.org/wp-content/uploads/2017/02/TheConservativeCaseforCarbonDividends.pdf.

⁵⁴ It is not clear whether dividend payments under the CLC proposal would have to be reduced in order to meet the requirement of the Statutory Pay-As-You-Go Act of 2010 (PL 111-139).

Making separate monthly payments to each eligible individual would result in twice or more the number of separate payments than would be necessary if payments were made to family units based on tax return information. If the intent is that Dividend payments are generally to be used for routine living expenses rather than being retained as savings, separate payments to each family member including dependent minors would require families to transfer children's Dividend payments from each child's bank account each month. Moreover, many dependents do not have their own bank accounts and would have to receive their Dividend payments by debit card or paper check. Thus, separate payment would increase costs and administrative burdens for families. **Separate payments would also increase the government's disbursement costs by a small, but non-trivial amount.**

Determining residency and, hence, eligibility for dividends based only on valid Social Security numbers is far more problematic. The Social Security Administration could only determine residence status for people with two special categories of social security numbers.⁵⁵ Beyond those categories coded when the person obtains a social security number, SSA could not distinguish eligibles and non-eligibles.

There are two important situations where Social Security would not provide the necessary information.

The first situation relates to residents of the various United States possessions. If residents of possessions were not eligible for Dividends, use of only a valid social security number would not enable the Social Security Administration to identify the ineligible possession residents.

The second situation relates to United States citizens who reside abroad, either temporarily or permanently. Presumably, such persons would not be subject to the Carbon Fee during periods when they are not in the United States and, thus, should not receive Dividends from the carbon fee. Although use of the income tax system does not identify persons residing abroad with precision, in many instances it does provide sufficient information to identify some of those residing abroad. The only information that the SSA would have to identify persons actually living abroad would be a postal address. However, many of those living abroad already have and use domestic addresses for various purposes. Especially if postal addresses were used to determine eligibility, more persons residing abroad would have an incentive to use a domestic address in order to claim eligibility to which they were not otherwise entitled.

Dividends from a Carbon Fee could be paid to individuals based on social security information. However, basing Dividend payments predominantly on information already provided on Federal individual income tax returns would substantially reduce the number of individual disbursements required to be made each year and would provide information and answers in many specific situations that would require additional labor and duplication under an SSA based Dividend payment system.

⁵⁵ The two special categories include: social security numbers issued to persons lawfully admitted to the United States on a temporary basis either with or without authorization to work; and social security numbers issued for other valid purposes that require a social security number.