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ARE TAXES TOO HIGH?

New Data Show Federal Tax Burdens Have Fallen to Lowest Levels in Decades, Casting Fresh Doubt on Wisdom of More Tax Cuts In the Face of a Looming Fiscal Train Wreck

Large federal tax cuts have been sold in part in recent years on the grounds that tax burdens have risen to excessive levels and Americans are overtaxed. New data and analysis suggest otherwise. The percentage of income that most categories of taxpayers pay in federal taxes had declined even before the 2001 tax cuts were enacted and has now fallen to the lowest level in decades.

- Data from a new Congressional Budget Office study that covers years from 1979 through 2001 show that when households' total federal tax burdens are considered — including income, payroll, excise, and other taxes — most categories of households paid a smaller percentage of their income in federal taxes in 2001 than in any year on record, back to 1979.[1]

- For example, households in the middle fifth of the income spectrum paid an average of 16.7 percent of their income in federal taxes in 2001, the lowest level for any year in the 1979-2001 period the CBO study covered. Even before the recent tax cuts — in 2000 — the percentage of income that households in the middle fifth of the income spectrum paid in federal taxes was lower than in any other year since 1979.

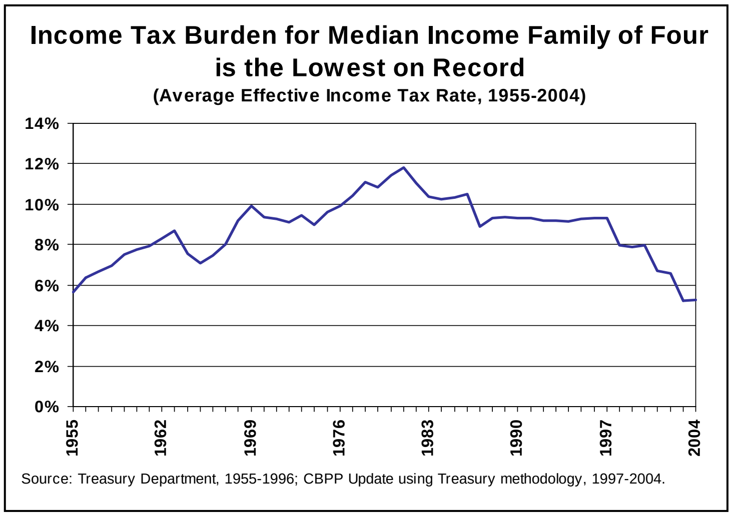
- The tax burden has fallen further since 2001, with the phasing in of more of the tax cuts enacted in 2001 and the subsequent enactment of additional tax cuts. The Center's update of the CBO data finds that in 2004, the percentage of income that households in the middle fifth of the income spectrum will pay in total federal taxes will fall to approximately 14.7 percent.

- Treasury data tell an even more dramatic story. They show that the drop in overall federal tax burdens is driven by a pronounced drop in *income-tax* burdens. The Treasury Department issued an analysis in 1998 examining changes since 1955 in the percentage of income that the median-income family of four pays in federal income taxes.[2] Updating these data through 2003 shows that the median-

[1] Congressional Budget Office, *Effective Federal Tax Rates, 1979-2001*, April 2004.

[2] Office of Tax Analysis, Department of the Treasury, "Average and Marginal Federal Income, Social Security and Medicare, and Combined Tax Rates for Four-Person Families at the Same Relative Positions in the Income Distribution, 1955-1999," January 15, 1998. The median-income family of four has an income that places it exactly in the middle of the income spectrum: half of all families of four have higher incomes than this family, while the other half of such families have lower incomes.

income family of four paid *just 5.3 percent of its income in federal income taxes in 2003, the lowest percentage on record going back to 1955.*



The percentage of income that the median family of four pays in federal income tax is now *about half* the average level in the 1980s. Such families paid an average of 10.3 percent of their income in federal income taxes in that decade.

- Here, too, the downward trend began before the 2001 tax cut: in 2000, the median family of four with two children paid a smaller percentage of its income in federal income taxes than in any year since 1966, except for 1999.

As these data indicate, the recent income tax cuts reduced taxes for middle-income families. Even so, the bulk of the benefits from those tax cuts have accrued to high-income households.

- The combination of the tax cuts enacted in 2001 and the tax cut enacted in 2003 is giving households that make more than $1 million a year an average tax cut of more than $120,000 in 2004, according to new analysis by the Urban Institute-Brookings Institution Tax Policy Center. This is nearly 200 times the size of the average tax cut that families in the middle of the income scale are receiving.

- A disparity persists even when the tax cuts are measured in terms of their effect on after-tax incomes. The Tax Policy Center data show that in 2004, the tax cuts will increase the after-tax incomes of the top one percent of households by 5.3 percent and raise the after-tax incomes of the "millionaire" group by 6.4 percent. By contrast, for families in the middle of the income scale, the tax cuts will raise after-tax incomes just 2.3 percent.

Tax Cuts and Deficits

The 2001 and 2003 tax cuts are a major reason why federal revenues have fallen sharply in recent years, as a share of the economy, and contributed to an explosion of the deficit. Federal revenues will fall this year to their lowest level, as a share of the economy, *since 1950*. Even after the economy recovers, federal revenues, as a share of the economy, are expected to remain below their average levels for the 1960s, 1970s, 1980s, and 1990s, if the 2001 and 2003 tax cuts are extended. This weakening of the federal revenue base has been a major contributor to the stunning fiscal deterioration of the past few years — and to the widespread projection that the nation will face persistent large deficits as far as the eye can see that ultimately may do significant damage to the economy, lead us into fiscal crisis, and threaten the ability of the federal government to perform basic functions adequately.

The data presented here on reductions in tax liabilities suggest that policymakers should stop using claims of excessive federal tax burdens on middle-income taxpayers to promote costly tax cuts that predominately benefit the well-off or to promote new middle-class tax cuts that are not paid for.