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FEDERAL TAX BURDENS FOR MOST NEAR THEIR LOWEST LEVELS IN DECADES

Bush Tax Cuts Are Key Reason for Sharp Drop for Highest-Income Households

By Kris Cox and Gillian Brunet

With April 15 approaching and many people focusing on what they owe in taxes, Americans may be surprised to learn that federal tax burdens for most income groups, particularly middle-income households, are near their lowest levels in decades — and were low by historical standards even *before* the 2001 and 2003 tax cuts.

Most income groups paid a smaller share of their income in federal taxes in 2006 than in any year before 2003 for which we have data. The drop in tax burdens was driven largely by a pronounced fall in individual income tax burdens that, for most income groups in 2006, approached their lowest levels since 1979. For the top 1 percent of households, individual income tax burdens were at their lowest level since 1986.

Tax burdens fell most sharply for those at the top, and recent tax cuts are a major reason why. When the tax cuts of recent years are fully in effect next year, households with incomes of over \$1 million a year will receive average tax cuts of \$168,000, while those in the middle will receive average tax cuts of \$1,150.

Overall Federal Tax Burdens Are Low by Historical Standards

- While federal tax burdens have risen very slightly from their nadir in 2003 and 2004, most income groups paid a smaller share of their income in federal taxes in 2006 than in every year prior to 2003 for which data are available, according to Congressional Budget Office data that cover the period 1979 to 2006.¹
- Tax burdens on middle-income households remain near their lowest levels in decades. Households in the middle fifth of the income spectrum paid an average of 14.2 percent of their income in federal taxes in 2006. By contrast, since 1979, the average federal tax burden on these households has equaled 17 percent of income.²

¹ The CBO study covers the 1979-2006 period and includes federal income, payroll, and excise taxes. Congressional Budget Office, “Historical Effective Federal Tax Rates, 1979-2006,” April 2009.

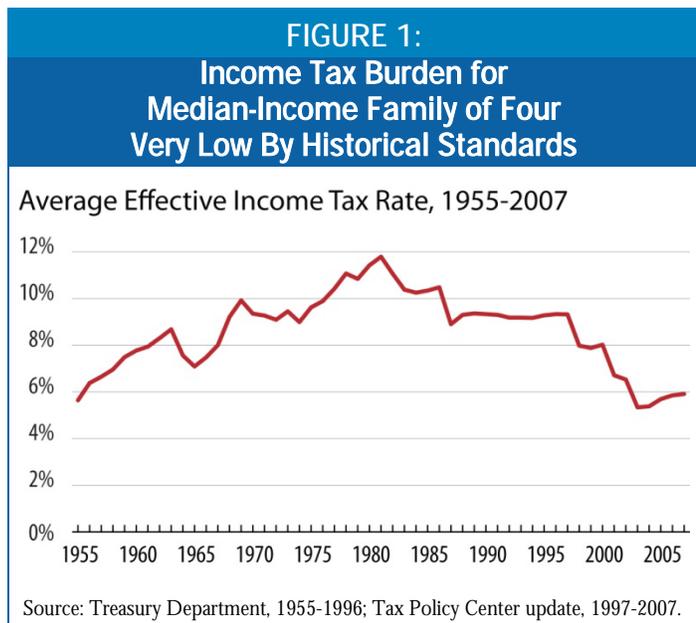
² The low point came in 2003. The middle fifth of households paid 13.8 percent of income in federal taxes that year.

- Even in 2000, *before* the 2001 and 2003 tax cuts, households in the middle fifth of the income scale paid a smaller share of their income in federal taxes than in any year since 1979, and tax burdens for most income groups were lower than their average for the 1979-1999 period.

Federal *Individual Income Tax* Burdens Have Fallen Significantly

The drop in overall federal tax burdens has been driven largely by a pronounced decline in individual income tax burdens.

- For most income groups covered by the CBO study, federal individual income tax burdens in 2006 were near their lowest level since 1979. For the top 1 percent of households, federal individual income tax burdens were at their lowest level since 1986. (*Overall* federal tax burdens on the top 1 percent of households were at their lowest level since 1992 and were also lower than in the first years covered by the CBO study, before the tax cuts of the 1980s.)
- The median-income family of four paid *only 5.9 percent* of its income in federal individual income taxes in 2007, slightly higher than the all-time low of 5.3 percent in 2003 (see Figure 1), according to the Urban Institute-Brookings Institution Tax Policy Center (which updated a Treasury Department study). The “effective tax rate” for the median-income family was lower in 2007 than in any year between 1956 and 2002.³
- Here, too, the downward trend began before the 2001 tax cut. In 2000, the median-income family of four paid a smaller percentage of its income in individual income taxes than in any year since 1967, except for 1998 and 1999.



Tax Burdens Have Dropped Most Sharply for the Highest-Income Households

Economists Thomas Piketty and Emmanuel Saez, who have done groundbreaking work on income inequality in the United States, studied how the progressivity of federal taxes has changed over time. Their data, like CBO’s, show that tax burdens for most groups of households are low by historical standards. But unlike CBO, Piketty and Saez examined tax burdens for groups up to the

³ Tax Policy Center, “Historical Federal Income Tax Rates for a Family of Four,” September 9, 2008. The Tax Policy Center’s estimates were derived by updating (using Treasury’s methodology) a 1998 Treasury Department analysis that examined changes since 1955 in the percentage of income that the median-income family of four pays in federal income taxes.

top one-hundredth of one percent of the population. They found that “the progressivity of the U.S. federal tax system at the top of the income distribution has declined dramatically since the 1960s.” That is, the very highest-income households have seen the sharpest drops in the percentage of income that they pay in federal taxes.⁴

Piketty and Saez point to recent tax cuts as one major reason that federal tax burdens have dropped most sharply for the highest-income households. This is hardly surprising, given other evidence that these tax cuts were skewed to the top.

In 2010, when the 2001-2008 tax cuts all are fully in effect, households with annual incomes of more than \$1 million a year will receive tax cuts averaging \$168,000, boosting their after-tax incomes by an average of 7.7 percent, according to Tax Policy Center estimates. Households in the middle fifth of the income distribution, in contrast, will receive tax cuts averaging \$1,150, boosting their after-tax incomes by an average of 2.6 percent. Almost one quarter of the total value of the tax cuts will go to the 0.3 percent of households with incomes of more than \$1 million per year. In contrast, less than one sixth of the total value of the tax cuts will go to the bottom 60 percent of households.

⁴ Since CBO does not provide data on income groups above the top 1 percent, it is only possible to compare the CBO and Piketty/Saez series for groups up to the top 1 percent. According to the Piketty Saez data — which are based on a somewhat different methodology than CBO’s and which, unlike the CBO data, include federal estate taxes — recent tax cuts have reduced tax burdens for the top 1 percent of households to a little *below* their 1980s levels. As noted above, the CBO data show tax burdens for these households a little *above* their 1980s levels. Both data series show that since the late 1970s, the top 1 percent of households have seen considerably larger percentage-point reductions in their federal tax rates than have low- or middle-income households. The comparison with the late 1970s takes into account the combined effects of the tax cuts of the 1980s, the tax increases of the 1990s, and the tax cuts of recent years.

For further discussion of the Piketty and Saez study, see Aviva Aron-Dine, “New Study Finds ‘Dramatic’ Reduction Since 1960 in the Progressivity of the Federal Tax System: Largest Reductions in Progressivity Occurred in 1980s and Since 2000,” Center on Budget and Policy Priorities, March 29, 2007, <http://www.cbpp.org/3-29-07tax.htm>.