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THE SKEWED BENEFITS OF THE TAX CUTS, 2007-2016

If the Tax Cuts Are Extended, Millionaires Will Receive More than $600 Billion over the Next Decade

By Aviva Aron-Dine and Joel Friedman

Under current law, nearly all of the tax cuts enacted since 2001 are slated to expire by the end of 2010. The President's budget calls for making most of these tax cuts permanent.

The enacted tax cuts and their extension carry a large cost. This raises the question: how would the large sums involved be distributed among different income groups?

There are no official government estimates on this matter.[1] But the Urban Institute-Brookings Institution Tax Policy Center has produced estimates of how the benefits of tax cuts enacted since 2001 in the individual income tax, the Alternative Minimum Tax, and the estate tax will be distributed in coming years among households at different income levels. Estimates from the Congressional Budget Office and the Joint Committee on Taxation indicate that the cost of the tax-cut provisions the Tax Policy Center has analyzed would be $3.2 trillion over the 2007-2016 period if these provisions are extended. Applying the Tax Policy Center estimates of the percentage of the tax cuts that will go to each income group to the CBO/Joint Tax Committee estimates of the tax cuts' cost yields the following results:

- From 2007 through 2016, households with annual incomes of more than $1 million — a group that comprises the top 0.3 percent of the population — would receive approximately $648 billion in tax cuts. This represents 20 percent of the total tax-cut benefits.

KEY FINDINGS

- **Over the next decade, households with incomes above $1 million will receive about $648 billion in tax benefits from the tax cuts enacted since 2001 (assuming these tax cuts are extended).**
- **In 2007, the tax cuts going to the top 1 percent of the income spectrum (those with incomes above $400,000 in that year) will *exceed* the amounts being devoted to programs the Administration identifies as national priorities, such as homeland security.**
- **Over the next five years, the total savings from the deep cuts the President would make in domestic discretionary programs — including education, veterans' health benefits, medical research, environmental protection, and various programs for low-income families — would be *less than* the cost of the tax cuts just for households with incomes above $1 million.**

[1] The Joint Committee on Taxation provided estimates of the distribution of the income tax cuts enacted in 2001, but these estimates extended only through 2006. See Joint Committee on Taxation, "Distributional Effects of the Conference Agreement for H.R. 1836," JCX 52-01, May 26, 2001.

Table 1: Distribution of Tax Cuts, 2007-2016		
	Dollar Amount	Percentage Share
Lowest 20 percent	$15	0%
Second 20 percent	155	5%
Middle 20 percent	265	8%
Fourth 20 percent	456	14%
Top 20 percent	2,316	72%
Total	3,215	100%
Top 1 percent	930	29%
Above $1 million	648	20%

Source: CBPP calculations based on Joint Tax Committee, CBO, and Tax Policy Center data.

- Some $930 billion — 29 percent of the tax cuts' total value — would go to the top 1 percent of households.

- The bottom 60 percent of households would receive 14 percent of the tax cuts, or $434 billion, which is less than half the amount that would go to the top 1 percent. Some 87 million households currently are in the bottom 60 percent of the population; 1.5 million households are in the top 1 percent. (See Table 1 above; for year-by-year detail, see the Appendix tables.)

Cost of Tax Cuts Relative to Other Administration Priorities

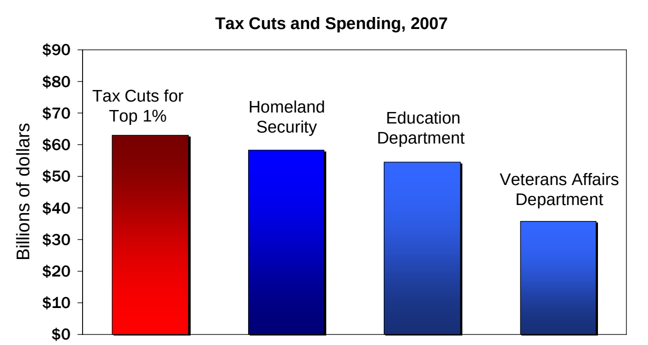
The cost of the tax cuts for the highest-income households substantially exceeds the amounts being devoted to other matters the Administration has identified as national priorities.

- The Administration's avowed top priority is national security, and homeland security is one of the few areas of the budget for which the President is requesting a funding increase in 2007. Nonetheless, the total amount that the Administration has requested for homeland security in 2007 — $58 billion — is slightly *less* than the $63 billion that the top 1 percent of households (those with incomes above $400,000 in 2007) will receive from the tax cuts in that year.

- The budget also requests additional funding for the Iraq War. The average annual cost of the Iraq War to date, about $85 billion per year, is about equal to the expected cost in 2007 of tax cuts for households with income above $200,000 (or about the top 4 percent of the population).

FIGURE 1

Tax Cuts for Highest-Income 1 Percent of Households Compared with Spending on Administration's Stated Priorities



Source: CBPP calculations from Office of Management and Budget, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data. Funding levels are those requested in the President's budget.

- The Administration's 2007 budget request for the entire Department of Veterans Affairs, at $36 billion, is a little more than half of the cost of the tax cuts for the top 1 percent of households.

- Another of the Administration's stated priorities is education. The total funding that the Administration is requesting for the Department of Education in 2007 — $54 billion — is less than the cost of the tax cuts for the top 1 percent that year.

- Still another Administration priority is the Medicare prescription drug benefit. According to CBO, the Medicare drug benefit will cost about $979 billion over the coming decade. This is only slightly more than the projected cost of the tax cuts for the top 1 percent over this period.

Finally, the Administration has emphasized the high cost of relief and reconstruction for areas hit hard by Hurricanes Katrina and Rita. Total hurricane relief enacted so far (including both expenditures and tax relief) amounts to $100 billion. This total will rise to $118 billion with the addition of the supplemental funding the President has just requested. That is less than half of what will be spent on tax cuts for the top 1 percent of households over the next five years.

Cost of Tax Cuts Relative to the Savings from Budget Cuts

The President's budget proposes to make permanent the tax cuts enacted in 2001 and 2003, and to add a number of new tax cuts that carry large price tags. At the same time, the budget proposes sizeable reductions over the next five years in nearly every domestic discretionary program area, including education, veteran's health benefits, medical research, environmental protection, and various programs for low-income families, such as housing assistance, energy assistance, nutrition assistance, and child care.[2]

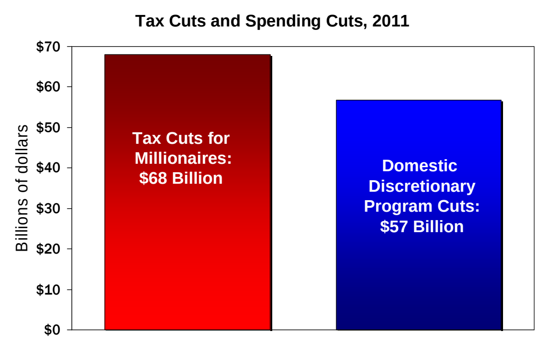
The *total* savings that would be achieved over the next five years from the cuts the budget would make in these and other domestic discretionary programs would be *less* than the cost of the tax cuts just for households with incomes over $1 million. In fact, in 2011, when the tax cuts would be fully in effect, the cost of the tax cuts just for households with incomes exceeding $1 million would be:

- more than 4 times the savings that would be achieved that year from the proposed cuts in elementary, secondary, and higher education, which would be large;

- more than 9 times the size of the combined savings from the proposed

FIGURE 2

President's Budget Proposes Deep Cuts in Domestic Programs, But Tax Cuts for Millionaires Are Larger



Source: CBPP calculations from Office of Management and Budget, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data.

[2] For a detailed discussion, see Richard Kogan, Isaac Shapiro, and Katharine Richards, "The Hidden Cuts in Domestic Appropriations: OMB Data Reveal Deep Funding Cuts After 2007," Center on Budget and Policy Priorities, February 9, 2006.

cuts in the National Institutes of Health, community health centers, HIV/AIDS treatment programs, and other health programs that are not entitlements;

- more than 13 times the savings from the proposed cuts in veterans health care and other veterans programs; and

- more than 15 times the savings from cuts in low-income housing programs.

These comparisons suggest that a deficit-reduction strategy predicated entirely on cuts in domestic programs poses serious equity concerns. It is highly problematic to advance such broad-based budget cuts while refusing to reconsider tax cuts, especially since rolling back the tax cuts for households with incomes over $1 million would itself yield larger savings than the savings that would be produced by the cuts the Administration is proposing in education, veterans health, medical research, environmental protection, national parks, various programs for the poor, and all other domestic discretionary programs *combined*.

Distributing the Tax Cuts over the Next Decade

This analysis applies the Tax Policy Center's estimates of how the tax cuts will be distributed across various income groups to the estimates that the Congressional Budget Office and the Joint Committee on Taxation have produced of the costs of these tax cuts. Because this analysis combines estimates from institutions that employ somewhat different tax models, the results should be viewed as approximations.

The Tax Policy Center analyzed the distribution of the tax-cut benefits that result from the changes enacted in 2001 and 2003 in the individual income tax, the AMT, and the estate tax. The tax provisions that the Tax Policy Center analyzed in this manner will cost $3.2 trillion between 2007 and 2016 if they are extended, according to CBO and Joint Tax Committee estimates. This represents more than 85 percent of the total cost of all tax cuts enacted since 2001, if all of these tax cuts are extended.

The tax-cut measures *not* covered in the Tax Policy Center analysis include the tax cuts contained in the energy bill enacted in 2005, the deduction for state and local sales taxes enacted in 2004, and various temporary tax cuts that are commonly referred to as "extenders" because they are routinely extended with bipartisan support. The cost of the tax cuts not covered here is estimated to be $469 billion over the next ten years, if those measures are extended.[3] If our estimates had included these additional tax cuts, the total cost of the tax-cut benefits going to high-income households (as well as to households in other income categories) would increase. The percentage share of the tax cuts going to each income category would likely remain about the same, however, as the tax cuts omitted from this analysis likely benefit high-income households in much the same manner as those

[3] The cost over the 2007-2016 period of all of the tax cuts enacted since 2001, if they are extended, is $3.7 trillion. If this cost is not offset, it will add to the deficit, resulting in higher interest payments on the debt. When the higher interest payments are taken into account, the ten-year cost of all tax cuts enacted since 2001, if extended, grows to $5.4 trillion over the 2007-2016 period. Of this total, $2.0 trillion represents the cost of the tax cuts enacted to date, plus interest, and $3.3 trillion reflects the cost of extending these tax cuts, plus interest. For a fuller discussion of these issues, see Joel Friedman and Aviva Aron-Dine, "Extending Expiring Tax Cuts and AMT Relief Would Cost $3.3 Trillion through 2006," Center on Budget and Policy Priorities, February 6, 2006.

included. For instance, a number of the provisions not included are business tax cuts, the benefits of which typically accrue primarily to high-income households. (For a more detailed discussion of the tax cuts not included in this analysis, see the appendix.)

The Distribution of the Tax Cuts When They Are Fully in Effect

Fiscal year 2011 is the first year in which the *full* cost of all tax-cut provisions examined here will be felt, assuming that the tax cuts are extended.[4] The cost of the individual income and estate tax cuts and related AMT relief would be $320 billion in that year.

- Households with incomes above $1 million — the top 0.3 percent of households — would receive $68 billion in tax cuts in 2011. The average tax cut for these households will be nearly $160,000 in that year.
- Households in the top 1 percent of the population (those with incomes above about $500,000 in 2011) would receive tax cuts worth $97 billion that year. Their average tax cut would be more than $60,000.
- In contrast, the bottom 60 percent of households would receive tax cuts worth $42 billion, less than half the amount going to the top 1 percent of households. The average tax cut for these households would be a little under $500 in that year.

Some may argue that the large tax cuts flowing to these high-income households are not inappropriate because these households pay the lion's share of federal taxes. But other measures confirm the highly regressive nature of these tax-cut measures. Many economists believe the best way to assess the progressivity or regressivity of a tax policy change is to compare the percentages by which the after-tax incomes of various income groups rise or fall as a result of the change. This approach can make tax cuts going to low-income households appear comparatively large, since a tax cut of a specific dollar amount will increase the after-tax income of a low-income household by a much larger percentage than it will increase the after-tax income of a high-income household.

Even by this measure, the benefits conferred by the 2001 and 2003 tax cuts are much greater for high-income households than for other households. The Tax Policy Center estimates show that in 2011 the tax cuts will boost the after-tax incomes of households with incomes above $1 million by more than 7 percent on average. In contrast, the tax cuts will raise the after-tax incomes of the bottom 60 percent of households by about 2 percent. Thus, even if the tax cuts are measured relative to households' incomes, the tax cuts are worth much more to high-income households than to those in the middle or bottom of the income scale.

[4] Estate-tax repeal does not take effect until 2010, and the full cost of repeal will first be felt in 2011, because of the normal delay between the time when an individual dies and the time when payment is made of any tax that may be due on the individual's estate.

APPENDIX: FURTHER EXPLANATION OF THE DISTRIBUTIONAL ESTIMATES

This appendix provides a more detailed explanation of the methodology used in this analysis and of which tax cuts are included in and excluded from our estimates. It also discusses some of the issues surrounding multi-year distributional estimates. Finally, it provides tables showing the year-by-year distribution of the tax cuts.

Tax Cuts Included and Excluded

This analysis examines the cost of the individual income tax and estate tax cuts enacted in 2001 and 2003 and associated AMT relief that will be provided to different income groups. It assumes these tax cuts are extended and remain in effect throughout the coming decade.

The tax cuts enacted in 2001 and 2003 and related AMT relief will cost a total of $3.2 trillion from 2007-2016. Of this total, $917 billion reflects the cost of tax-cut measures already enacted. The remaining $2.3 trillion reflects the cost of extending the tax cuts through 2016 (see Appendix Tables 1 and 2).

Extending the individual income tax and estate tax provisions of the 2001 and 2003 tax laws has a direct cost of approximately $1.6 trillion over the coming decade. The cost of extending AMT relief that is associated with these tax cuts adds another $671 billion in cost. (Because extending the tax cuts sharply increases the number of taxpayers subject to the AMT, it makes the underlying AMT problem — which results primarily from the fact that the AMT exemption level is not indexed for inflation — much more expensive to fix. Addressing the AMT problem that pre-dated the tax cuts would cost $243 billion between 2007 and 2016; addressing the AMT problem *with* the tax cuts in effect throughout the decade adds another $671 billion in cost, bringing the total cost of AMT relief to $914 billion over this period.)[5]

In addition to excluding a portion of the cost of continued AMT relief — the portion that would be incurred even without the 2001 and 2003 tax cuts — our estimates exclude the cost of certain other enacted tax cuts and their extension, the distribution of which is not estimated by the Tax Policy Center. We do not distribute the costs of enacted business tax cuts or of tax cuts that were enacted in response to Hurricanes Katrina and Rita and are targeted to Gulf Coast residents. We also exclude the cost of extending a variety of tax cuts that, along with the 2001 and 2003 tax cuts and AMT relief, are slated to expire over the next few years. (Many of these other expiring tax cuts, such as the credit for research and experimentation, are referred to as "extenders" because they are routinely extended with bipartisan support.) Several other expiring provisions that were enacted more recently, such as the deduction for state and local taxes, also lie outside of this analysis.

If all of the excluded tax cuts were covered here, the total cost of the tax cuts going to various income groups would rise. The percentage shares of the tax cuts going to the various income groups would probably remain more or less the same, however, since the overall distribution of the excluded tax cuts is likely to be similar to the distribution of the tax cuts covered here. While a somewhat larger share of the part of AMT relief not covered here would go to middle-income households, the business tax cuts that make up the bulk of the "extenders" are likely to be more

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[5] These figures include the cost of extending the AMT relief in effect in 2005 and indexing it for inflation, as well as extending the provision allowing taxpayers to claim non-refundable personal credits under the AMT.

skewed to higher-income households than the tax cuts our analysis covers.[6] For instance, the Tax Policy Center estimates that in 2006, about 50 percent of corporate income flows to the top 1 percent of households. These high-income households would therefore receive a larger share of the benefits from corporate and other business tax cuts than from the tax cuts distributed in this analysis (29 percent of the benefits of which flow to the top 1 percent).

Methodology

The Congressional Budget Office and the Joint Committee on Taxation have provided estimates of the cost of each enacted tax provision and of the cost of extending those provisions. From these estimates, we calculate the overall cost in each fiscal year of the tax-cut provisions that the Tax Policy Center's distributional estimates cover.

The Tax Policy Center provides estimates of the distribution of the tax cuts by income group for calendar years 2007, 2011, and 2015. This requires us to construct approximate distributions for the remaining years. Because not all provisions of the tax cuts take full effect until 2010, and their cost is not fully reflected until fiscal year 2011, we use the 2007 distributional estimates for the years 2007-2010. This means that our estimates of the shares of the tax cuts that will go to high-income groups in those years are conservative; in reality, estate tax changes and several other tax-cut provisions that focus exclusively on high-income households are phasing in over this period, so the overall distribution of the tax cuts is gradually becoming more skewed to the top.

For the years 2012-2014, we smooth the change between the 2011 and the 2015 distributional estimates; that is, we change the percentage share going to each group in each of these years by one fourth of the total change in that group's share of the tax cuts between 2011 and 2015. We continue the smoothing into 2016 by modifying the 2015 percentage distribution by the same amounts. This method approximates the likely changes in the actual distribution over time, which would be steady and gradual (and would largely reflect real income growth) once all provisions of the tax cuts were fully in effect.

Multi-Year Distributional Estimates

The value of the multi-year estimates presented in this analysis is that they allow us to examine the distribution of the 2001 and 2003 tax cuts and to make comparisons between the amounts being spent on tax reductions for various groups of households and the amounts being spent on other policy goals.

Some may argue that the multi-year distributional estimates presented here are problematic because the composition of income groups changes over time. In other words, the households that will make up the top 1 percent of the population in 2007 are not entirely the same as the households that will make up the highest-income 1 percent of the population in 2011. To the extent that households experience income changes over the ten-year period, the distribution of the tax cuts over time might be somewhat less skewed than these estimates show.

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[6] Throughout this analysis, the term "households" refers to tax units, as defined by the Tax Policy Center, and includes both filing and non-filing units.

The available evidence suggests, however, that most households do not experience dramatic income shifts over the course of a decade. Households that are high- or low-income in any particular year are most often also high- or low-income in the preceding and following years. For instance, a study that examined short-term economic mobility during the 1990s found that 75 percent of individuals who were in the bottom fifth of the income distribution in one year were still in the bottom fifth the next year.[7] Another study, by the Congressional Budget Office, compared distributional estimates of tax cuts based on annual measures of income with estimates based on multi-year income measures. It concluded that "the choice of either a longitudinal or an annual metric to measure a potential policy's effects would not dramatically shift the overall distribution of any of the changes CBO examined."[8] A study by economists in the Treasury Department's Office of Tax Analysis found similar results.[9]

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[7] Peter Gottschalk, "Family Income Mobility - How Much Is There, and Has It Changed?" in James A. Auerback and Richard S. Belous, eds., *The Inequality Paradox: Growth of Income Disparity.* Washington, DC: National Policy Association, 1998.

[8] Congressional Budget Office, "Effective Tax Rates: Comparing Annual and Multiyear Measures," January 2005.

[9] James Cilke, Julie-Anne Cronin, Janet McCubbin, James Nunns, and Paul Smith, "Distributional Analysis: A Longer Term Perspective," in *Proceedings of the 93rd Annual Conference on Taxation,* National Tax Association, 2001.

Appendix Table 1: Distribution of the Tax Cuts by Percentile

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-2016
Total Cost of Tax Cuts (billions) — Certain 2001 and 2003 Tax Cuts and Associated AMT Relief											
Enacted	199	205	202	206	105	0	0	0	0	0	917
Extended	40	45	62	67	215	330	351	373	396	420	2,299
Total	240	249	264	273	320	330	351	373	396	420	3,215
Dollar Amount by Quintile (in billions of dollars)											
Lowest 20 Percent	1	1	1	1	1	1	2	2	2	2	15
Second 20 Percent	12	13	14	14	15	16	16	17	18	19	155
Middle 20 Percent	23	24	25	26	26	26	27	28	29	30	265
Fourth 20 Percent	37	38	40	42	44	45	48	51	54	57	456
Top 20 Percent	166	173	183	189	233	241	256	273	291	310	2,316
Top 1 Percent	63	65	69	72	97	100	106	112	119	126	930
Percent Shares by Quintile											
Lowest 20 Percent	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	0%
Second 20 Percent	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Middle 20 Percent	10%	10%	10%	10%	8%	8%	8%	8%	7%	7%	8%
Fourth 20 Percent	15%	15%	15%	15%	14%	14%	14%	14%	14%	14%	14%
Top 20 Percent	69%	69%	69%	69%	73%	73%	73%	73%	74%	74%	72%
Top 1 Percent	26%	26%	26%	26%	30%	30%	30%	30%	30%	30%	29%

Appendix Table 2: Distribution of the Tax Cuts by Dollar Income Class

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016		2007-2016
Total Cost of Tax Cuts (billions) — Certain 2001 and 2003 Tax Cuts and Associated AMT Relief												
Enacted	199	205	202	206	105	0	0	0	0	0		917
Extended	40	45	62	67	215	330	351	373	396	420		2,299
Total	240	249	264	273	320	330	351	373	396	420		3,215
Dollar Amount by Income Class (billions)												
Below $50,000	40	42	44	46	43	43	44	46	47	48		442
Below $100,000	92	96	101	104	102	103	106	111	115	119		1048
Above $100,000	148	154	163	168	217	227	243	261	280	300		2161
Above $200,000	89	92	98	101	138	144	154	165	176	189		1344
Above $500,000	58	60	64	66	92	95	101	108	115	122		882
Above $1 million	43	45	47	49	68	70	74	79	84	90		648
Percent Shares by Income Class												
Below $50,000	17%	17%	17%	17%	13%	13%	13%	12%	12%	11%		14%
Below $100,000	38%	38%	38%	38%	32%	31%	30%	30%	29%	28%		33%
Above $100,000	62%	62%	62%	62%	68%	69%	69%	70%	71%	71%		67%
Above $200,000	37%	37%	37%	37%	43%	43%	44%	44%	45%	45%		42%
Above $500,000	24%	24%	24%	24%	29%	29%	29%	29%	29%	29%		27%
Above $1 million	18%	18%	18%	18%	21%	21%	21%	21%	21%	21%		20%

Note: Income classes are expressed in 2005 dollars. Households with incomes below $50,000 comprise about 60 percent of the population, while households with incomes below $100,000 comprise about 83 percent of the population. Households with incomes above $100,000 comprise about 17 percent of the population, households with incomes above $200,000 account for about 4 percent, households with incomes above $500,000 about 0.8 percent, and households with incomes above $1,000,000 about 0.3 percent. The population shares of the higher income groups grow slightly over the decade because incomes are assumed to grow in real terms over the period.