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THE SKEWED BENEFITS OF THE TAX CUTS, 2008-2017

With the Tax Cuts Extended, Top 1 Percent of Households Will Receive More Than $1 Trillion in Tax Benefits Over the Next Decade

By Aviva Aron-Dine

Under current law, nearly all provisions of the 2001 and 2003 tax cuts are scheduled to expire at the end of 2010. The President's budget calls for making these tax cuts permanent.

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

The Urban Institute-Brookings Institution Tax Policy Center has produced estimates of how the benefits of the income and estate tax reductions enacted in 2001 and 2003 will be distributed among households at different income levels in coming years, if these tax cuts are extended.[1] (The estimates assume that relief from the Alternative Minimum Tax is continued. Without extension of AMT relief, the AMT would cancel out a substantial portion of the 2001 and 2003 tax cuts; see the discussion on pages 6-7.)

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 $3.4 trillion over the 2008-2017 period, if these provisions are extended. Applying the Tax Policy Center estimates of the share of the tax cuts

KEY FINDINGS

- The top 1 percent of households (currently those with incomes over $400,000) will receive *more than $1 trillion* in tax cuts over the next ten years, if the 2001 and 2003 tax cuts are extended and relief from the Alternative Minimum Tax is continued.
- By 2012, the tax cuts will average $67,000 a year for households in the top 1 percent and $162,000 a year for households with incomes above $1 million.
- The cost of the tax cuts (when fully in effect) for people with incomes over $1 million will exceed the total amount the federal government devotes to K-12 and vocational education. It also will exceed what the federal government spends on hospital and other medical care for veterans.
- The annual cost of the tax cuts for those with incomes over $1 million also will exceed the total savings in each of the next five years from the cuts the President's budget proposes in an array of domestic non-entitlement programs, including education, health research, environmental programs, and others.

[1] The Joint Committee on Taxation issued 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. There are no other government estimates of this matter.

Table 1: Distribution of the Tax Cuts, 2008-2017		
Income Group	Dollar Amount (In Billions of Dollars)	Percentage Share
Lowest 20 percent	$15	0%*
Second 20 percent	147	4%
Middle 20 percent	263	8%
Fourth 20 percent	465	14%
Top 20 percent	2,505	74%
Total	3,404	100%
Top 1 percent	1,038	31%
Above $1 million	739	22%

Source: CBPP calculations based on Joint Tax Committee, CBO, and Tax Policy Center data.
* Less than 0.5 percent.

that would go to each income group to the CBO/Joint Tax Committee estimates of the tax cuts' cost shows:

- From 2008 through 2017, households with annual incomes of more than $1 million — a group that comprises the highest income 0.3 percent of the population — would receive $739 billion in tax cuts. This represents 22 percent of the total value of the tax cuts over the period.

- More than $1 trillion in tax cuts would go to the top 1 percent of households, a group with annual incomes above $400,000 in 2007. The highest income *1 percent* of households thus would receive *nearly one third* of the tax cuts' total value.

- The bottom 60 percent of households would receive 12 percent of the tax cuts' value, or well under half the amount that would go to the top 1 percent. (See Table 1; for year-by-year detail, see the appendix tables.)

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

Fiscal year 2012 is the first year in which the costs of choosing to extend the 2001 and 2003 tax cuts would be fully felt. It is informative to consider how the benefits of the tax cuts would be distributed in that year.

- In fiscal year 2012, the cost of the income and estate tax cuts examined by the Tax Policy Center would amount to $333 billion.

- Taxpayers with incomes above $1 million would receive tax cuts worth $73 billion, a little over one fifth of the tax cuts' total value in 2012. The average tax cut per household for this group would be $162,000, according to Tax Policy Center estimates.

- The top 1 percent of the population would receive tax cuts totaling $103 billion, close to one third of the tax cuts' total value. These households would receive tax cuts averaging $67,000.

- In contrast, the 20 percent of households in the middle fifth of the income scale would receive tax cuts worth $26 billion in 2012. This is only one fourth of the amount going to the top 1 percent of households, despite the fact that 20 times as many households are in the middle fifth of the income scale as are in the top 1 percent. The average tax cut for households in this group would be $840.

Other measures also show that the benefits of the tax cuts would be very unevenly distributed. Many economists believe the best way to assess the progressivity or regressivity of a tax cut is to compare the percentages by which the tax cut increases the after-tax incomes of different groups of households. This approach tends to make tax cuts going to low-income households appear relatively large, since a tax cut of a specific dollar amount will raise the after-tax income of a low-income household by a much larger percentage than it will raise 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 low- and middle-income households. The Tax Policy Center estimates show that in 2012, the tax cuts will boost the after-tax incomes of households with annual pre-tax incomes above $1 million by 7.5 percent on average. In contrast, the tax cuts will raise the after-tax incomes of households in the middle quintile by 2.3 percent and raise the after-tax incomes of households in the bottom quintile by less than 1 percent (see Table 2). Thus, even if the tax cuts are measured relative to households' incomes, they are worth much more to high-income households than to those in the middle or bottom of the income scale.

Table 2: Distribution of the Tax Cuts in 2012

Income Group	Average Tax Cut in Dollars	Percent Increase in After-Tax Income
Lowest 20 percent	$45	0.5%
Second 20 percent	470	2.1%
Middle 20 percent	840	2.3%
Fourth 20 percent	1,500	2.4%
Top 20 percent	8,000	4.6%
Top 1 percent	67,000	6.8%
Above $1 million	162,000	7.5%

Source: Tax Policy Center

Moreover, these estimates, which show all groups of households receiving at least some small benefit from the tax cuts, do not take into account the fact that the tax cuts ultimately must be paid for. As former Federal Reserve Chairman Alan Greenspan has warned, "If you're going to lower taxes, you shouldn't be borrowing essentially the tax cut… [T]hat over the long run is not a stable fiscal situation."[2] Tax Policy Center data indicate that, even if the enacted tax cuts and their extension eventually were paid for through a balanced package of program cuts and progressive tax increases (rather than solely through benefit cuts), the bottom *four fifths of households would likely lose*, on average, from the combination of the tax cuts and the measures needed to finance them. That is, once the need to pay for the tax cuts is taken into account, the 2001 and 2003 "tax cuts" are best

[2] Chairman Alan Greenspan in "US Representative Jim Nussle (R-IA) Holds Hearings on the Budget and the Economy," FDCH Political Transcripts, September 8, 2004.

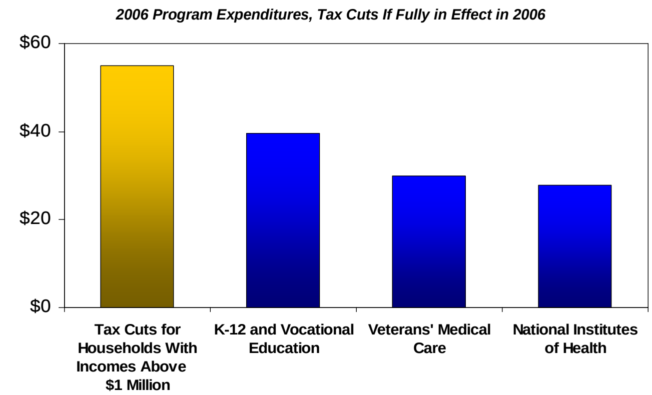
seen as net tax cuts for the top 20 percent of households, as a group, financed by net tax increases or benefit reductions for the remaining 80 percent of households, as a group.[3]

Putting the Cost of the Tax Cuts in Context

When the tax cuts are fully in effect, the cost of the tax cuts going to the very highest income households will be greater, in today's terms, than the amounts spent on various high-priority programs.

FIGURE 1

Cost of Tax Cuts for the Very Highest Income Households Exceeds Spending on High-Priority Programs



Source: CBPP calculations based on Tax Policy Center, CBO, & Treasury Department data.

- In 2006 terms, the cost of tax cuts for households with annual incomes above $1 million will exceed what the federal government spent last year on K-12 and vocational education. It similarly will exceed the federal resources dedicated to hospital and other medical care for veterans, as well the resources provided for medical research conducted by the National Institutes of Health (see Figure 1).

- The cost of tax cuts for the highest-income 1 percent of households will exceed the entire 2006 budget of the Department of Homeland Security. It similarly will exceed the entire 2006 budget of the Department of Veterans' Affairs. And it also will be greater than the *combined* budgets of the Departments of Housing and Urban Development, Energy, and the Environmental Protection Agency.

The Cost of the Tax Cuts Relative to the Savings From Program Cuts

The President's budget proposes to make permanent the tax cuts enacted in 2001 and 2003. At the same time, the President has argued that his goal of balancing the budget by 2012 will require substantial cuts to domestic programs. The budget proposes funding cuts amounting to $114 billion over the next five years in an array of domestic non-entitlement programs, including education programs, health research, environmental programs, and others.

The savings that would be achieved by these cuts in *each* of the next five years would be *less* than the cost of the tax cuts just for households with incomes above $1 million. In 2012, the President's budget would cut domestic programs by $34 billion; the cost of tax cuts for households with incomes above $1 million would be $73 billion (see Figure 2). In essence, the budget would use the resources from these benefit cuts, which would affect millions of low- and middle-income families,

[3] See William Gale, Peter Orszag, and Isaac Shapiro, "The Ultimate Burden of the Tax Cuts: Once the Tax Cuts Are Paid for, Low- and Middle-Income Households Likely to Be Net Losers, on Average," Center on Budget and Policy Priorities, June 2, 2004.

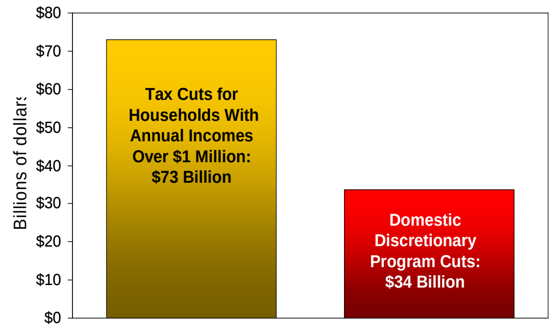
to defray a small portion of the costs of the President's tax cuts, which are providing very large tax benefits to the wealthiest families in the country.

As noted above, when the Tax Policy Center evaluated the distribution of the tax cuts in conjunction with possible approaches to paying for them, it found that most low- and middle-income families would likely lose, on net, from the combination of tax cuts and offsetting program cuts and tax increases. A similar outcome would almost certainly follow if the President's tax cuts were extended and then ultimately paid for largely or entirely through domestic program cuts of the kind recommended in the President's budget.

FIGURE 2

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

Tax Cuts and Spending Cuts, 2012



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

APPENDIX: FURTHER EXPLANATION OF THE DISTRIBUTIONAL ESTIMATES

This appendix provides a more detailed explanation of the methodology used in this analysis and of our treatment of the Alternative Minimum Tax. 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.

Methodology

This analysis examines the distribution of the individual income tax and estate tax cuts enacted in 2001 and 2003 and associated Alternative Minimum Tax relief. (See below for a discussion of the AMT.) The Congressional Budget Office and the Joint Committee on Taxation have provided estimates of the cost of these tax cuts and their extension, and the Tax Policy Center has issued estimates of the distribution of the benefits of these provisions. We apply the Tax Policy Center's distributional estimates to the cost estimates provided by CBO and the Joint Tax Committee.[4]

The Tax Policy Center provided estimates of the distribution of the tax cuts by income group for the years 2007, 2010, 2012, and 2017. We constructed approximate distributions for the intervening years. Because not all provisions of the tax cuts take full effect until 2010, we use the 2007 distributional estimates for the years 2008 and 2009. This means that our estimates of the shares of the tax cuts that will go to high-income households in those years are conservative, since several tax provisions that primarily benefit high-income households are phasing in over this period and, as a result,the overall distribution of the tax cuts is becoming gradually more skewed to the top.

For 2011, we take the average of the 2010 and 2012 tax cut shares going to each income group. Similarly, for the years 2013-2016, we smooth the change between the 2012 and 2017 distributional estimates; that is, we change the percentage share going to each group in each of these years by one fifth of the total change in that group's share of the tax cuts between 2012 and 2017. This method approximates the likely changes in the actual distribution over time, which would be steady and gradual (and largely reflect real income growth) once all the tax cut provisions were fully in effect.

Our Treatment of the Alternative Minimum Tax

The figures presented in this analysis are estimates of the benefits that the 2001 and 2003 tax cuts and their extension would provide to various income groups, assuming that the Alternative Minimum Tax relief that expired at the end of 2006 were extended.

If AMT relief were *not* extended, much of the value of the 2001 and 2003 tax cuts would be taken back by the AMT. This would occur because taxpayers owe the Alternative Minimum Tax whenever their tax liability, as calculated under the AMT, is higher than their tax liability under the regular income tax. The 2001 and 2003 tax cuts sharply reduced households' tax liability under the regular income tax, without changing the structure of the AMT. As a result, with the tax cuts in place, AMT liability exceeds regular income tax liability for millions of additional households. These households then owe tax based on their AMT and not their regular income-tax liability, and hence do not benefit in full from the tax cuts.

[4] The Tax Policy Center's distributional estimates are for calendar years, while the CBO and Joint Tax Committee cost estimates are for fiscal years. This discrepancy should have only a very small effect on our estimates.

According to the Urban Institute-Brookings Institution Tax Policy Center, the AMT will take back more than a quarter of the President's tax cuts by 2010 if AMT relief is not extended. Put another way, much of the cost of providing AMT relief reflects the cost of providing taxpayers with the full value of the 2001 and 2003 tax cuts. Specifically, CBO estimates that, if the 2001 and 2003 tax cuts are extended, extending AMT relief through 2017 will cost $1.0 trillion. Tax Policy Center estimates indicate that about two thirds of that cost reflects the cost of keeping the AMT from canceling out substantial portions of the 2001 and 2003 tax cuts.

The estimates in this analysis include the two thirds of the cost of AMT relief that reflects the cost of providing taxpayers with the full value of the 2001 and 2003 tax cuts. The estimates do not include the smaller portion of AMT relief that reflects the cost of addressing the AMT problem that preexisted the tax cuts.[5]

Multi-Year Distributional Estimates

The value of the multi-year distributional estimates presented in this analysis is that they allow us to examine the distribution of the 2001 and 2003 tax cuts over time and to make comparisons between the amounts being spent on tax reductions for households in various income groups 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 2008 are not all the same as the households that will make up the top 1 percent of the population in 2017. 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.

The available evidence suggests, however, that most households do not experience dramatic income shifts over the course of a decade. For example, a study that examined economic mobility over the course of the 1990s found that slightly more than half of those households that were in the bottom or top quintiles of the income scale at the beginning of the decade were in that same quintile at the end of the decade, and about three-quarters were in either the same or the next quintile.[6] 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 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."[7] A study by economists in the Treasury Department's Office of Tax Analysis found similar results.[8]

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[5] In addition, the estimates exclude the business tax cuts enacted in 2001 and 2003, such as Section 179 expensing, and also exclude several small provisions of the 2001 and 2003 tax cuts that were not included in the Tax Policy Center's distributional estimates, such as the education-related tax cuts.

[6] Katharine Bradbury and Jane Katz, "Are Lifetime Incomes Growing More Unequal? Looking at New Evidence on Family Income Mobility," *Federal Reserve Bank of Boston Regional Review*, vol. 12, no. 4, 2002.

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

[8] 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 Income Percentile

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-2017
Total Cost of Tax Cuts (billions) —2001 and 2003 Tax Cuts and Associated AMT Relief*											
Enacted	207	215	213	119	22	8	8	9	10	11	824
Extended**	45	42	53	202	311	346	365	384	405	428	2,580
Total	252	258	267	321	333	354	373	394	415	438	3,404
Dollar Amount by Quintile (in billions of dollars)											
Lowest 20 Percent	1	1	1	1	1	2	2	2	2	3	15
Second 20 Percent	11	11	11	14	14	15	16	17	18	18	147
Middle 20 Percent	23	24	21	25	26	27	28	29	30	31	263
Fourth 20 Percent	38	39	36	44	45	48	50	53	55	58	465
Top 20 Percent	179	183	196	236	245	261	276	292	309	327	2,505
Top 1 Percent	70	72	82	99	103	110	116	122	129	136	1,038
Percent Shares by Quintile											
Lowest 20 Percent	0%***	0%***	0%***	0%***	0%***	0%***	0%***	1%	1%	1%	0%*
Second 20 Percent	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Middle 20 Percent	9%	9%	8%	8%	8%	8%	7%	7%	7%	7%	8%
Fourth 20 Percent	15%	15%	14%	14%	13%	13%	13%	13%	13%	13%	14%
Top 20 Percent	71%	71%	73%	74%	74%	74%	74%	74%	74%	75%	74%
Top 1 Percent	28%	28%	31%	31%	31%	31%	31%	31%	31%	31%	31%

* Omits several small provisions of the 2001 and 2003 tax cuts that were not distributed by the Tax Policy Center. For a discussion of the treatment of AMT relief, see pages 5-6.
** The costs shown for extending the tax cuts in 2008-2010 represent the portion of the cost of extending AMT relief that reflects the cost of keeping the AMT from canceling out a substantial portion of the enacted 2001 and 2003 tax cuts. See discussion on pages 6-7.
*** Less than 0.5 percent.

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

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-2017
Total Cost of Tax Cuts (billions) —2001 and 2003 Tax Cuts and Associated AMT Relief*											
Enacted	207	215	213	119	22	8	8	9	10	11	824
Extended**	45	42	53	202	311	346	365	384	405	428	2,580
Total	252	258	267	321	333	354	373	394	415	438	3,404
Dollar Amount by Income Class (billions)											
Below $50,000***	38	39	34	40	41	42	43	44	45	46	413
Below $100,000	89	91	82	96	98	101	105	108	111	114	994
Above $100,000	162	166	184	224	234	251	268	285	303	323	2,401
Above $200,000	100	103	119	145	151	162	173	183	195	207	1,539
Above $500,000	66	68	78	95	99	106	113	119	127	135	1,005
Above $1 million	49	51	58	70	73	78	82	87	93	98	739
Percent Shares by Income Class											
Below $50,000	15%	15%	13%	13%	12%	12%	12%	11%	11%	11%	12%
Below $100,000	35%	35%	31%	30%	29%	29%	28%	27%	27%	26%	29%
Above $100,000	65%	65%	69%	70%	70%	71%	72%	72%	73%	74%	71%
Above $200,000	40%	40%	45%	45%	46%	46%	46%	47%	47%	47%	45%
Above $500,000	26%	26%	29%	30%	30%	30%	30%	30%	31%	31%	30%
Above $1 million	20%	20%	22%	22%	22%	22%	22%	22%	22%	22%	22%

* Omits several small provisions of the 2001 and 2003 tax cuts that were not distributed by the Tax Policy Center.

** The costs shown for extending the tax cuts in 2008-2010 represent the portion of the cost of extending AMT relief that reflects the cost of keeping the AMT from canceling out a substantial portion of the enacted 2001 and 2003 tax cuts. See discussion on pages 6-7.

*** Income classes are expressed in 2006 dollars. Households with incomes below $50,000 comprise about 60 percent of the population, while households with incomes below $100,000 comprise about 84 percent of the population. Households with incomes above $100,000 comprise about 16 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 percentage of the population in the higher income groups grow slightly over the decade because incomes are assumed to grow in real terms over the period.