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NEW TREASURY DISTRIBUTIONAL TABLE DEPARTS SHARPLY FROM PREVIOUS TREASURY METHODOLOGY

New Table Understates Gains to the Top and Overstates Gains for the Rest; Fuller Assessment Shows Gains Concentrated at the Top

by Isaac Shapiro

A table the Treasury Department released March 8 that assesses the effects of President Bush's tax proposal on taxpayers in different income categories departs markedly from the Treasury Department's established methodology for analyzing and providing information on the effects of tax proposals on different income groups. Unlike the standard Treasury distribution tables that reflect the established methodology, the new table covers selected parts — rather than all — of the tax proposal and also omits critical information normally part of such Treasury tables, even for the parts of the plan that it analyzes. The result is a presentation that understates the degree to which high-income taxpayers would benefit from the proposal and overstates the relative benefits to low- and middle-income taxpayers.

The first part of this short analysis of the new Treasury table examines four ways in which the table departs from Treasury's traditional methodology. The second part of this analysis provides a distributional analysis that follows the traditional Treasury methodology in all four respects, including a reliance on the Treasury Department's own previous estimates of the distribution of estate and corporate taxes. This more complete analysis finds the Bush tax package would significantly exacerbate income disparities, which already are the widest on record.

1. The new table only distributes major income tax cuts, omitting repeal of the estate tax and corporate tax changes; traditional Treasury methodology includes estate and corporate income tax changes in its distributional analyses. Estate and corporate income tax cuts make up about one-fourth of the Bush tax plan when the plan is fully in effect. Since 1990, the Treasury Department has included corporate income taxes in its distributional tables. Since completion of a major study by Treasury career staff in 1998 on the incidence of the estate tax, Treasury has included changes in the estate tax in its distributional analyses as well.

As stated in a paper issued in 1999 by the Office of Tax Analysis (OTA) on the Treasury Department's distribution methodology. "All federal taxes are included in Treasury's analysis: individual and corporate income taxes, payroll taxes, excises and custom duties, and estate and gift taxes. Estate and gift taxes and customs duties were added in 1998. The inclusion of all federal taxes is an improvement in Treasury's methodology because it allows a comprehensive analysis of all proposed tax changes."[1]

2. The new table compares the size of the income tax cuts only to the amount of *income* taxes that filers pay; the traditional Treasury methodology calls for providing information on the percentage reduction in *all* federal taxes. Traditional Treasury methodology has been to examine a proposed change in any tax in terms of the percentage increase or decrease it produces in *overall* federal tax burdens, including payroll, excise, estate and corporate income taxes. For the large majority of low- and middle-income families, payroll taxes are larger than their income taxes. As the OTA paper observed, "An analysis which omitted the payroll tax would yield the incorrect conclusion that the poor, on average, bear no federal tax burden."

For low- and middle-income families, a reduction in income taxes can result in a relatively small percentage reduction in their overall federal taxes. This information, traditionally provided by Treasury, is missing from these tables; only information on the percentage reduction in income taxes in shown. The omission of this information has a large effect on how low- and middle-income families appear to be affected by the tax proposal. Consider families that have income tax burdens of less than $100 but overall federal tax burdens of more than $3,000. Eliminating their income taxes is reflected in the new table as a 100 percent tax cut; under the traditional Treasury tables, information would be provided showing this to be a cut of only one or a few percentage points in these families' overall federal tax burdens. (Note: Joint Committee on Taxation distribution tables compare the size of an income tax cut to its effect on a fuller measure of the tax burden that includes payroll and excise taxes.)

3. The new table omits altogether three important measures of changes in tax burdens. The table fails to include three basic measures of the effect of the tax plan by income category that established Treasury methodology calls for and that Treasury tables have traditionally provided. The table fails to include information on: the average dollar tax reduction by income category; the total amount of dollars in tax reductions by income category; and the percentage increase in after-tax income as a result of the tax cuts. The recent OTA paper described the percentage change in after-tax income as a result of any tax proposal as being "the best measure of the change in a family's well-being."

As shown in the second part of this short analysis, an examination of the effects of the Bush tax package on after-tax income provides a strikingly different picture from that which the press release accompanying the new Treasury table seeks to convey. Examination of this issue shows that the tax cut would provide by far the largest increases in after-tax income to those at the top of the income scale and the smallest increases to those at the bottom.

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[1] Julie-Anne Cronin, U. S. Department of Treasury, Office of Tax Analysis, *U.S. Treasury Distributional Analysis Methodology*, OTA Paper 85, September 1999.

4. The new table fails to provide the number of families in each income category. In addition, it breaks out families only by income ranges. The traditional Treasury methodology would have provided the number of families in the categories and would have broken out families by five equal groups (or "quintiles"). It also would have provided data for the top one percent of families. In this respect, the new table provides much less useful information than the traditional Treasury tables. It is difficult to assess the distributional effects of a proposal when one does not know the proportion of families that fall into each income category.

A More Complete Distribution Analysis

This analysis provides a distributional analysis that follows the traditional Treasury methodology in the four areas in which the new table departs from that methodology. This analysis:

- Distributes all the tax cuts in the Bush package presented to Congress on February 8, using the Treasury's established method of distributing estate and corporate income taxes. (This analysis does not include a refundable tax credit for individually-purchased health insurance that was added to the President's tax package in the February 28th budget documents.[2] This credit will have modest benefits for some low- and moderate-income families, but there is not yet enough information available to include its effects in our distributional analysis.)

- Provides the percentage change — by income group — in all federal taxes, and not just the percentage change in income taxes;

- Examines the best Treasury measure of economic well-being, the effect of the tax cuts on after-tax income; and

- Provides information on the proportion of families in each income category.

To estimate the effects of the overall Bush tax package, this analysis uses the estimates of the distribution of the estate tax and corporate income tax that career staff at the Treasury Department developed and have been used in past Treasury distribution analyses. We also used information from Citizens for Tax Justice on the distribution of the individual income tax cuts and on 2001 income levels. The CTJ data come from the Institute for Taxation and Economic Policy tax model, which was developed in part by a former staff member of the Joint Committee

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[2] The health tax credit appeared as part of the Bush tax package for the first time when the Administration presented its budget blueprint on February 28th. The budget did not provide much detail regarding the credit. Although this credit is refundable, and thus has the potential to assist low-income families, it is relatively modest — reportedly about $70 billion to 80 billion over 10 years — compared to the overall Bush tax-cut package and thus will not have a dramatic impact on the overall distribution of its tax benefits. The Treasury estimates released March 8 do include the impact of this tax credit, but do not break them out separately.

on Taxation. In the past, Citizens for Tax Justice's estimates of the distributional impacts of changes in the federal income tax have generally been similar to the estimates the Treasury has produced.

The initial focus here is on the percentage change in after-tax income that would result from the tax cuts. This measure indicates the degree to which the income available to families increases as a result of the tax reductions. As Table 1 indicates, when the Bush tax package is fully in effect:

- The after-tax income of the one percent of families with the highest incomes would increase by an average of 6.2 percent.
- The average after-tax income of the middle fifth of families would rise by 1.9 percent. The after-tax income of the bottom fifth of families would rise a scant 0.6 percent.
- Thus, after-tax income would rise more than three times as fast among the top one percent of families than among those in the middle of the income scale, and ten times faster among the top one percent of families than among the bottom 20 percent of families.

As Table 1 also shows the tax-cut bill before the House of Representatives —which covers two of the major income tax provisions in the Bush package — would have similar, although somewhat less pronounced effects.[3] The changes it would make in tax rates would be of most benefit to high-income taxpayers.

Table 1. Tax Cut as a Percent of After-tax Income
(when fully phased-in)

	Top 1%	Next 4%	Next 15%	Fourth 20%	Middle 20%	Second 20%	Lowest 20%
Entire Bush Tax Package	6.2%	2.4%	2.4%	2.3%	1.9%	1.2%	0.6%
House Rate Cuts	3.8%	0.6%	1.1%	1.2%	1.2%	1.0%	0.5%

These figures reflect the fact that the top one percent of families would receive a share of the tax cuts that would be larger than their share of the national after-tax income. The top one percent of taxpayers would receive 39 percent of the tax cuts in the overall Bush plan. (These

[3] For more information on the House bill, see Isaac Shapiro and Joel Friedman, *Income Tax Rates and High-Income Taxpayers: How Strong is the Case for Major Rate Reductions*, Center on Budget and Policy Priorities, March 2001.

taxpayers would receive 44 percent of the tax cut benefits under the bill the House will vote on this week.) Both figures are more than double this group's share of the national after-tax income.

The new Treasury Department table itself appears to indicate that the Bush tax package would widen disparities in after-tax income. The table estimates that 25.4 percent of the income tax cuts would go to those with incomes above $200,000, if the cuts were fully phased in in 2000. This estimate substantially understates the share of the tax cut going to those at the top of the income spectrum because the estimate excludes the effects of the estate and corporate tax reductions in the plan. Even so, the figure suggests that the share of the tax cuts that would go to high-income families would be greater than the share of after-tax income that such families currently receive. Although the Treasury table does not provide information on the distribution of after-tax income, a table the Joint Committee on Taxation issued last year includes information indicating that those with incomes exceeding $200,000 would receive 19.1 percent of the national after-tax income in 2000. A more recent Joint Committee table for 2001 suggests such families will receive 22.5 percent of national after-tax income in 2001. Using either set of figures, the Treasury table suggests the Bush tax package will exacerbate after-tax income disparities, since the share of the tax cuts the top one percent would receive would be greater than this group's share of the after-tax income.

In short, according to our calculations, the tax cut would cause the after-tax incomes of the top one percent of families to rise by three times as large a percentage as the after-tax incomes of the middle fifth of taxpayers would rise — and by ten times as large a percentage as the after-tax incomes of the bottom fifth of families would grow. That the tax proposal would cause income disparities to widen further is disquieting. The after-tax income of the top one percent of families has risen much faster over the past decade than the after-tax income of families in the middle or bottom of the income spectrum. Income disparities in the United States already are at their widest level on record.

Changes in Federal Tax Burdens

We also examined the Administration's tax cuts in relation to their effect on overall federal tax burdens, not just income tax burdens. (See Table 2.) The results differ markedly from those in the new Treasury table, which provides data on the percentage reductions only in income tax burdens.

- For the bottom fifth of families, overall federal tax would be reduced 5.5 percent under the Administration's plan (again, we are not able to factor in the proposed refundable health credit). The Treasury table, by contrast, indicates that families with incomes of less than $30,000 would have their income taxes reduced 136 percent.

- Among the middle fifth of families, federal taxes would be cut 7.0 percent. By contrast, the Treasury table indicates those with incomes between $30,000 and $40,000 would have their income taxes reduced 38 percent and those with incomes between $40,000 and $50,000 would have their income taxes cut 28 percent. (Of interest here, a Joint Committee on Taxation table from last May found that the income tax cuts in the Bush campaign proposal would reduce overall taxes for those with incomes between $40,000 and $50,000 in 2005 — the latest year available from Joint Tax, but the year before the income tax cut provisions are phased in fully — by 6.7 percent.)

Table 2. Percentage Reduction in Federal Taxes Under Bush Plan
(when fully phased-in)

Top 1%	Next 4%	Next 15%	Fourth 20%	Middle 20%	Second 20%	Lowest 20%
12.9%	5.7%	6.2%	6.9%	7.0%	6.3%	5.5%

Table 3. Data from Treasury Table on Percentage Reduction in Income Taxes Under Bush Plan
(by income level, when fully phased-in,
income groupings below do not match grouping by share of families in Table 2)

$200,000 and over	$100,000 - $200,000	$75,000 - $100,000	$50,000 - $75,000	$40,000 - $50,000	$30,000 - $40,000	$0 - $30,000
8.7%	10.7%	16.3%	20.8%	28.0%	38.3%	136.2%