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THOSE \$1,600 TAX CUT CHECKS

by Isaac Shapiro and Robert Greenstein

“Under the President’s tax relief plan, the typical American family of four will be able to keep at least \$1,600 more of their own money.”

- The President’s Agenda for Tax Relief,
The White House, February 8, 2001

The \$1,600 figure has been the subject of much attention over the past week, and a \$1,600 tax refund check has been featured prominently as a backdrop at a Presidential event. This analysis examines the following questions:

- How is the \$1,600 figure calculated?
- How many families would receive checks of this size under the Administration’s tax package?
- When would these checks be sent?
- How much of the overall tax package is necessary to write these checks?

The \$1,600 Calculation

The \$1,600 check consists of two components. When the Bush Administration’s proposed expansion of the child tax credit is fully in place, this credit would increase by \$500 per child (from \$500 to \$1,000 per child) for a tax cut of \$1,000 for certain families with two children. In addition, when the proposed reduction in the marginal tax rate from 15 percent to 10 percent for the first \$12,000 in a two-parent family’s taxable income is fully in place, that would save a family up to \$600 (that is, 5 percent of \$12,000). In combination, these two provisions could reduce the taxes of a married couple with two children by \$1,600 when the provisions are fully in place, which would be in 2006. To qualify for this full \$1,600 tax cut, a married couple with two children would need income of about \$39,200 in that year.

How many would receive checks this size?

The large majority of families would receive a tax cut of less than \$1,600 in 2006. (Following Treasury usage, “families” includes single people as well as family units. All families

are included whether or not any member of the family files an income tax return.) Using the Institute for Taxation and Economic Policy (ITEP) model — a well-respected model developed in substantial part by former staff members of the Joint Committee on Taxation — Citizens for Tax Justice has found that in 2006, when the tax-rate reductions and child credit expansion in the Bush plan are fully in effect, 85 percent of families would either receive a nominal tax cut of less than \$1,600 or receive no tax cut at all.¹ The distributional analyses that Citizens for Tax Justice has prepared using the ITEP model have been validated over the years by the close congruence of the results of these analyses with the results of analyses that the highly respected career staff at the Treasury Department has produced.

Citizens for Tax Justice also has estimated that the median — or typical — family with children (that is, the family with children that falls precisely in the middle of the income distribution of all families with children) would receive a tax cut of \$1,142 when the plan is phased in fully. The median, or typical, family without children would receive a tax reduction of \$266. (Both of these figures are adjusted for inflation and expressed in terms of their purchasing power in 2001.)

The modest percentage of families that would receive a check of \$1,600 or more reflects the fact that single individuals, childless couples and the vast majority of families with one child would receive no more than \$500 from the child credit expansion, as well as the fact that a significant proportion of families would not have incomes sufficiently high in 2006 to pay \$1,600 in income taxes (as distinguished from payroll taxes) under current law and thus could not qualify for an income tax reduction of this amount. The Administration's tax cut plan affects only income taxes and taxes on large estates. It does not affect other taxes — most notably the payroll tax, the largest tax for three of every four families.

It would be inadvisable to reduce payroll taxes, as those taxes are needed for the Social Security and Medicare trust funds. There are, however, a variety of well-known mechanisms that operate through the income tax code and can be used to reduce tax burdens on low-income working families that pay substantial taxes. Moreover, these approaches can further other objectives while reducing tax burdens on these families, by reducing marginal tax rates and marriage tax penalties and advancing the goals of welfare reform.² For example, the child tax credit could be made available to low-income working families that pay payroll taxes (i.e., it could

¹ Some 90 percent of families would receive a tax cut of less than \$1,600 if the tax cuts are measured in 2001 dollars.

² An important new study by the Manpower Demonstration Research Corporation (MDRC) finds that increases in employment among former welfare recipients need to be accompanied by increases in family income if the lives of the poor children in these families are to improve significantly. MDRC examined five studies covering 11 welfare reform programs and found that increased employment among the parents in a family did not by itself significantly improve children's lives. Only in programs where the parents experienced increased employment *and* increased income were there positive effects, such as better school achievement, for elementary school-age children. *How Welfare and Work Policies Affect Children: A Synthesis of Research*, MDRC, January 2001.

be made “refundable” for these families).³ In addition, the Earned Income Tax Credit could be expanded. A bipartisan proposal introduced last year by Senators Rockefeller, Jeffords, and Breaux would improve the EITC in a way that modestly reduces marginal tax rates on many lower-income working families. There also has been strong bipartisan support in Congress for proposals to modify the EITC to reduce the marriage penalties that many low-income working families face. The Bush proposal does not include any EITC improvements or other mechanisms to provide tax relief to working families that do not pay income taxes but still incur sizeable tax burdens.

When would the checks be sent?

Under the Bush plan, the proposed doubling of the child credit and the creation of a new 10 percent tax bracket would not take full effect until five years from now. During the years these provisions are phasing in, the maximum benefit they provide would be well below \$1,600 to a middle-class two-parent family of four. As Table 1 shows, in 2002, the maximum combined tax cut from these two provisions would be \$320. In subsequent years, this amount would rise to \$640, \$960, and \$1,280 before reaching \$1,600 in 2006.

Furthermore, due to the effects of inflation, the “\$1,600 tax cut” in 2006 is worth less than \$1,600 in today’s dollars. As Table 1 also shows, after adjusting for inflation, the maximum benefit from the child credit expansion and the 10 percent bracket in 2006 would be worth \$1,405 in today’s dollars. After 2006, this \$1,405 amount would decline further when inflation is taken into account, because the child credit expansion is not indexed for inflation.⁴

There also is some possibility these tax cuts of \$1,600 would never take full effect because the surplus forecasts turn out to be too rosy and policymakers have to rein in the tax cuts. One of the principal reasons the Bush tax cuts would be phased in over time is that surpluses are smaller now but are projected to grow over the course of the decade. Yet the surplus projections for 2006 and subsequent years are highly uncertain. The Congressional Budget Office has explained, in its new report on the budget, that since 1981 its projections for the fifth year have been wrong by an average of 3.1 percent of the Gross Domestic Product. This translates into a potential error of \$400 billion in CBO’s projection of the surplus for 2006; the surplus projection for that year

³ A broader approach would be to extend the child credit to all children, a policy recommended by the bipartisan National Commission on Children in 1991. See *Beyond Rhetoric: A New American Agenda for Children and Families*, Final Report of the National Commission on Children, 1991.

⁴ The credit would remain at \$1,000 per child. In addition, the income range for the new 10 percent bracket — the first \$12,000 of income — would not be indexed for inflation until 2006. By contrast, all higher tax brackets would continue to be fully indexed for inflation from the current year forward.

Table 1

**Maximum Tax Cut From Child Credit Expansion and New 10% Bracket
(Married couple with two children, incomes of less than \$130,000)**

<u>Year</u>	<u>Without accounting for the effects of inflation</u>	<u>Accounting for inflation, expressed in 2001 dollars</u>
2002	\$320	\$311
2003	\$640	\$607
2004	\$960	\$887
2005	\$1,280	\$1,153
2006	\$1,600	\$1,405

could be too high or too low by that amount. CBO warns that the projections for years after 2006 have the potential to be off by still larger amounts. If the surplus projection for 2006 proves too high by anything close to \$400 billion, the non-Social Security budget will be in deficit, raising questions about the desirability of continuing to phase in the tax cuts.

To be sure, there is talk about making some of the tax cuts retroactive to this year, and the President has announced support for this idea. But the White House has not specified which tax cuts it favors accelerating or the degree to which it favors accelerating them. For checks of \$1,600 to be sent out this tax year, both the new 10 percent bracket and the doubling of the child credit would have to take full effect now. It is unlikely this will occur; the cost would be too large. Making these two proposals fully effective now would increase the cost of the tax plan by about \$270 billion over 10 years, unless the added costs were offset by scaling back other parts of the tax package.

How much of the tax cut package is necessary to write the \$1,600 checks?

The new 10 percent bracket and the expansion in the child tax credit would provide significant benefits to middle-class taxpayers. The cost of these two provisions, however, makes up only about one-third of the cost of the total tax package. When the tax plan is phased in fully, two other provisions — repeal of the tax on large estates and the reductions in tax rates in the *higher* tax brackets (i.e., the brackets above the 15 percent bracket) — would account for the majority of the tax cuts. (See Table 2.) These two provisions would confer the lion's share of their tax-cut benefits on people higher up on the income scale. Estate tax repeal would affect only the largest two percent of estates; all other estates already are exempt from taxation. In addition, only one-quarter of families owing income taxes are in a tax bracket higher than the 15

Table 2

The Size and Distribution of the Bush Tax Cuts, by Component		
	In 2010, fully phased-in	
<u>Proposed Tax Cut</u>	<u>Cost (in billions of dollars)</u>	<u>Share of Total Package</u>
Rate Reductions	\$69.1	29.7%
Estate Tax Repeal	55.3	23.7%
New 10% Bracket	45.4	19.5%
Increase in Child Tax Credit	28.5	12.2%
Charitable Contributions for Non-Itemizers	14.6	6.3%
Deduction for Two-Earner Families	13.9	6.0%
All Others	6.1	2.6%
Total	\$232.9	100.0%

Source: Joint Committee on Taxation.

percent bracket, and the biggest tax cuts from the proposed rate reductions in these brackets would go to those on the upper rungs of the income scale.

Even the proposed child tax credit expansion would be of the greatest benefit to higher-income taxpayers. Among families with two children, the current child credit is limited to families below \$130,000. The Bush plan would raise that figure to \$300,000 and provide the largest increases in the child credit to those with incomes between \$110,000 and \$250,000, even while failing to extend the benefits of the child credit to low-income working families that do not benefit from the credit.⁵ Furthermore, all families with income tax liabilities would receive a tax reduction from the proposal to establish a new 10 percent bracket, since part of the income of all such families would be taxed at a 10 percent rather than a 15 percent rate.

⁵ All families with two children in the \$110,000-\$250,000 range would receive an increase in their child tax credit in 2006 of *more than* \$500 per child. Families with two children and incomes between \$130,000 and \$200,000 would receive an increase of \$1,000 per child. These families receive no credit under current law but would receive a credit of \$1,000 per child in 2006 under the Bush plan.

This outcome results from two provisions of the Bush plan. The plan increases the point at which the child credit begins to phase out and also slows the rate at which it phases out. Under current law, the credit for a family with two children phases out between \$110,000 and \$130,000. Under the Bush plan, starting in 2006, the credit would phase out between \$200,000 and \$300,000. (For families with more than two children, the credit would phase out at even higher levels.)

Thus, the two principal provisions that would assist middle-income families with children would benefit many high-income families as well. By contrast, the two provisions that ultimately would account for the majority of the tax cuts in the package and are of greater benefit to those at the top of the income scale — estate tax repeal and rate reductions in the higher tax brackets — would not affect the bottom 75 percent of the population.⁶

This is not meant to suggest that everything in the package except the new 10 percent bracket and the child tax credit expansion be discarded. Nor is it meant to imply an endorsement of those two provisions of the Bush plan. (For example, the child credit proposal is subject to significant criticism; it provides the largest increases in the child credit to families with incomes between \$110,000 and \$250,000 but fails to assist 24 million children living in poor and near-poor families, 80 percent of which are families with earnings.⁷) What this analysis does indicate is that it is possible to design a tax package that, as compared to the Bush plan, provides similar-size tax reductions to middle-class families and more adequate relief to lower-income working families — and does so at a much lower cost.

⁶ In combination, the benefits of all the provisions of the Administration's plan are significantly skewed towards the top of the income spectrum. The top one percent of the population would receive about 40 percent of the tax cuts from the proposal, which is double the share of federal taxes that they pay. In addition, the share of the tax cuts that would be received by the top one percent of the population significantly exceeds the share that would be received by the bottom 80 percent of the population combined.

⁷ See Isaac Shapiro, Allen Dupree, Jim Sly, *An Estimated 12 Million Low- and Moderate-Income Families — with 24 Million Children — Would Not Benefit from Bush Tax Plan*, Center on Budget and Policy Priorities, February 8, 2001.