

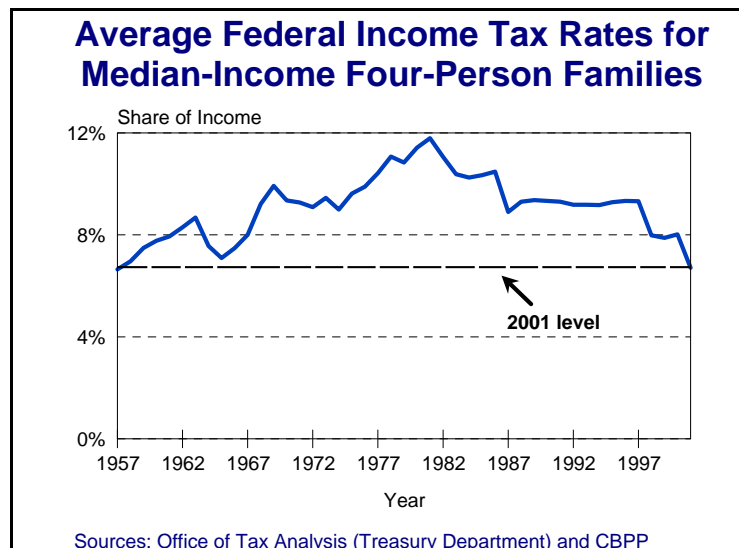
OVERALL FEDERAL TAX BURDEN ON MOST FAMILIES AT LOWEST LEVELS SINCE AT LEAST 1979

Income Taxes for Median Family of Four at Lowest Level Since 1957

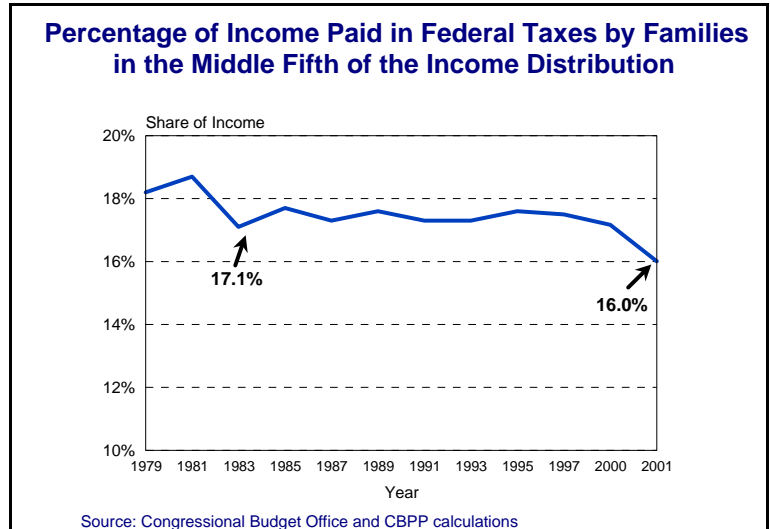
by Isaac Shapiro and Andrew Lee

As the April 15th filing date for income taxes approaches, and as the domestic budget discussion is dominated by the issue of tax cuts, it is timely to assess federal tax burdens. This assessment finds that the percentage of income that most families pay in federal taxes (referred to here as their “tax rate” or “tax burden”) has been falling in recent years rather than rising, a trend established even before the 2001 tax cut and before considering the effects of tax cuts now under discussion in Congress. Specifically, this analysis, based on updates of Congressional Budget Office data on overall federal tax burdens from 1979 to 2000 and Treasury data on *income* tax burdens from 1955 to 1999, reaches the following conclusions:

- Even before the tax cut in 2001 was enacted, overall federal tax burdens for middle- and low-income taxpayers were lower, on average, than they had been in most years of the past several decades. This was largely a result of income tax burdens having fallen fairly sharply. The Treasury data show that in 1999, the typical family of four with two children was paying a smaller percentage of its income in federal income taxes than at any time since 1966.
- The tax cut enacted in 2001 has reduced tax burdens further. This analysis’ update of the Treasury data shows that in 2001, the last year for which income data are available, a median family of four will pay a smaller share of its income in federal income taxes than in any year since 1957.
- Similarly, this analysis’ update of the CBO data on overall federal tax burdens finds that when households’ *total* federal tax burdens are considered — including



their payroll, excise, and other taxes, along with the income taxes they pay — most categories of households will face a lower average tax burden in 2001 than in any year from 1979 to the present. (1979 is the first year these CBO data cover.) For example, the middle fifth of taxpayers will pay an average of approximately 16.0 percent of income in total federal taxes in 2001, the lowest percentage during the 22-year period examined. The second-lowest percentage occurred in 1983, when such households paid an average of 17.1 percent of income in federal taxes, or more than a full percentage point higher than today.



- Our update of the CBO data — and our finding that federal tax burdens for most groups are at their lowest levels since at least 1979 — are confirmed by graphs released by CBO director Douglas Holtz-Eakin at a Tax Policy Center symposium on the “State of the Income Tax,” held at the Urban Institute on April 8. These graphs show how the share of income paid in taxes by each of the bottom four quintiles of the population is now lower than at any other time from 1979 to today. (The data underlying these graphs are not yet available.)

Since actual income data are available only through 2001 the main focus of this analysis is to extend the CBO and Treasury series through that year. Assuming incomes grow at the same rate as inflation in 2002 and 2003, however, tax burdens are slightly less now than in 2001. The slight drop reflects the fact that the initial round of rate cuts incorporated into the 2001 tax cut package were not in effect for all of 2001 but will be in full effect for all of 2002 and 2003. We estimate that the middle fifth of taxpayers will pay 15.8 percent of their income in taxes in 2003, down slightly from the 16.0 percent figure estimated for 2001.

Taxes as a share of income are not at the lowest point in the period examined for the top fifth of the population. But this does not mean high-income households have been unduly burdened by federal taxes. To the contrary, by 2000, the latest year for which actual income data for the very top of the population are available, income before taxes was more concentrated at the top of the income spectrum than at any time since the Great Depression. In addition, CBO data show that in 1997, the latest year for which these data are available, the share of the national income that high-income households received even *after* federal taxes are taken into account was at the highest level on record. (These CBO data, as well, go back to 1979.) The CBO data also

show that increases in after-tax income during the 1980s and 1990s were far larger among high-income households than among middle- and lower-income households.

Recent Trends in Income Tax Burdens

In 1998, the Treasury Department issued an analysis examining changes over time in the income tax rates paid by families of four with two dependents.¹ The Treasury projected that in 1999, the percentage of income the median family of four with two children would pay in income tax would be at its lowest level since the mid-1960s. (The median-income family is the family exactly in the middle of the income spectrum; half of families have income higher than the median family does, while the other half of families have income lower than the median family.) The Treasury's methodology is easy to replicate; this analysis does so and extends the data in the Treasury analysis through 2001, the latest year for which median family income information is available. The results show:

- The median four-person family with two dependents will pay 6.7 percent of its income in federal income tax in 2001. This is the lowest percentage since 1957.
- This 6.7 percent income tax rate is more than one-third lower than the average income tax rate of 10.3 percent that these median four-person families paid during the 1980s.

Trends in Total Federal Tax Burdens

The best data on trends in overall federal tax burdens come from the Congressional Budget Office.² These CBO data provide extensive information for the years from 1979 through 1997 and some data through 2000. This analysis updates these data through 2001.

- The average percentage of income that households in the middle fifth of the income spectrum paid in total federal taxes in 2000, before last year's tax cut was enacted, was close to the lowest on record for the period from 1979 to the present. These households paid an estimated average of 17.2 percent of their income in federal taxes in 2000, only slightly higher than the low point of 17.1 percent of income in 1983.³

¹ "Average and Marginal Federal Income, Social Security and Medicare, and Combined Tax Rates for Four-Person Families at the Same Relative Positions in the Income Distribution, 1955-1999," Office of Tax Analysis, Department of the Treasury, January 15, 1998.

² *Effective Federal Tax Rates, 1979-1997*, Congressional Budget Office, October 2001.

³ When CBO issued its latest report, the data that CBO compiles on household incomes were not yet available for years after 1997. CBO did have information, however, about federal tax law in 2000. CBO applied 2000 tax law to
(continued...)

- The tax cut enacted in 2001 was tilted toward high-income taxpayers, but many of the provisions of most benefit to that group were delayed for several years or more. By contrast, most of the tax cuts that benefit those in the middle of the income distribution took effect almost immediately in whole or significant part, reducing these households' tax burdens noticeably in 2001 and somewhat further in 2002.⁴

In 2001, the middle fifth of households will pay an estimated average of 16.0 percent of income in federal taxes. This is the lowest percentage on record for the period from 1979 to the present.

Increased Concentration of Taxes among High-income Households Not a Sound Justification for Reducing Their Taxes

Some have noted the increased concentration of taxes among high-income individuals as shown by Internal Revenue Service data through 2000 — emphasizing the increased concentration among the top one percent of the population — and contend that this means their taxes need to be reduced sharply. Recent income and tax trends do not support this contention.⁵

- The IRS data show that 21 percent of the nation's before-tax income flowed to the top one percent of the income spectrum in 2000, up from 14 percent a decade ago.
- A paper from the National Bureau of Economic Research shows that in 1998, the top one percent of the population received a larger percentage of the before-tax income in the nation than in any year since 1936. (This finding includes capital

³ (...continued)

1997 income levels and estimated that the middle fifth of households would pay an average of 16.7 percent of income in federal taxes in 2000. Actual income levels in 2000 were higher than they had been in 1997. Due to the progressivity of the tax code, this means that average tax burdens in 2000 were higher than CBO estimated when it applied 2000 tax law to 1997 income levels. Applying a "linear interpolation" method to the tax rates paid by households at different income levels in 1997 under 2000 law, this analysis estimates that the middle fifth of households paid an average of 17.2 percent of income in federal taxes in 2000.

⁴ Congress' Joint Committee on Taxation found that for taxpayers with incomes between \$30,000 and \$40,000 (which translates to taxpayers with incomes between the 43rd and 55th percentiles of the income distribution), the average percentage of income paid in federal taxes in 2001 would have been 16.1 percent without the tax cut and will be 15.1 percent when the tax cut is taken into account. These households' average tax rate will fall further, to 14.8 percent, in 2002. The Joint Tax Committee data show modestly lower overall federal tax burdens than CBO does due to methodological differences; the Joint Tax Committee data, for instance, do not account for corporate income taxes, while the CBO data do.

⁵ For a more in-depth discussion of this contention see Joel Friedman and Isaac Shapiro, "Are Taxes Too Concentrated at the Top? Rapidly Rising Incomes at the Top Lie Behind Increase in Share of Taxes Paid by High-Income Taxpayers," Center on Budget and Policy Priorities, revised December 18, 2002.

gains income, but the increased concentration does not simply reflect a jump in such gains. If capital gains income is excluded, the share of before-tax income the top one percent of the population received in 1998 was the largest since 1941.)⁶

- CBO data show that the top one percent of the population holds an exceptionally large share of the national income even *after* federal taxes are taken into account. In 1997, the last year for which these data are available, the top one percent of the population received a larger share of the national after-tax income than in any other year for which these data are available. These data go back to 1979.

Table 1

| Average after-tax income gains, 1979-97 | |
|--|-----------|
| Top 1% | \$414,200 |
| Middle fifth | \$3,400 |
| Bottom fifth | -\$100 |

- The CBO data also show that after-tax income rose tremendously among the top one percent of the population in the 1980s and 1990s, with the gains that high-income individuals made far outpacing the gains of other Americans. From 1979 to 1997 (the years CBO studied), the average after-tax income of the richest one percent of households climbed 157 percent, or \$414,000. Among the middle fifth of households, average after-tax income rose a much more modest 10 percent, or \$3,400. (The figures in this paragraph are adjusted for inflation and expressed in 1997 dollars.)⁷

Finally, the percentage of income that the top one percent of taxpayers pays in federal taxes does not appear to be at unusually high levels. It appears to be lower today than it was during most of the 1990s and the late 1970s. It is above the levels of the 1980s, when the budget was marked by large deficits and the national debt grew rapidly.

⁶ Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1918-1998," NBER Working Paper 8467, September 2001, Tables A1 and A3.

⁷ CBO, *op. cit.*