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PRESIDENT'S OWN EXAMPLE SHOWS BULK OF TAX PACKAGE IRRELEVANT TO MIDDLE-INCOME AMERICANS

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In response to criticism that his tax cut plan is skewed towards upper-income taxpayers, President Bush noted in a speech on January 9 that, under his proposal, a family of four making $40,000 would see its federal income taxes fall 96 percent in 2003, from $1,178 to $45. This represents a tax cut of $1,133. (If one includes other federal taxes such as payroll taxes, the percentage reduction in the family's taxes is much smaller; see text box below.)

While it is true that this family's income taxes would be cut by $1,133, closer examination reveals that the tax cuts that would benefit this family constitute less than one-quarter of the overall cost of the proposal. In other words, more than three-quarters of the package could be jettisoned and the $40,000 family mentioned by President Bush — as well as most other middle-class families — would receive just as much help. Thus, the example unintentionally illustrates the point that most of the tax cuts do not in fact help middle- or lower-income families.

The family of four with $40,000 receives its $1,133 tax cut through three provisions:

- The acceleration of the widening of the 10 percent bracket from $12,000 to $14,000 saves this family $100. (The family will have $2,000 taxed at the 10 percent rate instead of the 15 percent rate, saving $100.)

- The acceleration of the "marriage penalty relief" increase in the standard deduction from $7,950 to $9,500 saves the family $233. (The family will have its taxable income reduced by $1,550. Since it faces a 15 percent marginal tax rate, this saves the family $233.)

- The acceleration of the increase in the child tax credit from $600 to $1,000 saves the family $400 per child, or $800 overall.

Over ten years, the increase in the 10 percent bracket costs $48 billion, the "marriage penalty relief" increase in the standard deduction costs approximately $25 billion, and the increase in the child tax credit costs $91 billion. The three provisions thus cost a combined $164 billion. This is less than one-fourth of the entire $670 billion cost of the tax cuts in the Administration proposal.

Furthermore, the provisions that benefit middle-income families would merely accelerate tax cuts which are already scheduled — in contrast to the $364 billion dividend exclusion, which would provide a new, permanent tax cut primarily for high-income earners. Over the long-term, middle-class families would receive *no new* tax-cut benefits while high-income earners would receive large and permanent new tax cuts from the dividend exclusion.

It is also worth noting that many lower-income families are entirely left out of the Administration's tax plan. For example, a married family with two children and $20,000 in earnings (such as two minimum wage earners) would receive no benefit whatsoever from the tax package. According to the Urban Institute-Brookings Institution Tax Policy Center, nearly 11 million families with children — or one-fourth of all families with children — would receive no benefits from the proposed tax cuts.[1] These lower-income families are excluded despite the fact that they are most in need and most likely to spend additional funds and stimulate the economy.

Finally, while accelerating the widening of the 10 percent bracket, the "marriage penalty relief" increase in the standard deduction, and the increase in the child tax credit would provide benefits to middle-income families, accelerating these measures would not meet the standards for a well-designed stimulus package. As the Chairmen and Ranking Members of the House and Senate Budget Committees stated in setting forth bipartisan principles for economic stimulus in October 2001, all stimulus measures should be temporary and sunset within one year if possible. Accelerating these provisions of the 2001 tax cut would entail new costs every year through 2010, deepening deficits in years long after the economy has recovered. Indeed, the large majority of the costs of the three provisions discussed here — more than 80 percent — occur in 2004 and beyond.

Administration Percentage Includes Only Federal Income Taxes

The family of four making $40,000 would receive a 96 percent cut in federal *income* taxes. The family's federal income tax liability would fall from $1,178 to $45. This family, however, pays much more in federal payroll taxes than in federal income taxes. When one includes just the family's *employee* share of $3,060 in payroll taxes, they would receive a more modest 27 percent cut in federal income and payroll taxes. Furthermore, most economists have concluded that workers bear the burden of both the employee and the employer payroll taxes, with the employer portion being passed on to workers in the form of lower wages. If one includes both the employee and employer portions, the family pays $6,120 in payroll taxes and would receive a 16 percent reduction in federal income and payroll taxes under the Administration's plan.

A recent analysis from the Urban Institute-Brookings Institution Tax Policy Center shows that among tax filers with wage earnings, 90 percent of those with income below $100,000 pay more in payroll taxes than in individual income taxes.*

* William Gale and Jeffrey Rohaly, "Three-Quarters of Filers Pay More in Payroll Taxes Than in Income Taxes," *Tax Notes*, January 6, 2003.

[1] www.taxpolicycenter.org, Table 5 on the Administration's stimulus proposal.