CENTER ON BUDGET AND POLICY PRIORITIES

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RESPONSE TO THE TAX FOUNDATION ON "AVERAGE" TAX CUTS UNDER THE ADMINISTRATION'S "GROWTH PACKAGE"

By Andrew Lee and Joel Friedman

A recent Tax Foundation analysis claims that statistics used by the Center on Budget and Policy Priorities to assess the distribution of the Administration's tax-cut proposals are "misleading" because these figures include tax filers who owe no income tax.[1] This accusation is without merit. Including all tax filers is entirely appropriate and consistent with methods used by the Treasury Department and the Congressional Joint Committee on Taxation to determine the distributional impact of tax proposals.

Moreover, even if tax filers with no income tax liability were excluded from the assessment of the Administration's tax cuts, the Center's conclusion that the Administration's use of "averages" vastly exaggerates the benefits of its proposed tax cuts for most Americans remains true. Some 80 percent of all tax filers — *and at least 72 percent of filers who owe income tax* — would receive less than the "$1,083 average tax cut" the Administration advertises.

The Administration's Misleading Use of "Averages"

The Administration has tried to characterize its so-called "economic growth" package as offering broad-based tax benefits. The President has repeatedly stated that "92 million Americans would receive an average tax cut of $1,083." In response, the Center has issued analyses pointing out that this use of an "average" is misleading, because the average is skewed upward by the very large tax cuts that would go to a small number of high-income taxpayers.[2]

The Center's analyses rely on data from the Tax Policy Center, a joint project of two of the nation's most well-respected think tanks, the Urban Institute and the Brookings Institution. Tax Policy Center data show that 80 percent of tax filers would receive less than the $1,083 "average" amount, while about half of tax filers would receive $100 or less. Those in the middle of the income spectrum would receive an average tax cut of $256. The White House is able to generate the $1,083 figure by averaging together the massive tax cuts that high-income people would get — for people who make more than $1 million per year, for instance, the average tax cut would be $90,000 — with the much smaller tax cuts that most Americans would receive.

The Tax Foundation's Misdirected Claims

[1] "The Shrinking Pool of Taxpayers Gets Smaller Under Bush Plan," Tax Foundation Fiscal Facts, January 2003.

[2] See, for instance, Isaac Shapiro and Joel Friedman, "Administration's Use of 'Average' Tax Cut Figures Creates Misleading Impression About the Tax Cuts Most Households Would Receive," January 15, 2003.

The Tax Foundation argues that the Center's findings and the Tax Policy Center data are distorted because they include all tax filers, some of whom owe no income taxes. The Tax Foundation asserts that tax filers who owe no income taxes should be excluded from calculations of the distributional impact of the proposal. This approach is problematic for several reasons.

First, including all tax filers in an examination of the distributional impact of tax proposals reflects the standard methodology for analyzing how such proposals affect the American population. Such an approach is used not only by the Urban Institute-Brookings Institution Tax Policy Center, but also by the Treasury Department and the Joint Committee on Taxation.

Second, limiting distributional analyses of tax-cut proposals only to those filers who have positive income tax liability, as the Tax Foundation suggests, would exclude millions of working families who pay other federal taxes. The Tax Foundation wants to emphasize income tax liability because the progressive structure of the income tax means that it imposes a larger burden on high-income tax filers. But for most tax filers, payroll taxes — which account for 35 percent of all federal revenues in 2003 — represent a larger burden. A recent Tax Policy Center analysis 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.[3] A fixation on the income tax alone does not reflect the reality of the federal tax burden faced by most Americans.

Third, tax filers who owe no income tax are a legitimate part of the current debate on how to stimulate the economy. These filers have lower incomes and, as research indicates, are more likely to spend a higher proportion of additional tax benefits than higher-income families, who can more readily use tax-cut benefits to increase their savings. Yet only if funds are spent will they stimulate the economy; funds that are saved will do nothing to boost the economy in the short run while it is sluggish and stimulus is needed. Further, some stimulus alternatives, such as those offered by Senate Minority Leader Daschle and House Minority Leader Pelosi, target these low- and moderate-income tax filers who pay payroll taxes but not income taxes by proposing tax relief for everyone who pays payroll taxes. Only by using the distributional approach that includes this group is it possible to compare the impact of these plans with the Administration's proposal.

Finally, even if one focuses exclusively on tax filers with positive income tax liability, the benefits of the Administration's proposed tax cuts are still dramatically skewed toward high-income families. Restricting the analysis to this population does not change the basic finding that the "average" benefit touted by the Administration vastly exaggerates the benefits most Americans would receive. As noted above, 80 percent of all filers would receive less under the Administration's "growth" package than the $1,083 average tax-cut figure the Administration promotes. When the analysis is limited to those filers who owe income taxes, at least 72 percent would receive less than the advertised $1,083 figure. Similarly, 49 percent of all filers — and 37.5 percent of all filers who owe income tax — would receive a tax cut of $100 or less.

[3] The statistic cited follows standard economic analysis in attributing both the employer and employee shares of the payroll tax to the employee. Economists have concluded that workers bear the burden of both shares of the payroll tax, with the employer portion being passed on to workers in the form of lower wages. For more details, see William Gale and Jeffrey Rohaly, "Three-Quarters of Filers Pay More in Payroll Taxes Than in Income Taxes," Tax Notes, January 6, 2003.