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TAKING DOWN THE TOLL BOOTH TO THE MIDDLE CLASS?

Myth and Reality Governing the Bush Tax Plan and Lower-income Working Families

By Robert Greenstein and Isaac Shapiro

"The country has prospered mightily over the past 20 years. But a lot of people feel as though they have been looking through the window at somebody else's party. It is time to fling the doors and windows open and invite everybody in. It is time to reward the work of people trying to enter the middle class and put some more money in their pockets at a time when they need it."

"Above all, my plan unlocks the door to the middle class for millions of hard working Americans."

- *President George W. Bush Saturday Radio Address, February 3, 2001*

"In terms of who will have their life changed the most by a tax cut, it's clearly the people at the low and middle end of the income scale, because this represents a huge surge in their income."

- *White House Press Secretary Ari Fleischer, February 5, 2001*

In an attempt to counter concerns that the wealthiest Americans would benefit most from his proposed tax cut, President Bush stated on February 2 at a Congressional Republican retreat that the current tax system is "unfair to people at the bottom end of the economic ladder" and that a critical part of his plan is to provide tax relief to help struggling low-income families make it into the middle class.[1] The President cited, as he did during the campaign, the example of a struggling single-mother making $22,000 a year as the type of person for whom his tax cut would be of particular benefit.

White House officials also have made statements in recent days portraying the tax cut as being most beneficial to lower-income working families because they would receive a 100 percent tax cut while those at high-income levels would have their taxes reduced by much smaller percentages. In addition, the administration has presented its proposals to establish a new 10 percent bracket and to double the child credit as proposals that have been designed in substantial part to help low-income families enter the middle class.

These statements represent bold public relations strokes but generally are incomplete or misleading.

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[1] Mike Allen and Helen Dewar, "Bush Is a Hit at Democratic Retreat," *The Washington Post*, February 3, 2001, A14.

- The tax package President Bush is expected to introduce ignores working-poor families; such families would receive no assistance under the proposal. The proposal provides no relief until a family's income surpasses 130 percent to 160 percent of the poverty line, depending upon family size and configuration. (Throughout, this analysis examines the Bush plan as proposed in the campaign and recently introduced by Senators Gramm and Miller.)

- The plan does not reduce taxes for everyone who pays taxes. Many low-income working families that do not owe income tax pay significant payroll taxes, even when the effects of the Earned Income Tax Credit are considered; these families are not aided by the plan.

- A single mother with two children who works full time and earns $22,000 would receive *no tax cut whatsoever* under the Bush plan. This may be the reason that after citing such a mother on February 2, the President retooled his example the next day.

- The waitress earning $25,000 that President Bush mentioned in his February 3 radio address would get no tax cut or a tax cut of a few hundred dollars (depending on her child care costs). In contrast, her lawyer customer earning $250,000 would receive a tax cut of approximately $3,100 a year. (The lawyer's tax cut would be $8,400 if the Alternative Minimum Tax were eliminated, as some members of Congress are proposing to do.)

- Altogether, the bottom 40 percent of the population would receive just four percent of the tax cuts, about one-ninth what the richest one percent of the population would receive.

- Despite substantial focus by the White House on the need to reduce marginal tax rates among low-wage workers, the proposal does not reduce marginal rates at all on those working poor families that face the highest such rates of any families in the nation — working families with children that have incomes between about $13,000 and $20,000. The proposal also departs from a bipartisan Congressional consensus of the past two years by failing to include any marriage penalty relief for low-income working families, even though as a group such families face some of the largest such penalties of any families.

The Waitress and Her Customer at the Diner

In his Saturday radio address on February 3, the President pointed to a waitress with two children who earns $25,000 a year. He portrayed the hypothetical waitress as being a partner in the tax cut with a highly-paid attorney making $250,000 a year who is the waitress' customer at a diner. This portrayal is questionable.

- If the waitress is married and her family's income is $25,000, she, too, would receive no tax cut under the Bush plan. Yet her family pays a substantial amount of federal taxes, including $3,825 in payroll taxes (including both the employee and employer share; most economists concur that the employer's share of the payroll tax is passed along to workers in the form of lower wages) and lesser amounts in gasoline and other excise taxes. The family's Earned Income Tax Credit of $1,500 would offset well under half of those taxes.[2]

- Similarly, if the waitress is a single mother who pays at least $170 a month in child care costs so she can work and support her family — an amount that represents a rather modest expenditure for child care — she would receive no tax cut under the Bush plan despite having a significant net tax burden. If her child care costs are $100 a month, she would receive a small tax cut — less than $200 a year.[3]

- By contrast, the attorney with a $250,000 income with whom the waitress is said to share in benefitting from the tax cut would receive a tax reduction of approximately $3,100 per year, assuming the current law Alternative Minimum Tax. If, however, the AMT were eliminated, her tax cut would equal an estimated $8,400.[4]

- The average tax cut for those in the top one percent of the population would be about $40,000. (This figures includes the average effect on this group of repealing the estate tax, the benefits of which are heavily oriented among the top one percent of population.)

The Extent of Assistance to Low-income Working Families

The Administration's statements portray low-income working families as being among the principal beneficiaries of the plan. Yet the bottom 40 percent of the population would receive only four percent of the plan's tax cuts. This is about one-ninth the share of the tax cuts that would go to the wealthiest one percent of Americans.

To be sure, some moderate-income families would have their current income tax obligation eliminated – that is, they would receive a 100 percent income tax cut. For a substantial

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[2] The figures in these bullets represent the value the tax cuts would have in 2001 if the tax cuts were in full effect.

[3] If the waitress with two children who earns $25,000 has no child care costs, does not itemize deductions, and makes no pension contributions, she could receive a tax cut of $447.

[4] The lawyer earning $250,000 is assumed to be unmarried with two children. Her itemized deductions, after application of the itemized deduction phase-out, are worth 14.7 percent of her income; this is consistent with the share of itemized deductions for taxpayers in her income range in 1998. The tax calculation further assumes that the tax rate cuts and the child tax credit expansion in the Bush plan, which are phasing in through 2006, are fully in effect for 2001. Using these assumptions and assuming fully phased-in law, the lawyer would receive a tax cut of $8,464 in 2001. The AMT, however, which would tax back some of the tax reduction, would reduce the tax cut to approximately $3,100.

number of these families, however, the tax cut would be small. A married family with two children that earns $26,000 this year would have its income tax eliminated. But such a family owes only $20 in taxes. The elimination of 100 percent of its income tax liability would not be of much benefit to it.

The Administration is likely to observe that while such a family would get only a small tax cut in dollar terms, the family would have its "marginal tax rate" reduced by 15 percentage points (i.e., it would not have 15 cents of each additional dollar it earns taxed away). This is correct, although it is unclear from the economics literature that such a change would have a substantial effect on the amount the family works. But if the Administration's goal is to reduce marginal tax rates on the low-income working families that face the highest rates in the nation — a worthy goal — the plan falls far short.

- As conservative and liberal analysts alike have long recognized, the working families that face the highest marginal tax rates are those with incomes between about $13,000 and about $20,000. For each additional dollar these families earn, they lose up to 21 cents in the Earned Income Tax Credit, 7.65 cents in payroll taxes (15.3 cents if the employer's share of the payroll tax is counted), 24 cents to 36 cents in food stamp benefits, and additional amounts if they receive housing assistance or a child care subsidy on a sliding fee scale or are subject to state income taxes. No other Americans in any income bracket have as large a share of each additional dollar they earn "taxed away." The Bush plan fails to reduce marginal tax rates at all for these working families.

- Ways to reduce marginal tax rates for such families are available, well known, and not especially expensive. They basically entail raising the income level at which the Earned Income Tax Credit begins to phase down as earnings rise, and/or reducing the rate at which the EITC phases down. Bipartisan legislation introduced last year by Senators Rockefeller, Jeffords, and Breaux follows such a course, as do proposals made by Rep. Ben Cardin and the Clinton Administration. The Bush Administration has apparently chosen not to follow such a course and to leave marginal tax rates on these families at very high levels.

The likely Bush plan also departs from a bipartisan consensus formed in Congress over the past two years to reduce marriage tax penalties for low-wage working families, not just for middle- and upper-income families. Analysts generally concur that some of the most serious marriage penalties in the tax code are those that can face low-income working individuals as a result of the way the phase-out of the EITC is designed. Every major tax bill from both parties in the last year and a half — including major tax bills that Congress passed and President Clinton vetoed in 1999 and 2000 — has contained EITC reforms to provide marriage penalty relief for low-income working families. (Clinton vetoed the bills for other reasons; his budget, too, proposed EITC marriage penalty relief.) The Bush plan contains no such marriage penalty relief.

The Child Credit and the 10 Percent Bracket

Finally, the Administration is touting its proposals to create a new 10 percent bracket and to double the child credit as proposals designed in substantial part to benefit lower-income working families and help them enter the middle class. In fact, only a modest share of the tax-cut benefits from these proposals would go to low- or moderate-income families; much larger shares would go to high-income families. Approximately one-third of all children in the United States would fail to benefit from either proposal.

Consider the proposal to raise the child credit from $500 per child to $1,000. Under the Bush plan as outlined during the campaign, this proposal would cut taxes for families with children that have incomes up to $200,000. Those who would benefit most are filers with incomes in the $110,000 to $200,000 range; they would receive the largest tax cuts under this proposal because the Bush plan not only would double the child credit but also would raise the income level above which the child credit phases out from $110,000 to $200,000, thereby extending the credit for the first time to those in this income category. For many of these relatively affluent taxpayers, the child credit thus would rise from zero to $1,000 per child. For millions of children in low- and moderate-income working families, by contrast, the child credit would remain at zero or at its current level of $500 per child or rise to less than $1,000 per child (because their families would have insufficient income tax liability against which to apply the increase in the child credit).

As a consequence, when the increase in the child credit is fully in effect:

- Some 82 percent of the benefits from the child credit proposal would accrue to the 40 percent of families with children with the highest incomes.[5] Only three percent of the benefits from this proposal would accrue to the bottom 40 percent of such families.

- The top 20 percent of families would receive 46 percent of the tax-cut benefits from this proposal, a larger share than any fifth of the population would receive.

Several of these issues are discussed in more detail below.

The Income Levels at Which Families Would Begin to Receive Tax Cuts

The Bush plan would have no effect on working families that owe no federal income tax before the Earned Income Tax Credit is applied.[6] Many of these families pay significant amounts

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[5] Robert McIntyre, Citizens for Tax Justice, special data run for the Children's Defense Fund.

[6] There is one exception to the general observation that the plan would not affect families that currently owe no income tax before the EITC is applied: due to an obscure and complicated feature of the tax code, some families (continued...)

of federal taxes, but they make tax payments through the payroll tax (and to a much smaller degree, through excise and other taxes) rather than through the income tax.

The framers of the Bush plan could have reduced the high marginal tax rates and substantial marriage penalties that many such working families face by improving the EITC. Alternatively, the plan could have expanded the dependent and child care tax credit and made it available to the working poor, who currently are denied access to this credit because it is not refundable. The plan takes neither step. As a result, despite showering what is likely to be close to $2 trillion over 10 years in tax cuts — including tax cuts averaging approximately $40,000 each for the wealthiest one percent of Americans — the plan leaves out working-poor and near-poor families.

As Table 1 shows, the income level at which the tax cut would begin to take effect is about 140 percent to 160 percent of the poverty line for families with two children that incur no child care costs and do not itemize deductions. For families with child care costs and families that itemize, the income levels below which the Bush plan has no effect are higher. (See Table 2.) The income levels shown in these tables are the levels at which families begin to owe income tax

Table 1
Families With No Child Care Costs

Family Type	Income Level at Which Families Begin to Owe Income Tax, and at which the Bush Tax Cut Would Take Effect, if a Family Has No Child Care Costs and Does Not Itemize	Poverty Line for Families of This Type	Level at Which the Tax Cuts Take Effect as a Percentage of the Poverty Line
Married, two children	$25,867	$17,952	144%
Head-of-Household, two children	$22,017	$14,262	154%

Note: These figures are for 2001. The poverty line figures for 2001 are the Census Bureau's official poverty line figures for 2000, adjusted by using the increase that CBO projects in the Consumer Price Index between 2000 and 2001. The Census Bureau adjusts the poverty line each year based on changes in the CPI.

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[6] (...continued)
with three or more children that owe no income tax before the EITC is applied would receive a larger refundable child tax credit. For example, single-parent families with three children that owe no income tax and have incomes between $25,171 and $28,250 would get a larger refundable child credit. This feature applies only to families with three or more children (under the tax code, the refundable component of the child credit is limited to families with at least three children) that have incomes in certain narrow income ranges above the poverty line.

Table 2
Families with $200/month in Child Care Costs Per Child

Family Type	Income Level at Which Families Begin to Owe Income Tax, and at which the Bush Tax Cut Would Take Effect, if a Family Has Monthly Child Care Costs of $200 Per Child and Does Not Itemize	Poverty Line for Families of This Type	Level at Which the Tax Cuts Take Effect as a Percentage of the Poverty Line
Married, two children	$32,267	$17,952	180%
Head-of-Household, two children	$28,417	$14,262	199%
Note: See note to Table 1.			

before the EITC is applied and thus the levels at which the Bush tax cuts would begin to have an effect. Families with incomes slightly above these levels would receive small tax cuts.

The Portion of the Tax Cut that Would Go to Lower-income Families

To gain some perspective on the degree to which low- and moderate-income families are major beneficiaries of the Bush tax proposal, one can look at how the plan's tax cuts are apportioned among different income groups. Such an examination shows the plan to be heavily tilted away from low- and moderate-income families and toward wealthy individuals.

The principal analysis of how filers at different income levels would fare under the Bush plan — and how the tax-cut benefits would be divided among different income categories — is an analysis by Citizens for Tax Justice, using the Institute for Taxation and Economic Policy (ITEP) model. This is a well-respected model developed in substantial part by former staff members of the Joint Committee on Taxation. CTJ tax distribution analyses, using the ITEP model, have been validated over the years by the fact that they generally yield results very similar to those produced by the highly respected career staff at the Treasury Department.

The CTJ analysis of the tax proposal that President Bush presented in the campaign finds the following results (these results reflect the tax cuts when fully in effect):

- The bottom 40 percent of tax filers would receive four percent of the tax cuts. The average tax cut for this group would be $115.

- The bottom 60 percent of filers would receive 13 percent of the tax cuts, receiving an average of $227 each. The bottom 80 percent of taxpayers would receive 29 percent of the tax cuts.

- The 20 percent of filers exactly in the middle of the income spectrum would receive eight percent of the tax cuts and get an average tax reduction of $453.

- By contrast, the wealthiest one-percent of Americans would receive 43 percent of the total tax cuts, receiving an average tax cut of $46,000 each. The top five percent of filers would garner a little more than half of the tax cuts.

During the campaign, the Bush campaign issued quite different numbers regarding the proportions of the tax cut that would go to different income categories. The campaign also cited figures from the Joint Tax Committee that were said to show that the proportion of the tax cut that would go to the top one percent of filers would be much smaller than the CTJ figures indicate. But neither the campaign's figures nor those from the Joint Tax Committee provide an accurate picture of the distribution of the proposed tax cuts. *These figures exclude the effects of the proposal to repeal the estate tax, thereby substantially reducing the proportion of the tax cuts presented as going to those at the top of the income spectrum*. To assess how the tax cuts would be apportioned among different income categories, one must examine all of the major elements of the tax-cut proposal — including estate tax repeal — not just some of those elements.

In the past, there has been some debate among analysts about the best methodology to use to determine what percentage of the estate tax is paid by people in different income categories and thus what percentage of the benefits from estate tax repeal would accrue to each income group. Under the ITEP model that CTJ uses, 91 percent of the estate tax is estimated to be paid by the top one percent of tax filers, and virtually all of the tax is estimated to be paid by the top five percent of filers. Such results should not be surprising. IRS data show that the estate tax is levied only in the case of two percent of deaths and that half of all estate taxes are paid on the estates of the wealthiest one of every 1,000 people who die.

Recently, career staff at the Treasury Department undertook a major analysis of the distribution of taxes, including the estate tax, by income category. The Treasury published the results of this work in September 1999 and has used the findings of this analysis in distributional analyses it has conducted since then.

The Treasury findings are broadly similar, although not identical, to the estimates in the ITEP model, which was constructed before the Treasury study became available. The Treasury study estimates that the top one percent of tax filers pay 64 percent of the estate tax (and thus would get 64 percent of the tax-cut benefits that would result from estate tax repeal), rather than paying 91 percent of the tax as the ITEP model estimates. The Treasury and ITEP figures on the proportion paid by the top five percent, however, are quite similar; the Treasury study estimates that the top five percent of filers pay 91 percent of the estate tax, as compared to 100 percent of the tax under the ITEP model. Under both sets of estimates, the top 20 percent of filers pay virtually all of the estate tax, and the tax does not affect the other 80 percent of the population.

Consequently, another way to estimate the effect of the Bush tax cut on different income groups is to take the CTJ estimate and modify it by substituting the Treasury estimates on the incidence of the estate tax for those in the ITEP model. Under this approach, the top one percent of the population is estimated to receive 36 percent of the tax cuts under the Bush plan, rather than the 43 percent the CTJ analysis estimates (and to receive an average tax cut of $39,000 rather than $46,000). The top 20 percent of the population still is found to receive 71 percent of the tax cut, the same percentage as under the CTJ analysis. Similarly, the bottom 40 percent of the population still is found to receive four percent of the tax cut. Under either approach, the tax cut is found to be tilted heavily toward those with very high incomes and to provide only a modest percentage of its tax-cut benefits to the types of families that the White House appears to be touting as major beneficiaries.

Could Low-income Working Families be Adversely Affected?

If the magnitude of the Bush tax cut necessitates reductions in coming years in important programs for low- and moderate-income working families, such families could be adversely affected. This outcome must be regarded as a possibility. The cost of the tax cut exceeds $2 trillion over 10 years when one takes into account the increased interest payments on the debt the tax cut would engender and when the very reasonable assumption is made that the Alternative Minimum Tax will be reformed so it does not encroach heavily upon the middle class.[7] Yet the projected surpluses outside Social Security total only about $2 trillion when the Medicare portion of the surplus is set to the side and adjustments are made in the surplus estimate to reflect the cost of actions Congress is virtually certain to take, such as maintaining payments to farmers and extending the 20 tax credits that expire every couple of years and always are renewed.[8]

Furthermore, the CBO surplus estimates are only projections. Seventy percent of the projected non-Social Security surplus would occur in the second five years of the 10-year period, years for which budget projections are speculative and highly uncertain. The projected surpluses may not fully materialize. There consequently is risk that tax cuts of this magnitude could lead to budget reductions in future years. As the experience of the 1980s has shown, when such budget cuts are instituted, they are likely to have a disproportionate impact on programs for lower- and moderate-income families.

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[7] See "The Cost of the Bush Tax Cut," Center on Budget and Policy Priorities, February 5, 2001.

[8] Robert Greenstein and Richard Kogan, "What the New CBO Projections Mean: Can the New Surplus Projections Accommodate a Large Tax Cut?," Center on Budget and Policy Priorities, January 31, 2001.