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HOW WOULD FAMILIES AT DIFFERENT INCOME LEVELS BENEFIT FROM THE BUSH TAX CUT?

By Robert Greenstein

In recent days, the Administration has presented its tax cut as helping low-, middle-, and high-income families alike. Given the tax cut's cost, it is not surprising that large numbers of families and individuals would receive some reduction in their taxes from it (although millions of working poor and near-poor families would be left out). But saying that the tax cut will affect families at a number of different income levels does not tell us whether the tax cut would be tilted toward certain income groups.

Examination of this issue indicates that the tax cut would indeed be heavily skewed toward those at the top of the income spectrum. The richest one percent of the population would receive substantially more in tax cuts than the bottom 80 percent of the population combined. Moreover, the share of the tax cut that would go to the top one percent of Americans would be nearly double the share of federal taxes they pay. Consequently, those in the top one percent would receive a larger percentage reduction than people in any other income group in the total federal taxes they pay (as distinguished from just the income taxes they pay). High-income families would also receive the largest percentage increase in income.

In other words, no matter how benefits from the tax cut are measured, the top of the income spectrum benefits the most. The highest-income individuals would receive the largest average tax benefit in actual dollars by far, the largest percentage gain in income, and the largest percentage reduction in taxes paid. The share of tax cuts they would receive exceeds the amount of taxes they pay by a significant margin.

Tax Cuts by Income Category

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 richest 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 all deaths and that in 1997 (the latest year for which these data are available) half of all estate taxes were paid by the 2,400 largest taxable estates — the estates of the wealthiest one of every 1,000 people who died.¹

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.²

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

¹ See Iris Lav and Joel Friedman “Estate Tax Repeal: A Costly Windfall for the Wealthiest Americans,” Center on Budget and Policy Priorities, February 6, 2001.

² “U.S. Treasury Distributional Analysis Methodology,” Department of the Treasury, OTA Paper 85, September 1999.

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.

High-income Individuals Also Receive the Largest Percentage Tax Reductions, as well as the Largest Percentage Increases in Income

White House officials have been arguing that lower-income families would receive the largest percentage tax reductions. This argument rests, however, on data that show the percentage reduction in families' *income tax* burdens, when the most significant data are those on the percentage reduction in families' overall federal tax burdens. Low- and moderate-income families pay more in other federal taxes — principally the payroll tax — than in income taxes and often have very small income tax liabilities. It is possible to eliminate those income tax liabilities without providing the family much of a tax cut or reducing the family's total federal taxes by a very large percentage.

When the percentage reduction that the Bush tax cut would make in total federal tax burdens is examined, a different picture emerges. Under the Bush plan, the top one percent would receive a much larger percentage reduction in the federal taxes they pay than any other income group. (See Table 1.)

Table 1

Percentage Reduction in Federal Taxes Under the Bush Tax Plan		
Income Group	ITEP Model (Citizens for Tax Justice)	ITEP Model with the Treasury Estimates on Who Pays the Estate Tax
Bottom 20%	-5.5%	-5.5%
Second 20%	-6.5%	-6.5%
Middle 20%	-7.3%	-7.3%
Fourth 20%	-7.2%	-7.3%
Next 15%	-6.1%	-6.7%
Next 4%	-4.2%	-6.4%
Top 1%	-13.6%	-11.6%

The top one percent also would receive a much larger percentage increase in income as a result of the tax cut. The tax cut would increase the incomes of the poorest 20 percent of the population by an average of one-half of one percent and increase the incomes of the middle fifth of households by 1.5 percent. Among the top one percent of households, by contrast, the tax cut would boost their already very large incomes by an average of close to five percent. (See Table 2.)

Table 2

Percentage Increase in Income as the Result of the Bush Tax Cut		
Income Group	ITEP Model (Citizens for Tax Justice)	ITEP Model with the Treasury Estimates on Who Pays the Estate Tax
Bottom 20%	0.5%	0.5%
Second 20%	1.0%	1.0%
Middle 20%	1.5%	1.5%
Fourth 20%	1.7%	1.7%
Next 15%	1.7%	1.8%
Next 4%	1.2%	1.9%
Top 1%	5.0%	4.3%

Wouldn't High-Income Families Simply Get Tax Cuts in Proportion to the Share of Taxes They Pay?

One common justification for tax cuts heavily geared toward those at the top of the income spectrum is that high-income individuals pay a disproportionate share of taxes and hence should receive a corresponding share of the tax cuts. When applied to the Bush tax cut, however, this rationale falls short.

First, the Bush tax plan showers tax cuts on high-income individuals far out of proportion to the taxes they pay. The previously noted Treasury Department study shows that the wealthiest one percent of Americans pay *20 percent* of all federal taxes. As this Center report explains, however, the top one percent would receive at least *36 percent* of the tax cuts under the Bush plan. The share of the tax cuts these individuals would receive thus would be nearly double the share of federal taxes they pay. Yet this group has the least need for additional income, as the after-tax income of this group grew more rapidly than the income of any other group over the past decade. The percentage of federal taxes that very high-income tax filers pay consequently would decline somewhat, while the share paid by other Americans would edge up.

The Treasury analysis also indicates that the top five percent of taxpayers pays 36.5 percent of federal taxes. This group would receive at least 49 percent of the tax-cut benefits under the Bush plan.

During the presidential campaign, the Bush campaign staff used a competing set of figures that purported to show that the share of the tax cut going to high-income individuals would not be any larger than the share of taxes these individuals pay. The figures that the campaign issued to make this point, however, obfuscated rather than illuminated the issue.

Those figures showed the share of federal *income* taxes that different income groups paid, omitting payroll, estate, and other taxes. This made the share of taxes said to be paid by those at the top of the income spectrum into a larger percentage. The campaign then compared these figures to the percentage of the tax cut that each income group would receive *when the proposal to repeal the estate tax was omitted*, even though repeal of the estate tax represents nearly one quarter of the total Bush tax cut by 2010, according to Joint Committee on Taxation estimates. This made the share of the tax cut that would go high-income individuals look smaller than it actually is.

Families pay both income *and* other federal taxes. For a substantial majority of American families, their payroll tax bills exceed their income taxes. Furthermore, the Bush plan is not limited to the income tax; it contains tax cuts in other areas as well, such as the estate tax. Undertaking an appropriate comparison thus entails examining the relationship between the share of total federal taxes that a particular income group pays and the share of the overall Bush tax cut that group would receive. When this is done, the finding is clear that the share of the tax cuts that the highest-income Americans would receive substantially exceeds the share of the taxes they pay.

Moreover, the argument that the very well-to-do pay a large share of the taxes so they should get a correspondingly large share of the tax cut is itself flawed. Even if the Bush tax cut did give each income group a share of the tax cuts that equaled the share of federal taxes each group pays, that would not necessarily represent sound policy. When income disparities widen between wealthy and other Americans and a disproportionate share of the income gains from economic growth accrues to those high on the economic ladder and enlarges the already-substantial portion of the national income that they receive — as has occurred in recent decades — the share of federal taxes that these high-income individuals pay necessarily increases as well. If the principle is blindly followed that tax cuts should be divided among different groups in proportion to the taxes each group pays, this means that when income becomes more concentrated at the top of the income scale — and income gaps between wealthy individuals and other Americans widen — tax cuts should be targeted to a greater degree on those with high incomes. Stated another way, this principle means that the more fabulously wealthy those at the top of the income scale become, the larger the proportion of the tax cuts that should be directed to them. Such a principle does not represent sound policy.