

February 7, 2001

An Estimated 12 Million Low- and Moderate-Income Families — with 24 Million Children — Would Not Benefit from Bush Tax Plan

by Isaac Shapiro, Allen Dupree and James Sly

About 12 million low- and moderate-income families with children — nearly one in every three U.S. families — would not receive any assistance from the tax provisions that President Bush is likely to send to Congress on February 8. An estimated 24 million children under age 18 — one in every three children — live in these families.

For certain groups, the proportions of families and children not benefitting from the plan are higher. A majority of black and Hispanic children live in families that would not benefit from the plan. For these families and their children, the tax package neither raises after-tax income nor reduces their frequently high marginal tax rates.

This analysis investigates these figures in more detail and then examines the reason that so many families and children do not benefit — the families have incomes too low to owe federal *income* taxes. This leads to a discussion of whether families that do not owe income taxes should benefit from a large tax-cut proposal and the extent to which they owe taxes other than income taxes, most notably the payroll tax.

Who would be excluded?

We examined the latest data from the Census Bureau to estimate the number of families and children under 18 who would receive no assistance from the Bush tax plan. The data are for 1999. We examined the Bush plan as proposed in the campaign and recently introduced by Senators Gramm and Miller; our analysis considers the effects of the plan as if it were in full effect in 1999.

The findings of this analysis are consistent with an independent analysis of who is left out of the Bush plan that has been conducted by researchers at the Brookings Institution and with data from the tax model of the Institute on Taxation and Economic Policy. The findings of the Brookings researchers (as part of a general analysis of tax ideas to assist working families that will be published later this week) and the unpublished data from the Institute on Taxation and Economic Policy both indicate that nearly one in three families would not receive any assistance from the Administration's proposal.¹

¹ Isabel Sawhill and Adam Thomas, *A Tax Proposal for Working Families with Children*, Policy Brief No. 3, Brookings Institution, forthcoming; and Institute on Taxation and Economic Policy, unpublished tables prepared (continued...)

The key findings of our analysis include:

- An estimated 12.2 million low- and moderate-income families with children — 31.5 percent of all families — would not receive any tax cut from the Bush proposal. Some 80 percent of these families have workers.
- Approximately 24.1 million children — 33.5 percent of all children — live in the excluded families.
- Among African-Americans and Hispanics, the figures are especially striking. While one-third of all children would not benefit from the Bush tax plan, *more than half* of black and Hispanic children would not receive any assistance. An estimated 55 percent of African-American children and 56 percent of Hispanic children live in families that would receive nothing from the tax cut.
- Of the 24.1 million children living in families that would receive no benefit from the tax cuts, an estimated 10.1 million are non-Hispanic whites, 6.1 million are black, and 6.5 million are Hispanic.

Even the Bush proposal to double the child tax credit — the feature of his tax plan that one might expect to provide the most assistance to children in low- and moderate-income families — would be of little or no help to many of them. This proposal would provide the largest tax reductions to families with incomes in the \$100,000 to \$200,000 range and confer a much larger share of its benefits on upper-income families than on low- and middle-income families.

Under the Bush plan, the maximum child credit would be raised from \$500 per child to \$1,000. Filers with incomes in the \$110,000 to \$200,000 range would benefit the most from this proposal because the proposal raises the income level above which the child credit phases out from \$110,000 to \$200,000, extending the credit for the first time to those in this income category. For many of these relatively affluent taxpayers, the child credit would rise from zero to \$1,000 per child. By contrast, millions of children in low- and moderate-income working families would continue to receive no child credit, or their credit would remain 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, Institute on Taxation and Economic Policy data indicate that when the increase in the child credit is fully in effect:

1 (...continued)
for the Children's Defense Fund.

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

Why families would not benefit

During 2000, Bush campaign officials touted their tax-cut plan as benefitting lower-income taxpayers substantially in two key ways — by doubling the child credit to \$1,000 per child and by establishing a new 10 percent tax-rate bracket. Some married families also would benefit from the plan's two-earner deduction. None of these features, however, affect a family that has no income tax liability before the Earned Income Tax Credit is computed.

A large number of families fall into this category. As a result of the combination of the standard deduction (or itemized deductions if a family itemizes), the personal exemption, and existing credits such as the child tax credit, these families do not owe federal income taxes. (As described below, these families can pay substantial amounts in other taxes, such as payroll and excise taxes, even after the Earned Income Tax Credit is taken into account.)

The level at which families now begin to pay federal income taxes is approximately 130 percent to 160 percent of the poverty line, depending on family type and family size. For example, in 2001, a two-parent family of four does not begin to owe income tax — and thus does not begin to benefit from the Bush plan — until its income reaches \$25,870, some 44 percent above the poverty line of \$17,950. Families below the poverty line would receive no assistance from the tax cut. Nor would many families modestly above the poverty line.²

The framers of the Bush plan could have assisted low-income working families by improving the EITC. Alternatively, the Bush plan could have expanded the dependent and child care tax credit and made it available to the low-income working families who currently are denied access to this credit because it is not refundable. Or, the plan could have increased the degree to which the child tax credit is refundable. The plan takes none of these steps.

What families should benefit?

Since the reason 12 million families and their children would not benefit from the Bush plan is that they do not owe federal income taxes, some have argued that it is appropriate they not benefit. "Tax relief should go to those who pay taxes" is the short-hand version of this argument. This line of reasoning is not persuasive for several reasons.

² These issues are explained in greater detail in a recent Center on Budget and Policy Priorities publication, *Taking Down the Toll Booth to the Middle Class? Myth and Reality Governing the Bush Tax Plan and Lower-Income Working Families*.

1. *A significant number of these families owe taxes other than federal income taxes, often paying significant amounts.* For most families, their biggest federal tax burden by far is the payroll tax, not the income tax. Data from the Congressional Budget Office indicate that in 1999, three-quarters of all U.S. households paid more in federal payroll taxes than in federal income taxes. (This comparison includes both the employee and employer share of the payroll tax; most economists concur that the employer's share of the payroll tax is passed along to workers in the form of lower wages.) Among the bottom fifth of households, 99 percent pay more in payroll than income taxes. Low-income families also pay excise taxes and state and local taxes. While the Earned Income Tax Credit offsets these taxes for most working families with incomes below the poverty line, many families with incomes modestly above the poverty line who would not benefit from the Bush plan are net taxpayers.

Consider two types of families earning \$25,000 a year in 2001, an income level the Administration has used in some of its examples:

- A two-parent family of four with income of \$25,000 would pay \$3,825 in payroll taxes (again, counting both the employee and employer share) and lesser amounts in gasoline and other excise taxes. The family pays various state taxes as well. The family's Earned Income Tax Credit of \$1,500 would offset well under half of its payroll taxes.

Even if just payroll taxes and the EITC are considered, the family's net federal tax bill would be \$2,325. Nonetheless, this family would receive no tax cut under the Bush plan.

- The Administration has used the example of a waitress who is a single-mother with two children and earns \$25,000 a year. If this waitress 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, too, would receive no tax cut under the Bush plan despite having a significant net tax burden. In her case as well, her payroll taxes would exceed her EITC by \$2,325.³

2. *The Bush approach fails to reduce the high marginal tax rates that many low-income families face.* Throughout the presidential campaign and early into the new Presidency, President Bush and his advisors have cited the need to reduce the high marginal tax rates that many low-income working families face as one of their tax plan's principle goals. They have observed that a significant fraction of each additional dollar these families earn is lost as a result

3 If the single-mother waitress with two children who earns \$25,000 has child care costs of \$100 a month, she would receive a small income tax cut — less than \$200 a year. If she has no child care costs, does not itemize deductions, and makes no pension contributions, she could receive a total tax cut of \$447. In both scenarios, the waitress would receive a tax cut of less than \$500 per child (the amount of the expansion in the child tax credit) even though her net tax bill (including payroll and other taxes) would be significant.

of increased income and payroll taxes and the phasing out of the EITC.⁴ Ironically, however, a large number of low-income families that confront some of the highest marginal tax rates of any families in the nation would not be aided at all by the Bush plan.

Analysts across the ideological spectrum have long recognized that the working families who gain the least from each additional dollar earned are those with incomes between about \$13,000 and \$20,000. For each additional dollar these families earn, they lose up to 21 cents in the EITC, 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. Their marginal tax rates are well above 50 percent. Yet the Bush plan does not provide any assistance to them.

Ways to reduce marginal tax rates for such families are available and not especially expensive. They basically entail raising the income level at which the EITC 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.

3. Consistent with the objective of helping working families lift themselves out of poverty, an additional income boost would be worthwhile. A key theme of welfare reform has been to prod, assist, and enable families to work their way out of poverty. The principle of helping families work their way out of poverty has gained support across the political spectrum. This principle is important for married families and single-parent families, and there is considerable evidence that welfare reform — in combination with a strong economy, low unemployment rates, and the EITC — has significantly increased employment rates among single mothers. Providing increased assistance to the working poor through the tax system could further the goal of making work pay.

Such assistance is particularly important since much of the recent gains in the earnings of the working poor have been offset by declines in other supports. For example, from 1995 to 1999 the poorest 40 percent of families headed by a single mother experienced an average increase in earnings of about \$2,300. After accounting for their decrease in means-tested benefits and increases in taxes, their net incomes rose a mere \$292.⁵ (Both changes are adjusted for inflation.)

In addition, a study the Manpower Demonstration Research Corporation has just released finds that improving income — and not just employment — is important if the lives of children in

⁴ For example, for a family with two children, the size of the Earned Income Tax Credit is reduced by 21 cents for each dollar of income between \$13,090 and \$32,121.

⁵ Speech by Wendell Primus at the University of Michigan Conference on The New World of Welfare: An Agenda for Reauthorization and Beyond, February 1-2, 2001.

poor families are to improve.⁶ The MDRC report examined five studies covering 11 different welfare reform programs. The report's central finding was that increased employment among the parents in a family did not by itself significantly improve their children's lives. It was only in programs where the parents experienced increased employment *and* increased income that there were positive effects — such as higher school achievement — for their elementary school-aged children.

4. *The rewards from the surplus should be spread throughout the population.* The Bush tax package is likely to consume most, if not all, of the available surplus outside Social Security and Medicare. A recent Center on Budget and Policy Priorities analysis pegs the cost of the Bush plan at more than \$2 trillion over 10 years, which would exceed the surplus that is likely to be available outside Social Security and Medicare when realistic budget assumptions are used.⁷ If large tax cuts are to be provided, it is appropriate to dedicate some portion of those tax cuts to the people with the most pressing needs, such as low-income working families with children.

⁶ Pamela A. Morris, et. al., *How Welfare and Work Policies Affect Children: A Synthesis of Research*, January 2001.

⁷ See *What the New CBO Projections Mean: Can the New Surplus Projections Accommodate a Large Tax Cut?*, January 31, 2001.