

IN MANY STATES, ONE-THIRD TO ONE-HALF OF FAMILIES WOULD NOT BENEFIT FROM BUSH TAX PLAN

A Substantial Number of Families in Every State Would Not Benefit From Tax Plan

By Nick Johnson, Allen Dupree, and Isaac Shapiro

A substantial portion of families with children in each of the 50 states and the District of Columbia would receive no assistance from President Bush's tax plan submitted to Congress in early February. In some states, as high a portion as one in two children live in families that would receive no assistance under the provisions of the plan. In every state, the number of families that would not benefit from the plan is substantial.

Nationwide, an estimated 12.2 million low- and moderate-income families with children — 31.5 percent of all families with children — would not receive any tax reduction from the Bush proposal. Approximately 24.1 million children — 33.5 percent of all children — live in the excluded families. The vast majority of the excluded families include workers.

These families are distributed somewhat unevenly across the states. Among the states where high percentages of families and children would not benefit from the plan are Arizona, Arkansas, California, Georgia, Louisiana, Mississippi, Montana, New Mexico, North Dakota, Texas, and West Virginia, plus the District of Columbia. In each of those states, about 40 percent to 50 percent of all children live in the excluded families. In California alone, 1.7 million families with 3.7 million children would not benefit from the tax cut. Even in the states with the smallest proportion of low- and moderate-income families — such as Colorado, Connecticut, Maryland, Minnesota and Wisconsin — about one in five families would not benefit from the tax cut.

This analysis investigates these figures in more detail and examines the reason that so many families and children do not benefit — the families have incomes too low to owe federal *income* taxes. The Bush plan reduces only income taxes and taxes on large estates. 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. The large majority of the excluded families do pay payroll taxes and other federal taxes, plus substantial amounts of state and local taxes, and can have significant overall tax bills. Among all American families, three of every four pay more in federal payroll taxes than in income taxes.

Families and Children That Would Not Benefit from Bush Tax Plan, By State

<u>State</u>	<u>Number of Families</u>	<u>Percent of Families</u>	<u>Number of Children</u>	<u>Percent of Children</u>
New Mexico	117,000	47%	278,000	52%
District of Columbia	25,000	43%	54,000	48%
Mississippi	194,000	42%	339,000	45%
West Virginia	99,000	42%	161,000	45%
Louisiana	270,000	41%	496,000	44%
Arizona	278,000	41%	565,000	41%
Tennessee	298,000	39%	528,000	38%
Montana	50,000	38%	98,000	41%
Texas	1,167,000	38%	2,256,000	41%
Georgia	431,000	38%	859,000	41%
Arkansas	140,000	37%	276,000	40%
New York	922,000	36%	1,865,000	39%
Alabama	227,000	36%	436,000	38%
North Dakota	30,000	36%	61,000	40%
California	1,742,000	35%	3,744,000	40%
Kentucky	198,000	35%	326,000	35%
Hawaii	58,000	34%	108,000	33%
South Carolina	190,000	34%	338,000	37%
Idaho	62,000	33%	138,000	40%
North Carolina	349,000	33%	644,000	34%
Florida	630,000	33%	1,213,000	35%
Oklahoma	144,000	32%	282,000	35%
Oregon	146,000	31%	291,000	33%
Wyoming	22,000	30%	43,000	33%
Missouri	236,000	30%	435,000	30%
Kansas	107,000	29%	201,000	30%
Delaware	32,000	29%	70,000	34%
Ohio	460,000	29%	887,000	30%
Maine	49,000	29%	90,000	29%
Nebraska	63,000	28%	132,000	29%
Massachusetts	224,000	28%	471,000	31%
Illinois	482,000	28%	985,000	30%
Michigan	396,000	28%	807,000	28%
Nevada	76,000	27%	172,000	29%
Vermont	23,000	27%	43,000	28%
South Dakota	27,000	27%	50,000	27%
Iowa	107,000	26%	201,000	28%
Pennsylvania	413,000	26%	835,000	29%
Virginia	242,000	25%	439,000	26%
Washington	203,000	25%	391,000	28%
Rhode Island	34,000	25%	68,000	26%
Indiana	208,000	25%	390,000	26%
Alaska	25,000	24%	50,000	25%
New Jersey	247,000	23%	486,000	24%
Utah	78,000	23%	171,000	24%
New Hampshire	41,000	23%	83,000	23%
Maryland	136,000	21%	255,000	21%
Minnesota	134,000	20%	297,000	22%
Wisconsin	157,000	20%	316,000	20%
Connecticut	86,000	19%	191,000	21%
Colorado	106,000	18%	233,000	20%
US Total	12,182,000	31%	24,148,000	34%

Source: Center on Budget and Policy Priorities tabulations from U.S. Census, Current Population Survey.

Who Would Be Excluded?

We examined the latest data from the U.S. Census Bureau to estimate the number of families and children under 18 who would receive no assistance from the Bush tax plan. To ensure accurate estimates at the state level, we used data for the three years from 1997 to 1999; our analysis estimates the effects of the plan as if it were in full effect in those years. Using data for three years rather than data collected within a single year enlarges the sample size, thus increasing precision.¹

The table on page 2 shows how many of these families live in each state and in the District of Columbia. The figures indicate that throughout the country, there would be substantial numbers of children left out of the plan. In some states, extremely high numbers of children and families would receive no benefit.

- An estimated 3.7 million children in California, 2.3 million children in Texas, 1.9 million children in New York, and 1.2 million children in Florida, along with their families, would receive no benefit from the tax proposal. In each of another eight states — Arizona, Georgia, Illinois, Michigan, North Carolina, Ohio, Pennsylvania, and Tennessee — the families of half a million children, or more, would fail to gain from the tax cut plan.
- In less populous states, the numbers of children and families that would not benefit from the plan are smaller but still substantial. Even in the least populous states, such as Alaska, Vermont and Wyoming, tens of thousands of families with children would not benefit.
- Approximately 52 percent of children in New Mexico live in families that would not benefit under the tax proposal. Other states where approximately 40 percent to 50 percent of children live in families that would not benefit include Alabama, Arizona, Arkansas, California, Georgia, Idaho, Louisiana, Mississippi, Montana, New York, North Dakota, Tennessee, Texas, and West Virginia, plus the District of Columbia. Not surprisingly, because the families that would be excluded under the Bush plan are those with incomes below the poverty line or modestly above it, these states tend to have relatively high levels of child poverty.
- By contrast, families in wealthier states are least likely to be excluded from the

¹ Specifically, we used the Census Bureau's March Current Population Survey for each of those years. The data for 1997 and 1998 were adjusted to simulate the current \$500-per-child tax credit, and the combined data at the state level were slightly scaled to match nationwide estimates of the numbers of excluded families and children for 1999, the latest year for which CPS data are available. The resulting state-level figures may be considered accurate to within about 2 percent to 5 percent, depending on the state. For comparison, these figures are approximately as accurate as the U.S. Census Bureau's annual estimate of poverty rates by state, which also is based on three-year pooling of data.

Bush plan. Even in relatively low-poverty states, like Colorado, Connecticut, Maryland, Minnesota and Wisconsin, 18 percent to 22 percent of children and families would not benefit from the plan.

The finding that about one in three families nationwide does not benefit from the tax plan is consistent with the findings of independent analyses of who is left out of the Bush plan that have been conducted by researchers at the Brookings Institution, the Urban Institute, and the Institute on Taxation and Economic Policy.² All three sets of analyses indicate that among all families with children, nearly one in three would not receive any assistance from the Administration's proposal.

Even the Bush proposal to double the child tax credit — the feature of the President's 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 most of these children. This proposal would provide the largest tax reductions to families with incomes above \$110,000 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 in 2006.
- All families with two children in the \$110,000 to \$250,000 range, however, would receive an increase in their child tax credit *of more than* \$500 per child. For most of these affluent taxpayers, the child credit would rise from zero under current law to \$1,000 per child under the Administration's plan. This is because the Bush proposal extends the child tax credit to many families with high incomes who currently receive no credit at all. (This outcome results from two provisions of the Bush plan. The plan both increases the point at which the child credit begins to phase out and slows the rate at which it phases out. Under current law, the credit for a married family with two children phases out between \$110,000 and \$130,000. Under the Bush plan, when fully in effect starting in 2006, the credit for such a family would phase out between \$200,000 and \$300,000. Families between \$130,000 and \$300,000 thus would be made newly eligible for the credit.)
- By contrast, the Bush plan does not extend the credit to any low- and moderate-income families who currently receive nothing from the credit. Under the plan, increased coverage for high-income families with children is not accompanied by increased coverage for low-income families.

² Isabel Sawhill and Adam Thomas, *A Tax Proposal for Working Families with Children*, Policy Brief No. 3, Brookings Institution, January 2001; Frank J. Sammartino, *Federal Income Tax Cuts and Low-Income Families*, The Urban Institute, January 2001; and Institute on Taxation and Economic Policy, unpublished tables prepared for the Children's Defense Fund.

Why Don't Families 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 owes no income taxes under current law.

A large portion of families with children 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 in more detail, 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 well above the poverty line. 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 \$17,950.³ Families with incomes below the poverty line would receive no assistance from the tax cut, nor would many families with incomes modestly above the poverty line.

The framers of the Bush plan could have assisted low-income working families by improving the Earned Income Tax Credit, which provides tax relief and supplements wages for low- and moderate-income working families. Alternatively, the Bush plan could have expanded the dependent care tax credit — a credit that can offset a family's child care costs — and made it available to the low-income working families who now are denied access to this credit because it is not "refundable" (that is, it cannot exceed the income taxes a family otherwise owes). Or, the plan could have increased the now-limited degree to which the child tax credit is refundable and can be used to offset taxes other than income taxes.⁴ The plan takes none of these steps.

Which Families Should Benefit?

Since the reason that millions of 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

³ Such calculations 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*, February 2001.

⁴ Specifically, in a limited number of cases, working families with three or more children may claim some or all of the child credit as a refund. In such cases, the credit is limited to the amount by which the employee share of a family's payroll tax liability exceeds its EITC. IRS data show that only about 750,000 families benefitted from this provision in 1998.

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.

1. A significant number of these families owe federal taxes other than federal income taxes, often paying significant amounts. For most families, the biggest federal tax burden by far is the payroll tax, not the income tax. Data from the Congressional Budget Office show that in 1999, three-fourths of all U.S. families paid more in federal payroll taxes than in federal income taxes. (This comparison includes both employee and employer shares 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 federal excise taxes and state and local taxes, which are discussed further on the next page. While the Earned Income Tax Credit offsets these taxes for many working poor families, 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 President Bush has used in some of his speeches, including his first radio address to the nation about his tax package. In this radio address, the President used the hypothetical example of a waitress who is a single-mother with two children and earns \$25,000 a year and indicated her family would be a prime beneficiary of the tax cut. The figures suggest otherwise.

- A single mother with two children and 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 would receive an Earned Income Tax Credit of \$1,500, well under half of its payroll taxes.

As a result, even if just payroll taxes and the EITC are considered, the family’s net federal tax bill would be \$2,325. Nonetheless, this family might receive no tax cut under the Bush plan. If this single-mother 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 would receive no tax cut under the Bush plan despite having a significant net tax burden. (The amount of child care costs affects the calculation due to the interaction between the dependent care credit and the child credit. If she had no child care costs, she would qualify for no dependent care credit and would receive a modest income tax cut,

though it would be far below what she owes in payroll taxes.)⁵

- A two-parent family of four with income of \$25,000 would not receive a tax cut under the Bush plan, whether or not the family has child care costs. For such families as well, their payroll taxes exceed their EITC by \$2,325.

2. *Low and moderate-income families in every state pay state and local taxes, often paying a larger percentage of income in such taxes than higher-income families.* Families with incomes below or near the poverty line bear substantial state and local tax burdens. These taxes commonly include sales taxes, excise taxes on such items as gasoline, property taxes (passed on by landlords to tenants in the form of increased rent), various tax-like fees, and sometimes state- or locality-specific taxes such as local taxes on wages. In addition, many states have income taxes that tax families at much lower income levels than the federal tax does. The Institute on Taxation and Economic Policy estimates that state and local taxes altogether equal anywhere from eight percent to 17 percent of the income of an average low-income married couple, depending on the state. Furthermore, these burdens are inequitably distributed; in almost every state, lower-income families pay a larger share of their incomes in state and local taxes than higher-income families.⁶

Although some states have taken steps to reduce the burden of taxes on low-income families in recent years, they are limited in their ability to do so. States that for many years have levied the sales, excise and property taxes that are most burdensome on the poor cannot simply eliminate those taxes without dramatic effects on state budgets. In addition, it is cumbersome for states to target relief to poor families that are burdened by these taxes. For example, the sales tax is collected by merchants from consumers without regard to their income level, and property taxes are passed through from property owners to renters as part of a rent payment.⁷ Moreover,

⁵ A single-mother waitress with two children who earns \$25,000 qualifies for a dependent care credit of up to 22 percent of her child care costs. Since the credit is not refundable, however, its benefit cannot exceed her income tax liability (before the EITC) of \$447. If she has child care costs of \$170 a month (\$2,040 per year), her dependent care credit equals \$449 — enough to eliminate her pre-EITC income tax liability — so she gains no added benefit from the Bush plan. She would benefit from the tax plan if she had lower child care costs of \$100 per month and hence qualified for a lower dependent care credit, but her tax cut would be small — 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 either of the latter two scenarios, the waitress would receive a tax cut of less than \$500 per child (the amount of the expansion in the child tax credit), although her net tax bill (including payroll and other taxes) would be significant.

⁶ Institute on Taxation and Economic Policy, *Who Pays?*, 1996.

⁷ States that have income taxes do have the ability to enact refundable income tax credits that would help offset other taxes for poor families. Even the most generous such credits, however, offset only a portion of families' overall state and local tax burdens. In Minnesota, for instance, one of the two or three states that have made the most use of refundable tax credits and sales tax rebates, the Department of Revenue calculates that the overall state and local tax burden on low-income taxpayers exceeds 10 percent of income even after the credits and rebates are taken into account.

states with higher levels of poverty often have the least fiscal resources with which to pay for tax relief for low-income families.

These state and local taxes that poor families pay often help finance federally required services or joint federal-state programs. For instance, state contributions to Medicaid typically are financed in whole or in part by general fund taxes such as state sales taxes and excise taxes. Similarly, state contributions to federal highway construction often are financed by gasoline and other motor vehicle taxes. In part because these and other federal programs rely on state and local taxes, it can be appropriate for the federal government to administer tax relief that helps offset the burden of those taxes.

3. *An additional income boost would further the objective of helping working families lift themselves out of poverty.* 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.⁸ 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 gain in the earnings of the working poor has 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 only \$292.⁹ (Both changes are adjusted for inflation.)

In addition, a study the Manpower Demonstration Research Corporation recently released finds that improving income — and not just employment — is important if the lives of children in poor families are to improve.¹⁰ 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.

⁸ For example, the Heritage Foundation, a leading conservative organization, recently proposed expanding the EITC by \$5 billion per year for married families with children; see Angela M. Antonelli and Peter B. Sperry, eds., *A Budget for America*, Heritage Foundation, January 2001.

⁹ 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.

¹⁰ Pamela A. Morris, et. al., *How Welfare and Work Policies Affect Children: A Synthesis of Research*, January 2001.

4. *The Bush approach fails to reduce the high marginal tax rates that many low-income families face.* Throughout the 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 principal goals. They have observed that a significant fraction of each additional dollar these families earn is lost as a result of increased income and payroll taxes and the phasing out of the EITC.¹¹ Yet a large number of low-income families that confront some of the highest marginal tax rates of any families in the nation would not have their rates reduced 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), and 24 cents to 36 cents if they receive food stamp benefits. They lose additional amounts if they receive housing assistance or a state child care subsidy on a sliding fee scale, or if they are subject to state income taxes. Their marginal tax rates are well above 50 percent. The Bush plan does not reduce these rates.

Ways to reduce marginal tax rates for such families are available and not especially expensive. One approach is to raise the income level at which the EITC begins to phase down as earnings rise and/or reduce the rate at which the EITC phases down. Bipartisan legislation that Senators Rockefeller, Jeffords, and Breaux introduced last year follows such a course, as does another proposal made by Rep. Ben Cardin. Another way to lower marginal rates would be to expand substantially the existing, very limited refundable component of the child credit.¹²

5. *The rewards from the surplus should be spread throughout the population.* The Bush tax plan would take most or all of the surplus that is projected to occur over the next ten years outside Social Security and Medicare. Democratic leaders have proposed substantially smaller but still significant tax cuts. If tax cuts are to be provided as one of the principal uses of the surplus, as seems likely, it is appropriate to dedicate some portion of those tax cuts to people with the most pressing needs, such as low-income families with children.

¹¹ 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.

¹² The existing refundability provision is described briefly in footnote 4 on p. 5.