

Income Tax Rates and High-Income Taxpayers

How Strong is the Case for Major Rate Reductions?

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Summary

Should it be a national priority to lower marginal tax rates substantially in all tax brackets, including the higher brackets? Those who support large tax-rate reductions in the upper brackets emphasize that the share of federal taxes those in the top brackets pay has increased significantly in recent years. They also argue that as a result of increases in top marginal rates enacted in 1990 and 1993, these rates have grown so high that individuals in these brackets are discouraged from risk-taking and work effort. Both the amount of taxes that upper-income families pay and the marginal tax rates they face have been depicted as being sufficiently high as to be unduly burdensome, unfair, and injurious to the economy.

This analysis seeks to examine these issues. It relies primarily on the latest data available from the Internal Revenue Service on income and income tax trends. For some of this information, the latest IRS data are for 1997; for other information, the latest IRS data are for 1998. These IRS data break out taxpayers by the highest marginal tax rate they pay. The data also break out income and income tax trends for various groups — such as the top one percent of taxpayers — on an annual basis. The trends the IRS data depict are consistent with the trends reflected in estimates the Congressional Budget Office and the Joint Committee on Taxation have issued during the past two months.

The key findings of this analysis are summarized here.

Current Marginal Tax Rates and the Administration's Proposal

The tax code currently contains five income tax brackets, with marginal tax rates ranging from 15 percent to 39.6 percent. The marginal tax rate is the rate that applies to each additional dollar of taxable income.

Only a very small share of tax filers have incomes high enough to be subject to the highest marginal income tax rates. IRS data show that in 1997, the latest year for which this information is available:

- *Less than one-quarter* of all tax filers were in tax brackets higher than the 15 percent bracket.
- *Only four percent* of tax filers were in the 31 percent bracket or a higher bracket.
- *Less than one percent* of filers were in the top bracket, where the marginal tax rate is 39.6 percent. The average adjusted gross income of filers in the 39.6 percent bracket exceeded \$900,000 in 1997.

Since 1997, the proportions of families that have high incomes and thus are in the higher tax brackets have increased somewhat. Even so, with only four percent of tax filers facing marginal rates of 31 percent or above in 1997, the fraction of tax filers subject to the top rates remains small today.

The part of the Administration's tax proposal that the House of Representatives passed on March 8 includes a provision to reduce the higher marginal rates (i.e., the rates above 15 percent). These rate reductions would have no effect on the bottom three-quarters of tax filers. Nevertheless, this provision is the costliest part of the President's overall tax package; the rate reductions make up 30 percent of the cost of the Bush package, when it is phased in fully.

The Bush tax proposal and the House-passed bill (H.R. 3) also would create a new 10 percent tax bracket. This new bracket would benefit upper-income as well as middle-income taxpayers, since part of the taxable income of *all* such taxpayers would be taxed at the 10 percent rate.

Most low- and many moderate-income families would not be affected by any of these proposals because they do not owe federal income taxes. Many of these families pay significant amounts of other taxes.

Recent Tax Trends

The maximum marginal income tax rates that those at the top of the income spectrum pay are higher now than the marginal rates such individuals faced in the late 1980s. The current top rates are, however, much lower than the top marginal rates during the 1960s and 1970s.

A family's marginal income tax rate — the rate it pays on the last dollar of income it earns — differs from its *effective* income tax rate. A family's effective income tax rate is the percentage of its overall income that it pays in income taxes. Effective tax rates are much lower than marginal rates and have increased to a much lesser degree over the past decade. Average effective tax rates (referred to hereafter simply as "average tax rates") *remain below 20 percent even for most higher-income*

taxpayers. Average rates fell significantly between 1996 and 1998, the latest year for which these data are available.

For upper-income families, some income is not taxed at all due to deductions and exemptions available to all taxpayers, while some income is taxed at the 15 percent marginal rate, some is taxed at the 28 percent marginal rate, some is taxed at higher rates, and some is taxed at the capital gains tax rate of 20 percent. As a result, the average income tax rates that high-income families face are sharply lower than their marginal tax rates.

- The IRS data show that in 1997, filers in the 28-percent tax bracket faced an average income tax rate of only 14.3 percent. The average income tax rate that filers in the 31-percent bracket faced was 19.5 percent.
- Only those in the 36 percent and 39.6 percent brackets — a group that includes fewer than two percent of all filers — paid more than 20 percent of their income in federal income taxes.
- Even among the small number of families in the 39.6 percent marginal bracket — a group that includes fewer than one percent of all tax filers — the average income tax rate in 1997 was 30 percent, or less than one-third of their income. Indeed, the only Americans who pay more than one-third of their income in federal income taxes are a tiny group of extremely high-income individuals who make up a small fraction of one percent of all filers and who earn enormous amounts.

Marginal versus Average Income Tax Rates, 1997

Highest Marginal Rate	Average Income Tax Rate	Percent of Tax Filers
28%	14.3%	19.6%
31%	19.5%	2.4%
36%	23.2%	1.0%
39.6%	29.9%	0.6%

Source: CBPP calculations based on IRS data.

Recent Declines in Average Tax Rates for High-income Filers

In the past few years, the average income tax rate that the top one percent of tax filers pay has *declined*, falling from 28.9 percent in 1996 to 27.1 percent in 1998. This drop occurred primarily because of a large increase in capital gains income, which is taxed at a lower rate than other income and is heavily concentrated among those at the top of the income scale. The reduction in the top long-term capital gains tax rate from 28 percent to 20 percent enacted in 1997 also contributed to this decline in average income tax rates among high-income filers.

It may be noted that the Joint Committee on Taxation estimates the top one percent of taxpayers will face a somewhat lower average income tax rate — 25.7 percent — in 2001. The Committee’s estimate may be lower than the IRS estimate at least in part because of a continued decline in average tax rates between 1998 and 2001, although inconsistencies between the two sets of data make this difficult to assess. It is clear, however, that the IRS data modestly overstate the share of income that taxpayers pay in taxes because the IRS data use a narrower measure of income. (The IRS income measure, for instance, does not include tax-exempt interest or the portion of pension benefits that is not taxable. The Joint Tax Committee data include these income sources.)

These figures suggest that focusing solely on the marginal tax rates that high-income taxpayers face while ignoring their much-lower average tax rates may lead to an exaggerated sense of the tax burdens that high-income taxpayers face. For example, the President, in his speech before a Joint Session of Congress on February 27, 2001, stated that “No one should pay more than a third of the money they earn in federal income taxes.” IRS and Joint Tax Committee data show that even the top one percent of families currently pay significantly less than one-third of their income in federal income taxes; on average, they pay a little more than one-quarter of their income in federal income taxes.

Recent Income Trends

The share of income taxes that the top one percent of filers pay has increased substantially since the end of the 1980s. This is a point that proponents of lowering the top tax rates often cite. In 1989, the top one percent of filers paid 25.2 percent of federal income taxes, according to the IRS data. In 1998, they paid 34.8 percent. (The top one percent pay a much larger share of the progressive income tax than of *all* federal taxes; the top one percent pay 24 percent of all federal taxes.)

The primary driving force behind the increase in the share of income taxes that those at the top of the income spectrum pay has not, however, been increases in tax rates. The primary factor has been a dramatic increase in the before-tax incomes of these high-income individual, an increase that has far outstripped increases in income for other Americans. Approximately two-thirds of the increase in the share of income taxes paid by the top one percent of tax filers that occurred between 1989 and 1998 reflected the increased concentration of income at the top of the income scale rather than higher tax rates.¹

¹ As noted, from 1989 to 1998, the share of income taxes paid by the top one percent of tax filers rose from 25.2 percent to 34.8 percent. If the top one percent had paid the same percentage of its income in income taxes in 1998 as in 1989, it would have paid 31.4 percent of all income taxes in 1998. In other words, if the average income tax burden of the top one percent of tax filers had remained the same, this group’s share of all income taxes would have risen from 25.2 percent in 1989 to 31.4 percent in 1998, simply because of the increased share of the national income it received. The increasing concentration of income thus accounted for about two-thirds of the increase that occurred in the share of income taxes paid by the top one percent.

Both Before- and After-Tax Income Gains Substantial for Top One Percent

The IRS data provide information through 1998 on the incomes of the top one percent of tax filers, a group primarily made up of filers that face a marginal income tax rate of either 36 percent or 39.6 percent. The IRS data also provide information on the incomes of tax filers in the 95th through the 99th percentiles of incomes — that is, those in the top five percent of tax filers, except for those in the top one percent. Nearly all those tax filers in the 95th-99th percentiles are in the 28 percent, 31 percent, or 36 percent bracket.

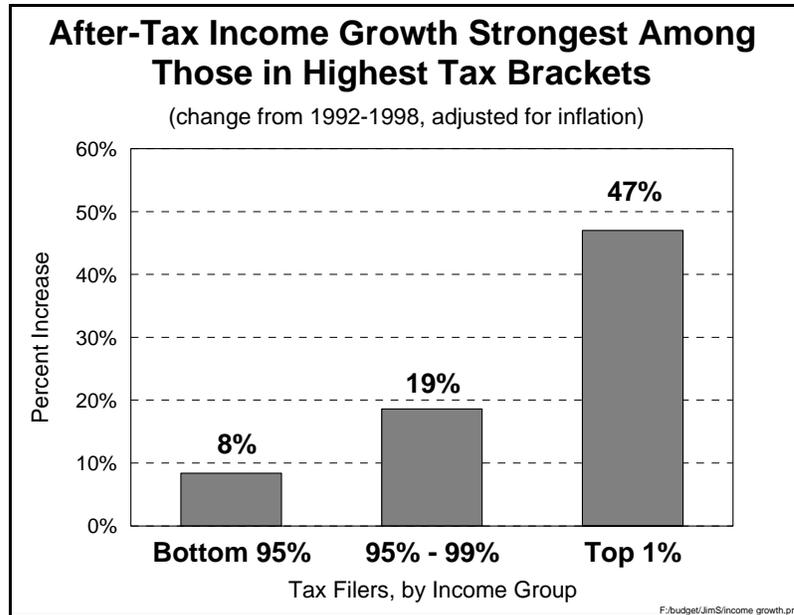
- The average before-tax income of the top one percent of tax filers rose 51 percent between 1992 and 1998, after adjusting for inflation. (We measure changes in income between 1992 and 1998, because 1992 is the year before the 36 percent and 39.6 percent marginal tax rates were established, while 1998 is the latest year for which these IRS data are available.)
- The before-tax income of those in the 95th to 99th percentiles also increased significantly, climbing 21 percent.
- In contrast, the before-tax income of the bottom 95 percent of tax filers rose a more modest nine percent.

These figures — as well as the robust growth in the economy in recent years — are not consistent with theories that the increases in the top marginal tax rates enacted in the early 1990s sapped risk-taking, entrepreneurship, and work effort among high-income individuals.

The trends in *after-tax* incomes are similar:

- Between 1992 and 1998, the average incomes of the top one percent of tax filers rose 47 percent after federal income taxes are subtracted. The average after-tax income of these taxpayers increased from \$405,000 in 1992 to \$595,000 in 1998, after adjusting for inflation, a gain of \$190,000 per filer.
- Among tax filers in the 95th to 99th percentiles of income, average after-tax income rose 19 percent during this period.
- Among the rest of the population, after-tax income increased eight percent.
- The average after-tax increase of \$190,000 among the top one percent of tax filers is several times greater than the *total* after-tax income of the typical American family.

We also examine data from 1989 (before the top marginal income tax rate was increased as part of deficit reduction legislation enacted in 1990) to 1998. The findings from this longer period are essentially the same — after-tax income has become concentrated to a much greater degree at the top of the income spectrum despite the increases in the top marginal tax rates that occurred during this period.



Joint Tax Committee Also Shows Increasing Income Concentration

This increased concentration of income is similarly in evidence in tables the Joint Committee on Taxation released on February 27. As recently as last June, the Joint Committee was projecting that the top one percent of taxpayers would receive 13.7 percent of the national after-tax income in 2001. The Joint Committee's now estimates that these taxpayers will receive 15.7 percent of the national after-tax income this year. This reflects a large upward revision in the Joint Committee's estimate of the average after-tax income of those in the top one percent of the population. The Joint Committee has raised its estimate of the average after-tax income these families will receive in 2001 by nearly \$120,000 — from \$589,000 in the estimate the Joint Committee issued in June to \$708,000 in the new estimate.

This recent widening of income disparities is a continuation of a longer-term trend. Data from the Congressional Budget Office, which extend back to 1977 and run through 1995, show that disparities in after-tax income grew substantially between the late 1970s and 1995. Census data on *before-tax* income that go back to 1947 similarly show that income disparities have been increasing since the mid-1970s. These various data indicate that income disparities are greater now than at any time recorded since the end of World War II.

Conclusion

These data demonstrate that after-tax incomes have climbed sharply in recent years among those at the top of the income spectrum and particularly among those who fall in the tax brackets in

which marginal rates were increased in the 1990s. The data also show that those at the top of the income spectrum receive a larger share of the national after-tax income than at any other time on record.

These patterns suggest that any tax cut should tilt against these trends or, at a minimum, not exacerbate them. While providing some tax reductions to high-income individuals may be appropriate, a tax-cut package should not be structured in a way that further widens the already vast income disparities between those at the top and other Americans. This goal can be achieved only if the share of the tax cuts that high-income families receive is no greater than their share of the national after-tax income. The Administration's tax proposal, as well as the bill that the House of Representatives passed on March 8, fail to meet this standard.

An analysis by Citizens for Tax Justice, using the Institute for Taxation and Economic Policy model, finds that the top one percent of taxpayers would receive 44 percent of the tax cut benefits under the House-passed bill to create a new 10-percent bracket and reduce marginal rates. This 44 percent share of the benefits is more than two and one-half times the share of after-tax income these individuals receive.

In addition to the income tax provisions in the House bill, the plan President Bush submitted to Congress on February 8 would make numerous other changes, such as addressing the marriage penalty relief, expanding the child credit, repealing the estate tax, and extending the research and experimentation credit. Combining CTJ data on all of the income tax provisions in the Bush tax plan with Treasury Department data on the distribution of estate and corporate income taxes provides an estimate that the top one percent of taxpayers would receive 39 percent of the tax cuts in the overall Bush plan. That is more than double their share of the national after-tax income.

Because the top one percent of taxpayers would receive a share of the tax-cut benefits that exceeds the share of the national income they already get — and most other income groups would receive a share of the tax cut that is smaller than the share of income they currently get — the tax proposal would further widen income disparities. This widening of income disparities is clearly illustrated when one looks at the change in after-tax incomes resulting from the two tax-cut proposals:

- Under the House-passed bill, after-tax incomes of the top one percent of taxpayers would rise by 3.8 percent, or three-times the 1.2 percent increase in the after-tax incomes for the 20 percent of families in the middle of the income spectrum.
- Under the Bush plan, after-tax income for the top one percent of taxpayers would grow by 6.2 percent. This is more than three times the income growth of 1.9 percent for the fifth of the population in the middle of the income spectrum.

At a time when income disparities in the United States are the widest on record, the Administration's proposal and the House-passed bill would enlarge the income gulf.

I. Introduction

On March 8, the House of Representatives passed the two components of President Bush's tax cut plan that the Administration has featured most prominently — the provisions to reduce the number of income tax brackets from five to four and to lower certain income tax rates. These provisions would take full effect in 2006 and consist of two basic parts.

First, the Administration and the House-passed bill (H.R. 3) propose to create a new 10 percent bracket to replace a modest part of the 15 percent bracket. Some of the income now taxed at a 15 percent rate would be taxed at a 10 percent rate instead. Most income currently taxed at a 15 percent rate would continue to be taxed at that rate.

The second part of the proposal applies only to those in the “higher brackets” — those whose incomes are large enough that the highest marginal rate at which their incomes are taxed is 28 percent, 31 percent, 36 percent, or 39.6 percent. In 1997, the latest year for which these data are available, less than one-quarter of tax returns fell into one of these higher tax brackets. Only four percent of tax returns — one in every 25 — was taxed, even in part, at a rate of 31 percent or higher. The Bush proposal and H.R. 3 would combine the current 28 percent and 31 percent marginal tax brackets into a single bracket and lower the marginal rate to 25 percent. Similarly, the current 36 percent and 39.6 percent brackets would be collapsed into a single bracket, with the rate reduced to 33 percent.

This is the single most expensive piece of the Administration's tax-cut plan. When fully phased in, it accounts for about 30 percent of the cost of its overall tax package.

This report examines these components of the tax package, with a particular emphasis on assessing the rationale for and impact of the rate reductions in the higher brackets. The report begins with an examination of the current marginal rates and how H.R. 3 would affect them. It then explores, in separate sections, two issues that have a bearing on the advisability of the proposal.

- The current tax burdens of those in the various tax brackets and how those burdens have changed over time.
- How the before-tax and after-tax incomes of families in different tax brackets have changed over time.

This report relies primarily on information from the Statistics of Income Division of the Internal Revenue Service. The IRS data are the most recent and complete available. For some matters, the most recent IRS data are for 1997; for other matters, the most recent data are for 1998.

The IRS data have some limitations. They include information on income tax payments but not on other tax payments. In addition, the measure of income in these data does not include a few sources of income. As a result, income taxes are shown as consuming a somewhat larger share of income than they actually do.

II. Current Tax Rates and Who Would Be Affected by the Bush Proposal

This section of the paper examines the current marginal rate structure of the federal income tax code. It also looks at the number of families in the various tax brackets.

The Distribution of Families by Tax Brackets

There currently are five income tax brackets, in which rates ranging from 15 percent to 39.6 percent are levied on taxable income.² Separate tax rates are applied to income resulting from the sale of a capital asset. Under our progressive income tax code, higher levels of income are taxed at higher rates. Consequently, the marginal tax rate — the rate that applies to each additional dollar of taxable income — increases as income rises.

Table 1 shows the distribution of all tax filers, including both individuals and families, based on the marginal tax rate they paid in 1997. This is the latest year for which these data are available.

- Three-quarters of tax filers either had no taxable income in 1997 — because their income was less than the available deductions and exemptions — or faced a marginal tax rate of 15 percent.

² Taxable income is the income subject to tax after the standard deduction (or itemized deductions if the taxpayer itemizes), personal exemptions, and other deductions are used to reduce total income. Because of these deductions and exemptions, some people with low levels of earnings are not subject to income tax, although they typically still pay other federal taxes, particularly payroll taxes.

- *Less than one-quarter* of all tax filers were in tax brackets where they faced a marginal tax rate of 28 percent or higher.
- *Only four percent* of tax filers were in the 31 percent bracket or a higher bracket.
- *Fewer than one percent* of tax filers were in the top bracket, where the marginal tax rate is 39.6 percent. The average adjusted gross income of families in the 39.6 percent bracket exceeded \$900,000 in 1997.

Table 1: Tax Filers Distributed by Their Highest Marginal Tax Rate, 1997

Highest Marginal Rate at Which Income (Other than Capital Gains) Is Taxed	Number of Tax Filers (In Thousands)	Share of Tax Filers	Average Adjusted Gross Income
No taxable income*	22,795	18.8%	\$7,135
15 percent	69,653	57.3%	\$26,784
28 percent	23,821	19.6%	\$69,839
31 percent	2,868	2.4%	\$137,711
36 percent	1,170	1.0%	\$249,356
39.6 percent	691	0.6%	\$928,332
Form 8615**	507	0.4%	\$6,128
Total	121,506	100.0%	\$41,343
* Includes 506,115 returns that paid tax on capital gains at the 10 percent rate, but had no other taxable income.			
** For children under age 14 who had investment income of more than \$1,300 in 1997; IRS does not distribute by tax rate.			

As discussed in more detail in subsequent sections of this report, the five percent of tax filers with the highest incomes experienced substantial real income growth during the 1990s, particularly when compared to families with lower incomes. Based on Internal Revenue Service data from 1998 tax returns, as well as recent data from the Congressional Budget Office and the Joint Committee on Taxation, these trends in income growth appear to have continued since 1997. Although the income tax brackets are indexed for inflation, this increase in the incomes of high-income taxpayers is likely to have resulted in some “bracket creep;” because of rising real incomes, more taxpayers have moved into the higher tax brackets. As a result, the share of taxpayers in the higher tax brackets is likely to be somewhat larger today than it was in 1997. Nonetheless, since only four percent of taxpayers were

subject to marginal rates of 31 percent or higher in 1997, the proportion of taxpayers subject to these rates remains small today.

Impact of Progressive Tax Structure on Taxes

Only a portion of the income of a high-income taxpayer is taxed at a high marginal rate. Some of the income of all taxpayers is not taxed at all, as a result of various deductions and exemptions available to taxpayers. In addition, lower rates apply to capital gains income.

Of particular importance, some of the income of families in the higher brackets is taxed at the rates that apply in the lower tax brackets. For example, a married couple with two children that has earnings of \$100,000 is likely to be in the “28 percent bracket.” But in 2001, such a family pays no tax on its first \$19,200 in income (this amount is not taxable because it is covered by personal exemptions and the standard deduction; the untaxed amount is higher than this if the family itemizes deductions). The family is then taxed at a rate of 15 percent on its next \$45,200 in income (i.e., on its first \$45,200 in *taxable* income). It would be taxed at a 28 percent rate only on income above this amount, which would be about one-third of its total income.

Similarly, a couple in the 39.6 percent bracket with taxable income of \$350,000 would have the portion of its taxable income below \$297,350 — the point at which the 39.6 percent bracket begins — taxed at the lower tax rates that apply to lower levels of income. Only the family’s taxable income above \$297,350 would be taxed at the 39.6 percent rate.

The impact of these graduated income tax rates, under which higher levels of income are taxed at progressively higher rates, is that a family’s *average* or effective income tax rate — the amount of income the family pays in taxes as a percentage of the family’s income — is substantially lower than the marginal tax rate the family faces. For instance, for taxpayers in the 36 percent bracket, the average tax rate was 23.2 percent in 1997. In other words, although the last dollar these families earned was taxed at a 36 percent rate, they paid an average of 23.2 percent of their income in federal income taxes. It is the average tax rate, rather than the marginal tax rate, that measures families’ overall tax burdens.

Table 2: Income Parameters of Tax Brackets for a Married Couple Filing Jointly, 2001

Taxable Income	Marginal Income Tax Rate
\$0 to \$45,200	15 percent
\$45,201 to \$109,250	28 percent
\$109,251 to \$166,500	31 percent
\$166,501 to \$297,350	36 percent
Over \$297,350	39.6 percent

Effects of the Bush Plan and the House-passed Bill

The Bush Administration proposes to reduce the number of income tax brackets from five to four and to lower most income tax rates. Its rate-reduction proposal has two components. First, the Administration proposes to create a new 10 percent bracket to replace the lower part of the 15 percent bracket. Second, the Bush proposal reduces the 28 percent and 31 percent marginal tax rates to 25 percent and lowers the 36 percent and 39.6 percent rates to 33 percent. The four highest income tax brackets thus are collapsed into two brackets with lower rates. Both components of the proposal would phase in gradually and take full effect in 2006.

On March 8, the House passed two pieces of the Bush plan, with modest modifications. The rate reductions in the House-passed bill are identical to the Bush proposal. But the House bill accelerated the implementation of the provision establishing the new 10 percent bracket and made the first stage of this provision retroactive to January 1, 2001.

Table 3 shows how the proposed tax brackets for a married couple compare to the brackets under current law. Under the proposal, only a modest portion of income currently taxed at the 15 percent rate would be taxed at a 10 percent rate. Once phased in fully, the income thresholds for this new lower rate would apply to the first \$12,000 of taxable income for a married couple. Unlike the higher tax brackets, this new bottom bracket would not be indexed to inflation until after 2006.

Table 3: Marginal Income Tax Rates For a Married Couple Filing Jointly

Taxable Income, 2001	\$0-\$12,000	\$12,001-\$45,200	\$45,201-\$109,250	\$109,251-\$166,500	\$166,501-\$297,350	over \$297,350
Current law rates	15%	15%	28%	31%	36%	39.6%
Bush rates, fully phased-in*	10%	15%	25%	25%	33%	33%

* Rate reductions are to be fully phased in by 2006. The new 10 percent bracket is indexed to inflation starting in 2007.

Because the first few thousand dollars of the taxable income of all taxpayers would be taxed at a 10 percent rather than a 15 percent rate, all taxpayers with taxable incomes would receive a tax cut from the creation of this new bracket. The creation of this new tax bracket would result in a maximum tax reduction in 2006 of \$600 for a married couple and \$300 for a single person.³ (It should be noted that the large majority of taxpayers in the 15 percent bracket would not see a reduction in their *marginal* tax rate; each added dollar they earn would continue to be taxed at a 15 percent rate.)

³ For a married couple filing jointly, the first \$12,000 would be taxed at a 10 percent rate, or five percentage points less than the current 15 percent rate. This would yield a maximum tax savings of \$600 ($\$12,000 \times 5\% = \600). The 10 percent rate applies to the first \$10,000 of earnings for a single parent, yielding a maximum tax savings of \$500 ($\$10,000 \times 5\% = \500), and to the first \$6,000 for a single person, yielding a maximum tax savings of \$300 ($\$6,000 \times 5\% = \300).

Since, in addition to establishing the 10 percent bracket, the House-passed bill and the Bush proposal call for income currently taxed at marginal rates of 28 percent or higher to be taxed at lower rates, people in the top tax bracket would receive tax benefits from the proposed rate reductions in every tax bracket. A taxpayer in the current 39.6 percent bracket would benefit from the creation of the 10 percent bracket, the reduction in the 28 percent and 31 percent marginal rates to 25 percent, and the replacement of the 36 percent and 39.6 percent rates with a 33 percent rate. By contrast, middle-income taxpayers in the 15 percent bracket would not enjoy these cumulative effects. They would receive the tax cut stemming from the creation of the 10 percent bracket but would be unaffected by the other rate reductions.

Although the reduction in the rates for the higher tax brackets would affect only a modest percentage of taxpayers, it would be the costliest part of the rate-reduction proposal.

- Joint Tax Committee estimates issued March 1 show that creating the 10 percent bracket and making it retroactive to 2001 would reduce revenues by \$383 billion through 2011. This \$383 billion in tax cuts would be divided among all families with taxable incomes, including those in the higher tax brackets.
- The Joint Committee also estimates that the reductions in the tax rates for those in the higher brackets — that is, the replacement of the four higher rates with a 25 percent rate and 33 percent rate — would cost \$560 billion over ten years. These tax-cut benefits would flow only to the one-quarter of families that are taxed at these higher rates.
- This reduction in rates for the top brackets is the most expensive part of the overall Bush plan. In 2011, when all the provisions of the Bush plan are in full effect, including for instance the repeal of the estate tax, the rate cuts represent 30 percent of the total.

A recent analysis of the House bill by the Citizens for Tax Justice confirms that a significant share of the tax cuts in the bill would benefit those with the highest incomes. According to the CTJ analysis, which relies on the tax model of the Institute for Taxation and Economic Policy, 44 percent of the tax-cut benefits provided by the House-passed bill would flow to the top one percent of taxpayers.

The tax cuts the House-passed bill would confer on families in the 28 percent bracket and the brackets above that would be even greater were it not for the Alternative Minimum Tax. Another analysis by the Joint Tax Committee found that the overall tax relief in the House bill is reduced by \$292 billion over 10 years because of the impact of the AMT. The rate reductions approved by the House would result in 15 million additional taxpayers becoming subject to the AMT by 2011. These taxpayers would have their tax cut reduced or eliminated by the AMT. To prevent this

from occurring would require changes in the AMT that would cost \$292 billion over the next ten years, according to the JCT analysis.

The Alternative Minimum Tax was intended to prevent high-income taxpayers from using a combination of tax breaks that would eliminate most or all of an individual's income tax liability. Taxpayers must pay the larger of either their normal income tax bill or the income tax they would

How Much Immediate Fiscal Stimulus Does the House Bill Provide?

The House-passed bill proposes to accelerate and make retroactive to 2001 the Administration's proposal to create a new lower-rate tax bracket for the first several thousand dollars of taxable income. Under the House bill, the rate for this bracket would initially be set at 12 percent, effective as of January 1, 2001. The full reduction to 10 percent would be phased in through 2006. Supporters of the House bill contend that with this change, the tax cut will provide needed stimulus to the economy, which has shown signs of weakness in recent months. In reality, only a tiny portion — a half of one percent — of this trillion dollar tax-cut bill is dedicated to immediate fiscal stimulus.

Economists are generally skeptical of the effectiveness of fiscal policy changes, such as tax cuts and spending increases, to provide stimulus to address short-term slowdowns in the economy, believing the Federal Reserve is better placed to address these problems through monetary policy. Economists also broadly agree that if tax cuts are used for stimulative purposes, the tax measures should put more money into the hands of lower- and middle-income families than higher-income families. Lower- and middle-income families are more likely to spend their tax savings, thereby stimulating the economy. Higher-income families are likely to save a larger portion of their tax cuts than families of lesser means.

The Administration did not design its tax proposal as a stimulus package, and the House-passed bill takes only a very modest step toward providing fiscal stimulus. According to Joint Committee on Taxation estimates, the bill's proposal to apply a 12 percent rate in 2001 to the first \$6,000 of taxable income for a single person and \$12,000 for a married couple (effectively providing a maximum tax cut of \$180 for singles and \$360 for couples) would inject less than \$6 billion into the economy during the current fiscal year. This represents five one-hundredths of one percent of the gross domestic product; it is far too small to have a noticeable stimulative impact. (Supporters of the bill assert a "psychological impact" would result from families anticipating larger tax reductions in the future, but any such effects are uncertain.)

Looked at another way, the tax cuts plus the associated interest costs total \$1.2 trillion, of which only 0.5 percent would be dedicated to stimulating the economy in 2001. Less than five percent of the cost would come in the first two years. Yet 95 percent of the bill's cost would come *after* 2002, by which time the slowdown should long have been over. In short, the bill provides no meaningful short-term stimulus and should not be seen as an attempt to address the economic slowdown. Rather, the bill should be viewed for what it is — primarily a rate-reduction bill for those in the higher-income brackets.

For more information on the short-term impact of rate reductions, see Peter R. Orszag "Is the House Bill Needed to Avert a Recession?," Center on Budget and Policy Priorities, March 5, 2001. For information on the long-term economic impact, see Jason Furman and Peter Orszag, "Tax Cuts vs. Spending Increases: Is Chairman Greenspan Right?," Center on Budget and Policy Priorities, forthcoming.

owe under the AMT. Because of flaws in the AMT's design, growing numbers of taxpayers will become subject to the AMT unless the problems in the AMT are addressed. According to the Joint Tax Committee analysis, the number of taxpayers subject to the AMT is expected to rise under current law from 1.5 million taxpayers in 2001 to 20.7 million in 2011. The House-passed bill would exacerbate this trend, raising to 35.7 million the total number of taxpayers affected by the AMT in 2011. While a significant number of families in the middle of the income spectrum would be affected by the AMT, the highest concentration of taxpayers affected by the AMT would still be in the current 28 percent bracket and brackets above that.

These figures on the AMT are significant, because virtually all knowledgeable tax observers believe Congress will not allow the AMT to swell in this manner and will act in the next few years to scale back its reach substantially. In testimony before the Senate Finance Committee last week, Treasury Secretary Paul O'Neill agreed the AMT problem will have to be addressed. When action to address the AMT problem occurs, as it surely will, the amount of tax reduction that goes to those in the top brackets as a result of the Bush plan will rise still higher, as well as the proportion of the tax cut benefits they receive.

III. Recent Tax Trends

Proponents of these rate reductions point to two developments in income taxes in the 1990s as reasons for supporting substantial reductions in the marginal income tax rates that high-income taxpayers face. First, the marginal rates increased as a result of legislation enacted in 1990 and 1993. Second, the share of income taxes that high-income tax filers pay has climbed substantially. This section of the report examines these issues.

Marginal and Average Income Tax Rates

Marginal income tax rates are higher today than they were in 1989 for those at the top of the income spectrum. In 1989, the top marginal income tax rate was 28 percent.⁴ The top marginal income tax rate was increased to 31 percent as part of the 1990 budget agreement, and new brackets of 36 percent and 39.6 percent were subsequently established as a result of the 1993 budget legislation. The current top marginal tax rate of 39.6 percent remains far below the top rate of 50 percent in place before the 1986 tax reform act and of 70 percent before the 1981 Reagan tax cuts.⁵

⁴ As discussed in the next footnote, in this report we ignored the effects on marginal tax rates of the phasing out of certain income tax exemptions and deductions. Thus, for 1989, we ignored the fact that some taxpayers in the 28 percent bracket paid marginal rates higher than that because, for instance, their personal exemption was being phased out.

⁵ Throughout this analysis we focus, as the Administration typically does, on the five “statutory individual brackets” and do not examine the effects on marginal tax rates of the phasing out of certain income tax exemptions and deductions. These phase-outs raise marginal rates by modest amounts. For example, for married taxpayers, the personal exemption of \$2,900 is reduced by two percent for every \$2,500 in adjusted gross income over \$199,450. The personal exemption completely phases out when AGI reaches \$321,950, primarily affecting those in the 36 percent bracket.

(continued...)

These higher marginal tax rates affect only a small proportion of the population. In 1997, only about four percent of all tax filers paid rates of 31 percent or more on some of their income. All other tax filers faced a maximum marginal tax rate of 28 percent or lower, as they did at the end of the 1980s.

The marginal income tax rates that high-income families face are substantially higher than their *average* income tax rates. Average income tax rates represent the percentage of total income that these filers pay in income taxes. Some of the income of upper-income families is exempt from taxation (as a result of deductions and personal exemptions), and some is taxed at the current 15 percent and 28 percent rates. Furthermore, some of the income of high-income filers is taxed at the capital gains tax rate of 20 percent. As a result, the overall percentage of income that these families pay in income taxes is much lower than the marginal tax rate they pay on each additional dollar they earn.

As Table 4 indicates, the average tax rate that most taxpayers pay is well below their marginal tax rate. (As the box on the next page explains, the IRS figures cited in this table overstate average income tax rates among high-income taxpayers. Data from the Joint Tax Committee for 2001 show that average income tax rates are currently lower than the rates shown by these IRS data.)

Table 4: Marginal versus Average Income Tax Rates, 1997

Highest marginal rate	Average income tax rate
28%	14.3%
31%	19.5%
36%	23.2%
39.6%	29.9%

- For those in the 28 percent tax bracket, the average income tax rate — the average percentage of adjusted gross income they pay in income taxes — was 14.3 percent in 1997. Their average tax rate was half their marginal rate.
- It is not until taxpayers face a marginal rate of 36 percent or higher that the average tax rate climbs above 20 percent. In 1997, only two percent of tax returns fell into these brackets.

⁵ (...continued)

We also do not consider the effect of payroll taxes on marginal tax rates. The inclusion of payroll taxes in the calculations would show the combined marginal rates of taxpayers in the 15 percent bracket to be much higher, as payroll taxes reduce their income by 15.3 cents for each dollar earned. The effect on high-income taxpayers is substantially smaller. The Social Security part of the payroll tax applies only to earnings up to \$80,400 in 2001; earnings above this level are not subject to this tax. Earnings at higher levels are subject to the payroll tax of 2.9 percent that funds the Hospital Insurance component of Medicare.

Data from the Joint Committee on Taxation Indicate That Average Income Tax Rates are Lower than the IRS Data Suggest

On February 27, Congress' Joint Committee on Taxation released tables on the *Distribution of Certain Federal Tax Liabilities by Income Class for Calendar Year 2001*. These tables indicate that average income tax rates for high-income families in 2001 are lower than the IRS data show for 1998.

- According to the Joint Tax Committee estimates, the top one percent of taxpayers will pay an average of 25.7 percent of their income in income taxes in 2001; the IRS data indicate that this group paid an average of 27.1 percent of their income in income taxes in 1998.
- The Joint Tax Committee data show that tax filers between the 95th and 99th percentiles will pay an average of 18.1 percent of their income in income taxes in 2001; the IRS data indicate their average income tax rate was 19.1 percent in 1998.

The differences between the Joint Tax and the IRS data may reflect an ongoing decline in average income tax rates. Because of the inconsistency between the two sets of data, however, this possibility is difficult to assess. What is more certain is that the IRS data overstate the share of income consumed by taxes because they rely on a narrower measurement of income. For example, the IRS adjusted gross income measure does not include tax-exempt interest or the portion of pension benefits that is not taxed. The Joint Tax Committee data includes these sources of income.

- Even for the small number of families in the 39.6 percent marginal bracket — a group that accounts for fewer than one percent of tax filers — the average income tax rate in 1997 was slightly below 30 percent.

Trends in Average Income Tax Rates

Average income tax rates for high-income families increased during the 1990s but not to the extent that marginal tax rates did. Moreover, in the past few years, the average income tax rates these families pay have declined. It is average tax rates, not marginal tax rates, that measure the overall tax burden that families face.

The top one percent of tax filers consists primarily of filers who are in the 39.6 percent marginal rate bracket and filers in the 36 percent bracket. The marginal rates in these brackets exceed the marginal rate in 1989 for those with the highest incomes, which was 28 percent. The *average* income tax rate these filers pay increased by a substantially smaller amount. In 1989, the average income tax rate for the top one percent of tax filers was 23.3 percent. In 1998, it was 27.1 percent.

In the past few years, the average income tax rate for those at the top of the income scale has fallen, dropping from 28.9 percent in 1996 to 27.1 percent in 1998, the lowest level since 1992. This occurred primarily because of a large increase in capital gains income. That form of income is taxed

at a lower rate than other income (especially after the 1997 reduction in the capital gains tax rate) and is heavily concentrated among high-income tax filers. In addition, while the percentage of income that the top one percent pays in *all* federal taxes (not just income taxes) is higher than in the late 1980s, it is lower than in the late 1970s.

Changes in the Share of Income Taxes that Various Income Groups Pay

The share of federal income taxes that the top one percent of tax filers pay has risen in recent years. The IRS data indicate the top one percent of filers paid 25.2 percent of all individual income taxes in 1989 and 34.8 percent in 1998. The share of income taxes that those in the 95th to 99th income percentiles pay also has risen but only modestly, from 18.7 percent of all income taxes in 1989 to 19.1 percent in 1998. The share of income taxes that the rest of the population pays has declined.

In assessing these data, several considerations should be borne in mind. First, high-income taxpayers pay a much larger share of *income* taxes than of *all* federal taxes. Data from the Joint Committee on Taxation indicate that in 2001, the top one percent of taxpayers will pay 36 percent of income taxes but 23 percent of all federal taxes that the Committee examined in this analysis. The analysis covers federal income, payroll, and excise taxes, but not corporate income or estate taxes. If Treasury Department estimates of the distribution of corporate income and estates taxes are used in conjunction with the Joint Tax Committee figures, the share of total federal taxes the top one percent of filers pays would be 24 percent.

Income taxes make up about half of all federal taxes and have been designed to be progressive — that is, they have been explicitly designed to consume a larger share of the income of high-income families than of other families. The net effect of other federal taxes is regressive; in combination they consume a larger share of the income of low- and middle-income families than of high-income families. Most notable in this regard are the payroll taxes that fund Social Security and Medicare; Congressional Budget Office data show that three of every four families pay more in payroll taxes than in income taxes. The progressivity of the income tax has traditionally served the role of offsetting the regressivity of much of the rest of the federal tax code and of state tax systems, which also tend to be regressive. The degree to which high-income families pay a large share of federal income taxes consequently should be examined in the context of their overall tax burden.

Another factor to take into account is assessing the increase in the share of federal income taxes that high-income taxpayers pay is that this increase is due primarily to a sharp increase in the share of national income these taxpayers receive, rather than to increases in the income tax rates they face. The case for lowering their taxes substantially would be stronger if the increased share of the income tax burden that high-income filers bear primarily reflected increases in the tax rates they pay, rather than a greater concentration of income at the top of the income spectrum. The next section of this report explores the factors underlying the increase in the share of income taxes these individuals pay.

IV. Recent Income Trends

This section of the report considers:

- Whether the increase in the share of income taxes that high-income filers pay primarily reflects the higher marginal tax rates enacted in the early 1980s or the increases in the share of the national income these filers receive;
- To what extent high-income families have experienced income gains after the income taxes they pay are taken into account; and
- How high-income families have fared in increasing their after-tax income, as compared to other families.

One of the most striking findings is the degree to which after-tax income has risen among high-income families in recent years, even after the effects of the increases in marginal income tax rates are taken into account. To examine this matter, we look both at the period from 1992 to 1998 (1992 was the last year before marginal tax rates were raised for high-income taxpayers by the 1993 budget agreement) and the period from 1989 to 1998 (1989 was the peak of the last economic recovery, and it preceded the increase in marginal tax rates for high-income taxpayers that was part of the 1990 budget agreement).

A second and related noteworthy finding is that the main reason for the increase in the share of income taxes paid by the top one percent of tax filers is the large relative rise in their incomes, not increased tax rates.

The 1992-1998 Period

In 1993, the top marginal tax rate was raised, and two new rates were established — one of 36 percent and one of 39.6 percent. Despite the increase in marginal rates, high-income taxpayers have fared extraordinarily well since then.

- The before-tax incomes of the top one percent of tax filers rose an average of 51 percent between 1992 and 1998, after adjusting for inflation.
- The before-tax income of those in the 95th to 99th percentiles increased significantly as well, climbing an average of 21 percent.
- In contrast, the after-tax income of the bottom 95 percent of tax filers rose a more modest nine percent.

It is possible that those in the upper-income brackets would somehow have worked substantially harder, been more entrepreneurial, and increased their incomes even more from 1992 to 1998 if their marginal tax rates had not increased, although such an argument lacks solid empirical support and, on its face, appears unlikely. The enormous growth in their before-tax incomes over this period suggests that the higher marginal tax rates could not have posed much of an obstacle to increasing their incomes. Similarly, the enormous growth in the U.S. economy over this period undermines any argument that these marginal rate increases had a significant adverse effect on economic activity. The predictions of those who in 1993 forecast dire outcomes for the economy as a result of that year's marginal tax rate increases have not been borne out.

Because of the increase in marginal tax rates for high-income families (and the fact that if a family's income rises faster than inflation, more of its income may be taxed at a higher rate), the *after-tax* incomes of the nation's highest-income families did not grow as fast as their before-tax incomes. But the difference was modest. Even after income taxes are taken into account, high-income families still gained enormously from 1992 to 1998, far more so than other families did.

- The average incomes of the top one percent of tax filers *after* income taxes are subtracted climbed 47 percent between 1992 and 1998, after adjusting for inflation. The average after-tax income of this group increased from \$405,000 to \$595,000, a gain of \$190,000 per tax filer.
- Among tax filers in the 95th to 99th percentiles of income, average after-tax income rose 19 percent.
- Among the rest of the population, after-tax income increased eight percent. Gains were larger among those between the 75th and 94th percentiles — a group dominated by taxpayers in the 28 percent bracket — than among the bottom 75 percent of tax filers, a group consisting primarily of people in the 15 percent bracket. (See Table 5.)

Table 5: After-tax Income Gains Among Various Groups, Inflation-adjusted

	Top 1%	95th-99th Percentile	90th-94th Percentile	75th-89th Percentile	Bottom 75%	Bottom 95%
1992-1998	47.0%	18.6%	12.3%	9.2%	6.8%	8.4%

- The average after-tax income increase of \$190,000 among the top one percent of tax filers was several times greater than the total after-tax income of the typical family.

The 1989 to 1998 Period

The pattern from 1989 to 1998 was essentially the same.

- The average after-tax income of the top one percent of tax filers rose a robust 40 percent between 1989 and 1998, after adjusting for inflation. (The rates of income growth are lower for all income groups over this period than over the 1992-1998 period. This reflects the impact of the recession that began in 1990.⁶)
- For those between the 95th and 99th percentiles of the income spectrum (that is, those in the top five percent except for the top one percent), after-tax income climbed a healthy 18 percent.
- The bottom 95 percent of tax filers experienced an after-tax income gain of six percent over this nine-year period.

As a result of these sharp differences in income growth, income disparities between the highest-income taxpayers and the rest of the population grew substantially during the 1990s and reached their widest point since the IRS began collecting these data in 1986. In 1989, the top five percent of filers received 25 percent of the national after-tax income. By 1998, they were receiving 29 percent of the income. Most of the increase in the share of national income going to those on the upper rings of the income scale occurred among taxpayers at the very top. The share of the national after-tax income that the top one percent of taxpayers receive jumped from 12.5 percent in 1989 to 15.7 percent in 1998, an increase of one-fourth. At the same time, the share of after-tax income the bottom 95 percent of filers receive declined significantly.

Data from the Congressional Budget Office, which cover the years from 1977 to 1995, show that after-tax income disparities grew significantly between the late 1970s and 1995. In combination,

⁶ For additional information on after-tax income trends from 1989 to 1998 see Isaac Shapiro, "The Latest IRS Data on After-tax Income Trends," Center on Budget and Policy Priorities, February 26, 2001.

the IRS and CBO data indicate that the share of the national after-tax income that goes to those at the top of the income spectrum is larger now than at any other time in at least two decades.

In addition, the U.S. Census Bureau has collected data on *before-tax* income that goes back to the end of World War II. This data does not capture recent income gains at the top because they miss very large amounts of income that people at the high end of the income scale receive, such as capital gains income. Reflecting the incompleteness of its data, the Census Bureau does not publish income data for the top one percent of the population. Still, the Census Bureau data indicate that at the end of the 1980s before-tax income disparities between the top five percent of families and other families were the widest on record. When this trend is combined with the ongoing growth in before-tax income disparities during the 1990s that is depicted by the IRS data, it appears that before-tax income disparities are now the widest they have been since the end of World War II.

Increase in Share of Income Taxes Paid by Top One Percent Primarily Reflects Income Gains Not Higher Taxes

The rapid increase in incomes among the top one percent of taxpayers — at a pace much faster than among the rest of the population — is the primary reason that the share of income taxes the top one percent of the population pays rose as much as it did over the past decade. The increases enacted in 1990 and 1993 in the top income tax rates are not the principal cause of this development.

One way of showing this is to compute how much the share of income taxes that the top one percent pays would have changed if these taxpayers' average tax rate had been the same in 1998 as in 1989. This approach distinguishes the increase in the share of income taxes paid by these individuals that resulted from the large growth in their incomes from the increase in the share of income taxes they pay that resulted from higher tax rates.

Between 1989 and 1998, the share of income taxes the top one percent of tax filers pay increased from 25.2 percent to 34.8 percent. If the top one percent had paid the same percentage of their income in taxes in 1998 as they did in 1989, (i.e., if their average tax rate had remained unchanged), these taxpayers would have paid 31.4 percent of all income taxes in 1998. In other words, about two-thirds of the increase in the share of income taxes that the top one percent of taxpayers pay (6.2 percentage points of the overall 9.6 percentage-point increase in this share) resulted from the dramatic climb in the incomes of these taxpayers, rather than from increases in their tax rates.

Recent Trends in Capital Gains Income Suggest an Increasing Concentration of Income Between 1998 and 2000

A large increase in capital gains income has been an important factor fueling the recent income growth among the top one percent of the population. Capital gains income is heavily

concentrated among this group: IRS data show that in 1998, the top one percent of taxpayers received *close to two-thirds* of all capital gains income. The recent surge in capital gains income began well before capital gains tax rates were reduced in 1997. As CBO noted in its recent report on the budget and the economy, “Between 1994 and 1998, realizations of capital gains nearly tripled, with most of that increase occurring before the cut in tax rates for them in 1997.”

New Congressional Budget Office projections on capital gains realizations suggest that income growth between 1998 and 2000 continued to be especially robust among those with very high incomes.⁷ CBO estimates that capital gains income increased another 36 percent between 1998 and 2000, after adjusting for inflation. If these CBO estimates of recent growth in capital gains income are correct and the IRS findings on the share of capital gains income that went to the top one percent of filers in 1998 hold for 1999 and 2000, then the average after-tax income of the top one percent of tax filers jumped another \$57,000 between 1998 and 2000 just due to an increase in capital gains income.

New Joint Tax Committee Estimates Show Greater Income Concentration at the Top than the Joint Committee Estimated Nine Months Ago

On February 27, the Joint Committee on Taxation released its latest tables on the distribution of federal taxes by income category. These tables contain the Joint Committee’s estimates for 2001 and can be compared to similar tables the Joint Tax Committee issued last June, which also included projections for 2001. The new tables show that the Joint Tax Committee now estimates that high-income families will receive much larger amounts of after-tax income in 2001 than the Joint Tax Committee estimated just last June. (In these comparisons, after-tax income is income after federal income, payroll, and excise taxes.)

- Last June, the Joint Tax Committee estimated the top one percent of taxpayers would receive 13.7 percent of the national after-tax income in 2001. Now the Joint Committee estimates they will receive 15.7 percent of the national after-tax income this year. (The Joint Committee adjusted downward the share of the national after-tax income the bottom 95 percent of taxpayers is expected to receive by close to the same amount that it revised upward the top one percent’s share.)
- In June of last year, the Joint Committee estimated the average after-tax income of the top one percent of taxpayers would be \$589,000 in 2001. Now the Joint Committee estimates this group’s average after-tax income will be \$708,000. This is an upward revision of 20 percent, or nearly \$120,000 per high-income taxpayer. By comparison, the Joint Committee raised its estimate of the average after-tax income of the bottom 95 percent of taxpayers by a scant two percent.

⁷ The Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011*, January 2001, pages 54-61.

The data in the Joint Committee on Taxation's tables are revised periodically to reflect the latest information available on income and tax trends. The dramatic revision in the Joint Committee's tables between June and February suggests the latest data on income shows much stronger gains at the top of the income scale — and a greater concentration of income at the top — than was known just nine months ago.

V. Conclusion

Between 1989 and 1998, the after-tax income of the top one percent of taxpayers grew at a rate nearly seven times faster than the after-tax income of the bottom 95 percent of taxpayers. Those with incomes between the 95th and 99th percentiles experienced after-tax income gains at triple the pace of those with lesser incomes. As a result, the share of national after-tax income that the top five percent of taxpayers receive reached its highest level in at least two decades and their share of before-tax income appeared to be at its highest level since the end of World War II. The taxpayers who gained the most over the past decade were those in the top tax brackets.

These patterns suggest that a large tax cut package should not further enlarge after-tax income disparities, which already are wider than at any point on record, and should not confer the largest tax cuts on those with the highest incomes, a group that already has gained the most in recent decades. That, however, is what the Administration's tax package, as well as the House-passed bill, would do.

- Citizens for Tax Justice has estimated that the top one percent of taxpayers would receive 44 percent of the tax cut benefits from the House-passed bill when the bill's provisions are fully in effect.
- If the CTJ estimates for the distribution of all of the individual income tax cuts of the Bush plan (including those not reflected in the House-passed bill) are combined with estimates of the Administration's corporate and estate tax proposals that are based on Treasury methodologies, the top one percent is estimated to receive 39 percent of the benefits from the entire tax-cut package that President Bush submitted to Congress on February 8.⁸

⁸ When the Administration submitted its budget on February 28th, it added to its February 8th tax package \$123

(continued...)

- The share of the tax cuts the top one percent of taxpayers would receive from the House-passed bill, as well as the share of the tax cuts this group would receive from the overall Administration tax package, thus substantially exceed the group's share of the national after-tax income, which is 16.7 percent according to the data in CTJ's model.

As a result, the Bush tax cuts result in more growth in the after-tax incomes of the top one percent of taxpayers than for any other group, which will only serve to widen the gap in income disparities. A 1999 paper by the Treasury Department's Office of Tax Analysis described the percentage change in after-tax income as a result of any tax proposal as being "the best measure of the change in a family's well-being."⁹

Table 6 shows the percentage increase in after-tax income that different income groups would receive as a result of the entire Bush tax package as well as the portions of that package — the rate reductions and the creation of the 10 percent bracket — included in the House bill. The estimates reflect the impact of these provisions when they are fully in effect:

- The after-tax income of the one percent of taxpayers with the highest incomes would increase by an average of 6.2 percent under the entire Bush package.
- By contrast, the average after-tax income of the middle fifth of families would rise by 1.9 percent, less than one-third of the increase among the top one percent. The after-tax income of the bottom fifth of families would rise a scant 0.6 percent under the entire Bush plan.
- Thus, after-tax income would rise more than three times as fast among the top one percent of families as among those in the middle of the income scale, and ten times faster among the top one percent of families than among the bottom 20 percent of families.
- The House rate cut bill is similarly skewed. Under the House bill, the after-tax income of the middle fifth of taxpayers would increase by 1.2 percent. Meanwhile, the after-

⁸ (...continued)

billion over ten years of "additional tax incentives," the largest of which is a refundable tax credit to purchase health insurance. The budget document provided few details on these proposals, and we are therefore unable to include them in the Center's distributional analysis of the Bush plan. Although a refundable health insurance tax credit could potentially benefit lower-income families, given the modest size of these additional tax incentives relative to the other components of the Bush plan, it is unlikely that they would substantially impact the distribution of the overall Bush tax-cut plan.

⁹ Julie-Anne Cronin, U. S. Department of Treasury, Office of Tax Analysis, *U.S. Treasury Distributional Analysis Methodology*, OTA Paper 85, September 1999.

tax incomes of the top 1 percent would increase by 3.8 percent, more than three times the increase for the middle fifth.

- No income group besides the top 1 percent would see its after-tax income rise by more than 1.2 percent.

Table 6. Percentage Increase in After-tax Income Due to Tax Cuts
(when fully phased-in)

	Top 1%	Next 4%	Next 15%	Fourth 20%	Middle 20%	Second 20%	Lowest 20%
Entire Bush Tax Package	6.2%	2.4%	2.4%	2.3%	1.9%	1.2%	0.6%
House Rate Cuts	3.8%	0.6%	1.1%	1.2%	1.2%	1.0%	0.5%

In sum, under both the House-passed bill and the full Administration tax package, those at the top of the income spectrum would receive a share of the tax cuts that would be more than double their share of national after-tax income. Since the top one percent would receive a much larger share of the tax cut than the share of income they already have — and most other income groups would receive a share of the tax cut that is smaller than their current share of income — both tax proposals would further widen the nation’s already large income gulf.