

*Revised March 7, 2001*

## **BUSH TAX CUT AND HOUSE RATE CUTS WIDEN RECORD AFTER-TAX INCOME DISPARITIES**

### **Percentage Increase in After-tax Income for Those at the Very Top Three Times Larger than for Middle Fifth**

by Isaac Shapiro and James Sly

The House Ways and Means Committee recently passed a slightly modified version of the reduction in individual income tax rates that President Bush has proposed. The House is scheduled to vote on the tax-rate cuts later this week. Both the entire package of tax cuts President Bush has proposed and the House bill would significantly widen after-tax income disparities between the top one percent and the rest of the population. The after-tax incomes of the top one percent would rise, as a result of the bill, by three times as large a percentage as the after-tax incomes of the middle fifth of taxpayers would increase, even though the after-tax income of the top one percent has risen much faster over the past decade than the after-tax income of those in the middle or bottom of the income spectrum, pushing income disparities to their widest level on record.

### **Effects of the Bush Tax Package and the House Bill**

Changes in after-tax income are an important measure of the effects of any tax cut proposal. This measure indicates the degree to which the income available to families increases as a result of the tax reductions. It is widely understood that in absolute dollars, the Bush tax package and the House bill would provide far more to those at the very top of the income spectrum (whose tax cuts would average tens of thousands of dollars) than to those in the middle of the income spectrum (whose tax cuts would average significantly less than a thousand dollars).<sup>1</sup> What is less well understood is that the percentage increase in after-tax income received by those at the very top would be substantially larger than the increase among those in the middle and bottom parts of the income spectrum.

To estimate the effects of the overall Bush tax package on after-tax income, we relied on the distributional estimates of the estate tax and the corporate income tax developed by career staff at the Treasury Department in 1999. We relied on distributional information on the

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<sup>1</sup> Combining Treasury Department data on estate and corporate income taxes with Citizens for Tax Justice data on the distribution of income and income tax cuts, we find that when the Bush tax package is fully in effect, the top one percent of families will receive an average tax cut of about \$46,000 from the Bush tax package while the middle fifth of families will receive an average tax cut of about \$500.

individual income tax cuts, and on income levels, from Citizens for Tax Justice. The CTJ data come from the Institute for Taxation and Economic Policy tax model. Analyses based on this model of the distributional effects of proposed income tax reductions have consistently tracked analyses the Treasury Departments has produced.

As Table 1 indicates, when the Bush tax package is fully in effect:

- The after-tax income of the one percent of families with the highest incomes would increase by an average of 6.2 percent. (“Families” as used here refers to both individuals and families.)
- 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.

**Table 1. Tax Cut as a Percent of After-tax Income**  
(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%

The tax-cut bill before the House of Representatives is similarly skewed.<sup>2</sup> The changes it would make in the marginal tax rates would be of most benefit to high-income taxpayers.

- Under the House bill, the after-tax income of the middle fifth of taxpayers would increase by 1.2 percent.
- Meanwhile, the after-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.

These figures reflect the fact that the top one percent of families would receive a share of the tax cuts that would be larger than their share of the national after-tax income. The top one percent of taxpayers would receive 39 percent of the tax cuts in the overall Bush plan. These taxpayers would receive 44 percent of the tax cut benefits under the bill the House will vote on this week. Both figures are more than double this group’s share of the national after-tax income.

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<sup>2</sup> For more information on the House bill, see Isaac Shapiro and Joel Friedman, *Income Tax Rates and High-Income Taxpayers: How Strong is the Case for Major Rate Reductions*, Center on Budget and Policy Priorities, March 2001.

The Bush Administration recently released an estimate by the Joint Committee on Taxation indicating that in 2005, some 22 percent of the income tax cuts in its plan would go to the top one percent. This estimate substantially understates the share of the tax cut going to the top one percent, because the estimate excludes the effects of the corporate and estate tax reductions in the plan — which ultimately make up about one-quarter of the plan’s cost — and because it fails to assess the proposal when the reduction in income tax rates for those at the top are phased in fully. Even if one used the understated 22 percent figure, the share of the tax cut the top one percent would receive would still exceed the share of after-tax income it currently receives. No matter what set of figures are used, after-tax income disparities are shown to widen further.

### **Recent After-tax Income Trends**

The growth in after-tax income disparities that would result from the Administration and House tax bills would further widen gaps that already are the largest on record. Over the last decade, after-tax income has grown substantially faster for the top one percent than for any other part of the income distribution. The most recent data in this regard are for 1998 and come from the Internal Revenue Service. These data are from 1989 (the peak year of the last economic recovery) to 1998 and are adjusted for inflation.

- The one percent of families with the highest incomes saw their after-tax income increase by an average of \$171,000, a gain of 40 percent.
- Those in the 95<sup>th</sup> to 99<sup>th</sup> percentiles (i.e., taxpayers in the top 5 percent but not in the top 1 percent) secured an increase in their average after-tax income of about 18 percent.
- The average after-tax income for the bottom 95 percent of families rose a much more modest six percent, a rate of income growth less than one-sixth the rate of growth among the top 1 percent.

The IRS data also show that those at the top of the income spectrum received a larger share of after-tax income in 1998 than in any other year for which IRS has compiled these data. (The data go back to 1986.) 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. In combination, the IRS and CBO data indicate that the share of after-tax income the top one percent of taxpayers receive is larger than at any time since at least 1977. This means that at a time when after-tax income disparities are the widest on record, the Administration and House tax bills would make them still wider.<sup>3</sup>

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<sup>3</sup> Census data on *before-tax* income that go back to 1947 similarly show that income disparities have been increasing since the mid-1970s. When combined with IRS data on before-tax incomes, it appears that before-tax income disparities are greater now than at any time recorded since the end of World War II.