

Revised April 16, 2002

## ARE WE SOAKING THE RICH?

by Isaac Shapiro

There has been growing attention recently to a finding that high-income households are paying a larger share of federal income taxes than in the past. The most recent Internal Revenue Service data available indicate that the top one percent of taxpayers paid about 25 percent of federal income taxes in 1989 but paid 36 percent of income taxes in 1999. The share of federal income taxes that the top five percent pays increased as well, but virtually all of that increase was due to the substantial rise in the share of income taxes that the top one percent pays.

Some have assumed these data mean that high-income taxpayers are now shouldering the lion's share of the overall federal tax load, that taxes have been raised sharply in recent years on high-income taxpayers, and that these taxpayers' after-tax incomes have been squeezed as a consequence. In fact, none of these conclusions are correct.

1. ***High-income households pay a much lower share of federal taxes overall than they pay of the income tax.*** Examining only the percentage of *income* taxes that the top one percent (or the top five percent) of the population pays overstates the degree to which these individuals are shouldering the overall federal tax load. Last year, the Congressional Budget Office published an exhaustive analysis of federal tax and income trends, with data through 1997.<sup>1</sup> CBO found that the top one percent of households paid 23 percent of all federal taxes that year, including payroll, excise and other federal taxes. This is substantially lower than the percentage of federal *income* taxes that this group pays; the differences reflects, in large part, the impact of the payroll tax,<sup>2</sup> which falls more heavily on lower- and middle-income households than income taxes do. The top one percent of the population pays only 4.2 percent of the payroll taxes.
2. ***The percentage of income that the highest-income households pay in federal taxes is not at a recent peak and is lower than in a number of previous years.*** At the time that CBO issued its report on tax rates and tax burdens, the data that CBO uses on household incomes were not yet available for years after 1997. CBO did have information, however, on federal tax law in 2000. So CBO applied 2000 tax law to 1997 income levels and estimated that, on average, the top one

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<sup>1</sup> Congressional Budget Office, *Effective Federal Tax Rates, 1979-1997*, October 2001.

<sup>2</sup> These CBO data show the top one percent paying a slightly smaller share of federal income taxes (33 percent) than the IRS data show this group as paying for 1999 (36 percent). The larger figure under the IRS data reflects, in large part, the continued increase between 1997 and 1999 in the share of the national income that the top one percent of households receives.

percent of households paid 32.7 percent of their income in federal taxes overall, including income, payroll, excise, and other taxes. This percentage is lower than the percentage of income that CBO found the top one percent of households paid throughout most of the rest of the 1990s as well as in the late 1970s. For example, the top one percent of households paid 37.3 percent of income in federal taxes in 1979, the first year for which these CBO data are available, and 36.4 percent of income in federal taxes in 1995. The percentage of income that very high-income households pay in federal taxes has not jumped sharply in the past few years. (The top one percent did pay a lower percentage of income in federal income taxes in the 1980s, following enactment of large tax cuts in 1981. The years after 1981 were marked by large federal deficits and sharp increases in the national debt.)

3. ***The principal reason that high-income households are paying a larger share of federal taxes than in the past is not that the percentage of income they are paying in taxes has increased but that they receive a much larger share of the total income in the nation.*** The top one percent of the population now receives a larger share of the national income than in any year since the mid-1930s. A recent study by the National Bureau of Economic Research (NBER) found that in 1998, the latest year for which these data were available at the time of the study, the top one percent of the population received a larger percentage of the before-tax income in the nation than at any time since 1936.<sup>3</sup>

Because these households receive a larger percentage of the income, they pay a larger percentage of the taxes. Furthermore, as a result of a progressive nature of the federal tax system, high-income taxpayers pay a larger share of their income in federal taxes than middle- and lower-income people do. Since high-income individuals pay taxes at somewhat higher rates, overall federal tax receipts tend to rise as a share of GDP when income becomes more concentrated at the top of the income scale.

This set of developments — an increase in the concentration of income at the top of the income scale, leading to an increase in the percentage of the income tax that high-income households pay and an increase in federal tax receipts as a percentage of GDP — is precisely what has occurred in recent years.

4. ***The top one percent of the population has experienced extraordinary after-tax income gains that vastly exceed the gains in after-tax income the rest of the population has secured. The increase in the percentage of federal taxes that these households pay has not squeezed these households.*** The CBO data show that the after-tax incomes of the top one percent of the population rose

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<sup>3</sup> Thomas Piketty and Emmanuel Saez, “Income Inequality in the United States, 1918-1998,” NBER Working Paper 8467, September 2001, Tables A1 and A3.

tremendously in the 1980s and 1990s. From 1979 to 1997, the average after-tax income of the richest one percent of households climbed a remarkable 157 percent, or \$414,000, after adjusting for inflation. By comparison, among the middle fifth of households, average after-tax income rose a far more modest 10 percent, or \$3,400.<sup>4</sup>

The CBO data also show that the share of the after-tax national income the top one percent of households received in the late 1990s was at the highest level on record. (These CBO data go back to 1979.) When these CBO data are combined with data from the NBER study, it appears that the top one percent of the population is now receiving a larger share of the national after-tax income than at any time since at least 1941.

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<sup>4</sup> These figures are expressed in 1997 dollars.