WHO WOULD BENEFIT FROM THE TAX PROPOSAL BEFORE THE SENATE?

by Robert Greenstein and Isaac Shapiro

This analysis examines how people in various income categories would fare under the proposals in the tax bill that the Senate Finance Committee approved on May 15 and the full Senate is now considering.

- The Senate Finance Committee bill would provide significant new assistance to low- and moderate-income working families with children. When the tax cuts are phased in fully, a single parent with two children who earns $15,000 would receive a child tax credit benefit of $750, while a married family with two children that earns $15,000 would receive a tax benefit from the child credit and EITC marriage penalty relief provisions in the Senate bill of about $1,150. In this area, the proposal is a major improvement over both the House legislation and the Administration’s plan.

- Even so, the biggest winners by far would be very-high-income taxpayers. The one percent of taxpayers with the highest incomes would receive an average tax cut of more than $37,000 when the tax cuts are fully in effect. In addition, the tax cuts would increase after-tax income by a significantly larger percentage for the top one percent of taxpayers than for middle- or lower-income households. As a result, the proposal would cause income disparities, which are at record levels for recent decades, to widen further. That is, income inequality would actually grow under the proposal.

- The tax cuts provided to those in the 39.6 percent bracket — a group that includes fewer than one percent of all taxpayers — would not be as massive as under the Bush and House packages, although the tax cuts this group would get still would be extremely large. The Senate bill would, however, provide larger tax cuts than the Bush and House packages to those in the rest of the top fifth of the income spectrum.

As a result, the share of the tax cuts that would go to the top fifth of taxpayers under the bill is only slightly lower than the share that would go to the top fifth under the Bush and House packages. Similarly, the share of the tax cuts that would go to the bottom 80 percent of the population is nearly the same under the bill and under the Bush and House packages.

- The tax cuts are more skewed toward those with high incomes if one assumes, as is likely to be the case, that a fix to the Alternative Minimum Tax will be adopted.
in the next few years. Under the Senate bill, a stunning 39.6 million taxpayers would be subject to the AMT in 2011. This is more than 25 times the 1.5 million taxpayers who are subject to the AMT this year and nearly double the number of taxpayers who would be subject to the AMT in 2011 under current law. There is near-universal agreement that such a swollen AMT is unacceptable and that changes will be made to prevent the AMT from burgeoning in this manner in coming years. When these changes in the AMT are made, the magnitude of the tax cuts that higher-income taxpayers would receive from the provisions in the tax packages would grow, as would the share of the tax-cut benefits they would secure. In particular, the average tax cut received by the top five percent of taxpayers would increase by several thousand dollars.

Effects on Low- and Moderate-Income Taxpayers

The Senate bill would begin phasing in the child tax credit at $10,000 of earnings. This proposal to phase in the credit as families’ earnings rise above $10,000 would benefit nearly 11 million children in working families that would not benefit from the child credit expansion in the House legislation and 15 million such children who would not benefit from the Administration’s child credit proposal. The House legislation provides far less in tax benefits to working parents with incomes between $10,000 and $20,000; the Bush approach provides almost no assistance to these families. This provision was included in the Senate bill at the behest of Senators Snowe, Lincoln, Kerry, Jeffords, and Breaux.

Under the Senate bill, the overwhelming majority of full-time working families with children would benefit at least slightly from the child-credit expansion. By contrast, the House legislation would leave out more than four million families with full-time workers who earn low wages, including many families with incomes between $13,000 and $20,000 who face extremely high marginal tax rates. The Administration’s proposal would leave out a still-larger number of families with a parent who works full time. Much of the new child credit assistance in the Senate bill would effectively offset the payroll and excise taxes these families pay.

Under the Bush approach, a total of 26 million children in low- and moderate income families would fail to benefit from the child credit expansion. Under the House approach, 21.2 million children would not benefit. Under the Senate bill, this number is 10.6 million children.

Through an expansion in the Earned Income Tax Credit, the Senate bill also provides marriage penalty tax relief to low-income families; the Bush plan includes no such relief for those families. The House legislation also includes an EITC expansion that provides marriage-penalty relief. Because the House package begins to phase in its EITC expansion for married families at a lower income level than the Senate bill does, the House legislation provides more in
The House legislation provides more in EITC benefits than the Senate bill provides in EITC and child credit benefits combined to married families with two or more children that have incomes between $10,020 and $12,675. The House legislation provides more assistance to married families with one child who have incomes between $7,140 and $11,620. The Senate bill provides more assistance, however, to the much-larger numbers of families with children that have incomes between these levels and about $35,000.

The Overall Distribution of Tax-cut Benefits in the Senate bill

As significant as the tax cuts for low-income taxpayers would be under the Senate bill, they pale in size relative to the tax cuts that high-income taxpayers would receive. For example, the reductions in the estate tax that would be in place even prior to elimination of that tax would, by 2010, benefit the estates of only the 60,000 wealthiest people expected to die that year but would substantially exceed the size of the expansions in the child credit and the EITC that would benefit millions of low-income working families. When the provisions in the Senate bill are fully in effect, high-income taxpayers would benefit much more than any other taxpayers.

The data presented below show the effects of the Finance Committee bill on different income groups, measured along three dimensions: the average tax cut — in dollars — that each income group would receive; the percentage increase in after-tax income that each group would secure as a result of the tax cut; and the proportion of the tax-cut benefits that each group would get. The principal analyses of the distributional effects of this (and other) tax-cut proposals used here are the analyses that Citizens for Tax Justice has prepared, using the Institute for Taxation and Economic Policy (ITEP) model. This is a well-respected model. CTJ tax-distribution analyses, based on this model, have been validated over the years by the fact that they generally produce results similarly to those produced by the Treasury Department career staff. The data discussed below come principally from CTJ’s analysis of the Finance Committee bill.

With regard to who pays the estate tax — and thus who would benefit from its repeal — two similar, but not identical, methodologies are available. One is the methodology in the ITEP model that CTJ uses; this methodology is based on the approach outlined in a study the Joint Tax Committee issued in 1993, which presented a methodology for estimating who pays the estate tax. The other methodology is one the Treasury Department career staff developed in the late 1990’s after extensive study of this issue. The Treasury methodology was used by the Treasury Department in preparing distributional analyses of estate-tax proposals from the time of the methodology’s development in 1998 until the current Administration halted its use. The Treasury study that sets forth this methodology is posted on the Treasury website.

Both the ITEP and Treasury methodologies find that virtually all of the estate tax is paid by the top fifth of the population, more than 90 percent of it is paid by the top five percent of the population, and more than 60 percent of it is paid by the top one percent of the population. The

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methodologies differ in that the ITEP methodology estimates the top one percent of the population pays 91 percent of the estate tax, while the Treasury methodology estimates this group pays 64 percent of the tax. As a result, estimates of the distributional impact of the Finance Committee bill based on the ITEP estate-tax methodology show the top one percent of taxpayers receiving larger average tax cuts than estimates based on the Treasury estate-tax methodology. At the same time, use of the Treasury methodology results in estimates showing larger average tax cuts for the next-wealthiest four percent of the population than use of the ITEP method does.

The Results

When the tax provisions in the Senate bill are fully in effect, the top one percent of taxpayers would receive an average tax cut of between $37,146 (if one uses the Treasury methodology for the estate tax) and $44,293 (if one uses the CTJ/ITEP estate tax methodology). The average income tax reduction for the top one percent of taxpayers would be $19,900 per year. These figures dwarf the average tax cut of $562 that the middle fifth of the taxpayers would receive under the Senate bill.

<table>
<thead>
<tr>
<th>Estate Tax Method</th>
<th>Top 1%</th>
<th>Next 4%</th>
<th>Next 15%</th>
<th>Fourth 20%</th>
<th>Middle 20%</th>
<th>Second 20%</th>
<th>Lowest 20%</th>
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<tr>
<td>CTJ/ITEP</td>
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<td>Treasury</td>
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<td>$2,236</td>
<td>$942</td>
<td>$562</td>
<td>$364</td>
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Table 1

To be sure, higher-income taxpayers have much larger incomes and pay much more in taxes than other taxpayers, so one would expect them to receive larger tax cuts in dollar terms. But the tax cuts are found to be skewed to the top under other measures as well.

For example, the tax provisions in the Senate bill would result in much larger percentage increases in after-tax income for high-income taxpayers than for other taxpayers. Congressional Research Service and Treasury Department analyses have noted that measuring the percentage change that various groups would experience in after-tax income is one of the best ways to measure the distributional impact of tax cuts.

- When fully phased in, the tax reductions in the Senate bill would increase the after-tax income of the top one percent of families by an average of at least five percent.
By comparison, the average after-tax income of the middle fifth of families would rise by 2 percent. The average after-tax income of the bottom fifth of families would rise 0.8 percent.

Thus, after-tax income would rise more than twice as fast among the top one percent of families as among those in the middle of the income scale, and more than six times faster among the top one percent of families than among the bottom 20 percent of families.
The share of the tax cuts that would be received by various groups of taxpayers would also continue to tilt toward those at the top. As Table 3 indicates, the top one percent of taxpayers would receive 29 percent to 35 percent of the tax cuts from the Senate bill when the tax-cut measures are fully in effect. Since these taxpayers pay approximately one-fourth of all federal taxes, the share of the tax cut they would get would exceed the share of the taxes they pay. The bottom 40 percent of taxpayers would get less than seven percent of the tax cuts. The middle fifth would receive nine percent.

How the Distributional Effects Compare to Those of the House Legislation and the Bush Plan

Although the tax cuts for the top one percent of taxpayers would remain large and disproportionate under the Senate bill, they would not be as large or disproportionate as under the House legislation or the Administration’s proposal. This largely reflects the fact that the Senate bill does not lower the top tax rate as much as the House and Administration’s proposals would. At the same time, the tax cuts going to the remaining taxpayers who make up the top fifth of the taxpayers (i.e., taxpayers in the top fifth, except for those in the top one percent) would be larger under the Senate bill than under the Administration’s or House plan.

One tax cut that is smaller under the Senate bill than under the Bush and House packages is the change in the 31 percent rate. This rate would be reduced to 28 percent under the Senate
On the other hand, the Senate bill adds several new tax cuts that are of benefit to the top fifth of taxpayers and that are included in neither the House nor the Administration packages. These include two new tax-cut provisions that primarily benefit the five percent of taxpayers with the highest incomes — elimination of the phase-out of the personal exemption, which applies only to higher-income taxpayers, and a scaling back of the provision of current law that limits the itemized deductions that higher-income taxpayers may claim.²

These taxpayers also would benefit from inclusion in the Senate bill of a provision that substantially expands tax cuts for married couples with higher incomes. This provision provides a tax cut to married couples whose combined income places them in the current 28 percent tax bracket or a higher bracket. The provision would raise the income level at which the 15 percent bracket ends for married filers and the 28 percent bracket begins. (This provision is also in the House legislation; it is not part of the Administration’s proposal.) This provision benefits only those married families that have incomes above the level at which the 15 percent bracket currently ends. Only one-quarter of all tax filers and one-third of married-couple filers have incomes this high. (There has been some effort to portray this proposed expansion of the 15 percent tax bracket as a middle-class tax cut that improves the distribution of the tax package; that is not the case.) The Senate bill also includes pension and education tax cuts that are of most benefit to those in the top fifth of taxpayers, although not to those with the very highest incomes. The House also has passed pension tax cuts.

The net effect of the changes in the Senate bill — which result in the top one percent of taxpayers receiving smaller tax cuts than under the Bush or House packages but the rest of the top fifth of the taxpayers receiving larger tax cuts than under the Bush and House packages — is that the share of the tax cuts going to the top fifth of the taxpayers would be only slightly smaller under the Senate bill than under the House and Administration plans. For example, under the Senate bill, the top 20 percent of taxpayers would receive 69.5 percent of the tax cuts, as compared to 70.4

<table>
<thead>
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<th>Version</th>
<th>Share of Tax Cuts to Top Fifth of Taxpayers</th>
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<tbody>
<tr>
<td>Senate</td>
<td>69.5%</td>
</tr>
<tr>
<td>House</td>
<td>70.4%</td>
</tr>
<tr>
<td>Bush</td>
<td>71.4%</td>
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2 The Senate bill would eliminate the personal exemption phase-out. Under current law, individuals with adjusted gross incomes above $132,950 and joint filers with income above $199,450 cannot take the full amount of their personal exemptions. The exemptions are phased out gradually for taxpayers with incomes between $132,950 and $255,450 for individuals and $199,450 and $321,950 for joint filers.

The Senate bill also would raise the income level at which the total amount of itemized deductions a taxpayer may take begins to be reduced. Under current law, most itemized deductions are reduced by three percent of the amount by which a taxpayer’s AGI exceeds $132,950. Under the Senate bill, the point at which these itemized deductions would begin to be reduced would be increased to about $245,500 in 2009 (or about $200,000 in 2001 dollars).
percent of the tax cuts under the House legislation and 71.4 percent of the tax cuts under the Bush plan.\(^3\)

**Record After-tax Income Disparities Would Widen Further**

The distributional effects of the Senate Finance Committee bill, as well as the House and Administration packages, are of particular concern as they would reinforce existing trends toward widening disparities in after-tax income. From 1989 to 1998 the average after-tax income of the top one percent of tax filers rose a robust 40 percent, after adjusting for inflation. (These data are based on the latest IRS information and reflect income after income taxes are subtracted out.) By contrast, the bottom 95 percent of taxpayers experienced an average after-tax income gain of only six percent over this 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, as they did during the 1980s. The shares of the national after-tax income that the top one percent, the top five percent, and the top fifth of taxpayers receive are at the highest levels on record, with these data going back to 1977.

Thus, at a time of record income disparities between the top of the income spectrum and the rest of the population, the Senate bill would increase the after-tax incomes of those at the top by a larger percentage than it would increase the after-tax incomes of other groups. Income disparities consequently would widen further.

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\(^3\) These figures reflect the Treasury Department’s distribution of the estate tax. The results, however, are virtually identical if one were to use CTJ’s distribution of the estate tax. The top fifth of taxpayers would receive 69.6 percent of the tax cuts under the Senate bill, 70.8 percent under the House bill and 71.7 percent under the Bush bill.