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AN ANALYSIS OF THE REBATE PROPOSAL IN THE ANNOUNCED STIMULUS DEAL

By Aviva Aron-Dine

The centerpiece of the stimulus deal announced yesterday by House Speaker Nancy Pelosi, House Minority Leader John Boehner, and Treasury Secretary Henry Paulson is a proposal to send rebate checks to 117 million U.S. households.

The structure of the proposed rebate, while not ideal from a stimulus standpoint, is far superior to the structure of the rebate proposal that the Administration developed last week. Where the President's proposal would have left out approximately 26 million low- and moderate-income working households,¹ the rebate proposal included in the compromise package would reach almost all of these households.

The principal weakness of the new rebate design is that it would provide smaller rebates to low- and moderate-income working families than to families at higher income levels, despite the fact that rebates provided to low- and moderate-income families are the most effective as stimulus. It also may be noted that the proposal does not cover the 22 million mostly low-income households who do not file income tax returns. It is nearly impossible to reach such households through a tax rebate, but millions of these households could have been reached through a temporary increase in food stamp benefits. The food stamp provision, however, was dropped from the stimulus package.

This analysis first explains the rebate proposal included in the announced stimulus deal and then compares it with the Administration's earlier proposal.

How the Proposed Rebate Would Work

The proposed rebate would be paid as follows.

- Low- and moderate-income filers with at least \$3,000 of earnings would qualify for a rebate of \$300 per individual or \$600 per couple, *plus* an additional rebate of \$300 per child.
- Filers with incomes high enough to owe at least \$300 (for an individual) or \$600 (for a couple) of income tax would be eligible for an additional rebate of up to \$300 per individual or \$600 per

¹ The Urban Institute-Brookings Institution Tax Policy Center has estimated that the President's proposed rebate would leave out about 30 million working households; of these, several million are upper-income households that pay the Alternative Minimum Tax.

couple, on top of the rebates described above.²

- The rebates would be phased out for couples with incomes above \$150,000 and individuals with incomes above \$75,000. For each dollar in income above those levels, filers would lose five cents of the rebate (i.e. it would phase out at a 5 percent rate).

For example, a married couple with two children and earnings between \$3,000 and about \$30,000 would receive a rebate of \$1,200.³ Above that income level, the couple would begin to benefit from the portion of the rebate available only to those with income tax liability, and at an income level of about \$36,000 it would be eligible for a full rebate of \$1,800. At an income level of \$150,000, this rebate would begin to phase down and would be fully phased out at an income level of \$186,000.

Table 1 shows how much the rebate would be worth for various sample families.⁴

Table 1: Value of the Rebate for Families at Various Income Levels				
	Income/Earnings Level			
	\$15,000	\$50,000	\$100,000	\$200,000
Single individual, no children	\$300	\$600	\$0	\$0
Single parent, one child	\$600	\$900	\$0	\$0
Single parent, two children	\$900	\$1,200	\$0	\$0
Married couple, no children	\$600	\$1,200	\$1,200	\$0
Married couple, one child	\$900	\$1,500	\$1,500	\$0
Married couple, two children	\$1,200	\$1,800	\$1,800	\$0

Source: CBPP estimates.

Comparing This Proposal with the Administration's

The rebate proposal included in the announced stimulus deal would provide a sizeable rebate to all income tax filers with earnings of at least \$3,000. In contrast, as Table 2 shows, households would not have begun to benefit from the Administration's proposed rebate until their income reached much higher levels. The Administration had suggested that the rebate be provided by reducing the 10 percent tax rate to zero. To benefit from such a change *at all*, a married couple with two children would need an income of about \$25,000. Moreover, such a family would receive only a relatively modest rebate until its income climbed well above \$25,000.

² The full additional amount would be available only to individuals who owed at least \$600 of income tax and couples that owed at least \$1,200.

³ The rebate checks would initially be calculated and sent out based on 2007 income tax return data. Filers who would be better off with a rebate based on their 2008 than their 2007 income could file for the larger rebate when they filed their 2008 tax return in the spring of 2009. Filers in the reverse position (those whose 2007 income entitled them to a larger rebate than their 2008 income) would not have to pay back any part of their rebates.

⁴ These filers, and the married couple described above, are assumed to have only earned income, to claim the standard deduction, and to claim no tax credits besides the Earned Income Tax Credit and the Child Tax Credit. Households that itemize deductions or claim additional nonrefundable credits (such as the dependent care credit or education credits) would need even higher incomes to qualify for the additional rebates available to those with income tax liability.

For example, under the rebate proposal in the compromise package, a low-income couple with two children and with earnings of \$3,000 or more would be eligible for a rebate of \$1,200. To receive a rebate this large under the President's proposal, the couple would need an income of at least \$36,900.

Table 2: Income Levels Needed to Benefit		
	From the Rebate in the Compromise Deal	From the Administration's Proposal
Single individual, no children	\$3,000	\$8,950
Single parent, one child	\$3,000	\$22,630
Single parent, two children	\$3,000	\$28,030
Married couple, no children	\$3,000	\$17,900
Married couple, one child	\$3,000	\$21,400
Married couple, two children	\$3,000	\$25,190

Source: CBPP estimates

Compared with the Administration's proposal, the rebate included in the stimulus deal thus would reach many more low- and moderate-income working households. Of the approximately 26 million low- and moderate-income working households left out by the Administration's proposal, all but a few million would receive a rebate under this approach.

The deal announced yesterday also would target a far larger share of the rebate's total value to low- and moderate-income families. The Administration's proposal would direct only 11 percent of the rebate's value to the 42 percent of households with incomes below \$30,000, according to estimates by the Tax Policy Center. In contrast, 23 percent of the value of the rebate in the compromise package would go to these households. According to Joint Tax Committee figures, at least \$34 billion of the rebate would be paid to households with incomes too low to owe income taxes.

This is important not only because low- and moderate-income families are among those struggling the most in the weakening economy, but also because rebates targeted to them have the greatest stimulus impact. As Federal Reserve Chair Ben Bernanke recently testified before the House Budget Committee, "If you're somebody who has lots of financial assets and you receive an extra dollar, you may not change your spending much... If you're somebody who lives paycheck to paycheck, you're more likely to spend that extra dollar."⁵ Because low- and moderate-income households will quickly spend most or all of whatever rebates they receive, funds targeted to them provide the greatest economic boost.

In addition, the rebate included in the compromise package would be phased out for higher-income households. Since those households are unlikely to spend their rebates quickly, the phase-out increases the "bang for the buck" that the rebate delivers in terms of providing effective stimulus to the economy.

Stimulus Deal Falls Short in Other Respects

The rebate included in the deal announced yesterday could nevertheless be better targeted. Working-poor families with incomes too low to owe income tax would receive smaller rebates than families at higher income levels. Yet it is funds provided to low- and moderate-income families that do the most to stimulate the economy (as well as to alleviate hardship).

⁵ Quote in Sarah Lueck, John D. McKinnon, and Michael M. Phillips, "Bush, Democrats, Rush to Roll Out Stimulus Plan," *Wall Street Journal*, January 18, 2008.

The stimulus deal also missed the opportunity to reach some of the millions of households who will be left out of any tax rebate that is based on income tax returns. About 22 million mostly low-income households (including most low-income seniors) do not file income tax returns. Millions of these households — including many poor seniors and poor families with children — could have been reached through measures such as a temporary increase in food stamp benefits. That provision was dropped from the final package even though respected analysts rate it as one of the most effective forms of economic stimulus that Congress can provide.

The deal also failed to include an extension of unemployment benefits or any fiscal relief for states, many of which are already facing deficits as tax revenues fall due to the weakening economy. An extension of unemployment benefits would be highly effective stimulus because it would put money in the hands of workers who have lost their jobs and thus are trying to cope with a significant reduction in their income, while providing targeted relief to states whose economies are souring would help them avert program cuts and tax increases that would further weaken their economies and the national economy.