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NEW, UNNOTICED CBO DATA SHOW CAPITAL INCOME HAS BECOME MUCH MORE CONCENTRATED AT THE TOP

Data indicate that cutting taxes on capital gains and dividend income is likely even more regressive than in the past

By Isaac Shapiro and Joel Friedman

Congress is considering whether to extend reductions in the tax rates on capital gains and dividend income beyond their scheduled expiration date at the end of 2008. Proponents of these extensions often argue that stock ownership is widespread and thus the benefits of extending these tax cuts will be widespread as well. In other analyses, we have shown the fallacy of this argument; data from sources such as the Urban Institute-Brooking Institution Tax Policy Center clearly show that the large majority of the benefits from such an extension would go to very-high-income households. This analysis goes one step further, showing that the benefits of tax cuts for capital income have become more concentrated over time.

Specifically, CBO data released in December 2005 indicate that capital income — income from interest, dividends, rents, and capital gains — that is subject to taxation has become considerably more concentrated over time among the top one percent of the population.[1] This finding has not received attention, largely because these data lie beneath other aspects of a new, data-rich and rather technical CBO report. The new data show that the policy of lowering taxes on capital gains and dividend income is likely to have even more regressive effects (that is, the benefits of such tax-cut measures are likely to be even more concentrated among very-high-income households) than was the case in the past.

As Figure 1 illustrates, the CBO data show:

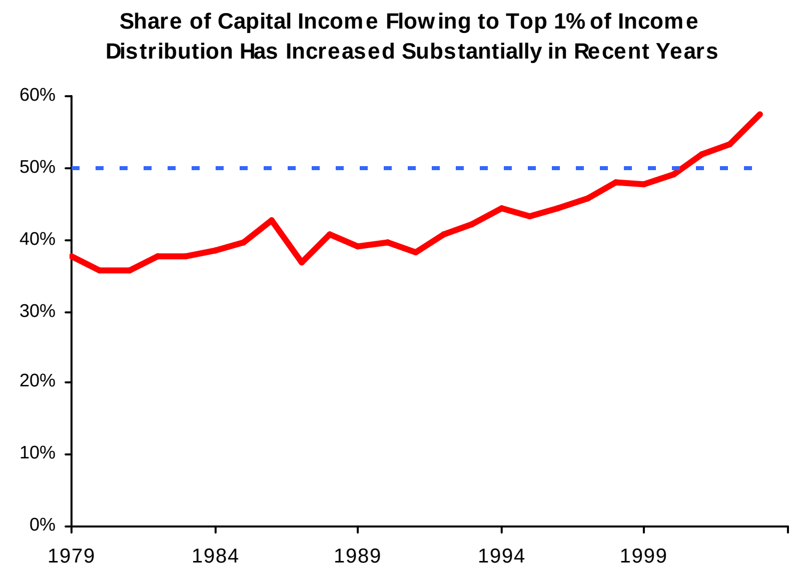
- In 2003, the top one percent of the population received 57.5 percent of all capital income. This was larger than in any other year examined by CBO, with its data going back to 1979. (The top one percent consisted in 2003 of households with *after*-tax incomes that averaged $701,500.)

[1] The data anlayzed here are from Congressional Budget Office, *Historical Effective Federal Tax Rates: 1979 to 2003*, December 2005.

- Prior to 2001, the share of capital income that was received by the top one percent never exceeded 50 percent and typically was well below that mark.

- In other words, prior to 2001, the top one percent received *less than* half of the capital income. Now it receives significantly *more than* half of such income. Accordingly, the degree to which the highest-income households benefit from efforts to reduce taxes on capital income has increased as well.

FIGURE 1



- The flipside of this trend is that the share of capital income that is held by the rest of the population has dropped markedly. In 2003, the bottom 80 percent of the population received only 12.6 percent of such capital income, the lowest share on record (with data back to 1979). As recently as 1989, for instance, the bottom 80 percent of the population received 23.5 percent of capital income subject to taxation, a share nearly twice as high. (See Table 1.)

Capital Gains and Dividend Tax Cut Would Exacerbate General Growth in Income Disparities Depicted by the CBO Data

The capital income that CBO analyzed consists of four sources: interest, dividends, rents, and capital gains. The CBO data do not separate out capital income by source. The CBO data reflect interest income that is subject to taxation as well as tax-exempt interest income (such as interest earned on municipal bonds); however, the data only consider capital gains and dividend income that is subject to taxation. All capital income in tax-exempt retirement accounts is not reflected in the data. As a result, for the most part the CBO data only reflect capital income subject to taxation.

Although the CBO do not break out trends by the specific source of capital income, the general trend depicted by the data strongly suggests that policies that reduce taxes on capital gains and dividend income are of growing benefit to high-income households, since such households are receiving an increasing share of capital income.

Adding to concerns over the increasingly regressive effects of extending lower taxes on capital gains and dividend income, the CBO data also show a dramatic widening in overall income disparities during the past two and one half decades. From 1979 (the first year for which CBO has compiled these data) to 2003 (the most recent year for which the data are available):

- The average after-tax income of the top one percent of the population more than doubled, rising from $305,800 to $701,500, for a total increase of $395,700, or 129 percent. (CBO adjusted these figures for inflation and expressed them in 2003 dollars.)

- By contrast, the average after-tax income of the middle fifth of the population rose a relatively modest 15 percent (less than one percentage point per year), and the average after-tax income of the poorest fifth of the population rose just 4 percent, or $600, over the 24-year period.

Extending lower tax rates on capital gains and dividend income would exacerbate the long-term trend toward growing income inequality.

The Unnoticed CBO Data

The data described here are from a CBO report released in December 2005. The findings related to the concentration of capital income have gone unnoticed, in part because readers of this report and similar past CBO reports tend to focus on the trends that these reports depict in federal tax burdens and in overall income inequality. The findings also have gone unnoticed because of how the information appears in the report.

Table 1B of the CBO report shows the share of corporate income tax liabilities paid by various income groups. Because corporate tax returns are filed by corporations while taxes are ultimately borne by individuals, CBO must distribute corporate taxes liabilities to individual taxpayers based on information about taxpayers' sources of income. In keeping with a widespread consensus among economists, CBO distributes corporate income tax liabilities to households based on their shares of capital income.

Because of CBO's methodology, CBO's findings regarding the distribution of corporate tax liabilities are a reflection of its findings regarding shares of capital income.[2] That is, CBO's finding that 57.5 percent of corporate income tax liabilities in 2003 were paid by the top one percent is simply a reflection of CBO's estimate that 57.5 percent of capital income in 2003 was received by the top one percent. It is presumably because the information on the share of capital income going to various groups is never presented directly in the CBO report that the trend described in this analysis has not previously come to light.

[2] Specifically, as the report states: "CBO assumes that corporate income taxes are borne by owners of capital in proportion to their income from interest, dividends, rents, and capital gains."

Table 1. Share of Capital Income Flowing to Households in Various Income Categories								
	Income Category							
Year	Lowest Quintile	Second Quintile	Middle Quintile	Fourth Quintile	Highest Quintile	Top 10%	Top 5%	Top 1%
1979	1.8%	4.1%	6.7%	10.5%	76.5%	66.7%	57.9%	37.8%
1980	1.8%	3.9%	7.0%	11.3%	75.5%	65.0%	55.6%	35.6%
1981	1.6%	3.8%	7.1%	11.9%	74.9%	64.6%	55.4%	35.8%
1982	1.7%	4.0%	7.5%	12.1%	73.8%	63.3%	54.9%	37.7%
1983	1.6%	3.8%	7.5%	12.2%	74.2%	63.7%	55.2%	37.6%
1984	1.9%	3.8%	7.5%	12.7%	73.2%	63.5%	55.1%	38.5%
1985	1.4%	3.7%	7.5%	12.3%	74.2%	64.9%	56.9%	39.7%
1986	1.4%	3.3%	7.2%	11.7%	75.7%	67.4%	59.5%	42.8%
1987	1.3%	3.8%	7.7%	12.8%	73.1%	64.0%	55.3%	36.7%
1988	1.2%	3.4%	7.5%	11.6%	74.9%	66.5%	58.4%	40.7%
1989	1.2%	3.6%	7.0%	11.7%	75.2%	66.0%	57.4%	39.1%
1990	1.2%	3.2%	6.9%	11.6%	75.6%	66.3%	57.4%	39.7%
1991	1.4%	3.4%	7.5%	11.6%	74.5%	64.7%	56.2%	38.3%
1992	1.3%	3.2%	6.9%	10.8%	76.4%	67.8%	59.0%	40.7%
1993	1.1%	3.0%	6.3%	10.3%	77.9%	69.2%	60.5%	42.2%
1994	1.0%	2.7%	6.2%	10.1%	78.5%	70.0%	62.1%	44.5%
1995	1.1%	2.6%	5.9%	10.0%	79.0%	70.1%	61.5%	43.2%
1996	0.9%	2.4%	5.8%	9.7%	80.1%	71.2%	62.4%	44.5%
1997	0.8%	2.2%	5.3%	9.2%	81.5%	72.6%	64.1%	45.7%
1998	0.8%	2.2%	5.4%	8.7%	82.0%	73.8%	65.4%	47.9%
1999	0.8%	2.2%	5.5%	8.5%	82.1%	73.8%	65.7%	47.8%
2000	0.9%	2.1%	5.3%	8.0%	82.9%	74.6%	66.5%	49.1%
2001	0.8%	2.1%	5.4%	7.7%	82.6%	74.8%	67.8%	51.8%
2002	0.7%	1.9%	5.2%	7.1%	83.4%	76.0%	69.5%	53.4%
2003	0.6%	1.6%	4.3%	6.1%	85.8%	79.4%	73.2%	57.5%