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HIGH - INCOME HOUSEHOLDS WOULD FACE LOWER TAX BURDEN UNDER OBAMA BUDGET THAN IN CLINTON YEARS, WHEN ECONOMY PERFORMED WELL

by Chuck Marr and Jason Levitis

Despite claims that President Obama would impose a massive, damaging tax increase on wealthy Americans, the top 1 percent of Americans would actually pay a slightly *smaller* share of their income in federal taxes under the President's proposals than during the Clinton Administration, when the economy grew strongly.

Specifically, the top 1 percent — who have average annual incomes of $1.6 million — would pay an "average effective tax rate" (the percentage of income paid in taxes) of 32.6 percent in 2012, compared to 32.8 percent if the tax code under President Clinton were in effect that year, according to the Urban Institute-Brookings Institution Tax Policy Center.

High-income households below the top 1 percent would experience a somewhat larger drop in their tax burdens compared to the Clinton years, and low- and middle-income households would pay significantly lower effective tax rates under the Obama budget than during the Clinton Administration (see Figure 1). For example, the top 2 percent to 5 percent of households (the most affluent households except for those in the top one percent) would pay 25.3 percent of their income in federal taxes, compared to 26.9 percent under the policies of the 1990s.

The fact that the economy performed well in the Clinton years, with Americans at all income levels enjoying rising living standards, suggests that the Obama tax proposals are not inconsistent with strong economic growth. Moreover, those at the top of the income scale did particularly well under the Clinton-era tax system: according to the Congressional Budget Office (CBO), the real after-tax income of the top 1 percent of households grew by 78 percent between 1992 and 2000.

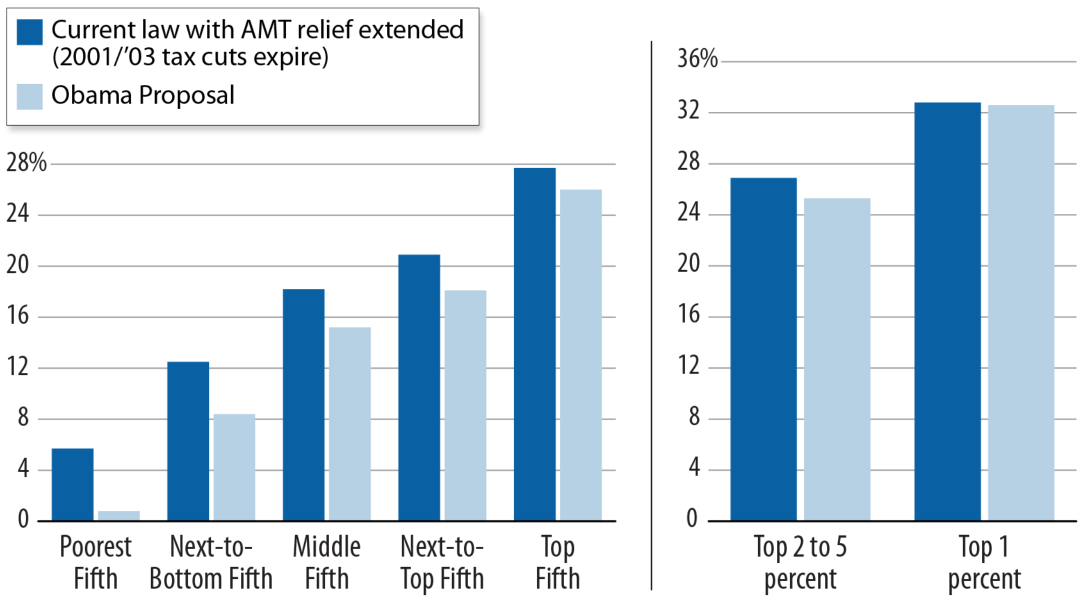
President Obama's budget would allow the Bush Administration's reductions in the top two marginal tax rates to expire after 2010 for households with incomes over $250,000 a year (over $200,000 for single filers) and would apply a 28 percent limit on itemized deductions to households above those income levels. But other elements of the Obama budget would preserve, in whole or in part, various benefits of the Bush tax cuts for high-income households. For example, the Obama budget would set the top tax rate on dividends at 20 percent, far below the 39.6 percent rate that prevailed in the 1990s when dividends were taxed as ordinary income rather than given a highly preferential tax rate.

In short, instead of extending the very large and increasingly unaffordable Bush tax cuts for high-income Americans — which Tax Policy Center data have shown will be worth an average of

FIGURE 1:

Effective Tax Rates Lower Under Obama Than Clinton

Average Federal Tax Rate (i.e. percentage of income paid in federal taxes)



Source: Tax Policy Center

$158,000 in 2010 to people with incomes above $1 million — the Obama budget would restore taxes for high-income Americans to more equitable and fiscally responsible levels.

It should not be surprising that tax burdens for the vast swath of American families would be lower under the Obama plan than in the Clinton era. President Obama's budget extends the middle-class tax cuts from the Bush years such as the new 10 percent bracket, a higher Child Tax Credit, and marriage penalty relief, and the Obama budget also proposes additional middle-class tax cuts. As a result, people in the middle income quintile (i.e., the 20 percent of Americans right in the middle of the income scale) would pay an average of 15.2 percent of their income in federal taxes, compared to the 16.5 percent rate that prevailed under Bush and the 18.2 percent rate that would prevail from a return to the tax policies of the 1990s. It also should not be surprising that the Obama proposals would raise the effective tax rate for the top 1 percent of Americans, compared to what it is under the current Bush tax code (from 30.2 percent under Bush policies to 32.6 percent under Obama policies).

It may, however, surprise some people that the tax burden at the top of the income scale is slightly lower under the Obama plan than in the Clinton era. The top marginal rates (36 percent and 39.6 percent) are the same under both, and the Obama plan's 28 percent limit on itemized deductions would increase the average effective tax rate of the top 1 percent of filers.[1] But other

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[1] Under the itemized deduction proposal, which would affect only 1.4 percent of households, the federal government would still subsidize high-income households for their deductible expenditures at nearly twice the rate it subsidizes middle-class households for those same expenditures. (Families over $250,000 would receive a subsidy of 28 cents per dollar of deductible expenditures, compared to a 15 cent subsidy for people in the 15 percent tax bracket.) Moreover, the 28 percent deduction rate would be the same as in the final years of the Reagan Administration, when the top tax

proposals in the Obama budget would more than offset the impact of the 28 percent provision. These proposals include (but are not limited to):

- **Retaining a low tax rate on dividends.** President Obama proposes a dividend tax rate of 20 percent, or *half* of the 39.6 percent rate that prevailed during the 1990s and that will return in 2011 unless Congress acts. This proposal alone amounts to an average tax cut of $10,400 for the top 1 percent of households, according to the Tax Policy Center.

- **Extending the 10 percent bracket and marriage penalty relief.** These middle-class tax cuts also provide modest tax savings at the top end of the income scale.

- **Extending the 25 and 28 percent tax rates.** The Obama plan would make permanent the tax cuts enacted in 2001 that lowered the tax rate in what was formerly the 31 percent bracket to 28 percent, and the tax rate in what used to be the 28 percent bracket to 25 percent. Taxpayers at the top of the income scale benefit from these rate reductions.

This is why the Tax Policy Center data show that under the Obama tax proposals as a whole, the average effective tax rate for the top 1 percent of filers would be 32.6 percent, slightly less than the 32.8 percent rate under the Clinton-era tax policies. (See table below.)

Decade-Long Tax Windfall for High-Income Households No Longer Affordable

The President's tax proposals affecting high-income households would not take effect until 2011; until then, the Bush tax cuts for this group would remain in place, adding to the decade-long tax windfall they have enjoyed. The Tax Policy Center estimates that the average household making

Effective Tax Rates, 2012
(i.e., percentage of income paid in federal taxes)

Household Income Group	Clinton Tax Law	Bush Tax Law	Obama Proposal
Poorest fifth	5.7%	5.0%	0.8%
Next-to-bottom fifth	12.5%	10.5%	8.4%
Middle fifth	18.2%	16.5%	15.2%
Next-to-top fifth	20.9%	18.9%	18.1%
80th to 90th percentile	23.8%	21.3%	20.8%
90th to 95th percentile	24.9%	22.5%	22.3%
Top 2 percent to 5 percent	26.9%	24.7%	25.3%
Top 1 percent	32.8%	30.2%	32.6%
All	23.0%	20.8%	20.6%

Source: Urban Institute-Brookings Tax Policy Center

Notes: "Clinton" scenario is based on current law in 2012 with the AMT patch extended. "Bush" scenario is current policy extended to 2012. Obama budget proposal includes major individual income and corporate income tax provisions, and maintaining the estate tax at 2009 parameters.

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rate was 28 percent. The Bush Administration's tax reform panel proposed going further than the Obama budget in equalizing tax subsidies for deductible expenses, recommending in 2005 that the value of the mortgage interest deduction be set at 15 percent for all tax filers.

more than $1 million will benefit from a cumulative $650,000 tax cut over the 2006-2010 period, just half of the decade.

These massive tax cuts have exacerbated the growth in income inequality in recent years between those at the top of the income scale and other Americans. CBO has compiled data for the 1979-2005 period showing that over that span, average after-tax income rose by 6 percent — or $900 — for the bottom fifth of Americans (after adjusting for inflation), by 21 percent — or $8,700 — for the middle fifth of Americans, and by *228 percent* — or $745,000 — for the top 1 percent of Americans.

In light of the daunting budget deficits the nation faces and worsening inequality, continuing the very large tax cuts for high-income households would be neither equitable nor fiscally responsible.