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The Rich Pay More Taxes: Top 20 Percent Pay Record Share of Income Taxes

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Since the passage of the 2001 and 2003 tax cuts, critics have claimed incessantly that they disproportionately benefited the rich while burdening the poor. Now that the data is in, these claims have been shown to be unquestionably false.

Squeezing the Wealthy Even More. According to a report issued by the Congressional Budget Office (CBO), the tax cuts significantly increased the share of federal income taxes paid by the highest-earning 20 percent of households compared to their levels in 2000, President Clinton's final year in office.

In 2006, the latest available year from CBO, the top 20 percent of income earners paid 86.3 percent of all federal income taxes, an all-time high.¹ This is an increase of over 6 percent from 2000, when the top 20 percent paid 81.2 percent. During the same period, the bottom four quintiles all saw their share of the federal income tax burden fall sharply:

- The bottom 20 percent of income earners' share of federal income taxes fell from -1.6 percent in 2000 to -2.8 percent in 2006;
- The next 20 percent's share declined from 1.1 percent to -0.8 percent;
- The middle quintile's share dropped from 5.7 percent to 4.4 percent; and
- The fourth quintile's share decreased from 13.5 percent to 12.9 percent.

Each of these four quintiles' shares was an all-time low.

2001 and 2003 Tax Cuts Removed Low-Income Earners from Roles. The 2001 and 2003 tax cuts removed millions of taxpayers from the federal income tax roles, leaving only those at the top to pay the bill. They lowered every federal income tax rate and created a new 10 percent bracket to further reduce taxes for low-income earners.

While these tax rate cuts lowered taxes for all taxpayers, low-income earners got the biggest cut. In addition to these rate cuts, the 2001 and 2003 tax cuts expanded the refundable Child Tax Credit from \$500 per child to \$1,000 per child. The combination of lower tax rates and an expanded Child Tax Credit meant many low-income taxpayers no longer paid any federal income taxes.

Was Greater Income the Cause? Critics counter that the increase in tax shares for high-earners was due to income increases at the top of the income spectrum. But a closer look at the data shows this just is not the case.

The top 20 percent of earners saw their share of pre-tax income rise from 54.8 percent to 55.7 percent, from 2000 to 2006. During that same period, their share of federal income taxes increased from 81.2 percent to 86.3 percent.

This paper, in its entirety, can be found at:
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The modest increase in incomes is not large enough to explain the large increase in the share of income taxes paid by the top 20 percent. Rather, the removal of substantial numbers of low-income taxpayers from the federal income tax rolls is the real culprit.

Refundable Credits Redistribute Income. The bottom 40 percent of income earners actually paid a negative share of federal income taxes in 2006. In other words, these taxpayers are actually paid money through the tax code. This happens through refundable credits like the Child Tax Credit and the Earned Income Tax Credit, which result in “refunds” when they are greater than the taxpayer’s total income tax liability.

For instance, if a family with one child has an income tax liability of \$300, it can claim the Child Tax Credit, which wipes out their tax liability, and still receive \$700 from the IRS for the remainder of the \$1,000 credit. On April 15, not only do the bottom 40 percent of all taxpayers pay no taxes, but they actually receive additional income from the IRS.

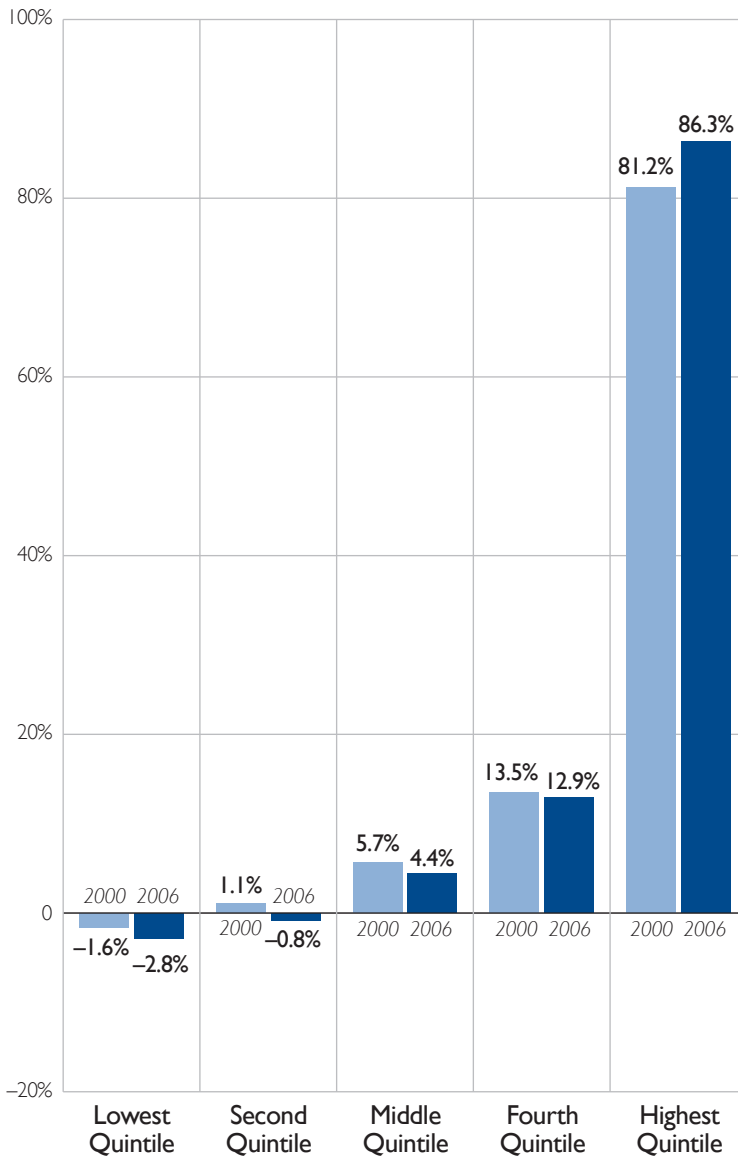
Refundable credits redistribute income from the top 20 percent of earners to the remaining tax filers, with the bottom 20 percent the prime beneficiaries. The bottom quintile’s share of income, measured after taxes, actually increased a whopping 17 percent compared to its pre-tax levels because of the income they got from refundable credits. Comparing shares of income before taxes are paid to after, only the top quintile saw their share of income decline.

Obama’s Tax Policies Widen the Gap. President Obama’s tax policies

Bush Tax Cuts Helped Lower-Income Earners Most

Between 2000 and 2006, only the highest quintile of income earners saw their share of federal income taxes increase. In turn, the lowest 40 percent earners not only paid no taxes but received income in the form of refundable tax credits.

Share of Federal Income Tax Liabilities in 2000 and 2006



Source: Congressional Budget Office, “Historical Effective Federal Tax Rates: 1979 to 2006,” April 2009, at http://www.cbo.gov/publications/collections/tax/2009/all_tables.pdf (April 23, 2009).

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1. Unless otherwise noted, all data come from Congressional Budget Office, “Historical Effective Federal Tax Rates: 1979 to 2006,” April 2009, at http://www.cbo.gov/publications/collections/tax/2009/all_tables.pdf (April 23, 2009).

would cause federal income taxes paid by the top 20 percent to increase and the shares of the remaining 80 percent to decrease even further. These policies include those passed as part of the stimulus legislation and those included in the President's Budget Blueprint.

The stimulus created the Making Work Pay Credit² and expanded the Child Tax Credit and Earned Income Tax Credit. These refundable credits will knock even more taxpayers from the federal income tax rolls and send more money to low-income taxpayers.³ With fewer low- and middle-income taxpayers paying federal income taxes, the burden will shift even further in the direction of top earners.

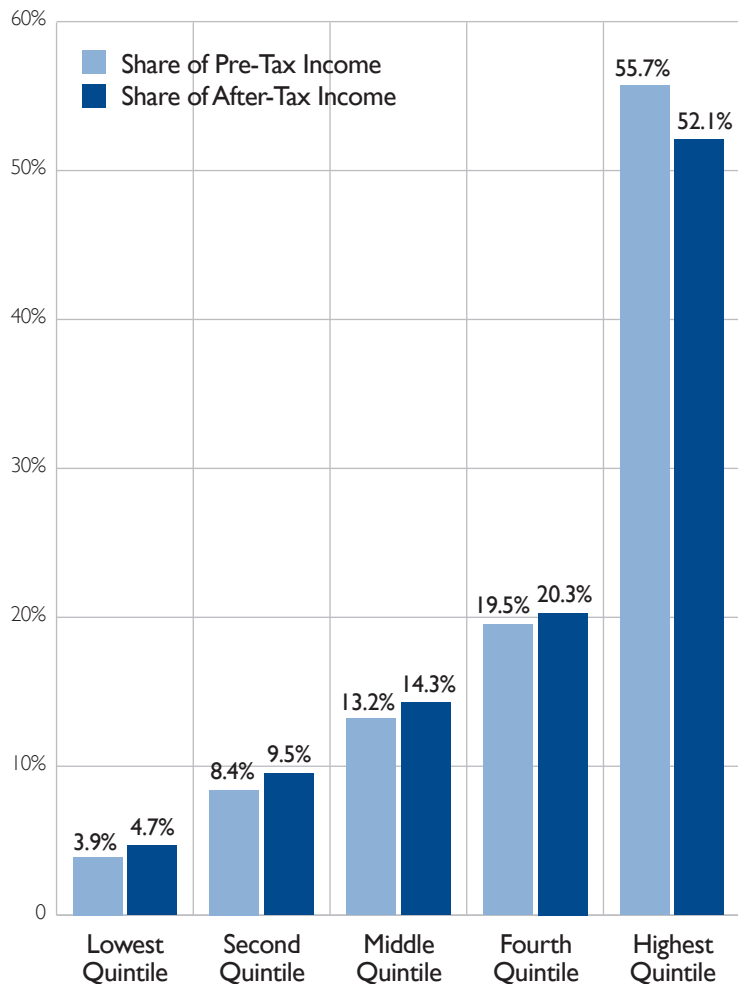
President Obama also proposed in his Budget Blueprint to increase income taxes on those making over \$250,000 by increasing their tax rates on investment income and reducing the amount they could deduct.⁴ This would dramatically increase the share of taxes paid by the top 20 percent while the remaining 80 percent of earners would not pay higher taxes as a result of these proposed tax hikes.

Stop Shifting Burden to Top 20 Percent. To stop the shifting of the tax burden to a dwindling number of taxpayers, Congress should:

- Make the 2001 and 2003 tax cuts permanent for all taxpayers, not just those making under \$250,000. This would slow the shifting of the burden to the top 20 percent.

Refundable Tax Credits Redistribute Wealth

When comparing pre-tax income to after-tax income, only the highest-earning one-fifth saw their incomes decrease in 2006. The remaining 80 percent had income increases due to refundable tax credits.



Source: Congressional Budget Office, "Historical Effective Federal Tax Rates: 1979 to 2006," April 2009, at http://www.cbo.gov/publications/collections/tax/2009/all_tables.pdf (April 23, 2009).

Chart 2 • WM 2420 heritage.org

2. Curtis S. Dubay, "‘Making Work Pay Credit’ Will Not Stimulate the Economy," Heritage Foundation *WebMemo* No. 2240, January 26, 2009, at <http://www.heritage.org/Research/Taxes/wm2240.cfm>.
3. Curtis S. Dubay, "Obama's Stimulus Has 'Spread the Wealth Around': Are Tax Hikes Next" Heritage Foundation *WebMemo* No. 2354, March 23, 2009, at <http://www.heritage.org/Research/Economy/wm2354.cfm>.
4. U.S. Office of Management and Budget, *A New Era of Responsibility: Renewing America's Promise* (Washington, D.C.: U.S. Government Printing Office, 2009), p. 123, Table S-6, at http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf (April 23, 2009).

- Stop creating and expanding refundable credits. Welfare spending and subsidies to low-income earners should be done through traditional spending programs, not hidden in the tax code. This would stop a growing portion of the population from being removed from the tax roles.
- Cut top tax rates to return the shares of income taxes paid by each quintile to their more-sustainable 2000 levels.

On Dangerous Ground. The shifting of the tax burden to a small segment of high-income taxpayers is economically dangerous. The beneficiaries of gov-

ernment services are increasingly those who share little or none of the tax burden to pay for them. As they become more numerous, they put more pressure on Congress for more services. Meanwhile, those who bear most of the burden are being squeezed even more, shrinking their number. The result is a growing group of government beneficiaries clamoring for more of a shrinking group's wealth. Congress should put an end to this practice.

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