Joint Economic Committee Democrats

Representative Pete Stark (D-CA) – Senior Democrat

Economic Policy Brief — August 2004

New CBO Analysis Confirms That The Bush Tax Cuts Are Skewed Toward The Rich

New estimates by the Congressional Budget Office (CBO) confirm that the Bush Administration's tax cuts disproportionately benefit the richest American households.[1] Based on the new CBO data, the Joint Economic Committee Democratic staff calculates that in 2004, the average tax cut for the 1 percent of households with the highest incomes is more than *seventy* times the tax cut for middle-income households.

That calculation includes the tax cuts from temporary investment incentives that expire at the end of this year. Excluding the effects of those investment incentives, the tax cut for the top 1 percent of households is still forty times as large as the cut for the middle class.

The disparity in the Bush tax cuts is so great that the resulting percentage increase in income after tax for the highest-income households is more than four times as large as the increase for middle-income households, and still 2 ½ times as large excluding this year's temporary investment incentives. The new CBO estimates show the Bush tax cuts to be even more tilted toward the top 1 percent of households than previous estimates by other tax analysts.[2]

Distribution of the Bush Tax Cuts in 2004

The CBO analysis compares federal income, payroll, and excise taxes under current law with the taxes households would pay if Congress had not enacted the 2001, 2002, and 2003 tax cuts. It does not include federal estate and gift taxes. In 2004, the combined Bush tax cuts result in an average tax cut of only $250 for the 20 percent of households with the lowest incomes, compared with $1,090 for the middle 20 percent of households and $78,460 for the top 1 percent of households (see Figure 1). The tax cut for the 1 percent of households with the highest incomes is $40,990 excluding the effects of bonus depreciation—a temporary investment tax incentive that expires at the end of the year.

The tax cuts result in a much larger increase in after-tax income for the highest-income households than for everyone else. In 2004, the tax cuts are a staggering 10.1 percent of after-tax income for the top 1 percent of households (including bonus depreciation), but only 1.6 percent of after-tax income for the lowest 20 percent of households, and 2.3 percent for the middle 20 percent of households (see Figure 2). The tax cuts result in a 5.3 percent increase in after-tax income for the top 1 percent of households excluding bonus depreciation—more than 2½ times the 2.0 percent increase for middle-income households. Appendix Table 1 shows additional measures of the distribution of the tax cuts across household income groups.

The tax cuts for the richest 1 percent of households are much larger than the cuts for other high-income households in the top 20 percent or even the top 5 percent of the population. While the increase in after-tax income was 10.1 percent for the top 1 percent, it was 4.8 percent for the four percent of the population just below the top 1. While less than half the increase for the top 1 percent, it was still over twice as large as the increase for middle-class families.

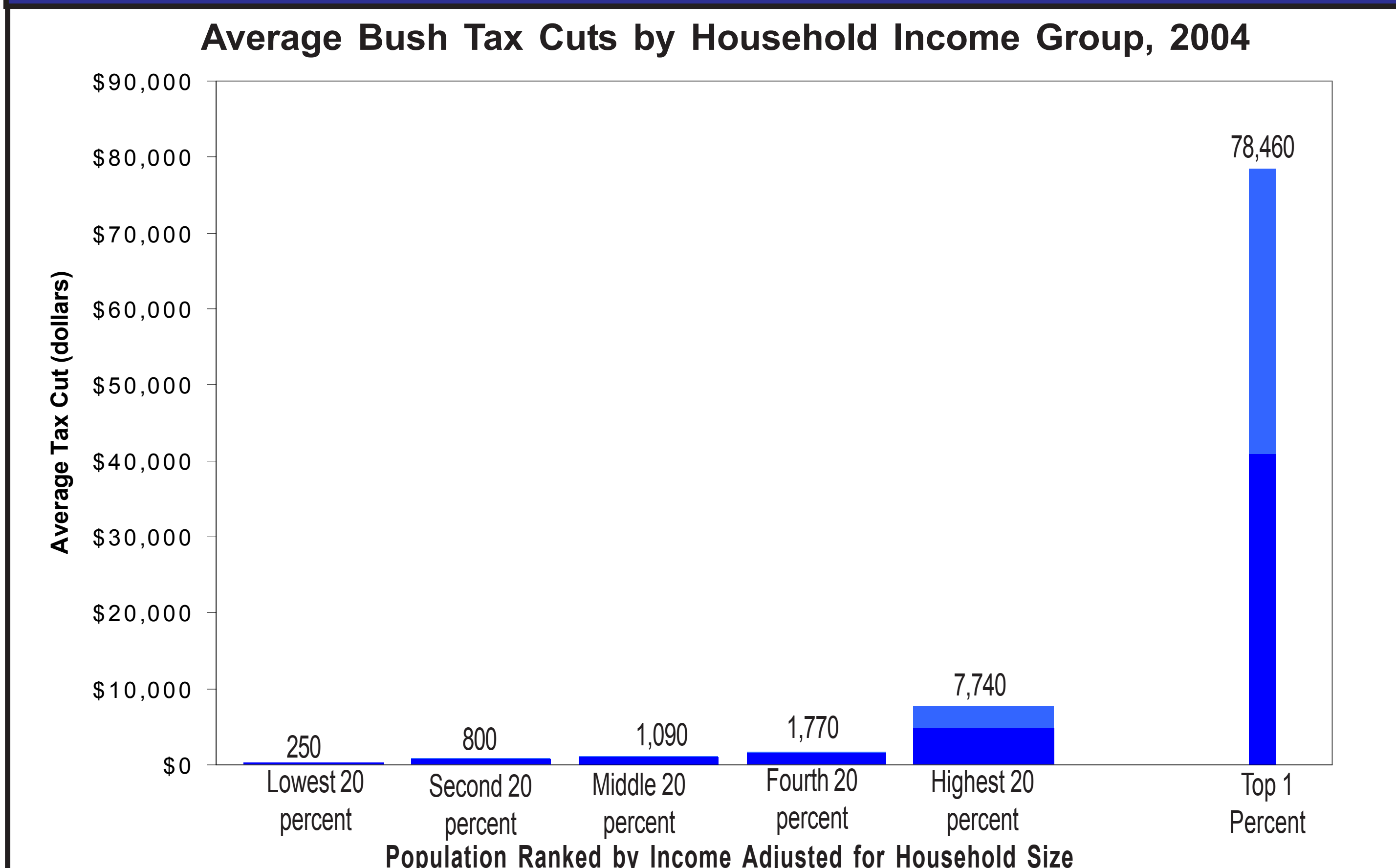
The skewed tax cuts reflect a significant lost opportunity. If the Administration had merely scaled back the tax cuts for the 5 percent of the population with the highest income so that they were the same percentage of after-tax income as for middle-income households, the cost would have been much less – nearly $90 billion less lost revenue in 2004 alone. Over three-quarters of this lost revenue went to the top 1 percent of households. Those savings could have been used to address some of our nation's many pressing needs.

The Distribution of the Tax Cuts after 2004

The status of the tax cuts after 2004 is highly uncertain. The CBO estimates follow current law. On that basis, if the tax cuts are not extended the estimates suggest that the tax cuts will be somewhat less highly skewed to high-income households after 2004. This is because certain provisions that benefit higher-income households are scheduled to expire in the next few years. In particular, the increase in the alternative minimum tax exemption and bonus depreciation expire after this year, and the reduced tax rate on dividends and capital gains expires after 2008. Currently, all provisions of the tax cuts are scheduled to expire after 2010. Appendix Table 2 shows when various provisions expire.

The Administration would like to extend the tax cuts beyond their scheduled expiration, however. The Bush Administration's 2005 budget proposed to permanently extend most of the tax cuts. The House has passed legislation that would extend certain tax cuts scheduled to expire at the end of this year, including

Figure 1



Note: Darker area of each bar excludes the effect of bonus depreciation.
Source: JEC Democratic staff calculations from CBO estimates.

the increase in the AMT exemption, and there is strong support in the Senate for extending at least some of the expiring cuts.[3]

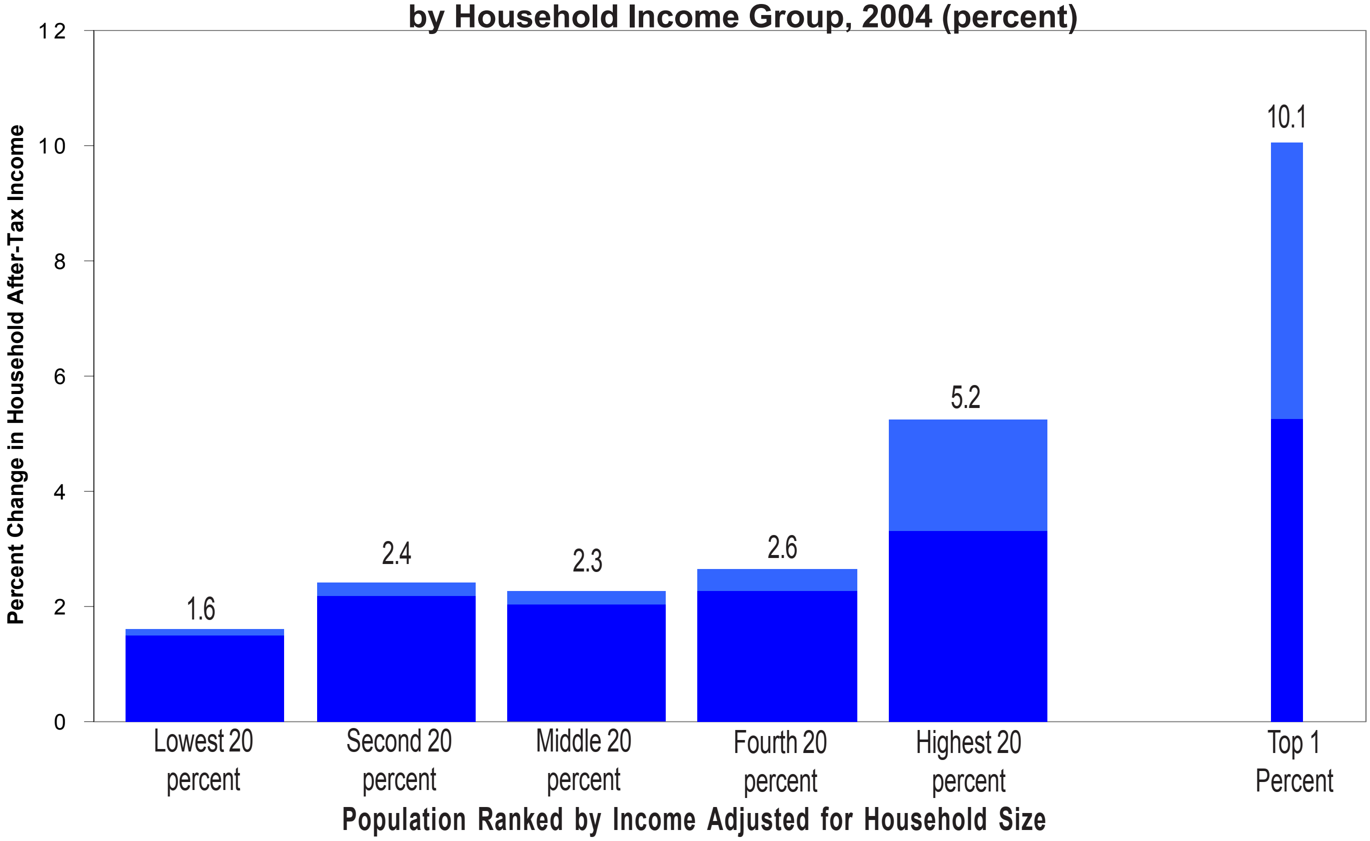
Neither the Administration's 2005 budget proposals nor the current House bills would extend bonus depreciation beyond this year, although previous bills introduced in both the House and Senate have proposed an extension[4]. Bonus depreciation was originally justified as a temporary economic stimulus, and if that justification prevails, it will probably expire as scheduled. Because this tax cut disproportionately benefits the highest-income households, the Bush tax cuts will be less regressive in the future if this provision is allowed to expire.

However, while the CBO estimates for the total tax cut in 2004 might overstate the regressivity of the tax cuts in later years because they include the effects of bonus depreciation, the estimates *understate* the future regressivity of the tax cuts because they do not include the effects of phase-out and repeal of the estate tax. Repealing the estate tax disproportionately benefits the highest-income households, and that effect would likely more than replace the effect of the bonus depreciation. The magnitude of the tax cut from repeal of the estate and gift tax is similar to the magnitude of the tax cut from bonus depreciation. At its fully phased-in level in 2004, bonus depreciation costs $62 billion in lost revenue, while the complete repeal of the estate and gift tax will cost $53 billion in lost revenue in 2011.

Finally, the CBO estimates do not include the impact on households of paying for the tax cuts. The Administration has pushed those costs into the future by increasing government borrowing to finance the tax

Figure 2

Change in After-Tax Income as a Result of the Bush Tax Cuts by Household Income Group, 2004 (percent)



Note: Darker area of each bar excludes the effect of bonus depreciation.
Source: JEC Democratic staff calculations from CBO estimates.

cuts, but eventually that debt must be paid either through spending cuts or increased revenues. A recent analysis suggests that when the cost of paying for the tax cuts is included, "the bottom four-fifths of households—households with income below about $76,400—would lose more than they gain from the tax cuts once the necessary financing is taken into account."[5]

Conclusion

Higher-income households have received a double bonus in recent years. Data compiled by the CBO show that income before taxes has grown significantly more for higher-income households than for lower-income households from 1989 to 2001.[6] By skewing the tax cuts enacted since 2001 to the rich, the Bush tax cuts have resulted in an even greater disparity in the growth of income after taxes.

(Endnotes)

1 The CBO analysis is available at: http://www.cbo.gov

2 Both the Urban-Brookings Tax Policy Center and Citizens for Tax Justice have estimated the effects of the Bush Administration's tax cuts. See:http://www.taxpolicycenter.org/TaxModel/tmdb/TMTemplate.cfm (Tables T04-0051 and T04-0052), and http://www.ctj.org/pdf/gwbdata.pdf. Differences in estimates between CBO and other analysts result from various technical factors such as different measures of income and different ways of classifying families into income groups. For example, CBO adjusts household income to account for household size, which moves larger households lower in the income distribution. Because larger households tend to include children, and therefore benefit from the increases in the child tax credit and dependent care tax credit, CBO estimates show larger tax cuts for families in lower-income groups than estimates that do not adjust income for household size.

3. H.R. 4275 would extend the increase in the maximum income for the 10 percent tax bracket. H.R. 4359 would extend the increase in the child tax credit and further expand the credit. H.R. 4181 would extend expiring tax benefits for married couples. H.R. 4227 would extend the increase in the AMT exemption.

4. For example, H.R. 4128, H.R. 2895, H.R. 2855, S.1475, and S. 2767.

5. See William G. Gale, Peter R. Orszag, and Isaac Shapiro, "The Ultimate Burden of the Tax Cuts," June 2, 2004, p. 3, available at: http://www.cbpp.org/6-2-04tax.pdf

6. Congressional Budget Office, "Effective Federal Tax Rates: 1979-2001," April 2004, available at: http://www.cbo.gov/showdoc.cfm?index=5324&sequence=0.

APPENDIX

Table 1. Distribution of Bush Tax Cuts in 2004, By Income Quintile

Income Category (percentile)	Average Income	Percent Change in After-Tax Income	Share of Tax Cuts (percent)	Average Tax Cut	Aggregate Tax Cuts (billions)	Effective Federal Tax Rate (percent)		
						Without Tax Cuts	With Tax Cuts	Change
Lowest 20 percent	$16,620	1.6	2.1	$250	$5.7	6.7	5.2	-1.5
Second 20 percent	$38,140	2.4	6.5	$800	$17.3	13.2	11.1	-2.1
Middle 20 percent	$57,430	2.3	9.1	$1,090	$24.2	16.5	14.6	-1.9
Fourth 20 percent	$84,310	2.6	14.7	$1,770	$39.0	20.6	18.5	-2.1
Highest 20 percent	$203,740	5.2	67.5	$7,740	$178.6	27.6	23.8	-3.9
All	$80,070	3.9	100.0	$2,400	$269.1	22.6	19.6	-3.0
81-90 percent	$116,630	3.0	11.4	$2,660	$30.3	23.3	21.0	-2.3
91-95 percent	$154,520	3.0	7.6	$3,420	$20.0	25.2	23.0	-2.2
96-99 percent	$243,150	4.8	14.9	$8,400	$39.5	27.8	24.3	-3.5
Top 1 percent	$1,171,030	10.1	33.6	$78,460	$88.9	33.4	26.7	-6.8

Source: JEC Democratic staff calculations from CBO estimates.

Table 2. Phase-in and Expiration Schedule of Key Bush Tax Cuts Under Current Law

Tax Cut	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Tax Rates and Brackets											
Create 10 percent tax bracket	EGTRRA: Bracket extends to $12,000 for couples, $6,000 for singles.		JGTRRA: Bracket extends to $14,000 for couples, $7,000 for singles. Indexed in 2004.		EGTRRA: Bracket extends to $12,000 for couples, $6,000 for singles.			EGTRRA: Bracket extends to $14,000 for couples, $7,000 for singles. Indexed in 2009.			Expires
Reduce tax rates in top four tax brackets	EGTRRA: Top rates 39.1% 35.5% 30.5% 27.5%	EGTRRA: Top rates 38.6% 35% 30% 27%	JGTRRA: Top rates 35% 33% 28% 25%		EGTRRA: Top rates 35% 33% 28% 25%						Expires
Reduce tax rates on capital gains and dividends	No change.		JGTRRA: Reduce rates to 5 percent (0 percent in 2008) and 15 percent.						Expires		
Limits on itemized deductions and personal exemptions											
Reduce or eliminate limits on itemized deductions and personal exemptions	No change.					EGTRRA: Reduce limits by one-third.		EGTRRA: Reduce limits by two-thirds.		EGTRRA: Repeal limits.	Expires
Children and Married Couples											
Increase child tax credit	EGTRRA: Increase credit to $600.		JGTRRA: Increase credit to $1,000.		EGTRRA: Increase credit to $700.				EGTRRA: Increase credit to $800.	EGTRRA: Increase credit to $1,000.	Expires
Increase dependent care credit	No change.	EGTRRA: Maximum credit of $3,000 for one child and $6,000 for two or more children.									Expires
Increase standard deduction for married couples	No change.		JGTRRA: Deduction for couples is 200% of the deduction for singles.		EGTRRA: 174% of the deduction for singles.	EGTRRA: 184% of the deduction for singles.	EGTRRA: 187% of the deduction for singles.	EGTRRA: 190% of the deduction for singles.	EGTRRA: Deduction for couples is 200%of the deduction for singles.		Expires
Expand 15 percent bracket for married couples	No change.		JGTRRA: Maximum income for couples is 200% of the maximum for singles.		EGTRRA: 180% of the maximum for singles.	EGTRRA: 187% of the maximum for singles.	EGTRRA: 193% of the maximum for singles.	EGTRRA: Maximum income for couples is 200% of the maximum for singles.			Expires
Expand EITC for married couples	No change.	EGTRRA: Increase beginning and end of phaseout by $1,000.			EGTRRA: Increase beginning and end of phaseout by $2,000.			EGTRRA: Increase beginning and end of phaseout by $3,000. Index in 2009.			Expires
Alternative Minimum Tax											
Increase exemption for the alternative minimum tax	EGTRRA: Increase exemption to $49,000 for couples, $35,750 for singles.		JGTRRA: Increase exemption to $58,000 for couples, $40,250 for singles.		Expires						
Bonus Depreciation											
Increase first-year depreciation allowance	JCWAA: Additional first-year depreciation allowance of 30 percent.		JGTRRA: Additional first-year depreciation allowance of 50 percent.		Expires						
Estate Tax											
Increase exemption level and reduce highest tax rate	No change	EGTRRA: $1 million exemption 50% top rate	EGTRRA: $1 million exemption 49% top rate	EGTRRA: $1.5 million exemption 48% top rate	EGTRRA: $1.5 million exemption 47% top rate	EGTRRA: $2 million exemption 46% top rate	EGTRRA: $2 million exemption 45% top rate		EGTRRA: $3.5 million exemption 45% top rate	EGTRRA: Estate tax repealed.	Expires

Source: Congressional Budget Office and the Joint Economic Committee Democratic staff

Note: EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001. JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003. JCWAA = Job Creation and Worker Assistance Act of 2002. Shaded areas are years in which JGTRRA provisions are in effect.

JOINT ECONOMIC COMMITTEE – DEMOCRATS
REPRESENTATIVE PETE STARK (D-CA) – SENIOR DEMOCRAT

804 HART SENATE OFFICE BUILDING
PHONE: (202) 224-0372 FAX: (202) 224-5568
INTERNET: WWW.SENATE.GOV/~JEC/DEMOCRATS