



# JOINT ECONOMIC COMMITTEE DEMOCRATS



REPRESENTATIVE PETE STARK (D-CA) – RANKING MEMBER

ECONOMIC POLICY BRIEF

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## LOW-INCOME WORKING FAMILIES DESERVE THE INCREASED CHILD TAX CREDIT

### REPUBLICANS USE PAYROLL TAXES TO FINANCE TAX CUTS FOR THE WEALTHY

#### Overview

House Republicans oppose legislation that would extend the recently enacted increase in the child tax credit to low-income working families. They argue that these families don't deserve tax relief because they don't pay income taxes. House Republicans also hope to use increases in the child tax credit for the working poor to leverage votes for future costly tax cuts that will once again favor upper-income families.

Despite erroneous claims to the contrary, low-income families do pay a significant amount of federal taxes. Payroll taxes for Social Security and Medicare are on average about 12 percent of income for families with income between \$10,000 and \$20,000.<sup>1</sup> These families also pay federal excise taxes, which, according to the latest estimates from the Congressional Budget Office, are approximately another 3 percent of their income.<sup>2</sup> On top of the federal taxes they pay, these families also pay income, sales, and property taxes at the state and local level.

In fact, wealthy families are protected from paying Social Security payroll taxes on all of their in-

come. Only earnings – not investment income – are subject to Social Security tax and the law caps taxable wages at \$87,000 – far below the earnings of many affluent Americans.

#### Payroll Taxes Finance the Tax Cuts

Republicans dismiss the Social Security payroll taxes paid by low-income families because, they claim, those taxes are used to pay Social Security benefits. Why this should somehow make payroll taxes irrelevant is a mystery. After all, upper income taxpayers receive tangible benefits from their taxes such as education, national defense, and homeland security. It's difficult to argue that income taxes paid by upper-income families for services that they use and value somehow matter, but

payroll taxes paid by lower-income families do not matter.

Moreover, the Republican claims are not even true. Under the policies of this Administration, a significant portion of Social Security taxes are not set aside for the Social Security program but are instead used – like income taxes – to finance the everyday functions of the federal government. In

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the current budget environment, every dollar that the House Republican leadership provides for permanent tax relief is a dollar borrowed from Social Security. While Social Security surpluses are invested in Treasury Bonds, these funds are not being used to pay down debt, increase national savings and prepare for the baby boom. Instead, these funds are being spent immediately. Therefore, payroll taxes are in fact financing tax cuts that largely benefit the wealthiest Americans.

According to the Congressional Budget Office, Social Security revenues will exceed outlays by \$160 billion in fiscal year 2003 and by a cumulative \$1.2 trillion in 2003 through 2008 (**Chart 1**). The surplus amounts to a third or more of Social Security revenues. While the Social Security program is running a surplus, the rest of government will run a deficit of over \$400 billion in 2003, and a cumulative deficit of over \$1.5 trillion in 2003-2008. These huge deficits will more than soak up the entire Social Security surplus.

Thus, over at least the next five years, the Administration will use a third or more of all Social Security payroll tax contributions – including those paid by low-income families – to pay for everything but Social Security benefits. A low-income family earning \$15,000 per year pays about \$1,860 in direct and indirect Social Security payroll taxes. Over \$600 of those taxes pays for non-Social Security spending.

This use – or misuse – of Social Security revenues to finance ordinary government functions only highlights the irresponsibility of tax cuts that add to the long-term deficit. The looming costs associated with the retirement of the baby boom generation will begin in less than a decade. Rather than adding to the burden that we will pass along to our children and grandchildren, the federal government should use surplus Social Security revenues to pay down existing debt and not to finance tax cuts that favor the wealthy few.

## Brief Description of the House and Senate Bills

The Jobs and Growth Tax Act of 2003, which was enacted just last month, excluded 6.5 million low-income families from receiving a child tax credit up to \$1,000 per child. The Senate has passed a relatively modest \$10 billion bill that would give the expanded child credit to families making from \$10,500 to \$26,625 a year. The Senate bill would fully pay for those benefits by extending Customs Service fees.

In an effort to leverage a broader set of tax cuts than the Senate has passed, House Republicans have unveiled a new unpaid for \$82 billion tax bill that would extend the child credit through 2010. Their bill is primarily an excuse to enact more tax breaks and not to help low-income families. The House bill does not include offsets for the new tax cuts, and therefore would further increase the deficit.

House and Senate Republicans could not resist tilting their bills in favor of higher-income families. Both bills would increase the child tax credit for married couples earning at least \$110,000. While no additional working poor families – those making less than \$10,500 a year – would become eligible for the credit, many families earning between \$150,000 and \$200,000 would become eligible once the changes are fully in place. The Senate bill makes this provision partially effective in 2008 (fully effective in 2010) at a cost of \$4.8 billion and the House bill is fully effective in 2003 at a cost of \$20.4 billion.

The increase in the upper-income limits for the child tax credit was made in the name of marriage penalty relief. When fully phased-in the income level at which the child credit phases out for married couples (\$150,000) will be twice the income level at which the credit phases out for single parents (\$75,000). Yet both bills fail to include a similar provision to accelerate scheduled marriage penalty relief for lower-income families receiving the Earned Income Tax Credit.

**Conclusion**

Low-income families pay their fair share of federal taxes and deserve the tax relief that would come from an increase in the child tax credit. Congress should pass legislation making more low-income families, not more high-income families, newly eligible for the child tax credit.

**Endnotes**

- <sup>1</sup> William G. Gale and Jeffrey Rohaly, “Three-Quarters of Filers Pay More in Payroll Taxes Than Income Taxes,” *Tax Notes*, January 6, 2003, p. 119.
- <sup>2</sup> Congressional Budget Office, *Effective Federal Tax Rates, 1979-1997*, October 2001, Table H-1a, p. 98.
- <sup>3</sup> Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, Table 1-5, p. 19 and Table 3-7, p. 64.

Chart 1

**GOP Uses a Third of Social Security Payroll Taxes to Finance Tax Cuts, Everyday Government Expenses**

	2003	2004	2005	2006	2007	2008	2003-2008
<b>Social Security Trust Fund Surplus (in billions)</b>	160	175	194	212	231	250	1,222
<b>Social Security Payroll Tax Receipts (in billions)</b>	532	558	588	619	651	685	3,633
<b>Surplus as a Percentage of Tax Receipts</b>	30.1	31.4	33.0	34.2	35.5	36.5	33.6

Source: Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, Table 1-5, p. 19 and Table 3-7, p. 64.