



# JOINT ECONOMIC COMMITTEE

DEMOCRATIC STAFF

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## A TALE OF TWO TAX CUTS

### Introduction

Americans are filing their first tax returns under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the legislation passed last June that implemented the Administration's tax cut. For some taxpayers, last summer's rebate is representative of the size of the tax cut they can expect over the life of the act, which includes a sunset provision that repeals the entire tax cut at the end of 2010. For others, however, the rebate was just a small downpayment on the full tax cut promised by the act.

### Summary of Findings

This note examines the distributional effects of EGTRRA by separating the income tax cuts into two parts: the provisions that are currently in effect in 2002 and the remaining provisions, which will be phased in over the life of the act. The analysis looks only at the main income tax components. It does not include the effects of repealing the estate tax. Key

findings include the following (see the accompanying table and chart):

- In 2010, when all provisions of EGTRRA are fully in place and the last year before the tax cut's scheduled repeal, provisions that are not in effect this year, including the reductions in marginal tax rates scheduled for 2004 and 2006, will account for about 44 percent of the aggregate income tax cut.
- In 2010, the distributional effects of the income tax cuts in place in 2002 are very different from those of the additional tax cuts to come after 2002.

√ 55 percent of the full income tax cut goes to the 18 percent of taxpayers with incomes of \$100,000 or more and 33 percent goes to the less than one percent of taxpayers with incomes of \$500,000 or more.

√ Looking only at the income tax cuts that are already in place, 46

percent go to taxpayers with income of \$100,000 or more and 12 percent go to those with incomes of \$500,000 or more.

√ Even without accounting for repeal of the estate tax, the tax cuts to come after 2002 are heavily skewed toward high income taxpayers: two-thirds go to those with incomes of \$100,000 or more; almost 60 percent go to those with incomes of \$500,000 or more, less than 1 percent of taxpayers.

### Analysis

These findings are based on an analysis of EGTRRA by the Democratic staff of the Joint Economic Committee using a microsimulation tax model similar to that used by the Congressional Joint Committee on Taxation, the Congressional Budget Office, and other tax analysts. The estimates are for income tax liabilities in calendar year 2010 and include refundable tax credits. The model incorporates the following elements of EGTRRA:



- 10-percent bracket. Under prior law, taxpayers paid a 15 percent marginal income tax rate on their taxable income, up to a maximum amount based on their filing status (single, married filing jointly, etc.). EGTRRA carved a new 10 percent bracket out of the first part of the old 15 percent bracket. For 2001, taxpayers received an advance rebate equivalent to their likely tax saving from the new bracket. For 2002-2007, the amount of taxable income at which taxpayers stop paying the 10 percent rate and begin paying a 15 percent marginal rate is not indexed for inflation. That level of income is increased in 2008 and indexed thereafter.
- Upper-bracket rate cuts. Under prior law, income was taxed in brackets with rates ranging from 15 percent up to 39.6 percent. EGTRRA cut all rates above 15 percent in three stages, with an immediate 1 percentage point reduction, followed by additional reductions in 2004 and 2006.
- Changes in deduction and exemption limits. EGTRRA phases out restrictions on itemized deductions and personal exemptions starting in 2006.
- Child credit. EGTRRA increased the child credit from \$500 to \$600 in 2001 for each child under age 17. The credit will be increased again in 2005 and 2009 before it reaches \$1,000 in 2010. The Act also made the credit refundable for eligible taxpayers with more than \$10,000 of earnings but who owe no income taxes.
- Taxes on married couples. Most of the changes designed to deal with the “marriage penalty” do not go into effect until 2005. Starting then, two provisions are gradually phased in: the standard deduction for married couples filing jointly is increased until it is twice that of single taxpayers; the end-point for the 15 percent bracket is increased for married couples to twice that of singles. A third provision that increases the income level at which the earned income tax credit phases out for married couples went into effect this year, with further increases to come starting in 200
- AMT exemption. The amount of income exempt from the alternative minimum tax is increased in 2001 to 2004, but then reverts back to the 2001 level, which is not indexed for inflation.

The analysis does not include the provisions of EGTRRA that gradually repeal the estate tax. Nor does it include the education provisions of the act or the pension and IRA provisions. The latter are relatively small and would not change the distributional analysis very much. Repeal of the estate tax, in contrast, would cost well over \$50 billion in 2010 and the distributional effects would be highly concentrated at the top of the distribution. An analysis by the U.S. Treasury assigns almost all of the estate tax to the top fifth of the income distribution, with a very high percentage going to the top 1 percent.<sup>1</sup>

EGTRRA provides for gradual reductions in the estate tax until 2010, when it is repealed, hence the estate tax provisions currently in place are relatively small. An analysis that included the effects of the estate tax would produce even more dramatic differences between the distributional effects of the tax cuts already in place and those of the cuts that are yet to come.

A second feature of the analysis that deserves mention is the impact of the alternative minimum tax (AMT), which limits the use of deductions to reduce tax liabilities. In 2001, fewer than 2 percent of taxpayers are subject to the AMT. This percentage is projected to rise to over 35 percent in 2010 under EGTRRA, compared with



less than 18 percent under prior law. The AMT reduces the size of the tax cut for upper income taxpayer, and completely eliminates the cut for many (although those with the very highest incomes are not affected).<sup>2</sup> EGTRRA provides modest AMT relief, but that relief is repealed after 2004. More aggressive efforts to provide relief from the AMT would most likely result in an even wider gap between the two sets of distributional effects reported in this paper.

### ***Conclusion***

A substantial portion of the tax cut implemented last year is composed of provisions that have not yet taken effect. This analysis shows that the tax cuts people have already received are much less unequally distributed than the tax cuts that will come in the future. In particular, the additional tax cuts to come after 2002 are highly concentrated among the highest income taxpayers, in large measure because of the cuts in the top marginal tax rate.

Last year's tax cut was a work in progress, with provisions phased-in and phased-out and the whole cut scheduled to be repealed at the end of 2010. In addition, economic and budget conditions have changed substantially since EGTRRA was enacted. Under these circumstances, the Congress is debating proposals ranging from immediate and permanent

implementation of the full tax cut to a freeze on further cuts (or even a repeal of some cuts already in place). This analysis provides information helpful in evaluating the distributional effects of some of these proposals.

<sup>1</sup> See Julie Ann Cronin, "U.S. Treasury Distributional analysis Methodology," U.S. Department of Treasury, Office of Tax Analysis. Working Paper 85. September 1999.

<sup>2</sup> For an analysis of the AMT, see Jerry Tempalski, "The Impact of the 2001 Tax Bill on the Individual AMT," U.S. Department of Treasury, Office of Tax Analysis, Mimeo, 2001.



Full Tax Cut				
Adjusted Gross Income Category (2010 dollars)	Percent of Total Returns (percent)	Total Tax Cut (millions)	Average Tax Cut (dollars)	Share of Total Tax Cut (percent)
Total Returns	100.0%	167,789	1,140	100.0%
Less than \$15,000	23.9%	2,132	60	1.3%
\$15,000 - \$30,000	19.5%	15,789	550	9.4%
\$30,000 - \$50,000	17.2%	19,833	780	11.8%
\$50,000 - \$100,000	21.6%	38,063	1,200	22.7%
\$100,000 - \$500,000	17.0%	36,371	1,450	21.7%
\$500,000 and over	0.8%	55,602	48,650	33.1%

Tax Cuts In Place in 2002				
Adjusted Gross Income Category (2010 dollars)	Percent of Total Returns (percent)	Total Tax Cut (millions)	Average Tax Cut (dollars)	Share of Total Tax Cut (percent)
Total Returns	100.0%	93,334	630	100.0%
Less than \$15,000	23.9%	1,866	50	2.0%
\$15,000 - \$30,000	19.5%	10,789	380	11.6%
\$30,000 - \$50,000	17.2%	12,317	490	13.2%
\$50,000 - \$100,000	21.6%	25,788	810	27.6%
\$100,000 - \$500,000	17.0%	31,459	1,250	33.7%
\$500,000 and over	0.8%	11,114	9,720	11.9%

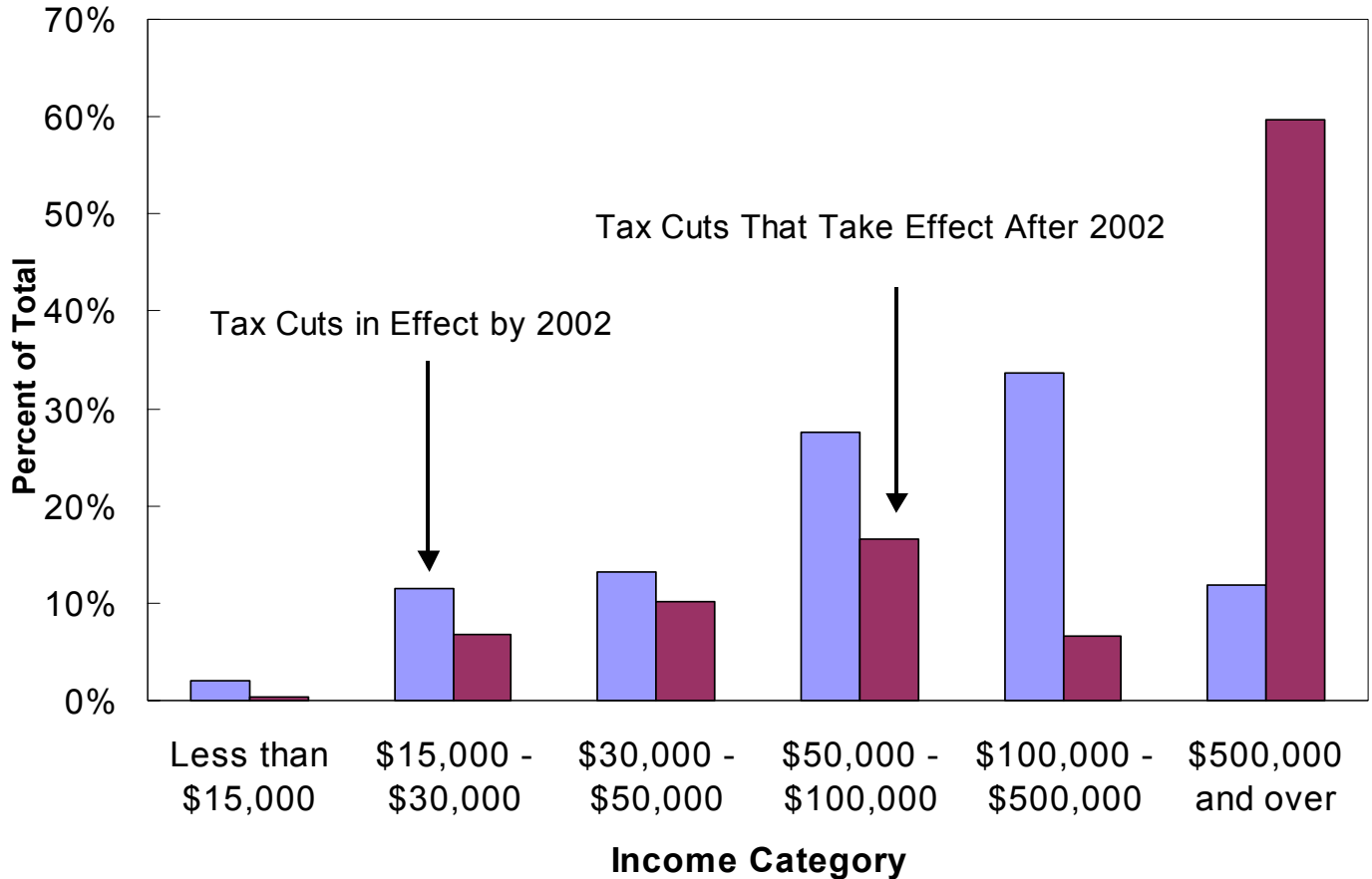
Additional Tax Cuts To Come After 2002				
Adjusted Gross Income Category (2010 dollars)	Percent of Total Returns (percent)	Total Tax Cut (millions)	Average Tax Cut (dollars)	Share of Total Tax Cut (percent)
Total Returns	100.0%	74,455	510	100.0%
Less than \$15,000	23.9%	266	10	0.4%
\$15,000 - \$30,000	19.5%	5,000	170	6.7%
\$30,000 - \$50,000	17.2%	7,516	300	10.1%
\$50,000 - \$100,000	21.6%	12,275	390	16.5%
\$100,000 - \$500,000	17.0%	4,912	200	6.6%
\$500,000 and over	0.8%	44,488	38,920	59.8%

Note: Tables include the following EGTRRA provisions: 10-percent tax bracket, rate reductions in the four top income tax rates, repeal of the restrictions on itemized deductions and personal exemptions, increase and expanded refundability of the child tax credit, increase in the dependent care credit, tax reduction provisions for married filers, and the temporary increase in the alternative minimum tax exemption. The tables do not include education, pension, and estate and gift tax provisions.

Source: Joint Economic Committee, Democratic Staff.



**Share of EGTRRA Income Tax Cuts in 2010**



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Source: Joint Economic Committee, Democratic Staff.