The Tale of the Top 1 Percent

A Rising Tax Share But Not A Rising Tax Burden

Joint Economic Committee – Democratic Staff

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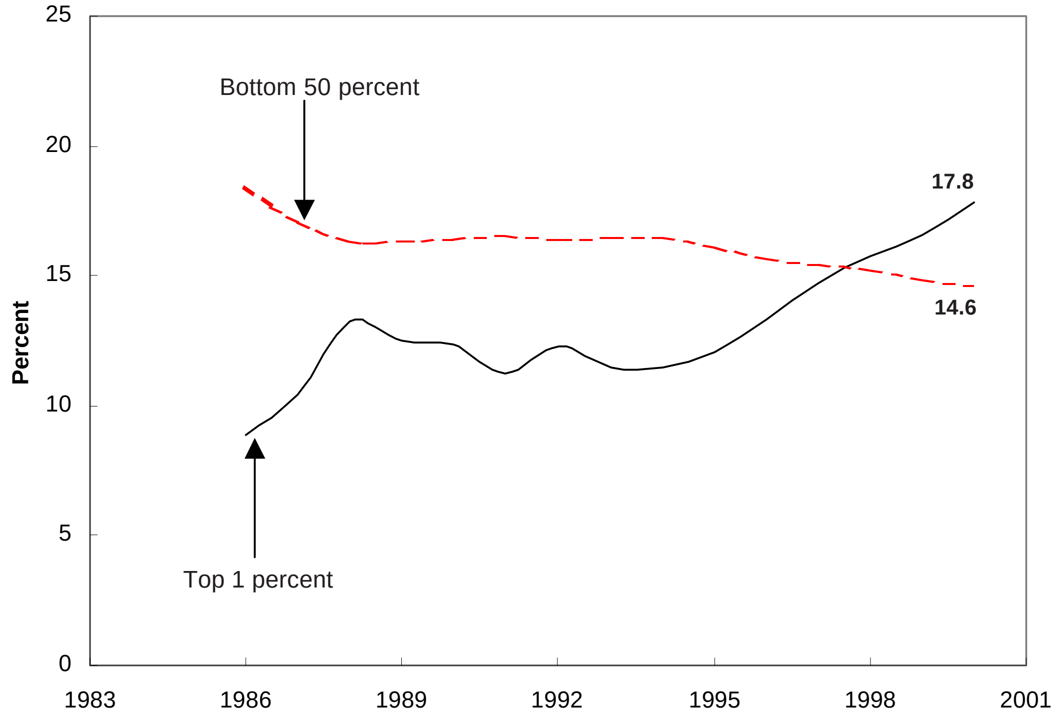
Figure 1

The After-Tax Income of the Top 1 Percent Now Exceeds That of the Bottom 50 Percent

Share of Total After-Tax Income



Source: Internal Revenue Service (Statistics of Income) and JEC Democratic Staff calculations.
Note: After-tax income is adjusted gross income minus income taxes paid.

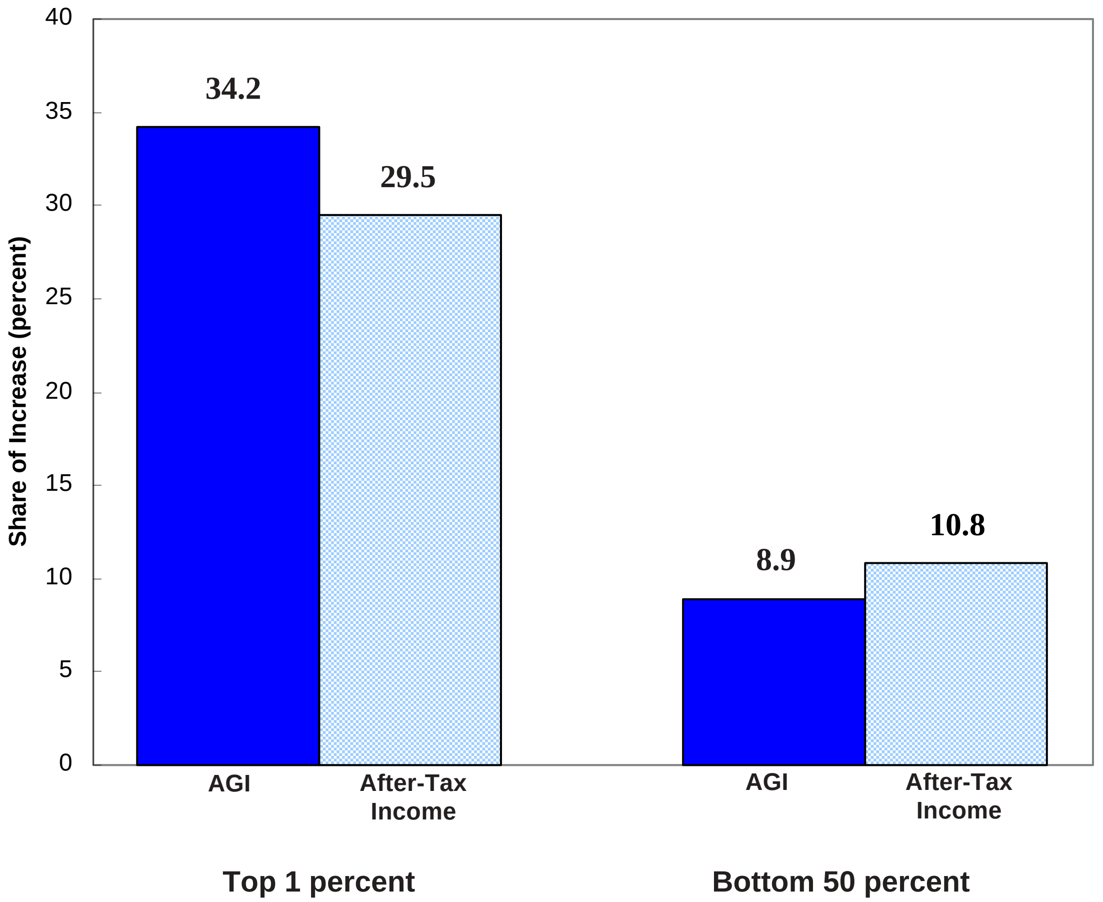
A strong economy produced gains for families at all income levels in the 1990s, but the gains after 1995 were particularly pronounced for the top 1 percent of the distribution (tax returns with adjusted gross income in excess of $313,000 in 2000). As a result, the share of total aggregate income received by the richest 1 percent of taxfilers has risen since the mid 1990s. Because growth in pre-tax income was so strong for the top 1 percent, their share of total income remaining after paying income taxes rose as well. It now exceeds the share of after-tax income of the entire bottom 50 percent of taxpayers (Figure 1).

With such strong growth in income, it is not surprising that the share of total federal income taxes collected from the richest 1 percent of taxpayers also increased since 1995. While this growth in the share of taxes paid might seem to imply that the tax burden on the very rich had increased, nothing could be further from the truth. Tax experts usually measure tax burdens

Figure 2

Much of the 1990-2000 Growth in Real Income Went to the Top 1 Percent

Share of Cumulative 1990-2000 Increase in Real Adjusted Gross Income and After-Tax Income



Source: Internal Revenue Service (Statistics of Income) and JEC Democratic Staff calculations.

not as the share of taxes paid but rather taxes paid as a percentage of income. By that measure the income tax burden on the top 1 percent has fallen, not risen, since the mid-1990s.

Disproportionate Income Growth at the Top

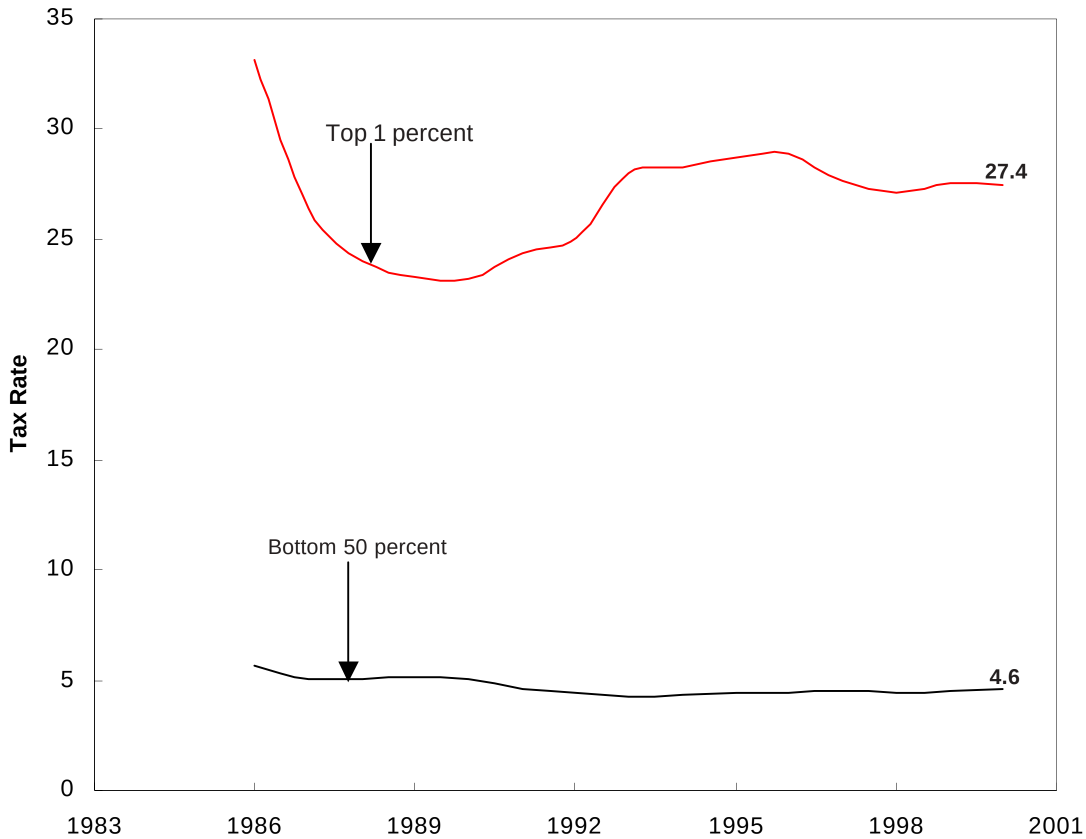
In 1995, 15 percent of total adjusted gross income (AGI) went to the top 1 percent of taxpayers. Because the income tax is progressive, their share of total income taxes paid was 30 percent. Nevertheless, the top 1 percent of taxpayers retained a hefty 12 percent of the aggregate income remaining after paying income taxes.

By 2000, each of these shares had increased. The share of pre-tax income had risen to 21 percent; the share of income taxes paid had risen to 37 percent, and the share of income remaining after income taxes had risen to 18 percent. These changes reflect the disproportionate growth in the pre-tax income of the top 1 percent in the 1990s (especially in the second half of the decade). As illustrated in Figure 2, more than a third of the cumulative increase in real (inflation-adjusted) AGI from 1990 through 2000 went to the top 1 percent. The bottom 50 percent of taxpayers also experienced gains in real pre-tax income, but their share of the cumulative gain was less than 9 percent.

The picture is very similar for after-tax income (AGI less income taxes paid). Almost 30 percent of the cumulative increase in real after-tax income between 1990 and 2000 went to the top 1 percent. Only about 11 percent went to the bottom 50 percent. Again, the growth in incomes for the top 1 percent was especially strong

Figure 3

The Effective Tax Rate for the Top 1 Percent Has Fallen
Average Personal Income Tax Rates by Income Group



Source: Internal Revenue Service (Statistics of Income).

over the latter part of the decade. Beginning in 1998 the top 1 percent of income tax filers had more aggregate after-tax income than did the entire bottom 50 percent.

The Effective Tax Rate of the Top 1 Percent Is Not Rising

When considering the "fairness" of the distribution of taxes, economists usually focus not on tax shares, but on taxes measured *relative* to ability to pay. A "progressive" tax system is characterized by a higher tax rate for those with greater ability to pay.

A standard indicator of the *degree* of tax progressivity is how steeply the "effective tax rate," or taxes paid divided by income, rises with higher incomes. The IRS data show that rather than rising as their share of pre-tax income increased, the effective individual income tax rate for the top 1 percent has actually gone down slightly since the mid-1990s (Figure 3).

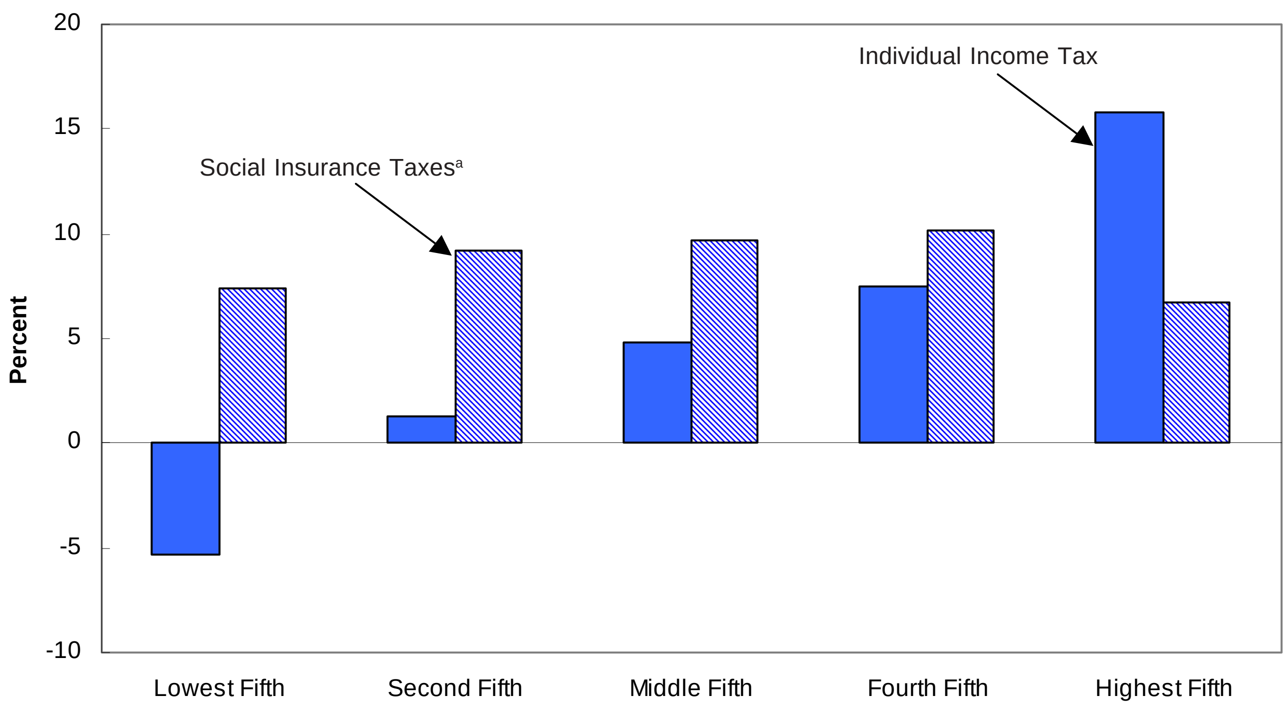
Other Taxes Reduce the Progressivity of the U.S. Tax System

Looking only at federal individual income taxes provides an incomplete picture of the distribution of taxes. A more complete analysis would consider the full set of federal taxes, including all taxes paid by both households and businesses, and should include state and local taxes as well.

At the federal level, the individual income tax accounts for about half of all revenues. The next largest revenue source is the payroll tax, which collects over a third of

Figure 4

Effective Federal Individual Income and Social Insurance Tax Rates, by Income Group, 1997



Source: Congressional Budget Office.
Note: The effective tax rate equals tax liabilities as a percentage of total income.
Quintiles, or fifths, of the income distribution contain equal numbers of people.
a. Payroll taxes financing Social Security, Medicare, and federal unemployment insurance.

federal revenues. Because payroll taxes are proportional and are collected only on labor income, with no exemption level, and are partly capped at a maximum income level, they are much less progressive than income taxes (Figure 4). The Congressional Budget Office's most recent analysis of federal tax rates shows that, taken altogether, the overall federal tax system (including individual income, corporate income, payroll, and excise taxes) is much less progressive than is the individual income tax alone.

Finally, while the federal government cut income taxes in 2001, state and local governments are less able to run deficits because of balanced-budget requirements. The recession has meant that many state and local governments have been forced to raise taxes. State-level taxes are almost always less progressive than federal taxes, because states generally rely much more on consumption-based sales taxes or income taxes with much flatter rate structures. Thus, once state and local taxes are taken into account, the overall tax system is far less progressive than the individual income tax and can become even less so in times of economic weakness.

Conclusion

The top 1 percent of taxpayers experienced a disproportionate rise in their income in the late 1990s. That income growth led to an increase in their share of aggregate income taxes paid. But their tax burden did not increase, and they saw disproportionate gains in after-tax income.

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