Joint Economic Committee
Republicans
Representative Kevin Brady
Vice Chairman

REPUBLICAN STAFF COMMENTARY

Debunking the Obama-Buffett Myth on Taxes

September 28, 2011

President Obama has cited billionaire investor Warren Buffett in his ill-conceived crusade to raise tax rates on high income individuals. In advocating for a so-called "Buffett Rule" the President argued:

> *Middle-class families shouldn't pay higher taxes than millionaires and billionaires … Warren Buffett's secretary shouldn't pay a higher tax rate than Warren Buffett. There is no justification for it. It is wrong that in the United States of America, a teacher or a nurse or a construction worker should pay higher tax rates than somebody pulling in $50 million.*[1]

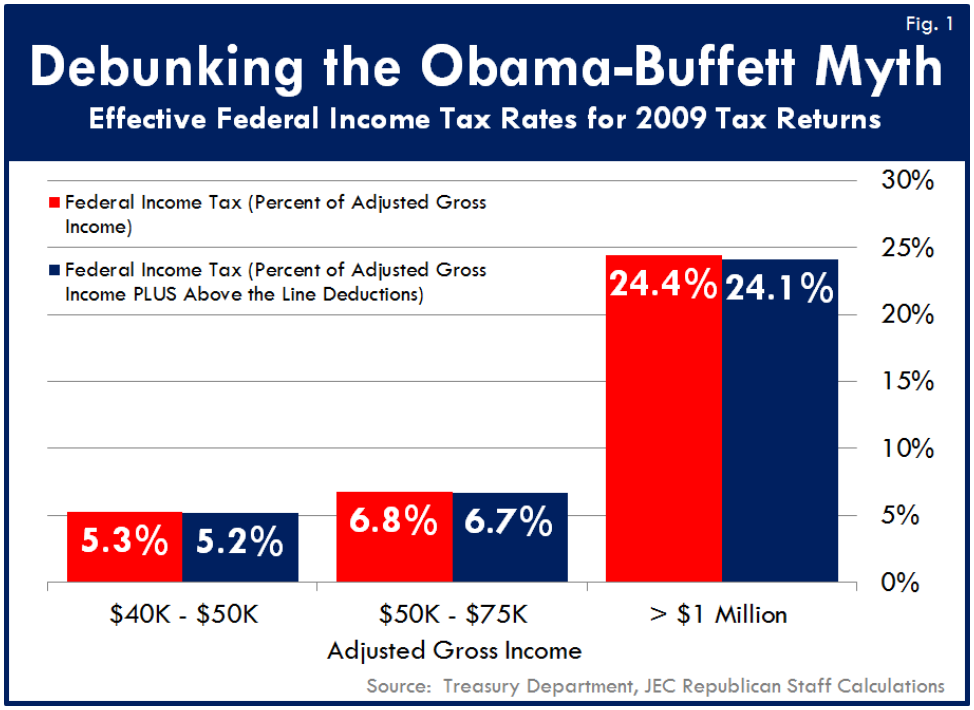
In "Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction" released on September 19, 2011 the President states that "people making over $1 million should not pay lower taxes than the middle class."[2] ***Leaving aside the harmful economic consequences of adopting the "Buffett Rule," the President and Warren Buffett are just plain wrong on the facts.***

This Republican Staff Commentary will present information derived from data published by the Internal Revenue Service (IRS)[3] that demonstrates the false premise on which the President's proposal is based.

Summary

- In 2009, 62.8% of all taxable income for those with adjusted gross incomes in excess of $1 million was taxed at the maximum statutory rate of 35% and another 25.5% was taxed at the long-term capital gains and qualified dividend rate of 15%.
- More than 73% of taxable income for those with adjusted gross incomes at $1 million and up was assessed tax rates of 25% or greater.
- The highest 1% of income earners has not seen their share of the income tax burden decline. And their share of income is essentially the same as it was in 2000.
- Collectively, only taxpayers with incomes greater than $100,000 pay a share of taxes that is greater than their share of income.
- More than half of returns reporting positive income of less than $75,000 in adjusted gross income had no positive income tax liability.
- While the capital gains tax reductions that took effect in 1997 and 2003 resulted in lower average tax rates among the top 400 returns, their share of total income taxes paid actually increased.
- The data clearly shows that the highest income earners are not a stagnant group, but a constantly changing set of taxpayers.

Effective Income Tax Rates



For tax year 2009, there were 236,883 returns filed with the IRS that showed adjusted gross income in excess of $1 million, or 0.17% of all tax returns filed. Returns with adjusted gross incomes in excess of $1 million reported total adjusted gross income of $726.9 billion, or an average of $3,068,649.[4] Adding back "above the line" deductions from adjusted gross income, this $1 million plus returns accounted for $735.1 billion in income.[5] Above the line deductions include items that taxpayers may deduct from their total income (Line 22 on IRS Form 1040) even if they choose to take the standard deduction instead of itemizing.

The total income tax liability of the group, after applying applicable credits, was $177.5 billion. That is an effective tax rate of 24.4% on adjusted gross income or 24.1% of income before above the line deductions.

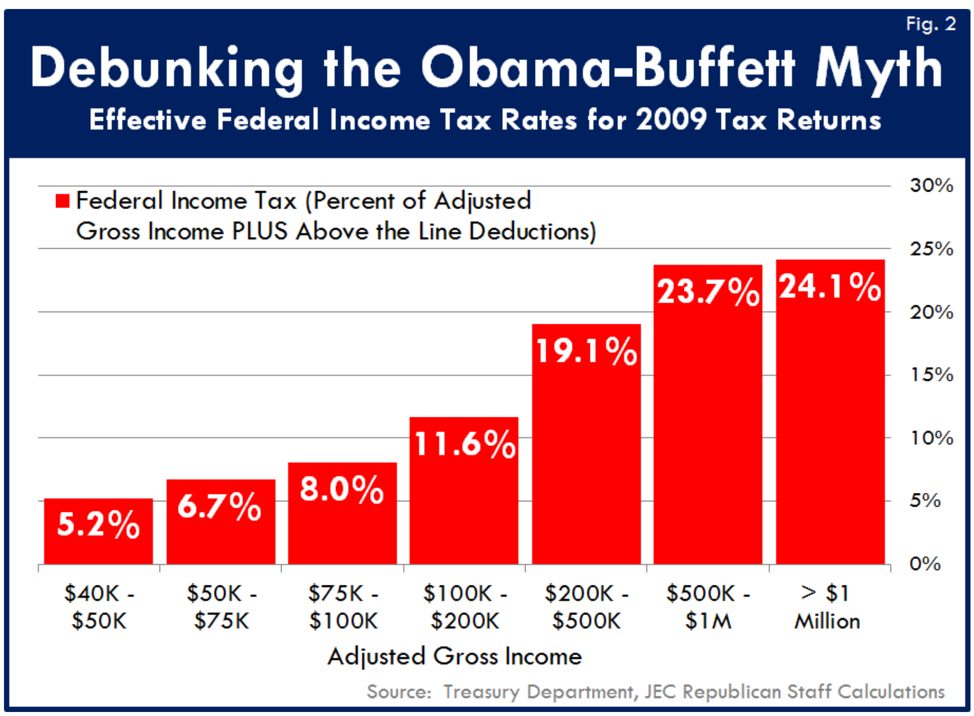


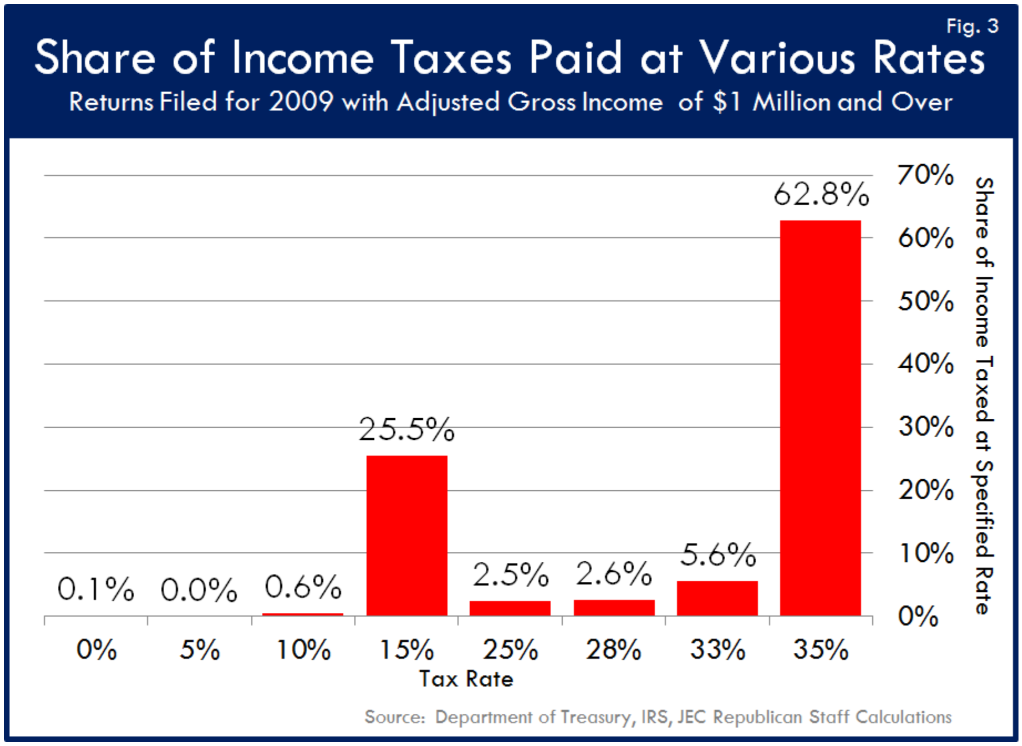
Figure 1 looks at comparable figures for the middle class (returns reporting $40,000 - $50,000 and $50,000-$75,000 in adjusted gross income). As can be seen, the effective income tax rates of those returns are significantly lower than the rates paid by those reporting more than $1 million.

Critics may observe that this analysis does not take into account payroll taxes paid by workers. Yet even if one assumed that those reporting over $1 million in adjusted gross income paid no payroll taxes and the lower income groups paid the 7.65% (in 2009) payroll tax on their entire adjusted gross income their effective rates would still be significantly below the rates paid by those with adjusted gross incomes above $1 million.

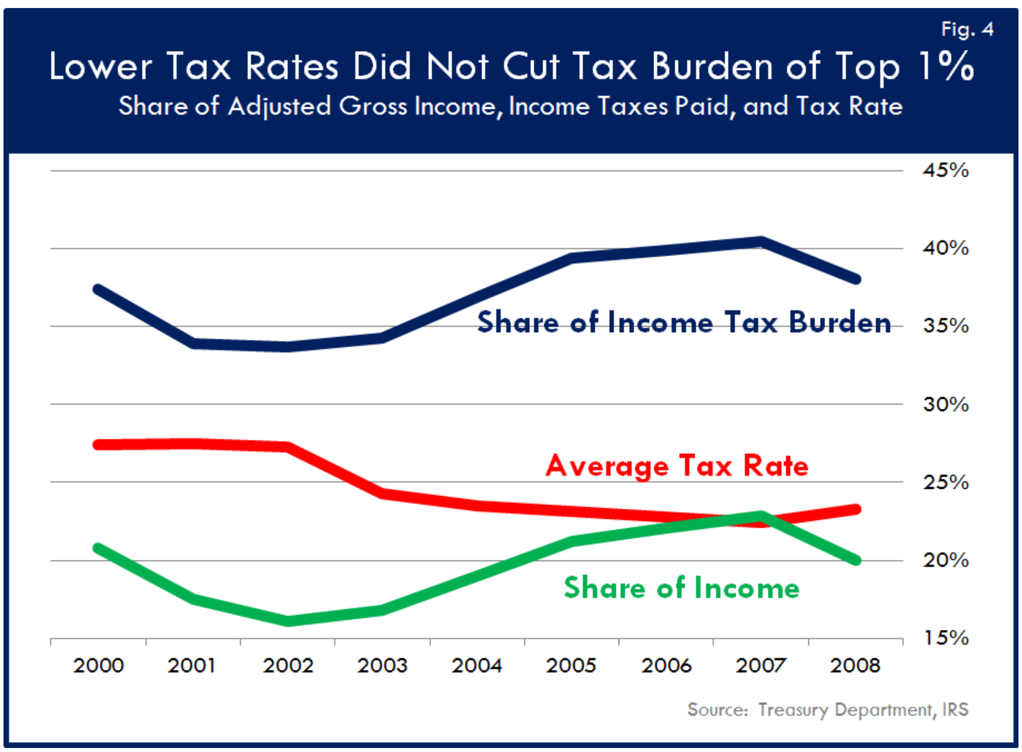
Figure 2 provides a further delineation of the rates paid by the various income classes as a percentage of adjusted gross income plus above the line deductions.

Share of Income Taxed at Various Rates

A common misconception is that those reporting adjusted gross incomes of greater than $1 million pay very little in taxes at higher ordinary income rates. As **Figure 3** illustrates, ***fully 62.8% of all taxable income for those with adjusted gross incomes in excess of $1 million was taxed at the maximum statutory rate of 35%*** and another 25.5% was taxed at the long-term capital gains and qualified dividend rate of 15%.[6]



Hence, more than 73% of taxable income for those with adjusted gross incomes at $1 million and up was assessed tax rates at 25% or greater. While these taxpayers do have a significant fraction of their income taxed at the 15% rate, the impression that they face rates of 15% or lower rate on their overall income is inaccurate.



Did the Tax Cuts of the Last Decade Unfairly Favor the Wealthy?

In 2000, the top 1% of positive adjusted gross income tax returns accounted for 20.81% of adjusted gross income. That same year those returns accounted for 37.42% of all income taxes. In 2008,[7] the share of adjusted gross income was 20.00% and the share of income taxes paid was 38.02%.

Despite lower average or effective income tax rates, ***the top 1% of adjusted gross income returns has not seen their share of the income tax burden decline. Their share of income and income tax burden is essentially the same as it was in 2000.***

Tax Burden Relative to Share of Income

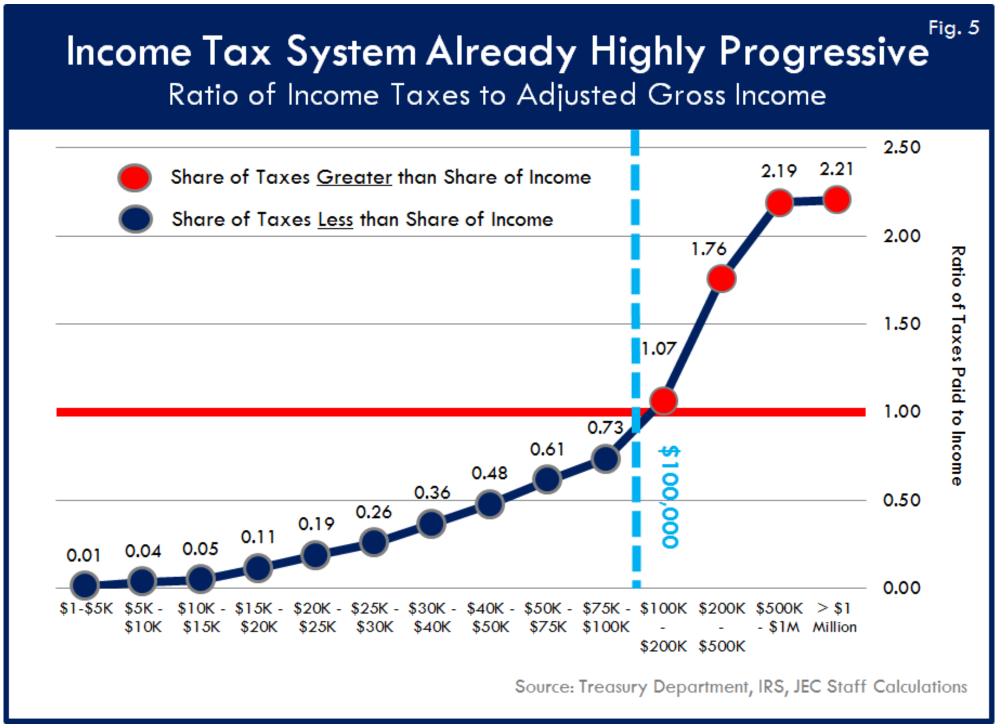
The President argues the case for his plan in a manner that would lead casual observers to conclude that "not paying your fair share" means that you have a bigger share of the income than the share of the income taxes you pay.

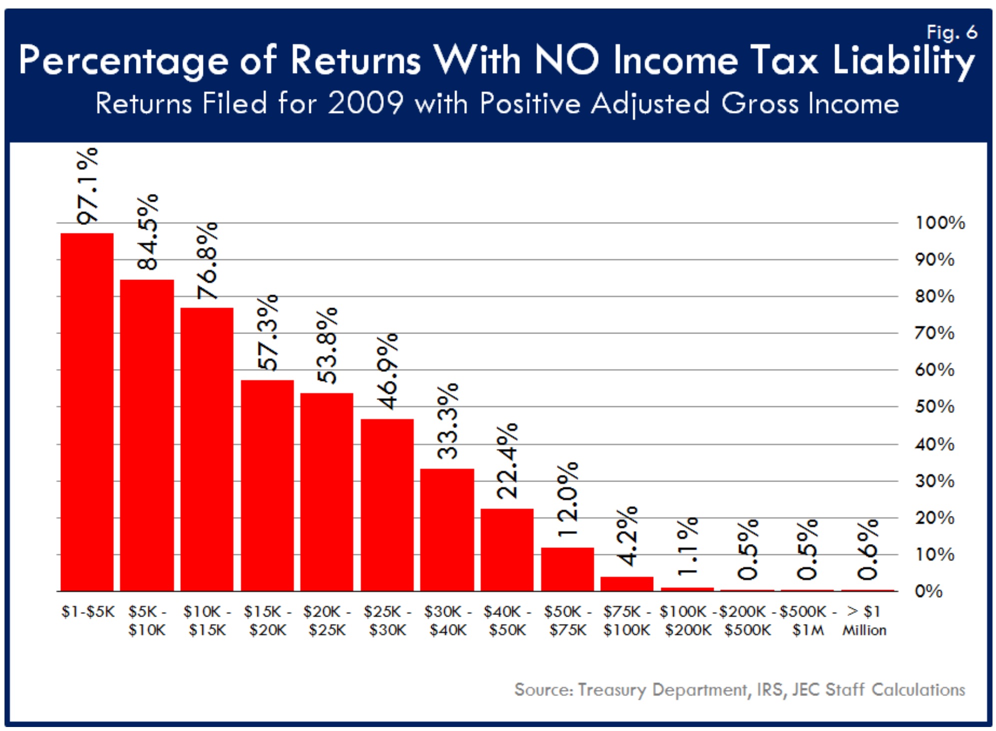
As **Figure 5** illustrates, nothing could be further from the truth. In a pure flat tax world, taxpayers earning 10% of income would pay 10% of income taxes.

One can measure the progressivity or redistributive character of the tax system by dividing the share of income taxes paid by the share of income received.

In looking at IRS data, it is important to remember that this only considers income from individuals required to file tax returns.

Collectively, ***only those taxpayer groups with adjusted gross income's greater than $100,000 pay a share of taxes that is greater than their share of income.***[8]





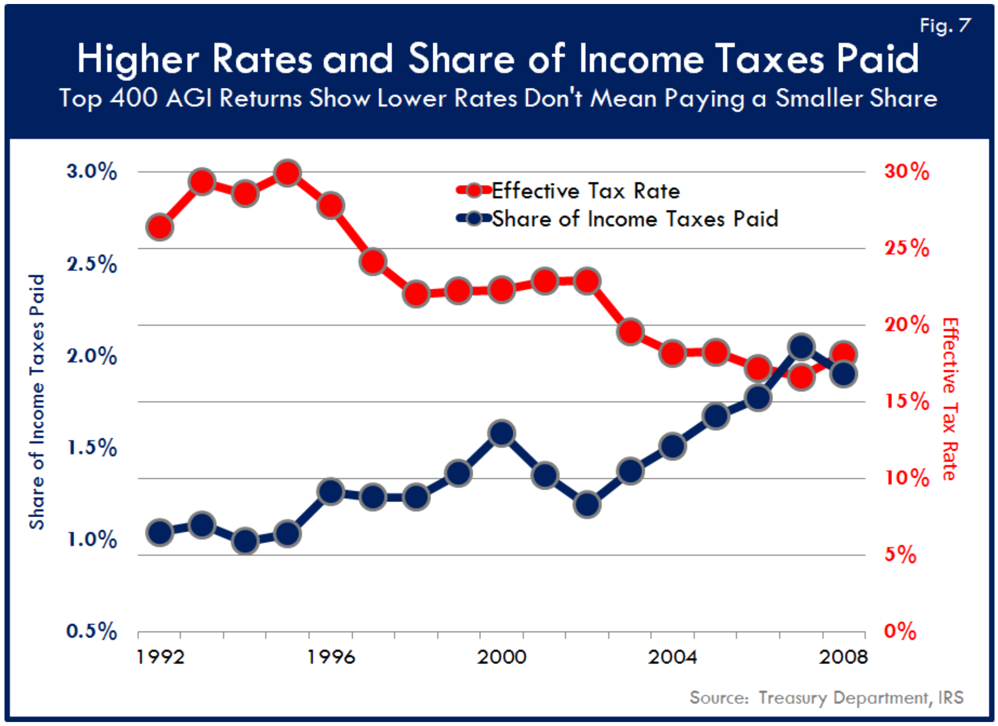
Another indicator of the progressive nature of the tax system is the share of filed tax returns showing positive adjusted gross incomes in each of the income categories that have an income tax liability after applying all the relevant tax credits. As **Figure 6** shows, a high percentage of filed returns with lower reported adjusted gross incomes do not have any income tax liability after applying credits.

Cumulatively ***more than half of positive adjusted gross income returns reporting less than $75,000 in adjusted gross income had no positive income tax liability.***[9]

Tax Rates and the "Super Rich"

The IRS has compiled data on the 400 tax returns with the highest adjusted gross incomes from 1992-2008. Looking at the data from those returns leads to results that would be surprising even to those advocating President Obama's mantra of "making the rich pay their fair share."

As **Figure 7** illustrates, higher average or effective tax rates do not necessarily result in an increase in the share of income taxes paid. ***While the capital gains tax reductions that took effect in 1997 and 2003 resulted in lower average tax rates among the top 400 returns, the share of total income taxes paid actually increased.***[10]



Not only is there is a tendency to equate high levels of income with high levels of wealth. There is a tendency to assume that the highest income earners in one year are the same taxpayers in other years, or "once rich, always rich." They are not.

The data clearly shows that the highest income earners are not a stagnant group, but a constantly changing set of taxpayers. Over these 17 tax years, a total of 6,800 returns were identified. There were 3,672 different taxpayers representing the top 400 returns of each year. Of these taxpayers, a little more than 27 percent appear more than once and slightly more than 15 percent appear more than twice. ***In any given year, on average, about 39 percent of the top 400 adjusted gross income returns were filed by taxpayers that are not in any of the other 16 years. Only four of the taxpayers made the top 400 all 17 years***.[11]

Conclusion

The President has tried to sound a populist tone by suggesting that higher income taxpayers are shirking their responsibility and not paying their fair share. Higher income taxpayers are paying a greater share of the nation's income tax burden than their share of income. Directly raising tax rates, or raising them indirectly by limiting deductions, will not necessarily cause those taxpayers actually to shoulder a greater share of the income tax burden.

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[1] President Obama, September 19, 2001.

[2] "Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction," Office of Management and Budget, September 2011, page 45.

[3] Data utilized in this analysis was retrieved from tables published on the IRS website at www.irs.gov/taxstats. The tables present aggregates for returns meeting certain criteria. It is important to remember that within any group there will be wide variation based upon filing status and other factors.

[4] "Table 1.1 Selected Income and Tax Items, by Size and Accumulated Size of Adjusted Gross Income, Tax Year 2009," retrieved at http://www.irs.gov/pub/irs-soi/09in11si.xls.

[5] JEC Republican Staff Calculations based on "Table 1.4 All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2009," retrieved at http://www.irs.gov/pub/irs-soi/09in14ar.xls.

[6] JEC Republican Staff Calculations based on "Table 3.5 Returns with Modified Taxable Income: Tax Generated, by Rate and by Size of Adjusted Gross Income, Tax Year 2009," retrieved at http://www.irs.gov/pub/irs-soi/09in35tr.xls.

[7] This is the last year for which the IRS has published this time series table. "Table 5.--Returns with Positive Adjusted Gross Income (AGI): Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2008," retrieved at http://www.irs.gov/pub/irs-soi/08in05tr.xls.

[8] JEC Republican Staff Calculations based on "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2009," retrieved at http://www.irs.gov/pub/irs-soi/09in33ar.xls.

[9] JEC Republican Staff Calculation based on "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2009," retrieved at http://www.irs.gov/pub/irs-soi/09in33ar.xls.

[10] From Table 1 in "The 400 Individual Income Tax Returns Reporting the Highest Adjusted Gross Incomes Each Year, 1992-2008," retrieved at http://www.irs.gov/pub/irs-soi/08intop400.pdf.

[11] From Table 4 and accompanying discussion in "The 400 Individual Income Tax Returns Reporting the Highest Adjusted Gross Incomes Each Year, 1992-2008," retrieved at http://www.irs.gov/pub/irs-soi/08intop400.pdf.