

BRIEF ANALYSIS

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Why All Taxpayers Deserve a Tax Cut

The tax burden is measured in different ways, but by almost every measure, federal taxes are at an unprecedentedly high level, Congress can solve that problem by moving quickly to reduce the tax burden by cutting income tax rates at least 10 percent this year.

According to the Department of Commerce, federal receipts reached 21.8 percent of the gross domestic product in the third quarter of 1998, an increase from just 19 percent in the first quarter of 1993. This is far and away the highest tax burden in American history, exceeding even that during World War II.

■ With GDP at about \$9 trillion this year, Americans will pay \$250 billion more to the federal government this year than if federal revenues remained at 19 percent of GDP, close to the postwar average.

■ With income tax revenues estimated at \$863 billion this year, just lowering federal receipts to 19 percent of GDP would require a 30 percent tax rate reduction.

According to President Clinton's Office of Management and Budget, which calculates revenues differently, federal receipts have risen from 17.8 percent of GDP in fiscal year 1993 to an estimated 20.6 percent this year. Although this percentage does not exceed the World War II peak, it is the highest level since 1944. In any case, the OMB data also show federal revenues rising by 2.8 percent of GDP during the Clinton administration.

According to the U.S. Census Bureau, federal income taxes have risen from 12.1 percent of the average family's income in 1992 to 14.9 percent in 1997. Reducing such taxes to their 1992 level would have given the average

family a tax cut of \$1,775 in 1997, or 19 percent of its income tax burden.

Proposed Tax Relief. Many members of Congress now propose an across-the-board income tax rate reduction. The most popular measure (H.R. 3, sponsored by Rep. John Kasich of Ohio) would reduce tax rates by 10 percent, which would lower the top rate from 39.6 percent to 35.64 percent and the bottom rate from 15 percent to 13.5 percent, effective January 1, 2000. Although such a tax cut would offset only about a third of the tax increase since 1992, it is at least Reaganesque in

treating all taxpayers to a tax cut.

Despite its minuscule size, however, the 10 percent proposal has come in for withering attack from the left as a giveaway to the rich. For example:

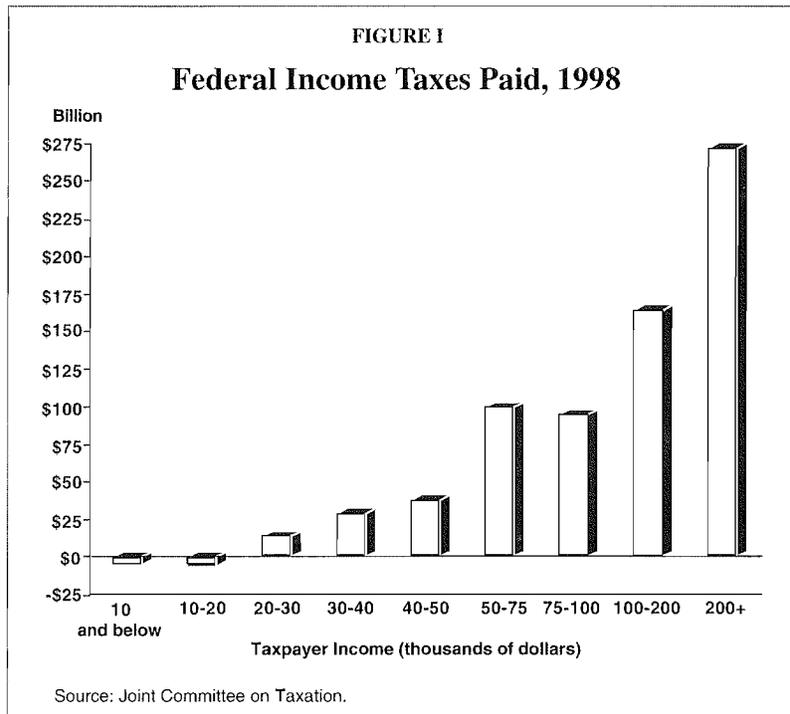
■ The union-backed Citizens for Tax Justice charges that the plan would reduce taxes by an average of just \$99 per year for families with incomes under \$38,000, while cutting taxes an average of \$20,697 for those with incomes above \$301,000.

■ The liberal Center on Budget and Policy

Priorities says that 35 million taxpayers — 27 percent of all taxpayers — would receive no tax cut at all under the 10 percent proposal.

These numbers are essentially correct, as far as they go. What is unstated is that those with modest incomes pay little, if any, federal income taxes now. Indeed, a large percentage actually have a negative tax liability; that is, they receive tax refunds from the government while paying no income taxes whatsoever. Moreover, a very high and rising share of the total tax burden is now borne by those with upper incomes.

Who Pays Taxes. As Figure I shows, according to Congress's Joint Committee on Taxation, in 1998 all families with incomes below \$20,000 had a negative tax



liability, mainly due to the Earned Income Tax Credit, which is refundable. This group received almost \$12 billion in tax “refund” checks from the federal government last year. By contrast, those with incomes above \$100,000 paid \$437 billion, 62.4 percent of all federal income taxes.

Furthermore, taxes on the rich have risen more sharply than for any other income group since 1993. According to the Congressional Budget Office, those with incomes above \$200,000 have seen their share of total income taxes rise from 29.5 percent in 1993 to 37.2 percent in 1997, although they represent just 1.5 percent of all taxpayers. Those with incomes above \$1 million increased their share of the total tax burden from 11.3 percent to 16.6 percent over the same period, though they represent a scant 0.1 percent of taxpayers.

- According to the Internal Revenue Service, the top 5 percent of taxpayers now pay a majority of all income taxes and the top 25 percent — those with incomes above \$45,833 in 1996 — pay more than 80 percent of all such taxes. [See Figure II.]
- By contrast, those in the bottom 50 percent of the income distribution — with incomes below \$23,160 — pay a mere 4.3 percent of all federal income taxes.

In short, the well-to-do receive a larger tax cut in dollar terms simply because they shoulder the vast bulk of the tax burden. But under the 10 percent proposal all taxpayers still would receive the same reduction in their tax liability in percentage terms. The only people left out would be the many who pay no taxes. A tax cut, after all, can only aid those who actually pay taxes.

For these reasons, the case can be made that an across-the-board tax rate reduction is the fairest tax cut one could enact. Targeted tax cuts, by contrast, give tax relief to some taxpayers and not others. They represent

attempts at social engineering and income distribution. They are contrary to the principles of good tax policy and add to the complexity of the tax code.

Why Give the Rich a Tax Reduction? Past tax rate reductions encouraged wealthy individuals to scale back their use of tax avoidance schemes and to increase their investments and work more. These actions caused the tax base to expand, leading to an increase in tax payments by the wealthy. Following the Reagan tax cut, for example, the top 1 percent of taxpayers increased their

share of total income taxes from 17.6 percent in 1981 to 27.5 percent in 1988.

In today’s fast-moving, high-tech world we are ever more dependent on entrepreneurs and innovators like Bill Gates of Microsoft to invent and improve computers, software and other products that are essential to every worker, businessman and consumer. Today’s millionaires are not the robber barons of yore, but are more likely to be ordinary people who had the good fortune to get in on the

ground floor of companies like Yahoo and eBay. Imposing high tax rates on such people does less to equalize incomes than it does to penalize saving, risk-taking and hard work.

Conclusion. The rising tax burden demands a significant tax cut. In a time of substantial budget surpluses, there is simply no justification for resisting such an action. An across-the-board tax rate reduction is the best way to cut taxes and 10 percent is a good start. Arguments that such a tax cut would be a giveaway to the rich are unfounded and based on half-truths. All taxpayers would benefit equally in percentage terms, with one’s actual tax cut being exactly proportional to one’s tax liability. This is only fair.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett.

