

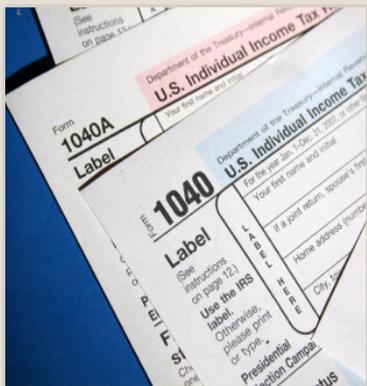
Do the Rich Pay Their Fair Share in Taxes?

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by Peter Ferrara

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The central theme of President Obama's tax policy has been that "the rich" do not pay their fair share of federal taxes, and the middle class pays more as a result. But a report issued by the Congressional Budget Office (CBO) in July 2012 shows this to be false.



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What the Rich Pay in Taxes.

According to the CBO, the top 1 percent of income earners paid 39 percent of federal individual income taxes in 2009, while earning 13 percent of the income. That is down from 2007, before President Obama was elected. In 2007, after 25 years of Reagan Republican tax policies, the top 1 percent paid 40 percent of federal individual income taxes — more than double the 17.6 percent share of taxes paid by the top 1 percent when President Reagan entered office in 1981.

The CBO also reports that:

- In 2009, the bottom 40 percent of income earners were *paid* cash equal to 10 percent of federal individual income taxes by the Internal Revenue Service (IRS), net of any federal income taxes they paid.
- In that same year, the middle 20 percent of income earners — the true middle class — paid a net 2.7 percent of total federal individual income taxes, while earning 15 percent of before-tax income.
- And the top 20 percent of income earners — those earning more than \$74,000 — paid 94 percent of federal individual income taxes, 85 percent more than the share of national income they earned.

Altogether the bottom 60 percent of income earners, which includes the middle class, paid zero percent of

total federal individual income taxes as a group. Instead, as a group, they received net cash payments *from* the IRS.

Federal Income Taxes and the Poor.

Abolishing federal income taxes for low-income individuals began with the Earned Income Tax Credit (EITC). The EITC grew out of then Governor Ronald Reagan's famous testimony before the Senate Finance Committee in 1972, where he proposed exempting the working poor from all Social Security and income taxes as an alternative to welfare, with the credit serving as a way to offset payroll taxes for the poor and low-income workers. As president, Reagan cut federal income tax rates across the board for all taxpayers by 25 percent. He also indexed the tax brackets for all taxpayers to prevent inflation from pushing working people into higher tax brackets.

In the Tax Reform Act of 1986, President Reagan reduced the federal income tax rate for middle and lower income families all the way down to 15 percent. That act also doubled the personal exemption, shielding a higher proportion of income from taxation for lower income workers than for higher income workers.

Other efforts also reduced taxes for lower income individuals during this period. Consider:

- Newt Gingrich's Contract with America included a child tax credit of \$500 per child that reduced the tax liabilities of lower income people by a higher percentage than for higher income people.
- President George W. Bush

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doubled that credit to \$1,000 per child, and made it refundable so that low-income people who do not even pay \$1,000 in federal income taxes could still get the full credit.

- Bush also adopted a new lower tax bracket for the lowest income workers of 10 percent, reducing their federal income tax rate by 33 percent.

What about Payroll Taxes?

Some on the Left argue that CBO statistics only account for income taxes and not the payroll taxes that working people still do pay. But the CBO's accounting is proper, because President Obama argues that the rich do not pay their fair share of federal income taxes — not payroll taxes — and it is federal income taxes that he is proposing to increase, not payroll taxes. Indeed, it has been argued by many on the Right that payroll taxes should be phased out entirely and replaced by personal savings, investment and insurance accounts, relieving middle and lower income workers of those taxes entirely.

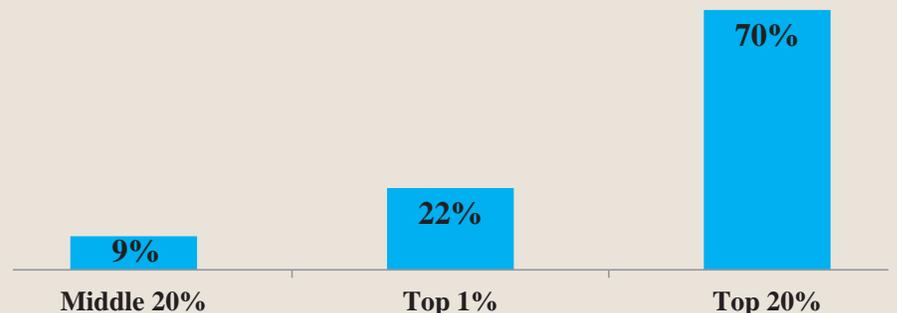
In addition, payroll taxes are paid in return for specific entitlement benefits or services, and so all should pay an equivalent amount proportionate to those benefits. The payroll tax consequently is not supposed to be progressive, and should not be.

Nevertheless, even counting payroll taxes in addition to other federal taxes, the story is the same. The “rich” and upper income workers still pay almost all federal taxes, with the middle class and lower income workers paying far lower proportions and rates.

Indeed, in 2009, according to the CBO [see Figure I]:

- The middle 20 percent of income earners paid just 9 percent of federal taxes, less than two-thirds their share of income.
- By contrast, the top 1 percent alone paid over 22 percent of all federal taxes, while earning 13 percent of the income.

Figure I
Percent of All Federal Taxes Paid by Income
(2009)



Source: Congressional Budget Office, “The Distribution of Household Income and Federal Taxes, 2008 and 2009.”

There was also a wide disparity in the tax rates paid by low-, middle- and high-income taxpayers in 2009 [see Figure II]:

- The bottom 20 percent paid an average federal tax rate of 1 percent.
- The middle 20 percent paid an average federal tax rate of 11.1 percent.
- However, the top 1 percent paid an average federal tax rate of 29 percent.

Conclusion. The federal government should abolish the remaining minor share of federal income taxes paid by the middle class. That would enable a rational flat tax to be adopted for the top 40 percent of income earners, who earn 72 percent of all income anyway.

In the last two decades, the two successful Democrat nominees for president campaigned on a tax cut for the middle class, then never delivered a permanent cut after they were elected. But with income taxes for the middle class eliminated, that game would be over.

Peter Ferrara is a senior fellow with the National Center for Policy Analysis. A version of this article appeared on Forbes.com.

Figure II
Average Federal Tax Rate by Income
(2009)



Source: Congressional Budget Office, “The Distribution of Household Income and Federal Taxes, 2008 and 2009.”

- And the top 20 percent of earners paid nearly 70 percent of all federal taxes, while earning 50 percent of the income.