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SENATE REPUBLICAN POLICY COMMITTEE

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The Democrats' Budget Raises Taxes on the Middle Class

Executive Summary

- On March 5, 2008, Senate Budget Committee Chairman Conrad unveiled his Fiscal Year 2009 Budget, a budget that will return to higher taxes and will increase taxes on a broad range of individuals and small businesses.
- While American families are tightening their belts and making tough choices on spending priorities, the Democrats' budget avoids these tough choices and in fact makes it harder on families by raising their taxes.
- An analysis of the 2001 and 2003 tax relief shows that it has made the individual income tax even more progressive, which means that a small group of high-income taxpayers pay most of the individual income taxes each year.
- Despite the rhetoric that the 2001 and 2003 tax relief was nothing more than a handout to wealthy individuals, the reality is that the total effective federal tax rate for the bottom 20 percent of U.S. households fell by nearly a third from 2000 to 2005.
- Since the measures went into effect, the tax share of the highest income group has actually *increased*, while the tax share of the bottom four income groups has *declined.*
- In total, 41 percent of the U.S. population is completely outside of the federal tax system. The proposed budget jeopardizes the exempt status of these people.
- In 2008, the projected tax share for lower-income taxpayers will *fall*, while the tax share for higher-income taxpayers will *rise*, hardly indicative of a tax system that is biased against low-to-middle-income taxpayers.
- The top one percent of taxpayers will pay 39.1 percent of all the personal income taxes in 2007, while the bottom 50 percent will pay only 3.1 percent.
- As the economy continues to struggle due to the housing crisis, and high energy, health and food costs, the last thing that the American people can afford is higher taxes.
- The current tax relief has provided a benefit to all taxpayers and has shifted the tax burden even more to the wealthy. Americans are concerned that they won't be able to make their next mortgage payment or fill up their car with gas. Congress should not add a looming tax increase to their list of worries.

Introduction

On March 5, 2008, Senate Budget Committee Chairman Conrad unveiled his Fiscal Year 2009 Budget, a budget that will return to higher taxes and will increase taxes on a broad range of individuals and small businesses. While American families are tightening their belts and making tough choices on spending priorities, the Democrats' budget avoids these tough choices and in fact makes it harder on families by raising their taxes. By ignoring the looming expiration of the tax relief, the proposed budget would place the economy in further jeopardy and would also saddle American taxpayers with the largest tax increase in the nation's history. The provisions that are in danger of expiring include:

- the 10-percent individual income tax bracket;
- reduction in individual income tax rates above the 15 percent rate bracket;
- reduction of marriage penalties, 15-percent rate bracket, and the earned income tax credit;
- increase in the child tax credit to $1,000;
- expansion of the partially refundable additional child tax credit;
- increase in the child and dependent care tax credit;
- simplification of the rules for determining income for the earned income tax credit;
- small business expensing;
- lower tax rate on capital gains and dividend income; and
- estate tax repeal.

At a time when the American people are struggling to pay their mortgages, struggling with rising health care costs, and struggling with rising food and gas costs, Congress cannot afford to increase taxes. Coupling current economic hardships with a tax increase could lead to disastrous results for the American economy.

In addition to the higher taxes, the proposed budget will make the tax system more regressive, which is a marked demarcation from our current system. An analysis of the tax relief shows that it has made the individual income tax even more progressive, which means that a small group of high-income taxpayers pay most of the individual income taxes each year. Despite the rhetoric that the 2001 and 2003 tax relief[1] was nothing more than a handout to wealthy individuals, the reality is that the total effective federal tax rate for the bottom 20 percent of U.S. households fell by nearly a third from 2000 to 2005.[2]

A Historical Look at the Tax System: Who Pays the Most?

Although many opponents of the 2001/2003 tax relief like to portray the provisions as primarily benefiting upper income earners, the facts show otherwise. The tax relief has actually shifted a larger share of the individual income taxes paid to higher income

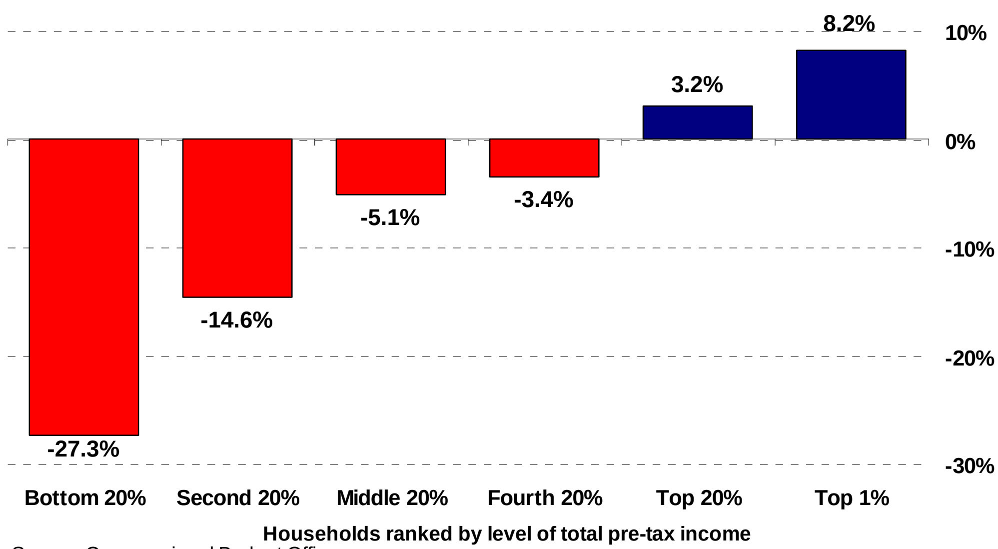
[1] The Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub.L. 107-16) and The Jobs and Growth Tax Relief Reconciliation Act of 2003 (Pub.L. 108-27).
[2] "About that Middle-Class Squeeze," *Investor's Business Daily*, March 4, 2008.

taxpayers. Since the measures went into effect, the tax share of the highest income group has *increased*, while the tax share of the bottom four income groups has *declined*.[3]

In a study for the independent National Center for Policy Analysis, Michael Stroup, a professor of economics at Stephen F. Austin University, shows that from 1986 to 2004, the total share of the income tax burden paid by the top one percent grew by nearly half, rising from 25.8 percent to 36.9 percent.[4] Yet, during that same time period, those in the bottom 50 percent saw their burden shrink from 6.5 percent to 3.3 percent.

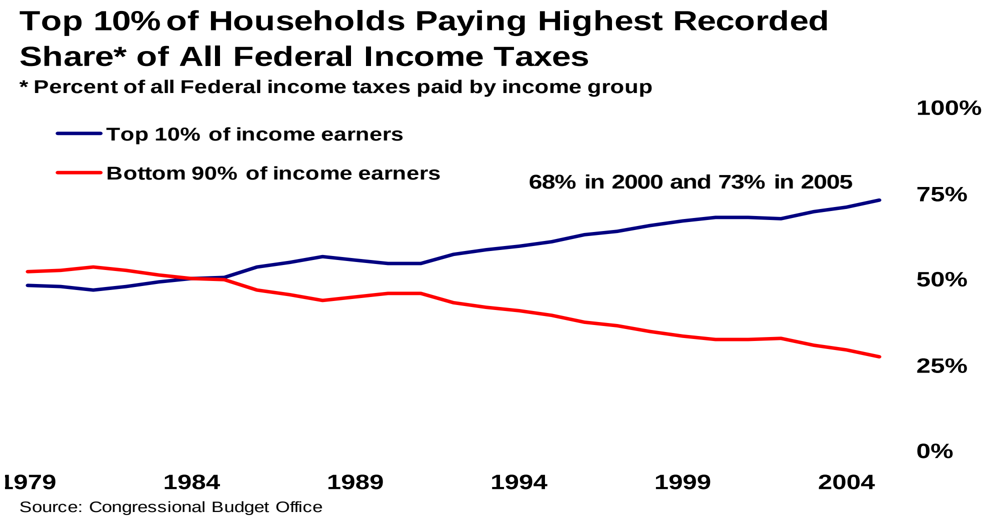
As the charts below depict, the top 10 percent of income earners currently pay a greater share of federal income taxes than ever before; in 2005, the top 10 percent of income earners paid a record 73 percent of all federal income taxes while the bottom 90 percent paid only 27 percent of all federal income taxes. To illustrate the wealthy taxpayer's tax burden further, the top 1.1 million American households pay a greater share of the income tax burden than the bottom 90 million households.[5]

Change in Share of Total Federal Tax Liabilities, 2000 to 2005



Source: Congressional Budget Office

[3] Joint Economic Committee, "Making Tax Relief Permanent," February 29, 2008.
[4] It is also important to note that this group's tax share has grown faster than their income share.
[5] "Buffet's Facts are Wrong: Top 1% Now Paying Record Level of Taxes," Fiscal Facts No. 114, The Tax Foundation, December 13, 2007.



The study by The Tax Foundation found that in 2000, a year before the first tax relief provision was passed, roughly 30 million tax returns had no income liability. Yet, by 2004, a year after the second round of tax relief was enacted, an additional 13 million returns (43 million returns) had no tax liability.[6] These 43 million tax returns are in addition to the 15 million households and individuals who file no tax return at all. In total, 41 percent of the U.S. population is completely outside of the federal tax system.[7] The Democrats' proposed budget jeopardizes the exempt status of the above mentioned, a category of people they claim they want to protect.

Recent Tax Relief has Made the Tax Code More Progressive

As the figures below indicate, the tax system is even more progressive than before the 2001 and 2003 tax provisions were enacted. This means that the tax relief has shifted a larger share of the individual income taxes paid to higher-income taxpayers. In 2008, the projected tax share for lower-income taxpayers will *fall*, while the tax share for higher-income taxpayers will *rise*, hardly indicative of a tax system that is biased against low-to-middle-income taxpayers.[8] The top one percent of taxpayers will pay 39.1 percent of all the personal income taxes in 2007, while the bottom 50 percent will pay only 3.1 percent.

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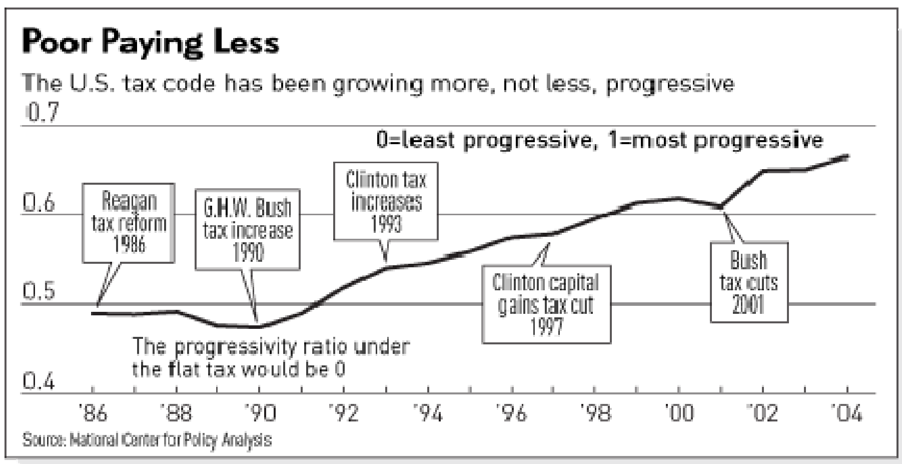
[6] "Rich Man's Burden," *Investor's Business Daily*, January 23, 2008.
[7] "Number of Americans Paying Zero Federal Income Tax Grows to 43.4 Million," Fiscal Fact No. 54, The Tax Foundation, March 30, 2006.
[8] Department of Treasury, Office of Tax Policy.

Who Pays Federal Income Taxes

Percentiles Ranked by Adjusted Gross Income (AGI)	AGI Threshold	Percentage of Federal Personal Income Tax Paid	
		With the Tax Cuts	Without the Tax Cuts
Top 1 percent	$425,036	39.1%	38.4%
Top 5 percent	$164,594	59.4%	57.8%
Top 10 percent	$117,241	70.1%	68.7%
Bottom 50 percent	< $35,134	3.1%	3.4%

Source: U.S. Department of Treasury, Office of Tax Policy.



The Democrats' Budget Takes the American Taxpayer in the Wrong Direction

If the tax relief is allowed to expire, as the majority's budget assumes, the country will face a tax hike of more than $1.2 trillion over the next 10 years, the *biggest tax increase in history*. According to the Treasury Department, *all* American taxpayers will experience a tax increase if the 2001 and 2003 tax provisions are not made permanent. On average:

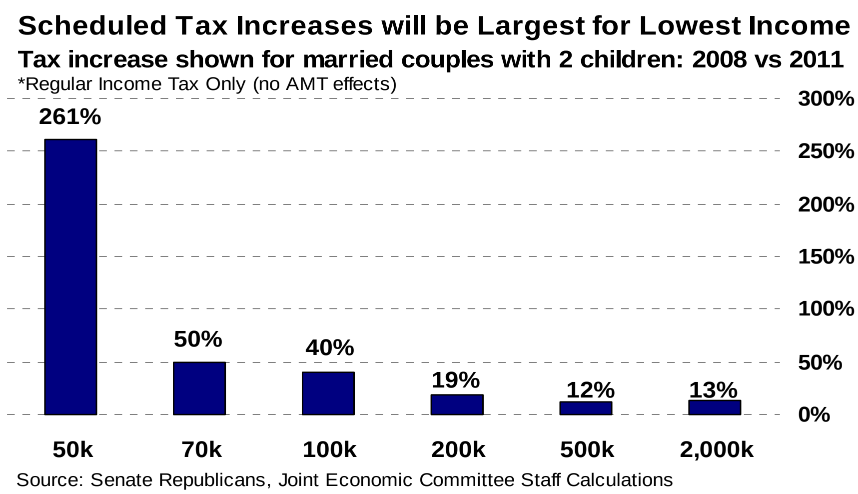
- A family of four with two children and an annual income of $56,300 ($50,000 today) will see its taxes increase by more than $2,000 — a **132 percent higher tax bill**. A family of four with $67,600 in annual income ($60,000 today) will see its taxes increase by more than $1,800 — a **58 percent higher tax bill;**[9]

[9] U.S. Department of Treasury release available at http://www.ustreas.gov/press/releases/reports/2011taxesmillions.pdf.

- 115 million taxpayers will see a $1,716 increase;
- 84 million women will see a $1,970 increase;
- 48 million married couples will see a $2,726 increase;
- 12 million single women with children will see a $1,062 increase;
- 17 million seniors will see a $2,034 increase;
- 26 million small business owners will see a $3,637 increase; and
- More than 6 million low-income individuals and couples will no longer be exempt from individual income tax.[10]

As the economy continues to struggle due to the housing crisis, and high energy, health and food costs, the last thing that the American people can afford is higher taxes. Coupling the current economic hardships with a tax increase could lead to disastrous results for the American economy.

While all American taxpayers will experience a tax increase with the expiration of the tax provisions enacted in 2001 and 2003, it will be felt the most by the lowest income earners. As the chart below depicts, a married couple with 2 children making $50,000 a year will see their tax bill go up by 261 percent in 2011 with the expiration of current tax policy.



[10] Department of Treasury, Office of Tax Policy. The tax increase figures assume that the following provisions of the President's tax relief expire in 2010: creation of the new 10-percent individual income tax bracket; reduction in individual income tax rates above the 15-percent rate bracket; reduction of the marriage penalties, 15-percent rate bracket, and the earned income tax credit; lowering the tax rate on capital gains and dividend income to 15 percent; increase in the child tax credit to $1,000; increase in the child and dependent care tax credit; and simplification of the rules for determining income for the earned income tax credit.

Conclusion

The Democratic budget takes the American people in the wrong direction. The current tax relief has provided a benefit to all taxpayers and has shifted the tax burden even more to the wealthy. At a time when economic anxiety is of paramount concern, Congress should not entertain the notion of increasing taxes. Americans are concerned that they won’t be able to make their next mortgage payment or fill up their car with gas. Congress should not add a looming tax increase to their list of worries.