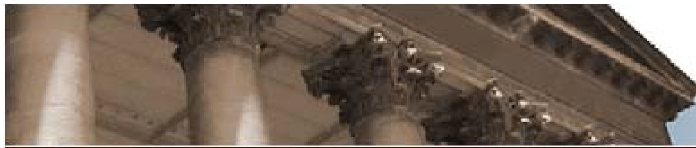

JOINT ECONOMIC COMMITTEE
SENATE REPUBLICANS

SENATOR SAM BROWNBACK, SENIOR REPUBLICAN SENATOR

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MAKING TAX RELIEF PERMANENT

The U.S. is set to undergo the largest tax increase in history, and this will occur without any legislative action. In 2011, America's tax burden will rise by $213 billion, or an average of $1,833 per taxpayer (expressed in 2008 dollars).

Because tax relief measures enacted in 2001 (Economic Growth and Tax Relief Reconciliation Act of 2001—or, EGTRRA) and 2003 (Jobs and Growth Tax Relief Reconciliation Act of 2003—or, JGTRRA) are all set to expire in 2008 and 2010, many Americans will be hit with smaller paychecks and larger end-of-year tax bills unless tax relief is extended or made permanent. The report below outlines what the 2001 and 2003 tax relief measures include; who benefits most from the tax relief; how expiration of the tax relief will affect various households; and why low tax rates are important for economic growth.

WHAT DID THE 2001 AND 2003 TAX CUTS INCLUDE?

The tax relief measures enacted in 2001 and 2003 resulted in substantially reduced tax liabilities for nearly all American taxpayers. However, most of the provisions of EGTRRA and JGTRRA are set to expire in 2010. The key features of the tax measures include:

- Creation of a new 10% tax bracket applying to the bottom 25% taxable income bracket which was previously taxed at a 15% rate (expires after 2010)
- Marriage penalty relief: raising of the standard deduction and income limits on the bottom two tax brackets for married couples filing jointly to 200% of the levels for singles (previous levels were 167% of singles) (expires after 2010)
- Doubling of the child tax credit from $500 to $1,000 (expires after 2010)
- Increasing the child and dependent care tax credit from $2,400 (maximum of $4,800) to $3,000 (maximum of $6,000) (expires after 2010)
- Reducing tax rates on long-term capital gains from 20% to 15% for individuals in the top four income tax brackets (expires after 2010), and from 10% to 5% for taxpayers in the two lowest tax brackets (becomes 0% in 2008 and then expires after 2010)
- Reducing tax rates on dividends from ordinary income to 15% for the top four tax brackets (expires after 2010) and 5% for the bottom two tax brackets (becomes 0% in 2008 and then expires after 2010)

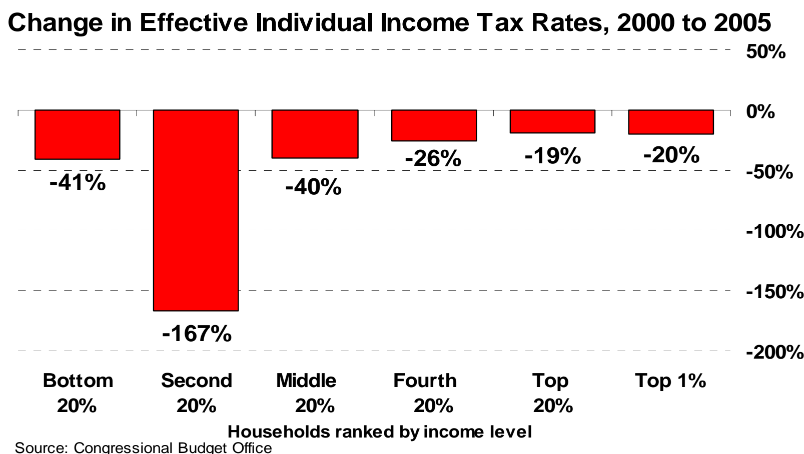
The chart on the following page shows income tax brackets and marginal tax rates (percent of an additional dollar of taxable income that must be paid in income taxes) for married couples and singles in 2008 compared with what they will be in 2011 if tax relief is allowed to expire (all figures are in 2008 dollars).

Married Filing Joint					
Taxable Income: **2008**			Taxable Income: **2011**		
Over	But not Over	Marginal Rate	Over	But not Over	Marginal Rate
$0	$16,050	10%			
$16,050	$65,100	15%	$0	$57,350	15%
$65,100	$131,450	25%	$57,350	$131,450	28%
$131,450	$200,300	28%	$131,450	$200,300	31%
$200,300	$357,700	33%	$200,300	$357,700	36%
$357,700	and over	35%	$357,700	and over	39.6%
Standard Deduction		$10,900	Standard Deduction		$9,100
Single					
Taxable Income: **2008**			Taxable Income: **2011**		
Over	But not Over	Marginal Rate	Over	But not Over	Marginal Rate
$0	$8,025	10%			
$8,025	$32,550	15%	$0	$32,550	15%
$32,550	$78,850	25%	$32,550	$78,850	28%
$78,850	$164,550	28%	$78,850	$164,550	31%
$164,550	$357,700	33%	$164,550	$357,700	36%
$357,700	and over	35%	$357,700	and over	39.6%
Standard Deduction		$5,450	Standard Deduction		$5,450

WHO BENEFITS FROM THE TAX RELIEF?

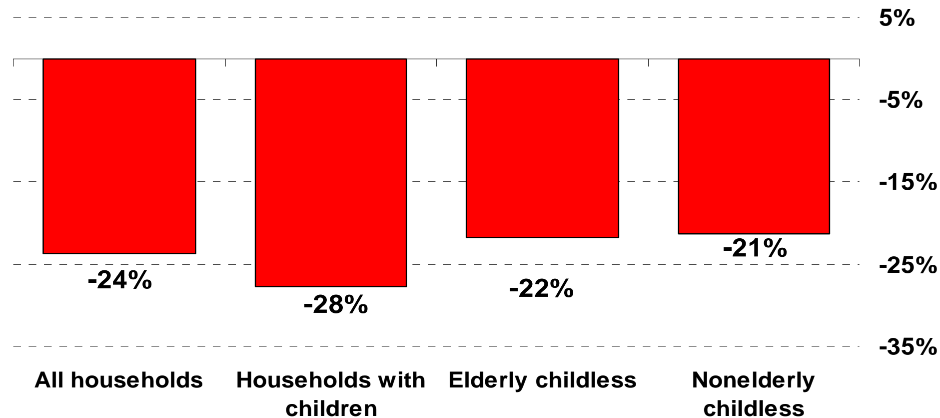
Virtually all income earners benefit from the 2001 and 2003 tax relief. Many who do not owe income taxes benefit from the partially refundable increase in the child tax credit. While upper-income earners receive a proportionally larger share of the total *dollar value* of the tax relief, their *share* of tax relief was actually smaller than their *share* of the total tax burden.[1] The fact that upper-income earners receive a larger *dollar amount* of the tax relief follows directly from the fact that those earners pay larger dollar amounts of income taxes. And, because many lower- and middle-income earners pay zero to small dollar amounts of income taxes, it would be difficult for reductions in tax rates to significantly change the dollar values of their income tax liabilities.

As the chart below shows, lower- and middle-income earners receive larger percentage decreases in their taxes than do upper-income earners.

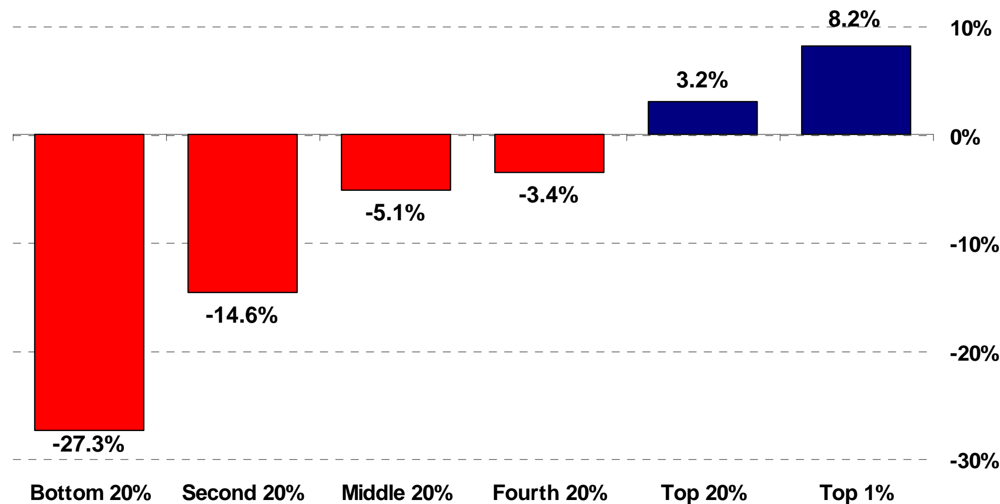


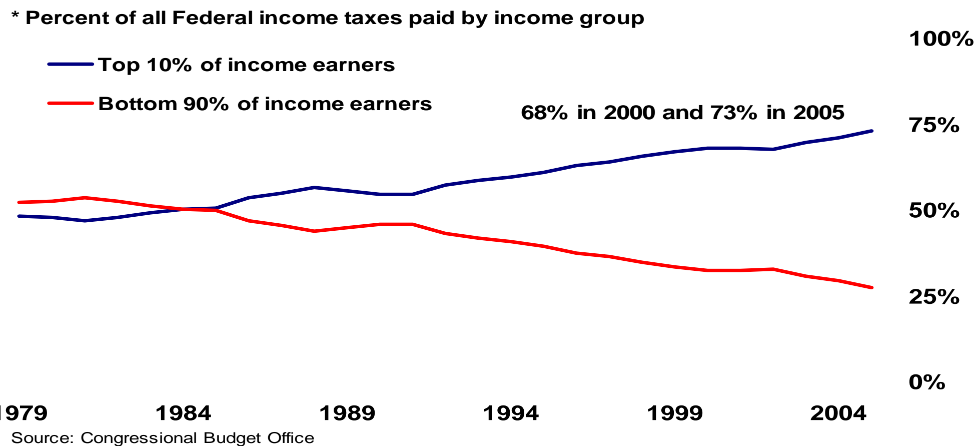
[1] According to the Tax Policy Center, between 2001 and 2006, 66.7% of the dollar value of the tax relief went to the highest income quintile. According to the most recent data available from CBO, the top income quintile pays 68.7% of all Federal taxes and 86.3% of all individual income taxes.

In addition to providing greater percentage cuts for lower-income earners, the 2001 and 2003 tax relief provides more relief for families. Households with children receive the largest percentage decrease in taxes, followed by elderly childless households, and nonelderly childless households.



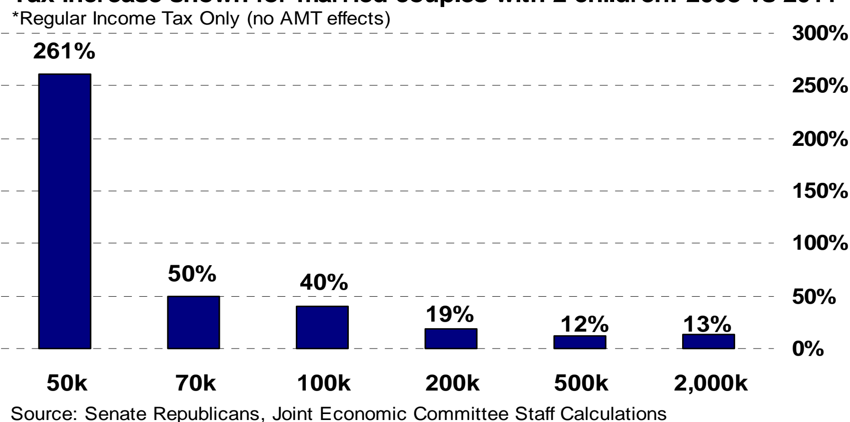
Despite the often heard claim that many of the provisions of the 2001 and 2003 tax relief measures have primarily benefitted upper income earners, the tax *share* of the highest income group has actually increased, while the tax share of the bottom four income groups have declined since the measures went into effect (the tax share of a particular group refers to the percentage of all Federal income taxes that are paid by a particular group). In fact, the top 10% of income earners now pay a greater share of Federal income taxes than ever before; in 2005, the top 10% of income earners paid a record 73% of all Federal income taxes while the bottom 90% paid 27% of all Federal income taxes.





HOW WILL EXPIRATION OF TAX RELIEF AFFECT VARIOUS HOUSEHOLDS?

Despite the often-heard claims that the tax relief enacted in 2001 and 2003 disproportionately favor the "rich," low- and middle-income households benefit significantly and stand to lose a great deal if tax relief is not made permanent. For example, if tax relief expires, as scheduled, and if nothing is done to fix the AMT, married couple households with 2 children and $70,000 in income will see their tax bill increase by 50% (see chart below).[2]



Because married couples and families with children benefit greatly from the doubling of the standard deduction and income limits on the lower tax brackets, as well as the increased child tax credit, they will experience larger tax increases in 2011 than single people or families without children.

Based on current tax returns and future projections, the Treasury Department predicts the following average tax increases for various individuals in 2011:

[2] Due to difficulty in estimating households' tax deductions, all calculations assume that households take the standard deduction. This results in a higher tax liability for many mid- to upper-income households, but because the liability is higher in each of the years, the percent changes in tax liability should, with relatively high accuracy, appropriately indicate households' percentage tax increases.

Group	Number of Taxpayers	Average Tax Increase
All taxpaying households	116 million	$1,833
Married Couples	48 million	$3,007
Families with Children	43 million	$2,323
Women	84 million	$2,121
Single Women with Dependents	12 million	$1,091
Seniors	18 million	$2,181
Small Business Owners	27 million	$4,066

WHY ARE LOW TAX RATES IMPORTANT FOR ECONOMIC GROWTH?

Low marginal tax rates help stimulate economic growth by providing incentives for individuals and businesses to work, save, and invest and also by reducing the incidence of tax avoidance and tax evasion. Lower tax rates provide higher after-tax returns to workers, savers, and businesses who invest in productive capital. While *tax cuts do not pay for themselves*, they do lead to higher levels of work, savings, investment, and income than would be the case absent the tax cuts. The higher levels of income, in turn, leads to additional tax revenue that partly offsets the revenue not collected as a result of lower tax rates.

Shortly after the 2003 tax relief measures that provided investment incentives went into effect, the slump in business investment spending that drove the 2001 recession reversed course. Growth in business investment spending turned almost immediately from negative (meaning declining investment) to robust positive rates following business-investment tax relief.

Studies of past major tax reforms (1962, 1971, 1981, and 1986) find similar evidence that changes in tax policy have economically significant effects on capital investment, with lower tax rates increasing investment and higher tax rates reducing investment.[3] Capital investment is a crucial component of economic growth. Capital helps create jobs and increases productivity. As productivity rises, so does our standard of living. Low tax rates are crucial to encouraging investment and maintaining a vibrant and competitive economy, particularly in light of the current environment of increased global competition.

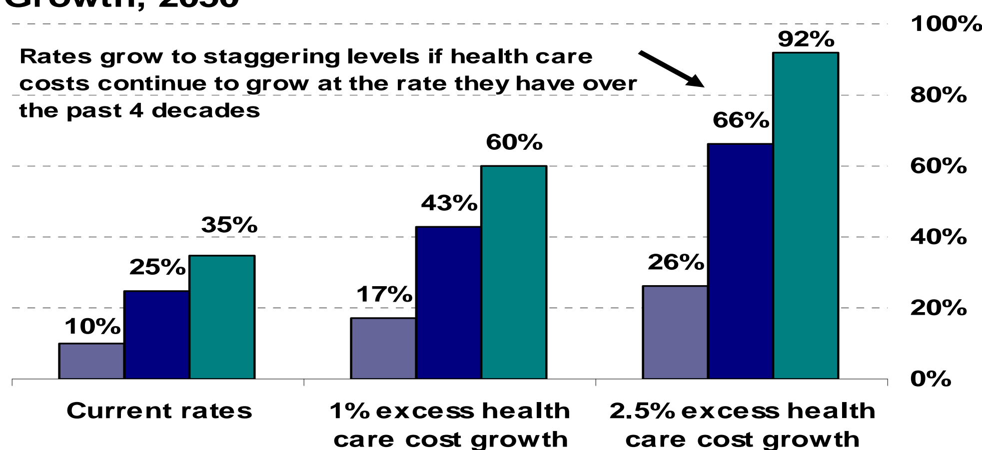
While the huge tax increase scheduled for 2011 will have a significant negative impact on individuals and businesses, the scheduled tax increases will do nothing to help solve the onerous and growing burden placed on our economy over the coming decades as a result of unsustainable promises embedded in our entitlement programs—namely, Social Security and Medicare.

Left unchanged, by 2030, the cost of Social Security and Medicare is projected to almost double as a percent of GDP, rising from 7.3% in 2006 to 12.7% in 2030.[4] By 2080, promised outlays from Social Security and Medicare alone will encompass 17.6% of GDP, according to projections. In comparison, total Federal revenues in 2007 amounted to 18.8% of GDP. According to current projections, immediate tax increases of 16% for the payroll tax and 122% for the Medicare tax [5]would be necessary to pay for promised benefits through 2080.[6] Alternatively, immediate

[3] Jason G. Cummins, Kevin A. Hassett and R. Glenn Hubbard, "Have Tax Reforms Affected Investment?" in *Tax Policy and the Economy*, Volume 9, ed. James M. Poterba, National Bureau of Economic Research (Cambridge, Massachusetts: the MIT Press, 1995).
[4] A Summary of the 2007 Annual Social Security and Medicare Trust Fund Report. http://www.ssa.gov/OACT/TRSUM/trsummary.html
[5] The Medicare payroll tax only covers part A, the Hospital Insurance (HI) part of Medicare. Parts B and D are paid for through a combination of general revenues (75%) and beneficiary premiums (25%). Thus, the 122% Medicare payroll tax increase would only cover the additional costs of the Part A component of Medicare. Workers and beneficiaries would have to pay additional taxes and premiums to cover the growing expenses of Parts B and D.

benefits cuts of 13% for Social Security and disability and 50% for Medicare would allow the programs to pay promised benefits through 2080. The programs would remain in peril beyond 2080 because, even with such action, actuarial deficits would re-emerge on a continuously growing basis. To address the infinite time horizon shortfall, the trustees' reports suggest tax increases on the magnitude of 28% for Social Security and 200% for Medicare would be necessary. Taking Social Security and Medicare together would require the combined tax rates to increase by 61%.

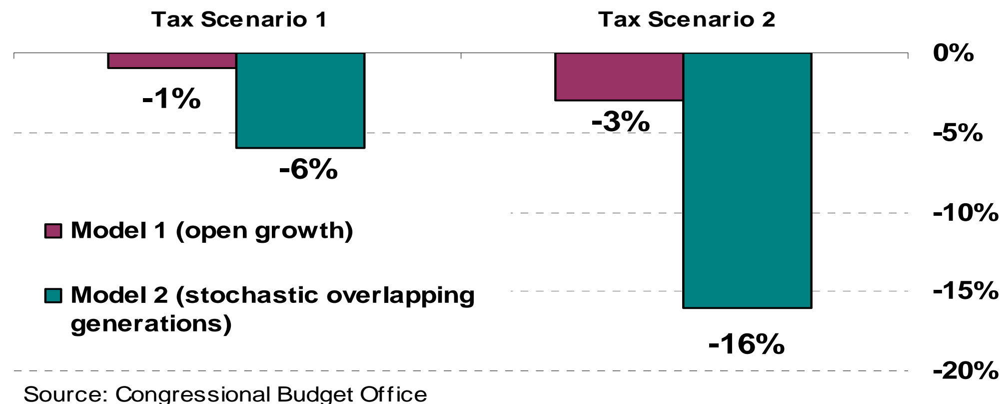
Our current budgetary situation regarding entitlement programs and the looming expiration of the 2001 and 2003 tax relief measures do not bode well for future U.S. economic growth. A study by the Congressional Budget Office (CBO) found that tax rates would have to rise significantly in order to maintain projected spending.[7] Even if medical costs grow only 1 percentage point faster than per capita GDP (over the past four decades, growth in medical costs has outpaced per capita GDP growth by 2.5 percentage points), the top marginal tax rate will rise from 35% today to 60% in 2050 in order to maintain projected spending (see chart below). And this would only account for Federal income taxes—tacking on payroll and state and local taxes would leave even middle class households with mere pennies on the dollar in marginal take-home pay and even less incentive to work.



CBO acknowledges that the extremely high tax rates listed under the 2.5 percentage point excess health-care-cost growth are likely unsustainable. CBO does, however, estimate effects on GDP growth of maintaining projected spending under a 1 percentage point excess health care cost growth scenario. Depending on the model and assumptions, CBO finds that if taxes are raised to finance projected spending, GDP growth will be between 1% and 16% lower than if revenues and spending were held constant as a share of GDP at their 2006 levels.

[6] This projection is based on the 2007 Social Security and Medicare Trust Fund Report. However, back in 1983 when Social Security was reformed, the projections showed that the reform measures would create a financially stable Social Security system through 2063. Current projections show that Social Security will be not be able to pay promised benefits beyond 2041-- 22 years earlier than was originally thought back in 1983.

[7] Congressional Budget Office, "Financing Projected Spending in the Long Run," July 9, 2007, http://www.cbo.gov/ftpdocs/82xx/doc8295/07-09-Financing_Spending.pdf



Clearly, raising taxes to maintain projected spending and promised entitlements would deliver a severe blow to the U.S. economy. As global competition intensifies, it becomes increasingly important for the U.S. to maintain low tax rates to encourage economic growth and to compete with many other countries that have been competitively cutting corporate tax rates.

CONCLUSION

Making permanent the tax relief measures of 2001 and 2003 are crucial to maintaining a vibrant and globally competitive U.S. economy. Doing so would:

- Encourage work and provide individuals with greater take home pay
- Encourage investment, stimulate job creation, encourage productivity growth and, therefore, growth in living standards
- Force the government to rein in wasteful, unproductive, and inefficient spending
- Force action on entitlement reforms, creating a better future for our children
- Allow the U.S. to maintain a competitive position in the global economy
- Support family formation by reducing marriage penalties
- Provide families with children a relatively lower tax burden, recognizing the financial challenges of raising children as well as the future economic benefit children provide to society and the economy