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Analysis of 2012 Federal Tax Reform, Part One: Proposed Federal Tax Plans Vary on Tax Equity

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This is the first of a series of issues briefs discussing federal budget changes and their implications on low- and middle-income families across America. This brief focuses on how proposed tax rate reductions, specifically the expiration of the Bush tax cuts, will impact different income groups and the overall progressivity of the tax system. Following issue briefs will explore additional revenue proposals, spending cuts and the implications of budget plans on the federal deficit.

Tax rates, spending cuts and the federal deficit are again the center of debate on Capitol Hill. With the Bush-era tax cuts set to expire at the end of 2012, budget discussions will be the major focus over the next couple of months as the American economy continues its fragile course to recovery.

Diverse perspectives in Congress have resulted in several fiscal reform plans, all containing vast and varying implications for American families. These tax packages range from simply extending all Bush tax cuts to letting them all expire, with the most popular plans picking and choosing parts of the Bush-era cuts to remain intact or lapse at the end of 2012.

The Bush Tax Cuts

The term “Bush tax cuts” refers to income tax and estate tax cuts that were enacted in President Bush’s Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). These cuts include reduced rates for all income-tax brackets, lower rates on capital gains and other investment income and some modifications to credits targeted at low- and middle- income taxpayers including the expansion of the Earned Income Tax Credit and the Child Tax Credit that were expanded in 2009 as part of the American Reinvestment and Recovery Act (ARRA).

House Leadership Plan

Income Tax Rates

The House leadership plan includes an extension of the reduced income-tax rates for *all* taxpayers and a continuation of reduced rates on capital gains and other investment-related income.

The Estate Tax

House leadership also wants to make all of the Bush-era estate tax cuts permanent. This would extend the increased amount of assets that are exempt from estate tax as well as reduce the estate tax rate.

Low- and Middle-Income Tax Credit Expansions

House leadership's plan would not extend the expansion of the Earned Income Tax Credit and the Child Tax Credit that were included in the 2009 ARRA package.

President Obama's Plan

Income Tax Rates

President Obama proposes to make all of the Bush income tax cuts permanent for taxpayers making less than \$250,000. This includes the extension of the reduced tax rates for all lower tax brackets. The President's plan also restores rates on capital gains and other investment income for those in the top tax brackets.

The Estate Tax

Similar to the income tax cuts, President Obama's plan would restore the estate tax and cap the cuts for higher-income taxpayers.

Low- and Middle-Income Tax Credit Expansions

President Obama would permanently expand the Earned Income Tax Credit and the Child Tax Credit.

***For full list of tax cuts, see endnotes*

Tax Equity

The passage of either of these two tax packages will impact the equity of the federal tax code with one option re-establishing higher income tax rates for the wealthiest Americans. By increasing income tax rates on upper income brackets, the "progressivity" of the federal tax system is increased. A progressive tax system is built on the principle that higher-income taxpayers have the ability to pay more in taxes.

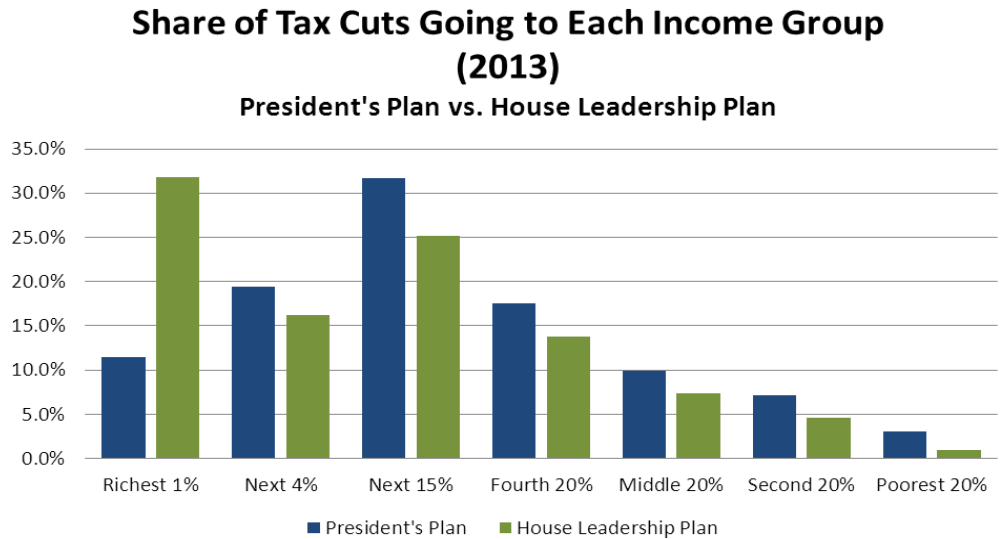
The federal income tax has historically been understood as progressive, with tax rates increasing with income. The Bush tax cuts made the tax system less progressive by reducing rates on the highest-income taxpayers. The House leadership plan and the President's plan treat the Bush tax cuts differently and each results in a different degree of progressivity.

For example, a study by the Institute of Taxation and Economic Policy (ITEP) found that under the House leadership plan, 31.8 percent of tax cuts would go to the richest one percent of Americans and almost half would go to the richest five percent. This would mean that taxes for the richest one percent would be cut by \$70,790 on average, while taxes for the poorest fifth of Americans would be cut by an average of \$120.

According to the same ITEP report, under President Obama's plan, 11.4 percent of the tax cuts would go to the richest one percent of Americans, while 30.8 percent would go to the richest five percent. Additionally, only 1.9 percent of all Americans would lose any portion of their Bush tax cut income

under the President’s plan because even though the income tax cut would be for income up to \$250,000, those making more than \$250,000 will be able to reduce their taxes on the first \$250,000 of their income, even if they must pay higher rates on income above the threshold.

The chart below shows the share of tax cuts going to each income group under the House leadership plan compared to the President’s plan:



Data provided by the Institute of Taxation and Economic Policy (www.itepnet.org)

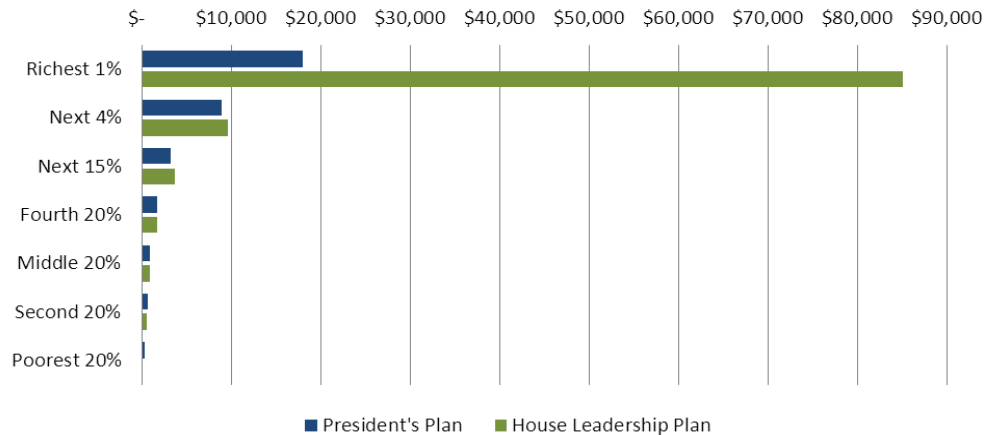
Bush Tax Cuts in Colorado

According to the ITEP study, under the House leadership plan, the richest one percent of Coloradans would receive a tax cut of \$85,110 on average per person, while lower-income Coloradans would only receive a \$140 cut on average.

Under the President’s approach, the richest one percent would receive a much smaller tax reduction of \$18,030 on average per person while the lowest-income Coloradans would receive an average tax cut of \$300.

This chart shows the average tax cuts for Coloradans under the two different tax packages:

Average Tax Cuts for Colorado Taxpayers in 2013



Data provided by Institute of Taxation and Economic Policy (www.itepnet.org)

Some Members of Congress want to go even further

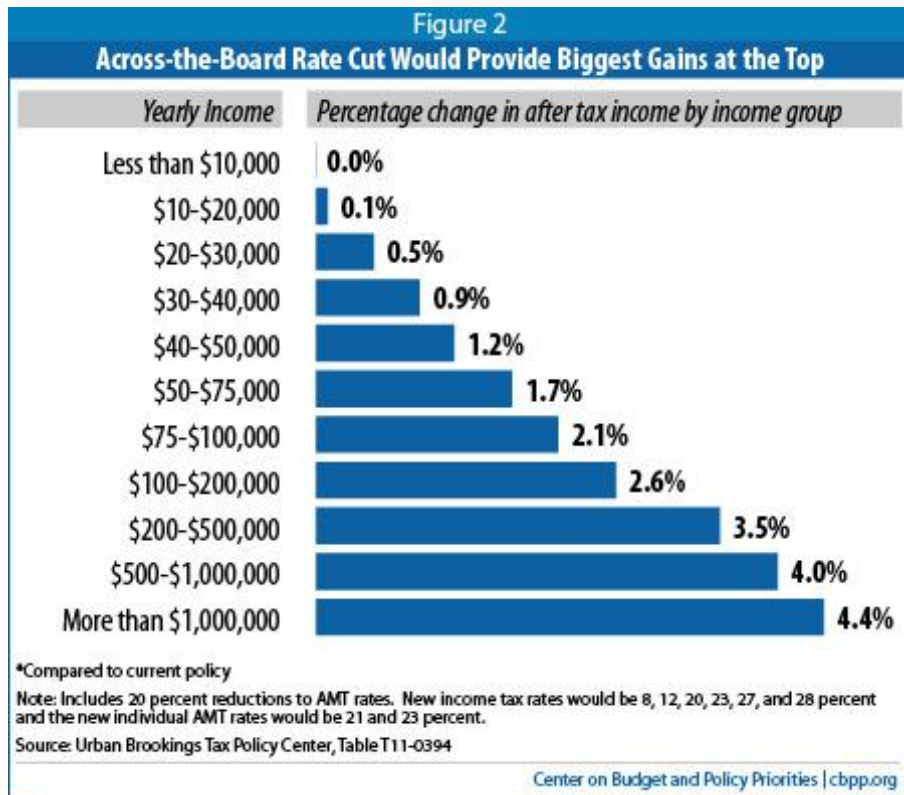
While the House leadership plan and the President's plan are the most widely accepted, some policymakers have proposed large rate cuts in addition to the extension of Bush tax cuts.

Senator Pat Toomey (R-PA), for example, has proposed that the Bush tax cuts be extended with a 20 percent rate cut across-the-board.

In this case, even though the tax rates fall by the same percentage for all tax brackets, the result is a larger tax cut for the wealthiest of Americans.

According to the Center on Budget and Policy Priorities, Toomey's plan would result in a *two and half times larger tax cut* for taxpayers making over \$1 million than for people making between \$50,000 and \$75,000.

The chart below from the Center on Budget and Policy Priorities illustrates the Toomey plan by yearly income:

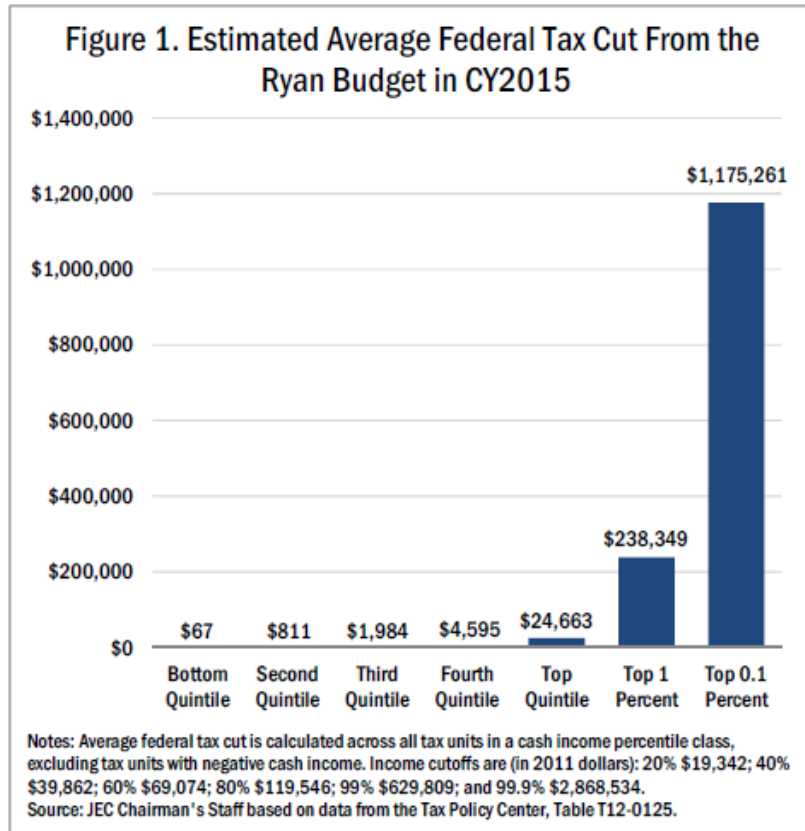


Source: Center on Budget and Policy Priorities

House Budget Committee Chairman Paul Ryan (R-WI) has offered another proposal. Under Chairman Ryan's plan, the federal tax rate structure would be replaced entirely with a two-tiered tax bracket system — 10 percent for lower-income and 25 percent for higher-income.

Again, the highest-income households would benefit the most from this tax system. Under the Ryan plan, the wealthiest one-tenth of one percent of taxpayers would see a 14.1 percent decline in their tax rate on average, while those in the bottom quintile would see only a 0.06 percent tax savings.

Below is a chart from the U.S. Congress Joint Economic Committee that shows the average tax cuts by income group from the Ryan plan:



Source: U.S. Congress Joint Economic Committee

Conclusion

All of the tax plans being considered in Congress impact who pays how much in federal income taxes. Increasingly, Americans are concerned about the fairness of a tax system that allows the richest taxpayers to devote the smallest percentage of their income in public investments. As we strive for a country that can support the community services that provide the foundation for a high standard of living for all, we need to pay close attention to issues of tax equity among taxpayers.

**The full list of Bush tax cuts:

Tax Break	House Leadership Plan	President Obama Plan
<i>Tax cuts first enacted in 2001 and 2003</i>		
Reduction of the 36% and 39.6% rates to 33% and 35%	Extended	Expire
Reduction of the 28% and 31% rates to 25% and 28%	Extended	Extended
Introduction of the 10% tax bracket (lowest bracket was previously 15%)	Extended	Extended
Reduction of rates for capital gains in bottom four brackets from 10% and 20% to 0% and 15%	Extended	Extended
Reduction of rates for capital gains in top two brackets from 20% to 15%	Extended	Expire
Reduction in rates on stock dividends in bottom four brackets from ordinary rates to capital gains rates	Extended	Extended
Reduction of rates on stock dividends in top two brackets from ordinary rates to capital gains rates	Extended	Expire
Expansion of Child Tax Credit	Extended	Extended
Elimination of "marriage penalty" in the standard deduction	Extended	Extended
Elimination of "marriage penalty" in the 15% rate bracket	Extended	Extended
Reduction in "marriage penalty" in the Earned Income Tax Credit	Extended	Extended
Expansion of the Dependent Care Credit	Extended	Extended
Repeal of the personal exemption phase-out	Extended	Partially Extended
Repeal of the itemized deduction disallowance	Extended	Partially Extended
Increase in the exemptions in the Alternative Minimum Tax (AMT)	Extended	Extended
<i>2009 Expansion of Certain Income Tax Cuts</i>		
Further reduction of the "marriage penalty" in the Earned Income Tax Credit	Expire	Extended
Increase in the Earned Income Tax Credit for larger families	Expire	Extended
Marking the refundable part of the Child Tax Credit more accessible to lower-income earners	Expire	Extended
<i>Estate Tax Cuts</i>		
Increase in the amount of assets exempt from estate tax	Extended	Partially Extended
Reduction in estate tax rates	Extended	Partially Extended

Source: Citizens for Tax Justice
For more information visit: www.ctj.org