

SPECIAL REPORT

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Economic Expansion Leads to Higher Taxes on Median One- and Two-Earner American Families

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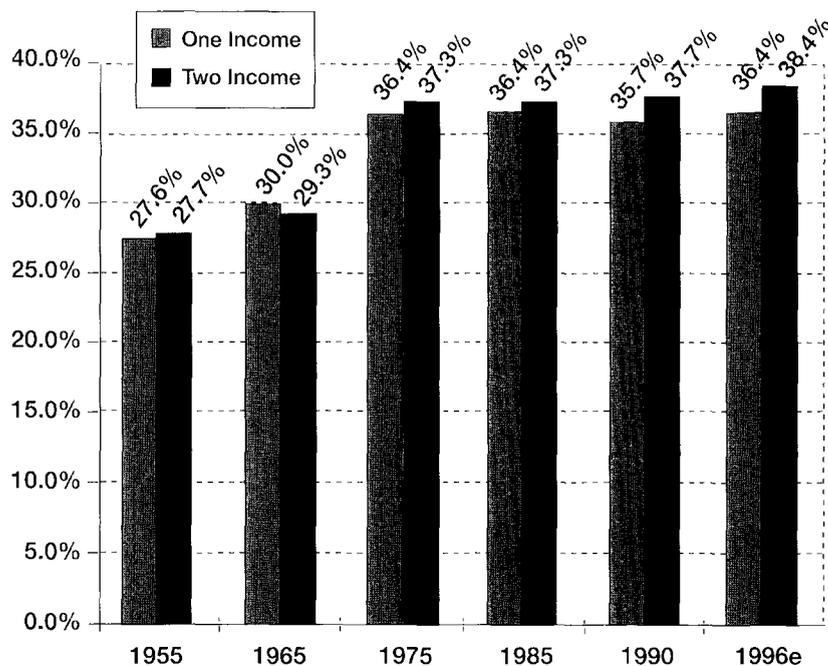
As the U.S. economy continues to expand, albeit slowly, so does the tax burden on America's median-income family. Taxes on the American family increased for the third straight year in 1996. This year, total taxes as a percent of income for a two-earner family are projected to increase to 38.4 percent, up from 38.1 percent in 1995; for a single-earner family, total taxes as a percent of income are projected to increase to 36.4 percent from 36.1 percent in 1995. (See Figure 1.)

These tax-burden levels rival the highest ever. For a dual-income family, the only years in which total taxes as a percent of income were higher than 38.4 percent were in the years 1980-1982. In those years, respectively, the shares were 38.6 percent, 40.6 percent, and 39.6 percent. However, for a single earner family, several years registered a total tax burden equal to or greater than 36.4 percent of income. Those years were 1975, 1977-1982, 1984, and 1985. The period encompassing the late-1970s and early-1980s was difficult for taxpayers because of the high rates of inflation during the 1970s: Real income stagnated and simultaneously pushed taxpayers into ever-higher federal tax brackets. As Figure 2 shows, this situation was not reversed until the federal income tax reductions (and bracket indexation) of the 1980s took effect.

In terms of inflation-adjusted dollars, the \$21,883 total tax burden projected to be borne by a dual-earner family with the median income in 1996 will be the highest ever. However, much of that reflects a secular increase in the real incomes of this family type. But the \$11,113 total tax burden expected to be borne by a single-earner family with a median income in 1996 is relatively low by post-1975 standards.

Table 1 shows the trend in the tax burden on double- and single-earner families (with a median income). The trend is illustrated decade-by-decade from 1955 through 1985. Thereafter, each year from 1985 through 1996 is presented. For double-income families, the tax burden as a percent of income has grown 10.7 percentage points since 1955; for single-income families the tax burden has grown 8.8 percentage points.

Figure 1
Taxes as Percentage of Income for the Median One- and Two-Income Families, 1955-1996



Source: Tax Foundation.

Taxes Most Responsible For Increased Family Burden

Two trends in taxation are most responsible for this increase: The upward trend in state and local taxation and the increase in the federal payroll tax used to fund social insurance schemes. State and local taxes combined have, as a share of income, grow about five percentage points from 1955 to 1996. Federal payroll taxes (individual share only) as a share of total family income have grown about 6.2 percentage points from 1955 to 1996. Moreover, economists are in general agreement that the employer's share of the federal payroll tax reduces wages by the amount of the tax, indicating that a median-income family's gross wages are about seven percent lower than they would be at 1955 payroll tax levels.

As a comparison between *Figures 3 and 4* demonstrates, the growth in the tax burden for median-income families over the past 40 years has come as a result of the general increase in both federal (payroll) taxes and state and local taxation. To a large extent, the growth in tax burdens has crowded out some important items of the family budget, such as saving. (Other items, such as food, are proportionally

smaller due to efficiency gains in the marketplace.)

Figure 4 also shows that taxation continues to dominate the family budget. For a double-income family, the tax burden (38.4 percent) will exceed the combined expenditures for housing, household operations, transportation, food, and clothing (34.4 percent).

Assumptions and Methods

The families represented in *Table 1* adhere to the Census Bureau's broad definition of family — two or more related people living in the same residence. Approximately 90 percent of the families represented in this report are married couples with an average of about 1.3 children per family.

Federal income taxes and payroll taxes are computed directly off the family income. The family types presented here represent a weighted average of standard deduction filers and itemizers, based on the reported family income. Tax credits are also taken into consideration. For payroll tax calculations, it is assumed that wage income for a double-earner family represents 96 percent of its total income. For a single-earner family, wages represent 97 percent of total income.

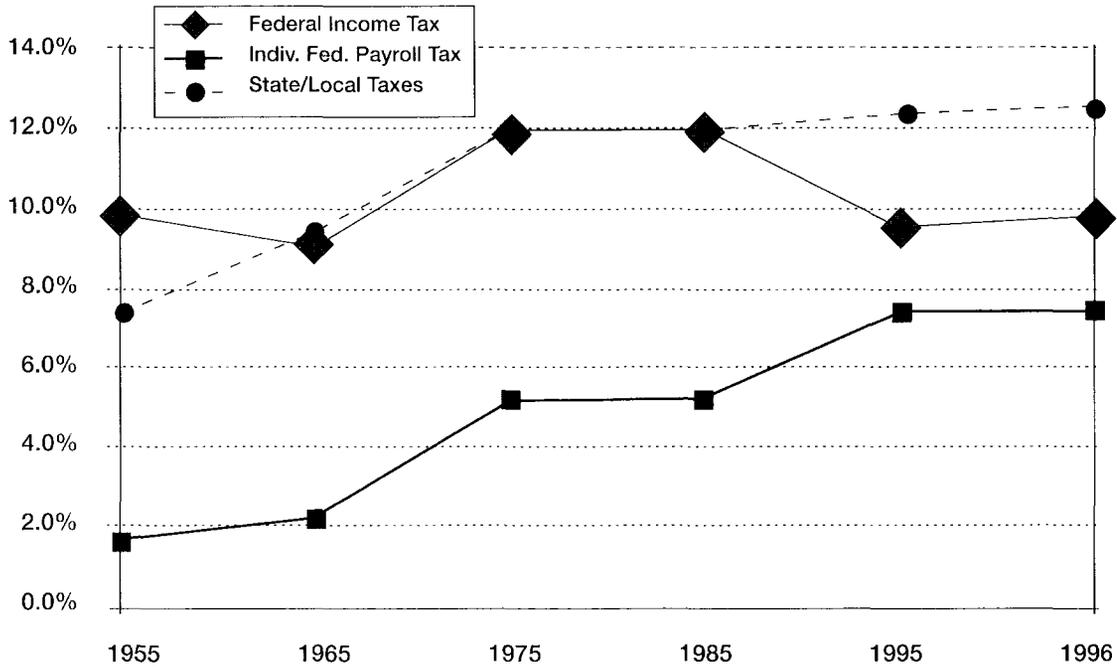
Table 1
Taxes and the American Family (Single and Dual Income Earners), 1955-1996

	1955		1965		1975		1985		1986		1987		1988	
	Single	Dual	Single	Dual	Single	Dual	Single	Dual	Single	Dual	Single	Dual	Single	Dual
Median Family Income	\$4,069	\$5,250	\$6,060	\$7,983	\$11,568	\$16,058	\$21,190	\$33,411	\$22,310	\$35,108	\$23,111	\$36,799	\$23,872	\$38,702
Federal Income Tax	366	513	526	727	1,177	1,918	1,790	3,853	1,802	3,906	1,622	3,367	1,681	3,519
Payroll Taxes:														
Employee Portion	79	84	174	174	656	825	1,449	2,261	1,547	2,410	1,603	2,526	1,739	2,790
Employer Portion	79	84	174	174	656	825	1,449	2,261	1,547	2,410	1,603	2,526	1,739	2,790
Other Federal Taxes	315	407	426	562	582	808	791	1,247	800	1,259	905	1,441	947	1,535
Total Federal Taxes	839	1,088	1,300	1,636	3,072	4,376	5,479	9,623	5,697	9,985	5,732	9,860	6,105	10,634
Total State/Local Taxes	304	392	570	751	1,380	1,915	2,522	3,977	2,722	4,284	2,810	4,474	2,838	4,601
Total Taxes	1,143	1,480	1,870	2,387	4,452	6,291	8,001	13,600	8,419	14,269	8,543	14,334	8,943	15,235
After-Tax Income	3,005	3,854	4,364	5,770	7,773	10,592	14,638	22,072	15,438	22,249	24,991	16,668	26,257	17,358
Total Taxes as a Percent of Income	27.6%	27.7%	30.0%	29.3%	36.4%	37.3%	35.3%	38.1%	35.3%	38.0%	34.6%	36.5%	34.9%	36.7%
Inflation-Adjusted Total Taxes (1996\$)	\$5,148	\$6,665	\$8,202	\$10,470	\$11,563	\$16,340	\$11,206	\$19,047	\$11,471	\$19,440	\$11,285	\$18,935	\$11,407	\$19,432

Note: The burden of federal and state corporate income taxes are included. After-tax income does not deduct employer's share of payroll taxes because the burden of the payroll tax is assumed to reduce income before the "gross" seen on paychecks. "Total taxes as a percent of income" is calculated by adding the employer's share of the payroll tax to the median family income.

Source: Tax Foundation.

Figure 2
Taxes as a Percentage of Median Two-Income Family's Income, 1955-1996



1989		1990		1991		1992		1993		1994		1995		1996e	
Single	Dual														
\$25,226	\$40,658	\$25,878	\$42,146	\$25,960	\$43,623	\$26,292	\$45,779	\$26,193	\$47,424	\$27,145	\$48,970	\$27,788	\$50,989	\$28,447	\$53,091
2,023	4,216	2,027	4,261	1,952	4,280	1,891	4,334	1,801	4,451	2,002	4,601	2,029	4,863	2,098	5,139
1,838	2,931	1,920	3,095	1,926	3,204	1,951	3,362	1,944	3,483	2,014	3,596	2,062	3,745	2,111	3,899
1,838	2,931	1,920	3,095	1,926	3,204	1,951	3,362	1,944	3,483	2,014	3,596	2,062	3,745	2,111	3,899
999	1,610	961	1,565	967	1,624	984	1,713	994	1,800	1,124	2,028	1,214	2,227	1,234	2,303
6,698	11,688	6,829	12,017	6,771	12,312	6,777	12,770	6,683	13,217	7,155	13,822	7,367	14,580	7,554	15,241
3,008	4,848	3,087	5,028	3,185	5,352	3,264	5,684	3,251	5,887	3,333	6,012	3,419	6,274	3,559	6,643
9,706	16,536	9,916	17,044	9,956	17,664	10,041	18,454	9,934	19,104	10,488	19,834	10,786	20,853	11,113	21,883
17,358	27,053	17,883	28,197	17,930	29,163	18,202	30,687	18,203	31,803	18,671	32,732	19,064	33,881	19,444	35,107
35.9%	37.9%	35.7%	37.7%	35.7%	37.7%	35.6%	37.6%	35.3%	37.5%	36.0%	37.7%	36.1%	38.1%	36.4%	38.4%
\$11,880	\$20,240	\$11,624	\$19,982	\$11,225	\$19,914	\$11,022	\$20,257	\$10,625	\$20,432	\$10,948	\$20,704	\$11,006	\$21,279	\$11,113	\$21,883

Figure 3
Representative Budget of Two-Income Family, 1956

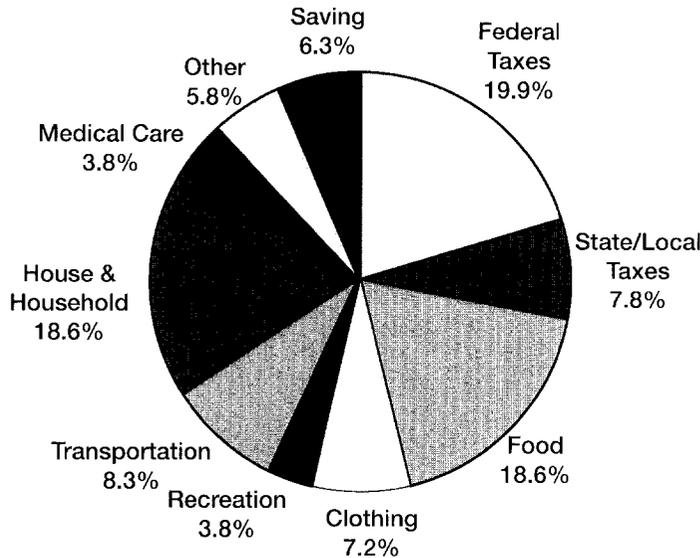
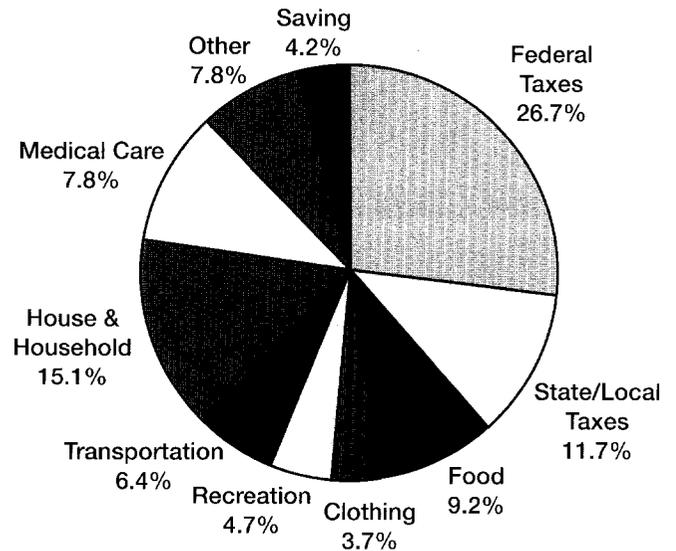


Figure 4
Representative Budget of Two-Income Family, 1996



Source: Tax Foundation.

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The burden of all other taxes - the array of federal excise taxes and customs duties, the federal estate and gift tax, the federal corporate income tax; and the array of state and local income taxes, sales taxes, excise taxes, property taxes, along with the array of miscellaneous state and local levies and fees - are calculated indirectly using formulas derived from national averages. These averages are calculated by dividing the revenue derived from the tax category in question by net national product (gross domestic product less the depreciation of physical plant and equipment). The resulting average tax rate is subsequently multiplied by the family median income to derive a dollar figure. The use of net national product as the income figure assures that all explicit and implicit forms of income are included in deriving an average tax rate.

The Tax Foundation imputes to individuals the burden of all taxes paid by business because, in general, economists agree with the adage which states: "Businesses don't pay taxes. People pay taxes." Businesses write checks to the government for taxes, but this is just one of the many costs that businesses must factor into their profit-making endeavor. The question is, Where does the burden of business taxation finally come to rest?

Economists generally agree that a business deals with the cost of taxation in one (or a combination) of three ways. First, a business may pass the cost to consumers by attempting to raise the prices of the goods or services it sells. Second, a business may pass it on to its employees by paying them less than it would have in the absence of taxes (or curtail planned pay increases). Third, business owners (which includes anyone that owns stock) may absorb the cost through lower profits than they would have realized in the absence of taxes. It is doubtful, however, that economists - or business managers, for that matter - will ever know with confidence what combination of the above three alternatives are at work.

That we cannot know the interplay of these factors does not mean that they do not raise each citizen's tax burden. The Tax Foundation employs its average-tax-rate method because it embodies an equal weighting of all three alternatives. An added benefit of this method is that it is consistent across time.