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## **New IRS Data: Tax Code More Progressive in 2004 than in 2000**

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### **Fiscal Fact No. 70**

The debate over the impact of the Bush tax cuts will continue for many years, but new IRS data, just published for tax year 2004, will certainly shape that debate by showing that the code was more progressive in 2004 than it was in 2000. This trend also sheds light on the surge of revenue that has cut the federal deficit so sharply in the summer and fall of 2006.

Some commentators try to change the definition of tax progressivity, either to prove that high-income people are paying too much or too little. Here we use the widely accepted definition: a tax system is progressive if high-income people pay a larger fraction of their income in taxes than lower-income taxpayers.

For each income group of U.S. taxpayers, we compare the shares of tax paid to the shares of income earned (see Table 1). A ratio of tax share to income share for each group in 2000 and 2004 shows how progressivity has increased. In the rightmost column of the table, we show the change in the tax-to-income share ratio. A positive number means the income group's tax share has grown faster than its income share. If the number is negative, the income share has grown faster than the tax share.

In a purely proportional income tax system, each income group's share of tax payments would be the same as its share of income. For example, if tax returns with AGI between \$200,000 and \$500,000 accounted for 9.97% of income (as they did in 2004 – see table), then they would pay 9.97% of the taxes. And if tax returns with AGI between \$40,000 and \$50,000 accounted for 6.97% of income (as they did in 2004), then they would pay 6.97% of the taxes. That is, in a proportional tax system, the ratio of tax share to income share is equal to 1. Because our system is progressive, the \$200,000-to-\$500,000 group didn't pay 9.97%; they paid much more, 17.89%. And the \$40,000-to-\$50,000 group didn't pay 6.97%; they paid much less, 4.20%.

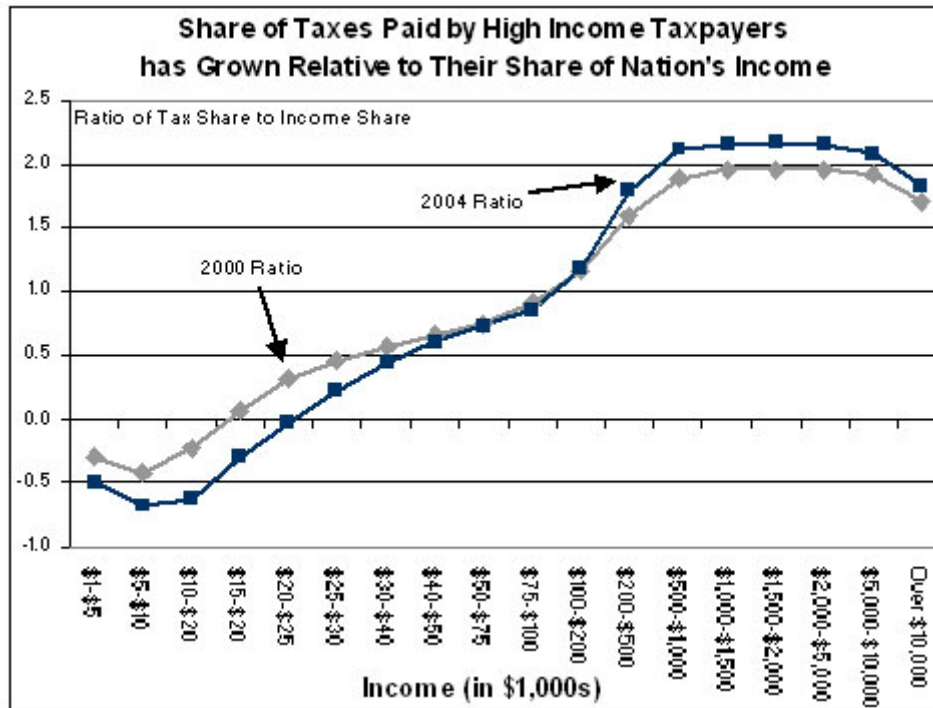
Because all of the major Bush tax cuts took effect in May 2003, tax year 2004 is the first to reveal their full effect. For many who predicted that these cuts only benefited "the rich," this data showing greater progressivity will be a surprise.

It may be tempting to conclude that the tax cuts targeted explicitly at low-to-middle income people—the new 10-percent bracket, the doubled child credit, the marriage penalty relief, and reduction of the 28-percent rate to 25 percent—outweighed those targeted at high earners. However, it is difficult to distinguish between the impact of Bush’s tax cuts and other developments in the economy.

We can say with certainty, though, that the tax cuts targeted at higher earners did not tilt the tax burden away from those high-income people.

As illustrated in Figure 1, the break point is \$100,000 a year. People who made more than that carried a heavier tax load in 2004 than in 2000, even factoring in any income gains. People who made less than \$100,000 saw income gains outpace tax payment, and therefore appear to have gotten a good deal from the Bush tax cuts.

**Figure 1.** Share of Taxes Paid by High Income Taxpayers has Grown Relative to Their Share of Nation's Income Since 2000.



Source: Internal Revenue Service, Tax Foundation calculations.

Many reporters have settled on \$200,000 as the income threshold for being “rich.” Whether this is true or not, it turns out that the \$200,000-and-over crowd is the only income group to have its share of the nation’s income shrink while its share of tax payments grew.

In 2000, tax returns with an adjusted gross income over \$200,000 earned 26.7 percent of all income, and they paid 47.3 percent of all income taxes. That’s a tax-to-income share

ratio of 1.79. Four years later in 2004, their share of income had fallen from 26.7 to 25.5 percent, but their share of taxes had risen to 50.0 percent. That brought the ratio up from 1.79 to 1.96 in 2004.

The biggest winners were in the \$25,000-to-\$30,000 range. If the Bush tax cuts are the determining factor, then the logical conclusion is that the new 10-percent bracket and the doubled child credit caused dramatic reductions in tax payment. As a result, the ratio of tax share to income share was cut in half.

Two other income groups stand out. People in the \$75,000-to-\$100,000 group benefited more than the group below earning between \$50,000 and \$75,000. Most likely, they earned enough to benefit from elimination of the marriage penalty and from cutting the 28-percent rate to 25 percent, but they didn't make so much that they lost the benefit of the doubled child credit or the new 10-percent bracket. Their share of the nation's income grew substantially, and their tax share grew by an infinitesimal amount.

People making between \$200,000 and \$500,000 saw their tax share increase even more than the groups above them. That is the effect of the Alternative Minimum Tax, which takes away many of the Bush tax cuts for people in this range. Above \$500,000 tax filers don't "fall into" the AMT because they already owe more under the regular income tax code.

### Conclusion

Overall, the federal income tax became markedly more progressive between 2000 and 2004. Without knowing exactly how much the Bush tax cuts caused this growing progressivity, one can tentatively conclude that in the mix of tax cuts passed in 2001 and 2003, the ones geared to people making less than \$100,000 turned out to be more powerful relative to those geared to help people making more than \$100,000.

With no data for 2005 and 2006, no one can say definitively that the income tax has become even more progressive since 2004. However, the recent wave of "unpredictable" tax receipts is powerful evidence that it has, because growing progressivity typically causes sudden waves of tax revenue when the economy booms and shocking fall-offs when the economy falters.

**Table 1:** Federal Income Tax Has Gotten More Progressive Since 2000

Income Group (AGI)	Income Group's Share of AGI		Income Group's Share of Federal Income Taxes Paid*		Ratio of Income Share to Tax Share		Change from 2000 to 2004
	2000	2004	2000	2004	2000	2004	
\$1 to \$5,000	0.54%	0.46%	-0.16%	-0.23%	-0.296*	-0.492**	na
\$5,000 to \$10,000	1.51%	1.34%	-0.65%	-0.90%	-0.432*	-0.673**	na
\$10,000 to \$15,000	2.38%	2.14%	-0.53%	-1.32%	-0.223*	-0.617**	na
\$15,000 to \$20,000	3.20%	2.90%	0.22%	-0.85%	0.069*	-0.294**	na
\$20,000 to \$25,000	3.53%	3.21%	1.09%	-0.11%	0.311*	-0.033**	na

\$25,000 to \$30,000	3.60%	3.44%	1.65%	0.75%	0.458	0.219	- 0.239
\$30,000 to \$40,000	7.40%	7.11%	4.22%	3.18%	0.570	0.447	- 0.123
\$40,000 to \$50,000	7.31%	6.97%	4.81%	4.20%	0.658	0.602	- 0.055
\$50,000 to \$75,000	16.41%	16.34%	12.19%	11.86%	0.742	0.725	- 0.017
\$75,000 to \$100,000	11.59%	12.85%	10.51%	10.98%	0.907	0.855	- 0.053
\$100,000 to \$200,000	16.75%	18.98%	19.39%	22.51%	1.157	1.186	+ 0.029
\$200,000 or more	26.71%	25.52%	47.27%	49.98%	1.770	1.958	+ 0.188
\$200,000 to \$500,000	9.64%	9.97%	15.42%	17.89%	1.600	1.795	+ 0.195
\$500,000 to \$1,000,000	4.23%	4.32%	8.01%	9.17%	1.894	2.123	+ 0.229
\$1,000,000 to \$1,500,000	1.89%	1.85%	3.70%	3.99%	1.953	2.160	+ 0.207
\$1,500,000 to \$2,000,000	1.21%	1.15%	2.37%	2.50%	1.969	2.179	+ 0.210
\$2,000,000 to \$5,000,000	3.13%	2.86%	6.13%	6.16%	1.957	2.151	+ 0.194
\$5,000,000 to \$10,000,000	1.89%	1.59%	3.62%	3.31%	1.908	2.075	+ 0.166
\$10,000,000 or more	4.72%	3.78%	8.02%	6.96%	1.701	1.842	+ 0.141

\* “Federal income taxes paid” equals income taxes after credits minus the refundable portions of both the Earned Income Tax Credit (EITC) and the additional child tax credit.

\*\*Certain values are negative because those income groups as a whole receive more back from the IRS (i.e., negative taxes) than they pay in federal income taxes.

Source: Internal Revenue Service, Tax Foundation calculations.

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