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Federal Transfer Payments to Low-Income Households Top \$17,000

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Fiscal Fact No. 85

On Thursday, April 26, 2007, the House Ways and Means Subcommittee on Income Security and Family Support will hold a hearing to discuss ways of reducing poverty. A recent report from the Census Bureau shows the poverty level remained stable between 2006 and 2007, but there has been a slight increase in the poverty rate since 2000.

Before the committee can answer the question, "How do we reduce poverty?" lawmakers first must have some basic facts on the amount of taxes paid by low-income Americans and the amount of spending they currently get from government.

A new Tax Foundation study, "Who Pays America's Tax Burden, and Who Gets the Most Government Spending?" shows that the typical low-income household pays \$1,684 in total federal taxes, yet receives \$17,724 in federal transfer payments alone, not to mention other federal programs such as education and public transportation.¹ In other words, the typical low-income household receives \$10.53 in transfer payments for every dollar it pays in federal taxes.

Not much more can be done through the tax system to help these households because the vast majority of low-income households pay little or no income taxes and only a modest amount of other federal taxes such as payroll and excise taxes. Indeed, some 44 million Americans file a tax return but have no income tax liability after taking advantage of their credits and deductions. An additional 15 million earn some income but not enough to be required to file an income tax return. This brings the number of Americans outside of the federal income tax system to 58 million.

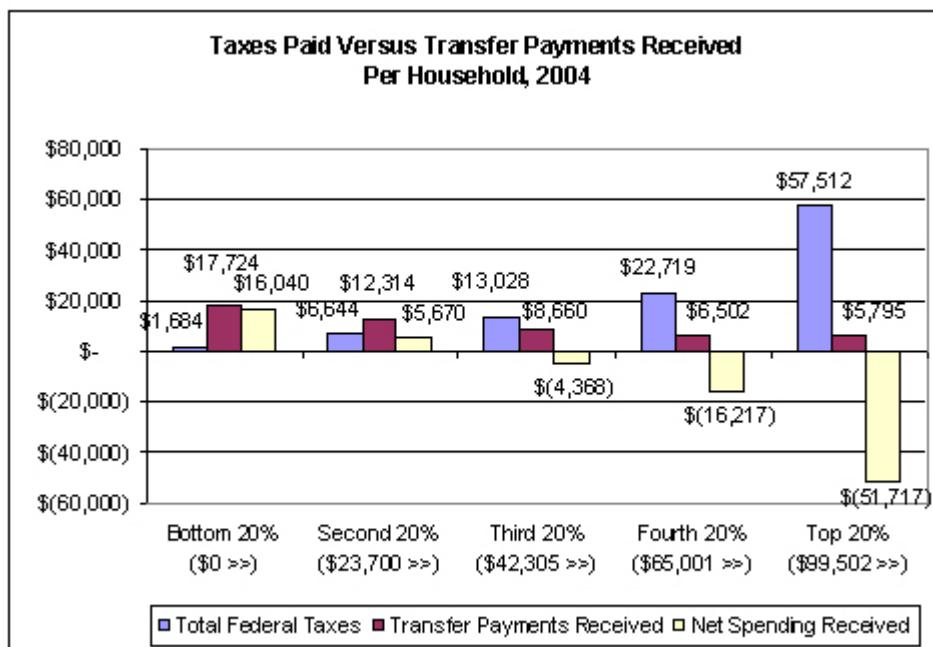
Many of those who pay no income taxes still get generous subsidies from the IRS through the Earned Income Tax Credit. Indeed, the IRS sends out some \$36 billion each year in "refundable" checks to low-income households. In many cases, these subsidies more than offset the amount these workers pay in payroll and excise taxes.

On the spending side, the federal government uses a vast array of programs to provide direct transfer payments² as its primary vehicles for poverty reduction. In 2004, transfer programs such

as Social Security, Temporary Assistance for Needy Families, Food Stamps, Medicare, and disability payments amounted to more than \$1.25 trillion.

As Figure 1 shows, the lowest-income Americans are not the only recipients of such transfer payments. Indeed, the typical household in the top 20 percent receives more than \$6,600 in transfer payments. However, \$538 billion, or 43 percent, of all transfer spending flows to the bottom income group. Net of taxes, the typical low-income household receives \$16,040 annually in federal transfer payments.

Figure 1. Taxes Paid Vs. Federal Transfer Payments Received Per Household, 2004



Source: Tax Foundation

These figures should raise a number of questions for lawmakers:

- If governments at all levels are spending \$21,294 in transfer payments for each low-income household and the poverty rate remains largely unchanged, then will more money solve the problem?
- Why is some of this spending—such as the Earned Income Tax Credit—not counted as income in the official poverty measures?
- The lines are becoming blurred between spending programs such as TANF and tax programs such as EITC. Which are most effective and efficient? And, is the tax system and the IRS the proper agent for delivering social welfare benefits?

To be sure, most Americans support efforts to reduce poverty, but any additional measures to "solve" the problem must begin with an accurate assessment of what the government is already doing for low-income households through both spending and tax programs.

Notes

1. Of course, the government directs other spending to low-income households in addition to transfer payments. Including public goods such as national defense and services such as public education, the typical low-income household receives a total of \$24,860 in federal spending—\$14.76 for every dollar it pays in federal taxes. The typical low-income household also receives \$3,569 in transfer spending from state and local governments through such programs as Medicaid, welfare and social services, and unemployment benefits. This brings the total amount of transfer spending per low-income household to \$21,294.

2. For a complete definition of direct transfer payments, see "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004" by Andrew Chamberlain and Gerald Prante

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