

# AMERICANS *for* TAX REFORM

## Federal Income Taxes: Who Pays and How Much

By  
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The Internal Revenue Service recently released official data on the payment of income taxes by different income groups, compiled from an intensive study of individual income tax returns from 2006, the latest year available. The results are shocking given the political rhetoric we hear from liberal Democrats regarding supposed Republican “tax cuts for the rich” and the need for “the rich to pay their fair share.”

This latest IRS data is shown in Table 1. It shows that the top 1% of income earners now pay 40% of federal income taxes, while earning 22% of income. The top 5% pay 60% of income taxes while earning 37% of income. The bottom 50% of income earners pay only 3% of federal income taxes.

**Table 1**  
Internal Revenue Service data, 2006

	Share of federal Income taxes	Share of Total Adjusted Gross Income
Top 1%	40%	22%
Top 5%	60%	37%
Top 10%	71%	47%
Top 25%	86%	68%

Top 50%	97%	87.5%
Bottom 50%	3%	12.5%

*Source: Internal Revenue Service*

Analyzing these numbers in conjunction with data from the Congressional Budget Office is even more instructive. The CBO data includes a breakdown by each 20% of income earners, or quintiles, from the lowest 20% of income earners to the highest 20%. This reveals more clearly what is happening with the tax burdens among the bottom 50% of income earners.

The latest CBO data, for tax year 2005, is shown in Table 2. The top 1% of income earners paid 39% of federal income taxes, while earning 18% of pre-tax income. The top 5% paid 61% of federal income taxes, while earning 31% of pre-tax income. These numbers are very similar to the IRS numbers above.

But the CBO data also shows that the middle 20% of income earners, the true middle class, paid only 4.4% of federal income taxes. The bottom 40% of income earners actually paid a negative 3.8% of federal income taxes. That means they got money back on net from the federal income tax system, rather than paying money. The top 40% paid 99.4% of federal income taxes, covering for the negative 3.8% paid to the lowest 40% of income earners.

**Table 2**  
Congressional Budget Office data, 2005

	Share of federal Income taxes	Share of Total Pre-tax Income
Top 1%	39%	18%
Top 5%	61%	31%
Top 10%	73%	41%
Top 20%	86.3%	55%
Second Highest 20%	13.1%	20%

Middle 20%	4.4%	13%
Second Lowest 20%	-0.9%	8.5%
Bottom 20%	-2.9%	4.0%

*Source: Congressional Budget Office*

This data reveals several important conclusions regarding federal tax policy today, and the result of all the changes in federal tax policy adopted since the supply side revolution beginning in the late 1970s.

First, with the top 1% of income earners paying 40% of federal income taxes, almost twice their share of income, *the rich certainly seem to be paying their fair share, and then some.* Liberal politicians who say we need to raise taxes on the rich so they will pay their fair share are either abusively misleading the public, or hopelessly ignorant regarding federal tax policy. If 40% is not fair for the top 1%, what would be fair, 50%, 100%?

Secondly, *liberal politicians wailing about Republican tax cuts for the rich are also either misleading the public, or hopelessly uninformed.* With the top 1% now paying 40% of income taxes, the top 5% paying 60%, and the top 40% paying 99.4%, where are the tax cuts for rich? Clearly, federal income taxes are overwhelmingly paid by upper income earners.

Thirdly, *the result of Reagan, Republican tax policy over the last 30 years has been to abolish federal income taxes for the working class, as well as the poor.* That is the conclusion to be drawn from the fact that the bottom 40% of income earners pay a negative 3.8% of income taxes, receiving money from the income tax system on net rather than paying into it. That started with Reagan's proposal for the Earned Income Tax Credit in the 1970s, before he even became President, which substantially reduced income taxes for these low and moderate income workers. The child tax credit first proposed by the Heritage Foundation also substantially reduced income taxes for these workers. Moreover, President Reagan's across the board 25% cut in income tax rates lowered the rates proportionally for these workers as well. President Bush further cut

income tax rates for the lowest income taxpayers by 33%, while only reducing income tax rates for the highest income earners by 11%. That certainly did not favor the rich, contrary to so much silly, crass political rhetoric.

Fourthly, *the result of Reagan, Republican tax policy over the last 30 years has been to almost abolish federal income taxes for the middle class.* That is the conclusion to be drawn from the fact that the middle 20% of income earners pay only 4.4% of federal income taxes. Hillary Clinton falsely said during the Democrat primaries this year that Republicans had cut taxes so much for the rich that it was hurting the middle class. But in light of the truth, it is hearing that ridiculously false statement coming from a top political leader that hurts.

Some argue that it is wrong to focus only on federal income taxes, and that all federal taxes should be considered in the analysis, especially payroll taxes. But that depends on what question is being analyzed. If the question is the impact of Reagan, Republican, supply side tax policies, then the federal income tax is precisely what needs to be examined, because all of those policies have involved changes in federal income taxes. Reagan, Republican tax policy has not involved any significant changes in payroll taxes at all. Similarly, if the question is the overall fairness of our federal income tax system, or what changes or policies should be adopted in that system, then the focus should be precisely on the current distribution of federal income tax burdens.

Moreover, the Reagan, Republican, supply side tax policy for the payroll tax is to phase it out completely over time and replace it with personal savings and investment accounts, which would eventually finance all of the benefits financed by the payroll tax today. This would be an enormous advantage for low and moderate income workers, the working class, and the middle class. For the first time, these workers would be able to accumulate substantial savings and capital over their working years, several hundred thousand dollars in real terms. With the accounts expanded to their full potential, middle income families could be expected to accumulate a million dollars or more. These accumulated funds would pay substantially more

than Social Security even promises, let alone what it could pay. Workers could also choose to leave some or all of the accumulated funds to their families and children, providing a major boost to the economic prospects for future generations, who could also accumulate substantial funds in their own personal accounts. What an enormous opportunity for lower income families and communities.

Finally, even considering all federal taxes, the CBO data shows that the top 1% of income earners pay 28% of all federal taxes, while earning 18% of pre-tax income. But, again, for considering the impact of past federal income tax policy changes, and what changes should be made in the future in those income tax policies, then the distribution of the federal income tax burdens is the most relevant consideration.

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