

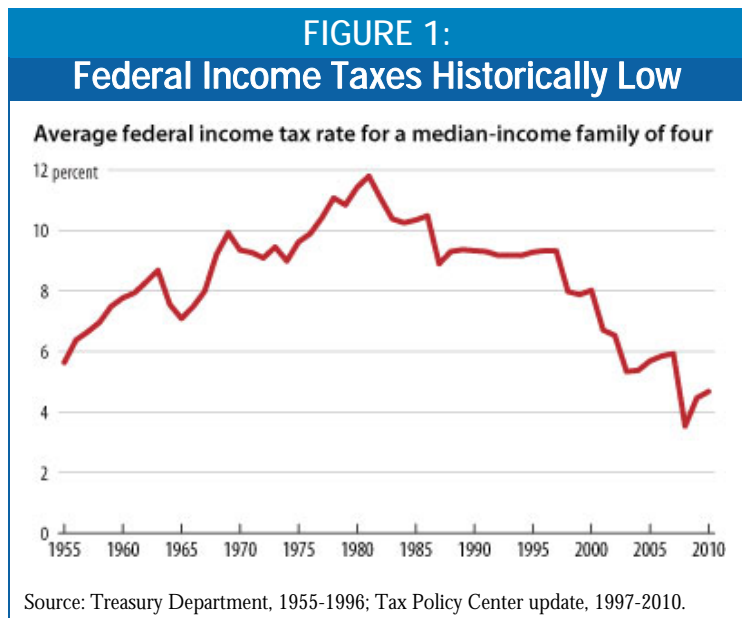
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FEDERAL INCOME TAXES ON MIDDLE-INCOME FAMILIES AT HISTORICALLY LOW LEVELS

By Chuck Marr and Gillian Brunet

Middle-income Americans are now paying federal taxes at or near historically low levels, according to the latest available data. That's true whether it comes to their federal income taxes or their total federal taxes.

- *Income taxes:* A family of four in the exact middle of the income spectrum will pay only 4.7 percent of its income in federal income taxes this year, according to a new analysis by the Urban Institute-Brookings Institution Tax Policy Center. This is the third-lowest percentage in the past 50 years, after 2008 and 2009.
- *Overall federal taxes:* Middle-income households are paying overall federal taxes — which include income as well as payroll and excise taxes — at or near their lowest levels in decades, according to the latest data from the Congressional Budget Office (CBO).



Federal Income Taxes Have Declined Significantly in Recent Decades

Federal income taxes on middle-income families have declined significantly in recent decades (see Figure 1).

In 2000, the year *before* the 2001 tax cut enacted by President Bush and Congress, the median-income family of four paid 8.0 percent of its income in individual income taxes, according to Tax

Policy Center estimates — a smaller share than in any year since 1967 (except for 1998 and 1999).¹ The Bush tax cuts further reduced middle-income tax obligations.

This year and last, the Making Work Pay tax credit, which President Obama and Congress enacted as part of the 2009 American Recovery and Reinvestment Act, is providing a credit of \$800 to married joint filers (\$400 to single filers). A median-income family with two children thus will receive an \$800 tax cut in the return it files this year.

With the Making Work Pay tax credit, the median family's federal income taxes will equal just 4.7 percent of its income in 2010. That is lower than in any year since 1955 (the first year for which these data are available) except for 2009, when taxpayers also received the Making Work Pay credit, and 2008, when another stimulus-related tax cut was in effect.

The 4.7 percent *effective* tax rate — the percentage of its income that a family pays in taxes — is well below the 15 percent *marginal* tax rate that a family of four in the exact middle of the income spectrum faces. Typically, such a family reduces its effective tax rate by taking the standard deduction (or, in some cases, itemized deductions), personal exemptions, and tax credits such as the child tax credit. The Making Work Pay tax credit further reduces that family's effective tax rate.

When taxpayers file their 2011 taxes next year, they will no longer receive the Making Work Pay credit. Instead, Congress has replaced Making Work Pay with a payroll tax reduction in 2011 of two percentage points. Most taxpayers will receive more from this payroll tax cut than they did from the Making Work Pay credit; for example, a couple with \$50,000 in wages will receive \$1,000 instead of \$800. Lower-income people will receive less under this payroll tax cut than they did under the Making Work Pay credit; for example, a full-time, minimum wage worker will receive \$300, compared to \$400 from Making Work Pay.

Overall Federal Taxes Also at Low Levels

While income taxes on middle-class households have declined in recent years, so, too, have *overall* federal taxes.

Households in the middle fifth of the income spectrum paid an average of 14.3 percent of their income in overall federal taxes in 2007, the latest year for which data are available, according to CBO.² This is just slightly above this group's effective tax rate of 13.8 percent in 2003, which was the lowest level since at least 1979.

Most Americans pay more in payroll taxes, which support Social Security and Medicare, than they

¹ Tax Policy Center, "Historical Federal Income Tax Rates for a Family of Four," April 14, 2011. The Tax Policy Center's estimates were derived by updating (using Treasury's methodology) a 1998 Treasury Department analysis that examined changes since 1955 in the percentage of income that the median-income family of four pays in federal income taxes.

² The CBO study covers the 1979-2007 period and includes federal income, payroll, and excise taxes. Congressional Budget Office, "Average Federal Tax Rates for All Households, by Comprehensive Household Income Quintile, 1979-2007," June 2010, http://www.cbo.gov/publications/collections/tax/2010/average_rates.pdf.

do in income taxes. Thus, the 14.3 percent figure reflects the impact of payroll taxes far more than income taxes.

Due to the impact of the recession and the temporary tax cuts in the Recovery Act, particularly the Making Work Pay tax credit, CBO data will likely show that middle-income families faced significantly lower effective overall federal tax rates in 2010 than in 2007.