

## Tax Burden and Distribution of “Stimulus” Payments

by Caroline Sallee, Consultant; and Patrick L. Anderson, Principal

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**Summary.** The weakening American economy has prompted an unusual bipartisan agreement between leaders in the House of Representatives and the President on a \$150 billion “fiscal stimulus package.” This bulletin analyzes the primary tool of the proposed “stimulus” package: the payments that would be sent to federal income taxpayers. In particular, we compare federal income tax burdens with eligibility to receive “rebate” payments. We summarize the data for the United States as a whole, as well as for the states of Illinois, Michigan, Texas, Virginia, and Kentucky.

We conclude:

- The proportion of taxpayers eligible for “rebate” payments varies from 86% of joint filers in Virginia to over 96% of individual filers in Michigan, Kentucky and Texas.
- A very large share of federal income taxes are paid by individuals and families that would be ineligible for “rebate” payments. Over 58% of federal income taxes paid by Michigan workers, and over 69% of income taxes paid by Texas workers, for example, are paid by individuals that would be ineligible for “rebate” payments.
- A smaller share of payments would go to taxpayers who did not earn enough to pay federal income taxes. Many of these workers would, however, have paid payroll taxes such as social security taxes. Unlike with the Earned Income Tax Credit (EITC), there is no direct relation between work, taxes paid, and the amount of the rebate or credit.
- The payments should not be considered “tax rebates.” The payments are only partially related to the taxes paid by the taxpayer; some low-income taxpayers pay no income tax but would receive a payment.
- The payment should not be considered “tax relief.” The payments cause no permanent change in incentives to work, invest, or save, nor would the agreement cause a permanent change in the federal tax burden or in the spending trajectory of the US government. The proposed payments would stimulate the economy solely by distributing money to people that would then be expected to spend it.

### Fiscal Stimulus Package

Leaders in the House of Representatives and the President last week reached agreement on a “stimulus package” that would:

- Provide payments of \$600 to individuals with adjusted gross incomes (AGI) below \$75,000, and \$1,200 payments to couples with incomes below \$150,000. A phase-out provision reduces or eliminates payments for workers earning above these thresholds.
- Provide payments of an additional \$300 per child to families that fall below the income thresholds.
- Provide payments for individuals and couples with incomes below \$3,000: \$300 for individuals, and \$600 for couples. (See “Definitions; Data Notes; Estimation Methodology” on page 5 for definition of AGI and other terms.)
- Change depreciation rules for businesses; change the size of the mortgage limit for use by government-sponsored mortgage entities; and make other changes related to business taxpayers. These are not analyzed in this bulletin.

**Preliminary Analysis Caution.** This analysis should be considered preliminary, and is based on the information available as of January 28, 2008.<sup>1</sup> Although leaders in both the Executive and Legislative

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1. The outline of the proposal analyzed here is based on the following sources: the summary posted on the White House web site; *Description of the “Economic Stimulus Act of 2008”* by the Joint Committee on Taxation (JCX-8-08, January 28 2008); and on news reports from the Associated Press, the *New York Times*, and other agencies. None of these descriptions were specific enough to fully describe a tax proposal.

branches are urging quick adoption, the bills are subject to amendment in the House and Senate. Furthermore, an enacted statute would contain specific provisions defining eligibility, phase-out, and other factors that are not currently defined.

### Who Would Benefit from the Stimulus Package?

The proposed payments would affect most federal income tax payers. Nationwide, 95% of individual tax payers and 89% of joint filers (couples) will be eligible for the fiscal stimulus payment. The proportion eligible, however, varies from state to state. The primary cause of this variance is the income thresholds, which reduce or eliminate payments to high-income taxpayers. Because the distribution of earnings, the cost of living, and the state & local tax burden, varies across the country; some states’ taxpayers will get larger aggregate distribution payments than others.

**TABLE 1. Estimate of Number of Individual and Joint Filers Eligible for Fiscal Stimulus Payment**

	Individual Returns			Joint Returns		
	Number of Returns Filed	Number Eligible for Payment	% of Filers Eligible	Number of Returns Filed	Number Eligible for Payment	% of Filers Eligible
<i>Select States:</i>						
Michigan	2,702,388	2,584,327	96%	1,860,382	1,681,037	90%
Illinois	3,616,994	3,415,658	94%	2,219,199	1,940,108	87%
Kentucky	994,347	966,465	97%	785,509	733,784	93%
Texas	5,846,107	5,592,286	96%	3,881,596	3,480,264	90%
Virginia	2,109,746	1,962,558	93%	1,431,011	1,227,291	86%
<i>United States</i>	<i>82,649,944</i>	<i>78,297,879</i>	<i>95%</i>	<i>52,607,676</i>	<i>46,805,538</i>	<i>89%</i>

*Memo:*

*Number of returns with no Adjusted Gross Income was 1.3% of all returns in the U.S. in Tax Year 2005. These individuals would qualify for half the full payment amount.*

*Note: Estimates based on Tax Year 2005 data*

*Data Source: Internal Revenue Service, Statistics of Income Division, Individual Master File System, January 2007*

*Analysis: Anderson Economic Group, LLC*

### Tax Relief? Tax “Rebates”?

The clear objective of the fiscal stimulus package is to stimulate the economy by putting money into the hands of American taxpayers, hoping they will spend it and therefore fuel consumer demand for goods and services. However, the payments are being described as “tax rebates” rather than “fiscal payments” or “checks to Americans.”<sup>2</sup> The word “rebate” means a payment back to a person that already paid some money; these payments are clearly not rebates. Some taxpayers that paid no federal income taxes will receive payments. In addition, no payments will be sent to taxpayers responsible for over half of the federal income tax paid in the United States.

Similarly, the payments should not be considered “tax relief,” for two reasons. First, the payments are only indirectly related to taxes paid. Second, the proposal would create no permanent change in incentives to

2. All the sources listed above use the term “tax rebates.”

work, invest, or save; and nothing in the agreement would cause a permanent change in the federal tax burden or in the spending trajectory of the U.S. government.

There are a number of serious questions about fiscal stimulus that we do not address in this bulletin.<sup>3</sup> However, as both the structure of the proposal and statements by proponents make clear, the payments are intended stimulate the economy solely by distributing money to people who would then be expected to spend it. For this reason, “distribution payments” or “fiscal payments” are more accurate terms than “rebate.”

## Tax Liability by Income

The U.S. has a progressive income tax system, with taxpayers with higher incomes paying a higher percentage of their income in taxes. Since the Reagan-era tax reforms, most low-income workers have had their federal income tax liability eliminated or reduced to a small fraction of their income. For example, joint filers now pay no federal income tax on the first \$20,000 of earnings. The average tax liability for taxpayers earning between \$50,000 and \$75,000 (considered “middle class” by most observers) is \$5,649. The average payment for those earning more jumps significantly; the average tax liability for Americans of all incomes is \$9,870. See Table 2.

**TABLE 2. Average Tax Liability by Size of Adjusted Gross Income, All Filers, Tax Year 2005**

All Returns		Size of Adjusted Gross Income				Not Eligible \$200,000 or more
		Eligible for Fiscal Stimulus Payment		Most Joint Filers Eligible for Fiscal Stimulus Payment		
		Under \$50,000	\$50,000 under \$75,000	\$75,000 under \$100,000	\$100,000 under \$200,000	
<i>Select States:</i>						
Michigan	\$8,088	\$1,762	\$5,548	\$8,707	\$18,072	117,714
Illinois	\$10,697	\$1,856	\$5,762	\$8,956	\$18,874	138,689
Kentucky	\$6,716	\$1,713	\$5,318	\$8,581	\$18,163	114,866
Texas	\$10,455	\$1,779	\$5,762	\$9,407	19,999	151,354
Virginia	\$10,497	\$1,884	\$5,743	\$8,949	\$18,638	113,108
<i>United States</i>	<i>\$9,870</i>	<i>\$1,828</i>	<i>\$5,649</i>	<i>\$8,892</i>	<i>\$18,604</i>	<i>\$137,027</i>

*Note: Total tax liability used to estimate average tax liability.*

*Data Source: Internal Revenue Service, Statistics of Income Division, Individual Master File System, January 2007*

*Analysis: Anderson Economic Group, LLC*

One result of this progressivity is that a large share of federal income taxes are paid by high-income taxpayers. Across the U.S., approximately 70% of the federal income taxes in 2005 were paid by taxpayers

3. Among these questions: should the federal government attempt countercyclical fiscal policy, or solely focus on long-term economic growth; should the tax system be primarily focused on minimizing disincentives and distortions, or on redistribution or fairness; whether having the federal government borrow the money for the payments, and then pay it back using future taxes, is a good idea; and whether payments (including “rebates”) are more effective as a short-term stimulus than tax rate reductions.

whose Adjusted Gross Income was \$100,000 or higher. This includes both joint taxpayers and taxpayers filing as single individuals. See Table 3.

**TABLE 3. Taxes Paid and Share of Total Taxes Paid by Adjusted Gross Income, Tax Year 2005**

	All Returns		AGI Less than \$100,000		AGI More than \$100,000	
	Amount (in thousands)	% of total taxes paid	Amount (in thousands)	% of total taxes paid	Amount (in thousands)	% of total taxes paid
<i>Select States:</i>						
Michigan	\$27,538,094	100%	\$10,364,755	37.6%	\$17,173,339	62.4%
Illinois	\$46,753,758	100%	\$13,438,529	28.7%	\$33,315,229	71.3%
Kentucky	\$8,758,762	100%	\$3,744,930	42.8%	\$5,013,832	57.2%
Texas	\$71,420,283	100%	\$20,038,019	28.1%	\$51,382,264	71.9%
Virginia	\$29,027,603	100%	\$8,368,113	28.8%	\$20,659,490	71.2%
<i>United States</i>	<i>\$989,191,350</i>	<i>100%</i>	<i>\$297,720,911</i>	<i>30.1%</i>	<i>\$691,470,439</i>	<i>69.9%</i>

*Data Source: Internal Revenue Service, Statistics of Income Division, Individual Master File System, January 2007*  
*Analysis: Anderson Economic Group, LLC*

### Taxes Paid by Taxpayers Ineligible for “Rebates”

We estimate that about 62% of federal income taxes are paid by those whose incomes would exceed the threshold under the stimulus. This varies by state, ranging from under 55% of taxes paid in Kentucky to over 69% in Texas, largely because the income distribution varies across states.<sup>4</sup> See Table 4.

**TABLE 4. Share of Taxes Paid by Those Eligible and Not Eligible for Fiscal Stimulus Payment**

	All Returns		Eligible for Fiscal Payment		Not Eligible for Fiscal Payment	
	Amount (in thousands)	% of total taxes paid	Amount (in thousands)	% of total taxes paid	Amount (in thousands)	% of total taxes paid
<i>Select States:</i>						
Michigan	\$27,538,094	100%	\$11,090,674	41.2%	\$16,179,555	58.8%
Illinois	\$46,753,758	100%	\$14,466,383	31.7%	\$31,920,848	68.3%
Kentucky	\$8,758,762	100%	\$3,897,179	45.3%	\$4,789,623	54.7%
Texas	\$71,420,283	100%	\$21,247,653	30.5%	\$49,653,795	69.5%
Virginia	\$29,027,603	100%	\$9,295,706	33.0%	\$19,458,625	67.0%
<i>United States</i>	<i>\$989,191,350</i>	<i>100%</i>	<i>\$319,539,397</i>	<i>33.1%</i>	<i>\$661,947,727</i>	<i>66.9%</i>

*Source: Anderson Economic Group, LLC*

*Note: Estimated percentage of total tax liability paid by taxpayers ineligible for fiscal payment using the IRS Statistics of Income. See Methodology on page 5.*

4. We estimate the number of tax filers not eligible (including both joint and individual returns) are: 297,406 in Michigan; 480,427 in Illinois; 79,607 in Kentucky; 655,153 in Texas; and 350,908 in Virginia.

## Differences from the EITC

It is important to note the difference between the “stimulus” payments and other policies on the incentives to work for entry-level workers. The Earned Income Tax Credit (EITC) explicitly links tax relief to work effort, earnings, and the number of children. The EITC is intended primarily to encourage work, not stimulate the economy. EITC payments are intended to increase the after-tax earnings of workers that typically earn under \$20,000 per year. Given the fact that federal income taxes have relatively high exemptions, most of the EITC is a rebate of payroll taxes such as social security.<sup>5</sup> On the other hand, payments in the stimulus package are largely unrelated to taxes paid, and those with high gross income (including investment income) are excluded. One-time payments such as those proposed in the stimulus plan are not likely to encourage or discourage work effort.

## Definitions; Data Notes; Estimation Methodology

Adjusted Gross Income (AGI) is a very broad definition of income. AGI includes wage and salary income, as well as dividends and interest, capital gains, and business income. The high-income brackets include taxpayers with consistently high wage and salary earnings, and taxpayers with lower wages but with one-time capital gains (such as from the sale of farm or other property) or business income imputed to them. Note that some other analyses of tax burden by income bracket use different definitions of “income.”<sup>6</sup>

The primary data source for the analyses in this bulletin are the IRS *Statistics of Income*, particularly the state and national data for 2005. Of course, income changes over time, as do tax rates. We did not attempt to estimate the effect of either income changes since 2005, nor changes in tax rates, in this analysis.

To estimate tax burdens under current law, and the number of distribution payments received, by income bracket, we used the following methodology:

Using the IRS *Statistics of Income* for each state, and for the nation, we estimated the share of joint filers, the share of individual filers, and the average tax liability nationally for each type of filer by size of adjusted gross income, and percentage of total tax liability paid by taxpayers ineligible for fiscal payment. Next we calculated for each state the tax burden of joint and individual filers for each AGI category by multiplying the number of joint and individual filers in each AGI category by the average tax liability for that category. Using the income thresholds as our guides, we allocated individual and joint tax liability to each category of adjusted gross income based on whether the income threshold made the filer eligible or ineligible for the fiscal payment. For the AGI category above \$100,000 but less than \$200,000, we assumed that 65% of the tax liability of joint filers came from filers with incomes above \$150,000, and thus were not eligible for the fiscal payment. We assumed that 35% of the tax liability for joint filers in this category came from filers with incomes below \$150,000.

## About Anderson Economic Group

Anderson Economic Group, LLC is a consulting firm with expertise in economics, public policy, financial valuation, market research, and land use economics. AEG has offices in Michigan, Illinois, and Texas.

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5. Because the EITC is a federal tax provision, it cannot exactly rebate payroll taxes (such as FUTA, UI, and state and local income taxes) that vary across states. Thus, in a narrow income range, some EITC filers receive credits that exceed 100% of payroll and income taxes. See Patrick L. Anderson, Caroline M. Sallee, and Alex L. Rosaen, *A Hand Up for Michigan Workers: Michigan's State Earned Income Tax Credit*, Michigan Catholic Council, January 2008. Available on the AEG web site at: <http://www.andersoneconomicgroup.com>.
  6. For example, the JTC analysis cited above defines “income” as including the employer share of FICA taxes and medicare insurance benefits. In general, using a broader definition of income causes more taxpayers to be shifted into the upper-income brackets.