CTJ Citizens for Tax Justice

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Myths and Facts about Tax Cuts

The tax cuts enacted under President George W. Bush and his allies in Congress will expire at the end of this year unless Congress acts to extend them. President Obama proposes to extend the Bush tax cuts for 98 percent of taxpayers but let them expire for the richest 2 percent. Some members of Congress, including Republican leaders in the House and Senate, oppose the President's proposal because they want the tax cuts extended for the richest 2 percent as well.

Here are some of the myths you may have heard during the debate over tax cuts, as well as the facts.

1. Myth: President Obama proposes to raise taxes on a large number of Americans.

Fact: President Obama proposes to extend the Bush tax cuts entirely for all but the richest 2.1 percent of taxpayers.

President Obama proposes to allow the Bush income tax cuts to expire at the end of this year, as scheduled, for unmarried taxpayers making over $200,000 a year and married couples making over $250,000 a year. This is only 2.1 percent of U.S. taxpayers.[1]

Even these best-off taxpayers would keep some of their Bush tax cuts, because the rate reductions for lower income tax brackets, which President Obama would make permanent, benefit people in the higher income tax brackets.

President Obama also would cut the federal tax on the estates of millionaires, but he would not make permanent the repeal of this tax that was part of the Bush tax cuts. Under Obama's proposal, only the very richest families (a fraction of one percent) would be affected by the federal estate tax.

2. Myth: The Republican approach to taxes will mean lower taxes for working people than would be the case under President Obama's proposal.

Fact: The Republican approach will actually mean *higher* taxes for many working people, since the Republicans oppose making permanent some recent improvements in the Child Tax Credit and Earned Income Tax Credit.

As stated above, only the richest 2.1 percent of taxpayers would be better off under the Republican approach to the Bush tax cuts than under President Obama's tax proposal. In addition, President Obama would make permanent improvements in the Child Tax Credit and the Earned Income Tax Credit that help working families and that were enacted on a temporary basis as part of the economic recovery act.

Republicans in Congress have made it clear that they oppose these provisions and would rather see them expire at the end of this year. As a result, the poorest three fifths of taxpayers would get a better deal, on average, under President Obama's approach than under the Republican approach.[2]

3. Myth: President Obama already has raised taxes on many Americans.

Fact: President Obama cut taxes for 98 percent of working Americans in 2009.

The economic recovery act signed into law by President Obama early in 2009 included improvements in the Child Tax Credit and Earned Income Tax Credit, relief from the Alternative Minimum Tax (AMT) and, most importantly, the Making Work Pay Credit, which provided a $400 break to most unmarried taxpayers with wages and an $800 break for most married couples with wages.

As a result, 98 percent of working taxpayers received federal income tax cuts in 2009 and no one received a federal income tax increase in 2009 or 2010.[3]

4. Myth: President Obama's tax policies will hurt small businesses.

Fact: Very few business people are rich enough to lose even a portion of the Bush tax cuts under President Obama's plan, and many of these rich business people are not really "small" business people at all.

Citizens for Tax Justice examined data on individuals who get more than half of their income from a business that they actively operate, and found that only about five percent of these individuals are rich enough to lose any portion of the Bush tax cuts under President Obama's proposal.[4]

This five percent includes many partners in law firms, hedge fund managers, high-priced accountants and other people who we would not consider "small" business taxpayers.

5. Myth: President Obama's tax policies will make it harder for small business people to make a profit and create jobs.

Fact: Income taxes are based on profits, which is what's left over after employees' wages and other expenses have been paid.

Sometimes people get the impression that higher tax rates will hurt struggling small businesses, but this is entirely false because a struggling business person (one who is not profiting) does not pay income taxes at all. A business person only pays income taxes on his or her profits.

Profits are what's leftover after a business pays wages and other expenses. This means that any income a business person uses to pay wages and other expenses is not even taxed, so tax rates have nothing to do with whether or not a business person will hire people.

6. Myth: President Obama's estate tax proposal would make death a taxable event.

> **Fact: Obama proposes to preserve the estate tax for only the very largest estates, which make up a fraction of one percent of estates.**

Under President Obama's estate tax proposal, an unmarried person could leave behind an estate worth $3.5 million, and a married couple could leave behind an estate worth $7 million, without any portion of it being subject to the federal estate tax. Other breaks can be used to allow people to leave even bigger estates behind without being subject to the tax.

Very few deaths will result in estate tax liability because very few people have this much money or assets to leave behind.[5]

Obama's estate tax proposal would also be a huge tax cut compared to what would happen if Congress simply did nothing and allowed the Bush policies to expire completely. No one expects that to happen, but if it did, then a single person could "only" leave behind $1 million without it being subject to the estate tax and a married couple could "only" leave behind $2 million without it being subject to the estate tax. Compared to that, Obama's proposal is a generous tax cut.

7. Myth: President Obama's estate tax proposal would result in double-taxing income.

> **Fact: Most of the value of estates that are subject to the estate tax is capital gains income that has never been taxed.**

Capital gain is a type of income, so it's subject to the income tax. It's the gain you enjoy if you buy something at one price and sell it later for a higher price.

If you inherit something that has appreciated in value over the years, you are not taxed on the capital gain that accrued before you owned it. This means that if your parents bought stock in 1960 for $1,000, left it to you when it was worth $10,000 and you sell it a year later for $11,000, you pay income taxes on only $1,000 of capital gain, because that's the amount that accrued to the asset when you owned it. (Even that $1,000 is taxed at lower rates than other types of income.) The other $9,000 of capital gains is exempt from the federal income tax.

In fact, over half of the value of estates subject to the federal estate tax is this sort of untaxed capital gains income.[6]

8. Myth: A lot of people don't pay any taxes because of refundable tax credits.

> **Fact: All Americans pay taxes. Some Americans don't have enough income to owe federal income taxes, but they still pay other types of federal taxes and state and local taxes.**

The federal income tax is only one tax that people pay. Everyone who works pays federal payroll taxes. Many people pay federal gas taxes and federal tobacco taxes. Everyone pays some sort of state and local taxes. These other taxes are regressive, meaning they take a larger share of income from poor and middle-class taxpayers than they take from rich taxpayers.

The federal income tax includes certain refundable credits like the Earned Income Tax Credit and the Child Tax Credit, which help offset the regressive impact of these other taxes. When a credit is refundable, that means you can benefit from it even if it reduces your income tax to less than zero. But even if you owe no federal income tax or even get a check from the IRS, you still have to pay these other types of taxes.

9. Myth: The rich pay a disproportionate share of taxes.

Fact: The rich pay a share of total taxes that is roughly equal to their share of total income.

The rich pay a disproportionate share of the federal income tax, but that's just one type of tax that people pay. When you add up all of the federal, state and local taxes that Americans pay, you find that the rich don't pay a disproportionate share.

In 2009, the richest one percent of taxpayers paid 22.1 percent of total taxes and received 20.4 percent of the total income that was received in the U.S. The next richest 4 percent of taxpayers paid 15.8 percent of the total taxes and received 14.2 percent of the total income. In other words, the share of total taxes paid by the rich is pretty close to their share of total income.[7]

Notes

1. Citizens for Tax Justice, "President Obama's Fiscal Year 2011 Budget: Federal Government Should Collect at Least as Much Revenue as Obama Proposes," February 10, 2010. http://www.ctj.org/pdf/obamabudgetfy2011.pdf

2. Citizens for Tax Justice, "Republican Approach to Extending the Bush Tax Cuts Would Result in Huge Break for Richest 1% and Higher Taxes for Middle Class, Compared to Obama's Approach," April 22, 2010. http://www.ctj.org/pdf/bushtaxcuts2010.pdf

3. Citizens for Tax Justice, "President Obama Cut Taxes for 98 Percent of Working Americans in 2009," April 13, 2010. http://www.ctj.org/obamastaxcuts.php

4. Citizens for Tax Justice, "Extending Bush Tax Cuts for High-Income 'Small Business' Owners Would Further Enrich the Wealthiest Taxpayers While Doing Nothing to Create Jobs," May 13, 2010. http://ctj.org/pdf/smallbiz2010.pdf

5. Citizens for Tax Justice, "Latest State-by-State Estate Tax Data Shows Why We Need a Strong Estate Tax," December 2, 2009. http://www.ctj.org/pdf/estatetax2009.pdf

6. James Poterba and Scott Weisbenner, "The Distributional Burden of Taxing Estates and Unrealized Capital Gains At the Time of Death," p. 19, NBER, July 2000. http://papers.nber.org/papers/w7811.pdf

7. Citizens for Tax Justice, "All Americans Pay Taxes," April 15, 2010. http://www.ctj.org/pdf/taxday2010.pdf