



The Effects of the Candidates' Tax Plans on Households at Different Income Levels: Examples

Presidential candidates John McCain and Barack Obama have both proposed to slash taxes dramatically. Senator Obama would give the very richest taxpayers a much smaller tax cut or, in some cases, a tax increase, while Senator McCain would give enormous and costly tax cuts to the richest one percent. On the other hand, Obama would give many low- and middle-income families a larger tax cut than they would receive under McCain's tax plan.

This paper examines hypothetical households that are representative of four income groups in 2012, a year when most of the provisions of the candidates' tax plans would be fully in effect if enacted. For each income group, we assume the average adjusted gross income (AGI) for that income group and then examine two types of households (a married couple with two children and a single individual) with that amount of AGI.

I. Introduction and Key Findings

We find that the hypothetical households in the bottom 20 percent and middle 20 percent of the income distribution have a larger tax cut under Obama's plan than under McCain's plan. Of the two hypothetical households in the fourth 20 percent, the family with two children has a larger tax cut under Obama's tax plan, while the single taxpayer has a larger tax cut under McCain's tax plan. Finally, the hypothetical households in the top one percent would have a tax increase that would be fairly small (as a percentage of their income) under Obama's tax plan, but they would receive breathtaking tax cuts exceeding \$270,000 under McCain's plan.

	Bottom 20%		Middle 20%		Fourth 20%		Top 1%	
	2012 Income: \$15,000		2012 Income: \$47,000		2012 Income: \$77,000		2012 Income: \$1,653,000	
	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single
Current Law <small>(Bush tax cuts expire)</small>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Bush Tax Cuts Extended <small>(does not include AMT relief)</small>	-\$285	-\$263	-\$2,168	-\$489	-\$1,000	-\$1,389	-\$61,704	-\$64,280
Obama Tax Plan <small>(including AMT relief and extension of Bush tax cuts for most)</small>	-\$1,215	-\$1,313	-\$3,342	-\$1,023	-\$3,778	-\$1,923	\$20,156	\$23,131
McCain Tax Plan <small>(including AMT repeal and extension of Bush tax cuts for all)</small>	-\$285	-\$773	-\$2,928	-\$994	-\$3,085	-\$4,019	-\$274,697	-\$271,863

We examine each hypothetical household under four scenarios. The first is "current law," meaning Congress does nothing and the Bush tax cuts expire as they are scheduled to at the end of 2010 and are therefore not in effect during the year we examine. The second scenario

is simply an extension of the Bush tax cuts. The third is the enactment of Senator Obama's tax plan (which includes the extension of the Bush tax cuts for *almost* all taxpayers, reform of the Alternative Minimum Tax, and additional tax cuts). The fourth scenario is the enactment of Senator McCain's tax plan (which includes the extension of the Bush tax cuts for all taxpayers, repeal of the Alternative Minimum Tax, and additional tax cuts mostly targeting business).

By necessity we make many assumptions to simplify these examples, meaning real-life households will usually have much more complicated tax situations. For example, we assume that all of these families use the standard deduction. (Most families in the richest one percent are likely to itemize their deductions.) We also assume that all income is "ordinary income," meaning it does not include capital gains or qualified dividends that are taxed at preferential rates. (Families in the richest one percent would be likely to have capital gains and dividend income.) These simplifying assumptions likely cause us to *understate* the tax cuts that Senator McCain's plan would provide for the richest one percent.¹

All of the tax changes calculated and illustrated in Table 1 are limited to changes in the personal income tax with one exception: We assume that our hypothetical households in the richest one percent hold corporate stock and are affected by reductions in the corporate tax as well as efforts to close loopholes used by corporations and high-income individuals. (This is explained in detail in the section on corporate tax changes.)

The Bush tax cuts generally include changes in the personal income tax and the estate tax. (We do not incorporate the estate tax into our analysis here because we assume that none of our hypothetical taxpayers will die in 2012.) The Bush tax cuts generally expire at the end of 2010. This leaves Congress and the next president facing an important question about which parts of these tax cuts should be made permanent.²

For more details on the candidates' plans and on their fiscal and distributional effects, see our longer report on the candidates' tax plans.³

II. Personal Income Tax Changes Proposed by the Candidates

Both candidates agree that the Bush personal income tax cuts should be made permanent for the vast majority of Americans, but they differ on how to treat the very richest taxpayers.

Senator McCain proposes to make the Bush income tax cuts permanent for all taxpayers — even the richest taxpayers — while Senator Obama proposes to make them permanent for *almost* all taxpayers. Specifically, Senator Obama would make the Bush income tax cuts

¹This is because McCain would make permanent the elimination of the rules that limit the use of itemized deductions for high-income people and because he would extend the top income tax rate of 15 percent for capital gains and qualified dividends. (Senator Obama would set these preferential rates at 20 percent.)

²The annual cost of extending them past the end of 2010 will be greater than the annual cost over the past 8 years (because the tax cuts have only been gradually phased in for most of the previous period) and this cost was never approved or even debated by Congress. It is reasonable then to begin any analysis with an assumption that the Bush tax cuts expire at the end of 2010 and any extension is a new tax cut.

³Citizens for Tax Justice, "The Tax Proposals of Presidential Candidates John McCain and Barack Obama," October 16, 2008. <http://www.ctj.org/pdf/presidential2008.pdf>

permanent for married couples with adjusted gross income (AGI) below \$250,000 and unmarried individuals with AGI below \$200,000. (These AGI levels would be indexed for inflation.) We project that in 2012 only 2.6 percent of taxpayers will be above this threshold.

Despite the publicity and controversy over the expanding reach of the Alternative Minimum Tax (AMT), the Bush income tax cuts do not include any permanent change to the AMT. As a result, Senator Obama's plan includes a reform of the AMT to ensure that it only affects high-income taxpayers, while Senator McCain has indicated a desire to repeal the AMT altogether.

Our calculations here assume that Obama's AMT reform would essentially make permanent the temporary AMT relief enacted by Congress recently, and also assume that McCain would fully repeal the AMT.

Both candidates would make additional changes in the personal income tax. Senator McCain proposes to increase the exemption for dependents. The dependent exemption would be increased by \$500 each year starting in 2010, until it reaches \$7,000 in 2016 (meaning this provision of McCain's plan is not yet fully phased in during the year we examine). McCain's plan does, however, give the full increase in the dependent exemption to \$7,000 immediately to families with AGI below \$50,000.

Senator McCain has also said that he wants to provide an alternative "simplified" tax that taxpayers could file under at their option. We assume that this would be similar to proposals made by former Senator Fred Thompson and Republicans in the House of Representatives involving large standard deductions and exemptions and just two income tax rates.

Our calculations here incorporate both of these changes proposed by McCain (the alternative simplified tax and the increase in the dependent exemption, including the larger increase for low-income families).

Senator Obama proposes a new "Making Work Pay" credit (MWPC) that would refund \$500 in payroll taxes (or \$1,000 for a couple if both spouses work). This is the equivalent of each working spouse getting a break from Social Security taxes on up to \$8,100 of earnings. Because the campaign says this credit will not be available to the rich, it is assumed that it would be phased out at higher income levels.

Obama also proposes to increase the Earned Income Tax Credit (EITC) for married couples with children and for childless workers.

Our calculations here incorporate both of these changes proposed by Obama (the MWPC and the EITC increases). For married couples, we assume that both spouses work and therefore the household can receive the full MWPC instead of just half.

There are several other changes that Obama has proposed for the personal income tax that we do not include in our calculations here, for simplification. For example, he proposes to offer a refundable credit of up to \$800 for mortgage interest paid by people who do not benefit from the itemized deduction for mortgage interest. He also proposes a refundable credit of up to \$4,000 for post-secondary education. He would exempt seniors with AGI below \$50,000 from income taxes. (Our hypothetical households do not include seniors.) These changes all would benefit low- and middle-income taxpayers. In other words, households in the bottom fifth or

middle fifth of the income distribution might often see larger tax cuts than what we calculate here for our hypothetical families.

But, as we explain in our longer [report](#) on the candidates' tax plans, the MWPC is the most significant of Obama's new cuts, and the EITC changes are perhaps the most likely (after the MWPC) to impact low-income households. Therefore, the calculations provided here give a good general picture of how households would be affected by Obama's tax plan.

Table 2 below shows, for our hypothetical households, the change in personal income tax liability, compared to current law, resulting from the other three policy options. Table 3 below shows the total personal income tax liability of our hypothetical families under each of the four policy options.

	Bottom 20% 2012 Income: \$15,000		Middle 20% 2012 Income: \$47,000		Fourth 20% 2012 Income: \$77,000		Top 1% 2012 Income: \$1,653,000	
	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single
	Current Law <small>(Bush tax cuts expire)</small>	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Bush Tax Cuts Extended <small>(does not include AMT relief)</small>	-\$285	-\$263	-\$2,168	-\$489	-\$1,000	-\$1,389	-\$61,704	-\$64,280
Obama Tax Plan <small>(including AMT relief and extension of Bush tax cuts for most)</small>	-\$1,215	-\$1,313	-\$3,342	-\$1,023	-\$3,778	-\$1,923	-\$8,457	-\$5,482
McCain Tax Plan <small>(including AMT repeal and extension of Bush tax cuts for all)</small>	-\$285	-\$773	-\$2,928	-\$994	-\$3,085	-\$4,019	-\$220,649	-\$217,815

	Bottom 20% 2012 Income: \$15,000		Middle 20% 2012 Income: \$47,000		Fourth 20% 2012 Income: \$77,000		Top 1% 2012 Income: \$1,653,000	
	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single	Married w/2 kids	Single
	Current Law <small>(Bush tax cuts expire)</small>	-\$5,264	\$788	\$2,278	\$5,809	\$7,320	\$14,209	\$613,654
Bush Tax Cuts Extended <small>(does not include AMT relief)</small>	-\$5,549	\$525	\$110	\$5,320	\$6,320	\$12,820	\$551,950	\$557,725
Obama Tax Plan <small>(including AMT relief and extension of Bush tax cuts for most)</small>	-\$6,479	-\$525	-\$1,064	\$4,786	\$3,542	\$12,286	\$605,197	\$616,523
McCain Tax Plan <small>(including AMT repeal and extension of Bush tax cuts for all)</small>	-\$5,549	\$15	-\$650	\$4,815	\$4,235	\$10,190	\$393,005	\$404,190

III. Why Households Are Affected Differently Under the Different Scenarios

The Bottom 20 Percent

Households in the bottom 20 percent of the income distribution are perhaps most in need of help. While many households in this group do not have income high enough to owe federal income taxes, virtually everyone who works does pay federal payroll taxes (as well as some excise taxes like the federal gasoline tax).

The Bush personal income tax cuts include only limited provisions for low-income households. Of our hypothetical households in the bottom 20 percent, the family with children receives a small benefit from a simple extension of the Bush tax cuts since this includes improvements in the child tax credit (increasing the maximum credit from \$500 to \$1,000 and making a portion of it refundable). The single individual in the bottom 20 percent receives a small benefit from an extension of the Bush tax cuts because of the reductions in the income tax rates for the lower brackets.

Both McCain and Obama would extend the Bush tax cuts for these households. Obama's plan, however, would do more, since these households would receive the Making Work Pay credit (MWPC). The hypothetical family with two children would receive most of the maximum credit for a married couple (because we assume both spouses have equal earnings) while the single taxpayer would receive the maximum credit for a single individual. The single taxpayer also benefits from the expansion in the EITC Obama proposes for childless workers, who generally have not benefitted very much from the EITC as it is currently structured.

Under McCain's tax plan, the hypothetical family with two children in the bottom 20 percent would not receive any tax cut beyond what they receive from the extension of the Bush tax cuts (the improvement in the child credit). But, under McCain's plan, the hypothetical single taxpayer in the bottom 20 percent would benefit a bit from the alternative simplified tax (AST). We assume that taxpayers would calculate their income tax liability under the regular personal income tax and then under the AST and opt for whichever results in a lower tax bill. In the case of the hypothetical single taxpayer in the bottom 20 percent, the AST would result in an income tax bill of just \$15, compared to \$788 under current law in 2012.

The Middle 20 Percent

Households in the middle 20 percent of the income distribution best exemplify "middle-class" taxpayers.

The hypothetical households in this income group would benefit more than those in the bottom 20 percent if the Bush income tax cuts are extended. The hypothetical family of four benefits from the increase in the standard deduction for married people, and an increase in the total child credit from \$500 to \$1,000. The hypothetical single taxpayer would benefit from the reduction in income tax rates in the lower brackets.

Both of these households would receive a larger tax cut under Obama's plan because of the MWPC. The family with two children would also benefit somewhat from Obama's proposed increase in the EITC.

Under McCain's tax plan, the proposed increase in the dependent exemption would give the hypothetical family of four a tax cut larger than the one they would receive under a simple extension of the Bush tax cuts, but smaller than the one they would receive under Obama's tax plan. The hypothetical single taxpayer would benefit from McCain's proposed AST, resulting in a bigger tax cut than she would receive under a simple extension of the Bush tax cuts, but smaller than the one she would receive under Obama's plan.

The Fourth 20 Percent

Households in the fourth 20 percent of the income distribution are perhaps in the position that many working people are striving towards. They are not among the richest fifth of taxpayers, but the fifth of taxpayers just below the top.

For our hypothetical households in the fourth 20 percent, the story is similar to the previous examples except that the family with children at this income level is affected by the Alternative Minimum Tax (AMT) under current law in 2012. This means that Obama's proposal to reform the AMT (which would remove this family from the AMT) makes a difference, as does McCain's proposal to repeal the AMT. Also, the hypothetical single taxpayer in this income group would benefit more under McCain's plan than Obama's plan because of McCain's proposed AST.

The Top 1 Percent

Finally, for the hypothetical households in the richest one percent, we see major differences in how the different policy options would affect taxpayers. Simply extending the Bush tax cuts would provide a tax cut in excess of \$60,000 for the family and for the single taxpayer. Obama's plan would (mostly) eliminate that tax cut for these hypothetical households. McCain's plan, on the other hand, would give these households an income tax break that is about three and half times the income tax break they would receive from a simple extension of the Bush tax cuts.

These figures only include changes in the personal income tax. As explained in the next section, we assume that our hypothetical households in the richest 1 percent would also be affected by the candidates' proposals affecting the corporations and very high-income individuals.

IV. Other Changes Proposed by the Candidates

Both candidates' tax plans include additional proposed changes that would mainly affect very rich taxpayers. We incorporate these changes in our calculations in Table 1 at the opening of this paper.

Both McCain and Obama propose to close some corporate loopholes, but McCain, unlike Obama, proposes a massive cut in the tax rate that corporations pay on their profits (from 35 percent to 25 percent) and would create new loopholes and opportunities for tax sheltering in the form of "expensing." Obama's proposals to close corporate tax loopholes and reduce tax avoidance will likely lead to tax increases (indirectly) on taxpayers with corporate stock (the majority of which is held by the richest one percent) and the wealthy beneficiaries of tax avoidance schemes. (To learn more details about the candidates' plans, see our longer [report](#).)

For corporate tax cuts and corporate tax increases (which take the form of closing corporate tax loopholes in these plans) we make the standard assumption that the effects would be born by the owners of corporate stock. We assume that the tax change resulting from these proposals for our hypothetical households in the richest one percent will be equal to the average tax change resulting from these proposals for the top one percent of taxpayers generally.

In Table 1 on the first page of this report, we simply add the average tax change from these proposals to the change in personal income tax for the households in the richest one percent. The result is that these households would see a tax increase under Obama's tax plan (although this increase would be relatively small as a percentage of the households' total income), and a massive tax cut under McCain's tax plan.

V. Conclusion

The hypothetical households here are meant to serve as examples illustrating how various tax options can affect households that are typical of a particular income group. Any actual taxpayer is likely to have a tax situation that is more complicated. However, the examples do demonstrate how many low- and middle-income families could receive larger tax cuts under Obama's tax plan than either the Bush tax cuts or McCain's tax plan would provide. They also demonstrate how McCain's plan would provide the richest households tax cuts even larger than the (considerable) tax cuts they received under Bush.