tax notes

Who Benefits From Tax Expenditures?

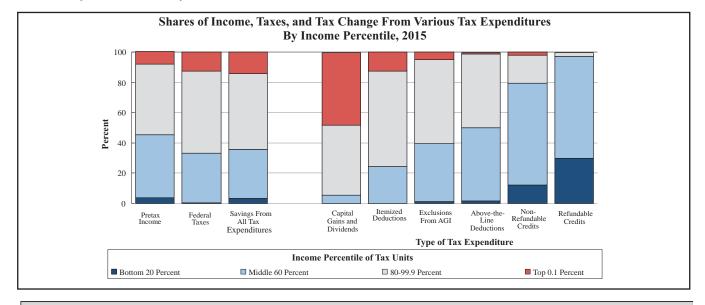
By Roberton Williams

The federal income tax is replete with tax expenditures, provisions that grant special benefits to selected taxpayers or for selected activities. Exclusions and deductions reduce taxable income, preferential rates cut the tax on specific types of income, and tax credits are subtracted directly from tax liability.

The various kinds of tax expenditures reduce taxpayers' individual income tax liability differently throughout the income distribution (see graph). More than 90 percent of the tax savings from preferential tax rates on long-term capital gains and qualified dividends go to taxpayers in the top quintile (or fifth) of the income distribution, and nearly half the benefits go to people in the top one-tenth of 1 percent. The top quintile gets about three-fourths of the savings from itemized deductions and more than 60 percent of the benefits of exclusions of selected sources of income such as employer health insurance contributions. Highincome households receive relatively larger benefits from special rates, deductions, and exclusions, because they have relatively more income from certain tax-favored sources (capital gains, dividends, tax-exempt interest) and because under our graduated income tax, exclusions and deductions are worth more to taxpayers in higher rate brackets.

In sharp contrast, most of the value of tax credits goes to households in the bottom four quintiles. Nearly 80 percent of nonrefundable credits and more than 95 percent of refundable credits benefit those households. Many credits phase out for high-income taxpayers, limiting their value, but they are a major reason why nearly half of all tax units pay no federal income tax. Nearly one-third of all refundable credits go to the poorest one-fifth of all households and often result in net payments from the government.

Overall, tax expenditures give more benefits to high-income households relative to income but are roughly proportional to tax liabilities. The top quintile collects 55 percent of all income, pays 67 percent of all taxes, and gets nearly 65 percent of the value of tax expenditures. Middle-income households earn slightly more than 40 percent of all income, pay one-third of taxes, and get one-third of tax benefits. The poorest quintile of households receives slightly less than 4 percent of both income and benefits from tax expenditures but pays only 0.5 percent of federal taxes, largely because refundable credits offset almost all their tax liabilities.





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