

Refundable Credits Have Cut Taxes For Low-Income Households

By Robertson Williams

In 1979, federal taxes claimed 8 percent of the income of households in the lowest quintile of the income distribution.¹ Over the following three decades, the average effective tax rate (ETR) — taxes as a percentage of income — fell by nearly half to 4.3 percent in 2005 (see graph). Most of the decline resulted from a sharp drop in the individual income tax, primarily due to expansion of the earned income tax credit and the child tax credit (CTC). Because the EITC is refundable and the CTC is partially refundable, they can reduce a household's tax liability below zero and generate a net payment.

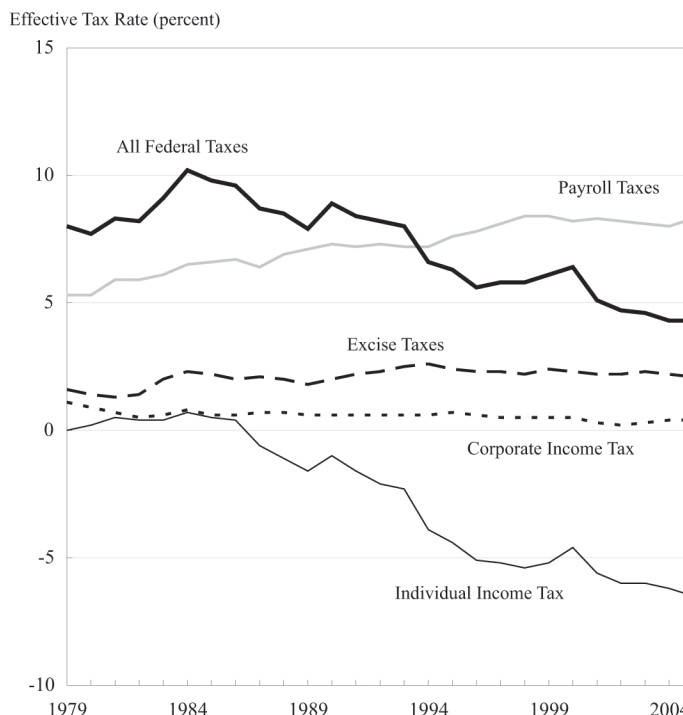
In 2005, households in the bottom quintile had an average income tax ETR of -6.5 percent — instead of paying income tax to the government, they received net payments averaging 6.5 percent of their pretax income. In contrast, payroll taxes claimed a growing share of income over that period; the payroll tax ETR for the lowest quintile climbed by more than half from 5.3 percent in 1979 to 8.3 percent in 2005. Excise and corporate income taxes together claimed about 2.5 percent of poor households' income in both years; higher excise taxes largely offset a drop in the corporate ETR.

Overall, the bottom quintile's federal ETR fell from 8 percent in 1979 to 4.3

percent in 2005. Because the growth of both the EITC and the CTC primarily affected households with children, that group saw much larger tax cuts than other types of households. Their average federal ETR plummeted from 9.1 percent to 1.3 percent. In contrast, elderly childless households saw their ETR inch down from 3.5 percent to 3 percent and the ETR for nonelderly households without children dropped from 11.1 percent to 10 percent.

For more information on taxes and the poor, visit the Tax Policy Center's *Tax Policy Briefing Book* at <http://www.taxpolicycenter.org/briefing-book/key-elements/poor/households.cfm>.

**Effective Federal Tax Rates for Households
In the Lowest Income Quintile, 1979-2005**



Source: Congressional Budget Office, Historical Effective Federal Tax Rates: 1979 to 2005, Dec. 2007, Table 1-A.
Note: "All Federal Taxes" includes individual and corporate income taxes, payroll taxes, and excise taxes.

¹Taxes for this analysis include individual and corporate income taxes, payroll taxes, and excise taxes. Congressional Budget Office estimates exclude estate taxes, tariffs, and miscellaneous taxes, all of which are inconsequential for low-income households.



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