

Held Harmless by Higher Income Tax Rates?

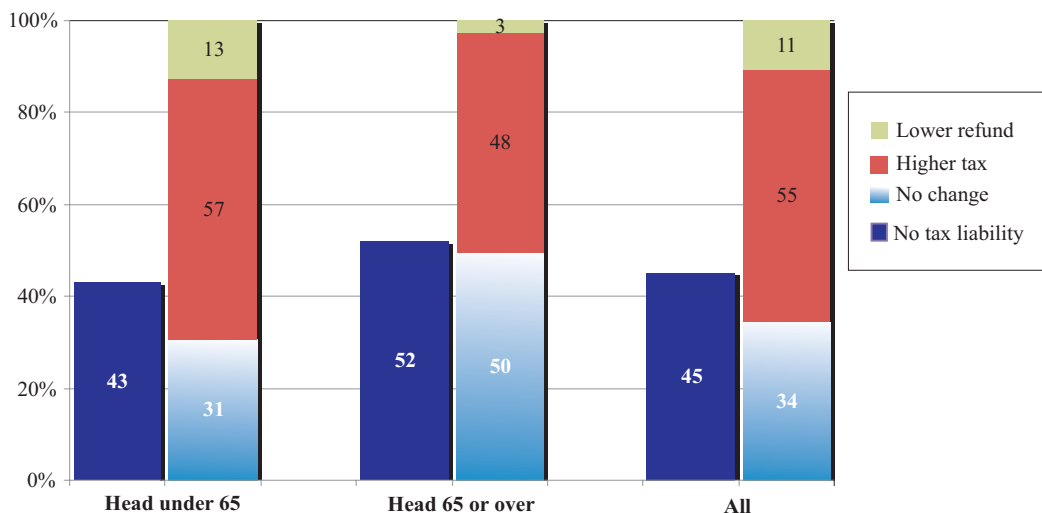
By Eric Toder and Rachel Johnson

The proliferation of tax credits has raised the number of Americans who either remit no federal income tax or receive a net income tax refund. The most requested publication on the Tax Policy Center Web site reports that nearly half (47 percent) of all tax units face zero or negative tax liability for tax year 2009. The updated figure for tax year 2010, assuming the alternative minimum tax patch is extended, is 45 percent — primarily because some temporary tax provisions in the stimulus bill have expired. People pay no income tax for one of two reasons: either they have no taxable income (almost all the elderly with no tax liability) or they can claim enough credits to offset the taxes they would otherwise owe.

This figure for those with no tax liability overstates the share of taxpayers who have “no skin in the game,” meaning their tax bills wouldn’t go up if income tax rates were raised. If all income tax rates (including AMT rates and rates on capital gains and qualified dividends) were raised by 1 percent, only 34 percent (not 45 percent) of tax units would be held harmless (see figure below) — 31 percent of those under age 65 and 50 percent of those over age 65. Many “nontaxpayers” would pay more because their net refunds decline.

Higher rates do not affect tax liability for those with no taxable income. But if taxable income is positive, higher rates raise net tax liability or reduce net tax rebates. Higher tax rates affect tax credit recipients the same way they affect beneficiaries of spending programs, such as farm subsidy payments, who may also receive government benefits in excess of the income taxes they pay. Yes, many earned income tax credit recipients do have skin in the game.

Effects of Increasing All Individual Income Tax Rates by 1 Percent
By Age Group, 2010



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-4).

Note: Proposal is a 1 percent increase in statutory tax rate, AMT rates, capital gains, and qualified dividend rates, while keeping all bracket thresholds at current law amounts. Includes both filing and nonfiling units but excludes those that are dependent on other tax units.



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