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The $31 Billion Revenue Fantasy

Those who make $200,000 a year are 3% of all taxpayers but pay 52% of all income taxes.

Speaking of the economy (see above), Congress's Joint Committee on Taxation recently dropped a study claiming that millionaires will pay $31 billion of the $36 billion in revenue that it expects will be raised next year if tax rates rise as scheduled on January 1. Naturally, Democrats are saying this proves the tax hike is a free lunch for everybody except the rich. Yada, yada, yada.

If you believe that, you probably also believed Joint Tax when it predicted that the rich would gain a huge tax windfall when tax rates were cut in 2003. Let's go to the videotape.

According to the most recent IRS data on actual tax payments, total revenues collected over the period 2003-07 were about $350 billion higher than Joint Tax and the Congressional Budget Office predicted when the 2003 tax cuts were enacted. Moreover, the wealthiest taxpayers paid a larger share of all income taxes from the beginning to the end of this period. The IRS data show that in 2003 those with incomes above $200,000 paid $313 billion in income tax. By 2007 they paid $610 billion.

Taxes and the Rich

Income taxes paid, in billions of dollars, by adjusted gross income, in 2003 and 2008

	2003	2008	Increase
$200,000 or more	$313	$537	72%
$1 million or more	132	249	89
$5 million or more	55	118	115
$10 million or more	35	84	140

Source: IRS, Statistics of Income, Table 1.1

When the recession hit, the payments fell to $537 billion in 2008. But even accounting for that decline, payments by the rich were still 65% higher five years after the rate cut that was supposedly a giveaway to the rich. The share of federal income taxes paid by the $200,000-a-year club was 42% in 2003 but 52% in 2008. (The IRS doesn't adjust these annual numbers for inflation.)

Guess what income group paid the most in higher taxes after tax rates were cut? Millionaires. From 2003 to 2008, millionaires increased their tax payments to $249 billion from $132 billion. One reason for the big increase in payments: the number of returns declaring $1 million or more in income increased 76% to 319,000 from 181,000 as the economy expanded.

The IRS data are a useful reminder of how dependent Uncle Sam is on the rich to pay the government's bills. Those who earn more than $200,000 a year in adjustable gross income, the group that Mr. Obama and the Democrats want to tax more, accounted for 3% of all taxpayers in 2008 but paid more than the bottom 97% of all taxpayers.

In part this reflects the fact that the share of income received by the top 3% of taxpayers rose to 37% in 2008 from 28% in 2003. But this is typically what happens when tax rates go down and reported income goes up. The lower the rates, the less incentive there is to avoid taxes. It's also what happens in a rising economy. If everyone's income rises by 10%, the income "gap" between rich and poor widens by definition.

We're not saying that tax cuts "pay for themselves." What we are saying is that the 2003 tax cuts proved again, as we should have learned in the 1960s and 1980s, that rich people are the most responsive to changes in tax rates. When tax rates are high, the wealthy invest less, hire accountants to protect more of their income from the IRS, and park more of their money in tax shelters, such as municipal bonds. Thus their contribution — in total dollars and as a share of total income tax payments — is smaller than it would otherwise be. The government soaks the rich less.

That's why it's a fantasy to think that raising income and capital gains and dividend tax rates on the rich is going to pry $31 billion out of millionaire households. History teaches that the best way to soak the rich and reduce the deficit is to promote rapid economic growth. But that's less likely to happen in 2011 if the economy is rear-ended with the biggest tax increase in at least 16 years.

If Democrats want to raise more revenue and have a better chance to hold the House and Senate in November, they'll extend all of the 2001 and 2003 tax rates.

Notes

[1] http://online.wsj.com/article/SB10001424052748703876404575200621394266894.html