

# **BULLSEYE ON THE POOR & MIDDLE CLASS**

**How Capital Gains and Dividend Tax Cuts  
Exacerbate Iowa's Growing Income  
Disparity**



**February 2006**

## **Executive Summary**

Income inequality has widened nationwide and Iowa is no exception. As the wealthiest 20 percent in Iowa have seen their income increase an average of \$27,969 since the early 1980's, working families have been left behind. The average income of the middle fifth of families in Iowa saw an average increase of only \$10,936, while the poorest fifth of families saw growth of only about \$3,952.

The tax policies of the current administration have exacerbated this growing income disparity in Iowa and nationwide by shifting the tax burden disproportionately to the poor and middle class. During the last five years, the top one percent of Iowa taxpayers, with average incomes of \$693,000 received an average of \$112,164 in tax breaks from the Bush administration's tax policies. Meanwhile, the middle 20 percent with average incomes of \$39,100 received, on average, a tax break of \$3,351 and the bottom 20 percent with average incomes of \$9,300 only received an average tax break of \$246.

State revenue lost directly as a result of federal tax and spending cuts has made state budget gaps wider. Iowa has faced a \$1.5 billion budget gap from 2002-2005 for programs and services mandated, but not sufficiently funded by the federal government. Nationwide, states have been forced to make up for lost revenue by increasing taxes, resulting in a 15 percent increase in the state and local share of the total tax burden from 2000 to 2003.

The capital gains and dividend tax cuts, which primarily benefit the wealthiest one percent of Americans with an average income of over \$1 million, will not expire until 2008. The Bush administration and Republican leaders in Congress however are attempting to extend those tax cuts for two years now as part of tax reconciliation.

Extending the capital gains and dividend tax cuts for two years would mean huge costs to our nation's economy – \$51 billion by 2015, according to the Joint Committee on Taxation – and to working families. While the top one percent of earners in Iowa would get an average tax cut of \$11,146, the middle 20 percent of earners would get an average cut of \$174 and the bottom 20 percent of earners would see an average cut of a mere \$1. In total, the top five percent of Iowa earners would reap 55 of all benefits to Iowa households.

At the same time the President's FY 2007 budget proposed \$14 billion in cuts to Medicaid, \$10 billion to veteran's benefits, and \$18 billion in cuts to elementary, secondary and vocational education over the next five years. The choice is clear: \$51 billion, the cost of extending the capital gains and dividend tax cuts for two years could be better spent to guarantee funding for these very important programs over the next five years.

## Introduction

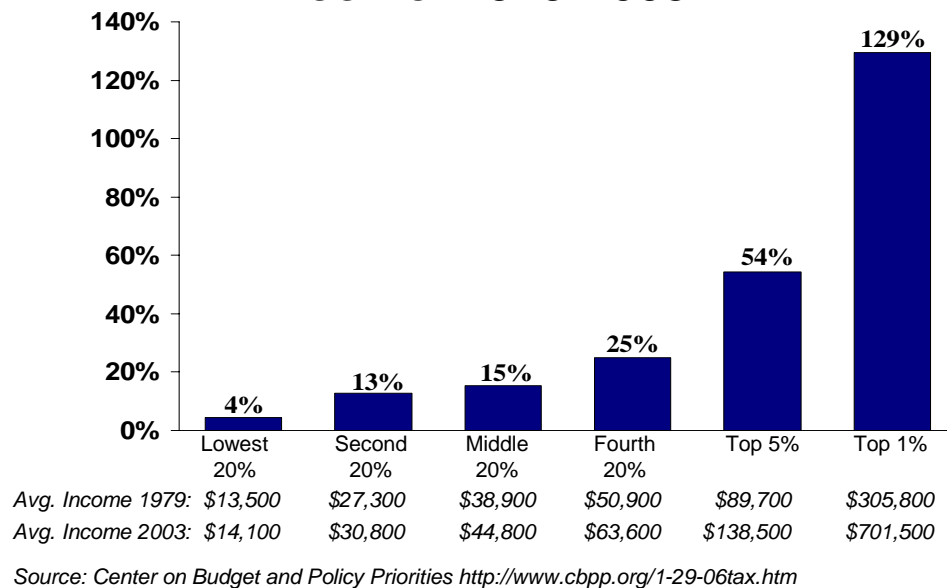
When the United States Congress returns from President's Day recess, it is expected to establish tax policy for the nation. The House of Representatives and Senate have each offered tax reconciliation bills. The House version of the bill includes a controversial two-year extension of the capital gains and dividend tax cuts; the Senate version does not. The two houses must now work out their differences in order to move to final passage. One of the most important decisions to be made is whether or not to include the extension of capital gains and dividend tax cuts.

## Recent Trends Show Income Inequality has Widened Nationwide

Over the last twenty years, income growth in America has been increasingly concentrated in the hands of the very few. Since the early 1980's, the wealthiest Americans have seen their incomes soar as the rest of Americans have seen comparatively little growth. While the top one percent of earners have seen a 129 percent increase in income since the early 1980's, the income of the middle 20 percent have seen an increase of only about 15 percent and the bottom 20 percent of earners have seen a meager growth rate of 4 percent<sup>1</sup>.

### Chart 1 – Over Last 20 years, the Income of the Wealthiest has Grown Most Rapidly

#### Change in Average After-Tax Income: 1979-2003



The total income in the United States has become increasingly concentrated in the hands of the wealthy, with the top five percent on the income spectrum holding a larger and growing share of income than is held by the bottom 40 percent of earners. Meanwhile, the bottom 40 percent of earners' share of the total income is decreasing<sup>2</sup>. The policies of the current administration have only worsened the income disparities. While programs that benefit our communities have been

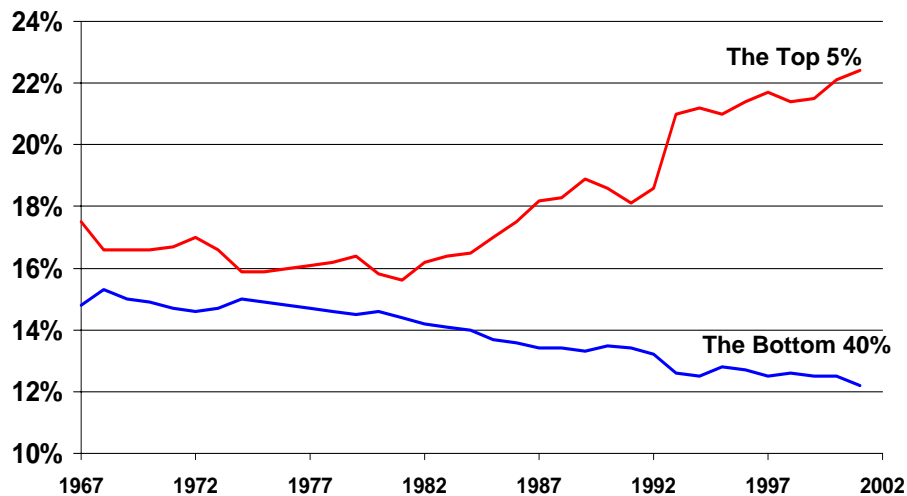
<sup>1</sup> Center on Budget & Policy Priorities, "New CBO Data Indicate Growth In Long-Term Income Inequality Continues," by Isaac Shapiro and Joel Friedman, January 29, 2006.

<sup>2</sup> U.S. Census Bureau. "Historical Income Tables - Households. Table H-2. Share of Aggregate Income Received by Each Fifth and Top 5 Percent of Households (All Races): 1967 to 2001;" last revised July 8, 2004. <http://www.census.gov/hhes/income/histinc/h02.html>

repeatedly targeted for budget cuts, the wealthy have been showered with new tax cuts. Even when compared to other industrialized nations, the income disparity in the United States is much larger<sup>3</sup>.

**Chart 2 – Concentration of Wealth: Over Last 20 years, the Share of Income of the Wealthiest five percent has Grown Relative to the Bottom 40 percent of Americans**

**Increasing Gap: Share of Total Income Received by Top 5% and Bottom 40%**

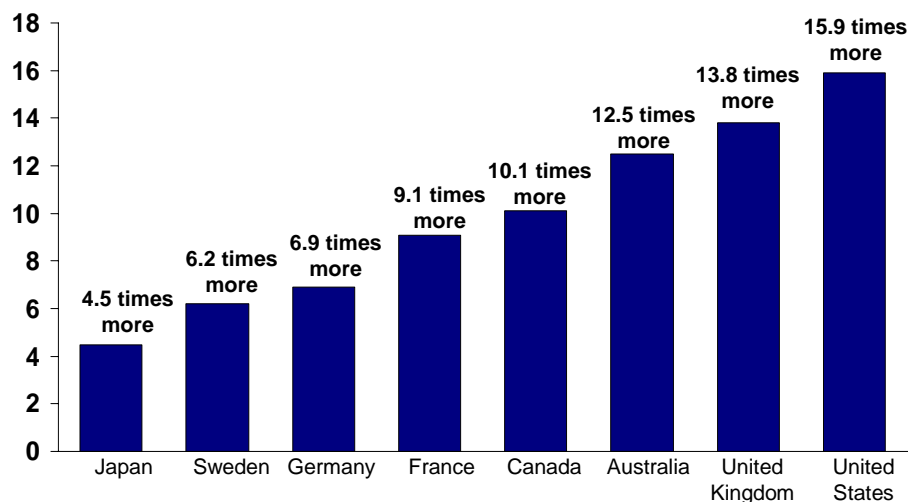


Source: U.S. Census Bureau Historical Income Tables  
<http://www.census.gov/hhes/income/histinc/h02.html>

**Chart 3– Compared to Other Industrialized Nations, Income in US is More Unequal**

**Income Disparity in US is Larger than other Industrialized Countries**

The top 10% in the US make 15.9 times more than bottom 10%



Source: Human Development Report 2005  
[http://hdr.undp.org/statistics/data/excel/hdr05\\_table\\_15.xls](http://hdr.undp.org/statistics/data/excel/hdr05_table_15.xls)

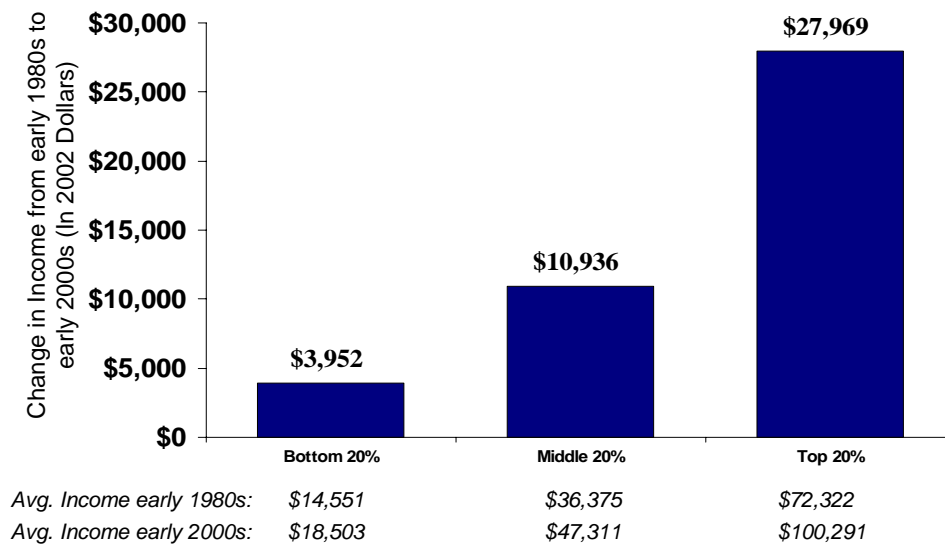
<sup>3</sup> United Nations Development Programme. "Human Development Report 2005. Table 15: Inequality in Income or Consumption." Pg 270. September, 2005. [http://hdr.undp.org/statistics/data/excel/hdr05\\_table\\_15.xls](http://hdr.undp.org/statistics/data/excel/hdr05_table_15.xls)

## In Iowa Working Families Have Been Left Behind

As in the nation as a whole, income disparity in Iowa has been a growing problem. In Iowa, the wealthiest 20 percent of households saw their income increase by \$27,969 or 39 percent from the early 1980's to the early 2000's. In the same 20-year period, Iowa families in the middle 20 percent income bracket saw growth of \$10,936 and the bottom fifth saw income growth of \$3,952<sup>4</sup>.

### Chart 4 – Wealthiest Families in Iowa have experienced largest Increase in Total Income since 1980s

#### Wealthiest Families in Iowa Have Experienced the Greatest Income Gains in the Last Two Decades



Source: Center on Budget and Policy Priorities <http://www.cbpp.org/1-26-06sfp.htm>

The data shows that even though the economy has grown significantly over the last 20 years, the benefits of that growth have overwhelmingly gone to the wealthiest. The tax policies of the Bush Administration have bolstered this growing disparity.

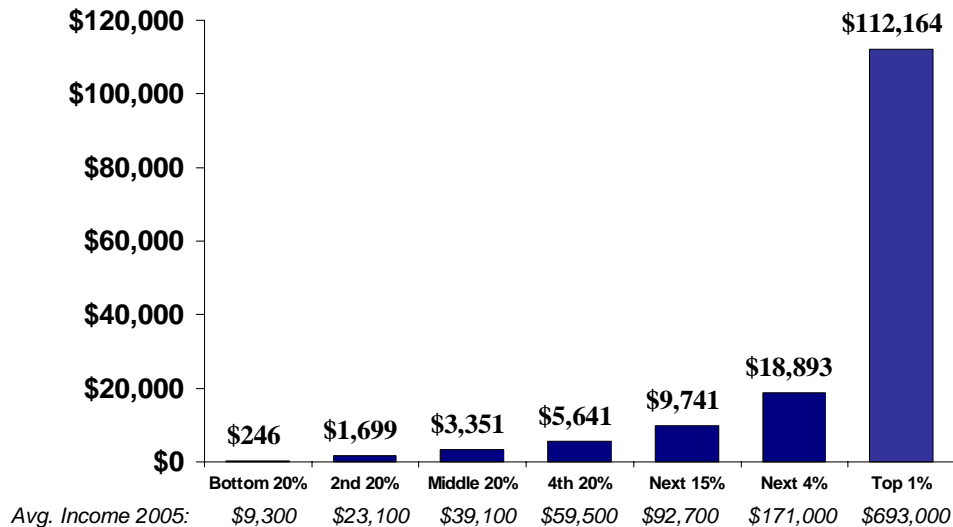
#### **Bush Administration tax policies have disproportionately benefited the wealthiest Americans and shifted financial burdens to the states.**

In 2001 and 2003, the Bush administration passed tax cuts that reduced taxes on capital gains and corporate dividends and further exacerbated the growing income gap between the wealthiest Americans and the middle class and poor.

<sup>4</sup> Economic Policy Institute / Center on Budget and Policy Priorities. "Pulling Apart: A State-by-State Analysis of Income Trends" January, 2006. <http://www.cbpp.org/1-26-06sfp.htm>

## Chart 5 – So Far Bush Tax Cuts Have Mostly Benefited the Wealthiest in Iowa

### The Wealthiest Families in Iowa Overwhelmingly Benefited from Bush Tax Cuts during 2001-2005



Source: Citizens for Tax Justice <http://www.ctj.org/pdf/gwbst06.pdf>

The Bush tax cuts so far have overwhelmingly benefited the wealthiest taxpayers in Iowa. From 2001-2005, the top one percent of Iowa taxpayers, with average incomes of \$693,000 received, on average, \$112,164 in tax breaks. Meanwhile, the middle 20 percent with average incomes of \$39,100 only received an average tax break of \$3,351 and the bottom 20 percent with average incomes of \$9,300 received an average tax break of \$246<sup>5</sup>.

States have also suffered from the Bush Administration's tax policy because it led directly to reduced state tax revenues and a ballooning federal deficit, which resulted in under-funded programs. Most states have faced significant shortfalls in under-funded programs and raised taxes to lessen the blow. From 2002-2005, Iowa was confronted with a budget gap of approximately \$1.5 billion for programs and services mandated, but not sufficiently funded by the federal government<sup>6</sup>.

From 2000 to 2003, the share of the total tax burden made up by the state and local taxes increased 15 percent nationwide. This was the largest tax shift of its kind in 50 years. This shift away from federal taxes and toward state and local taxes has also shifted the responsibility for funding public services onto the backs of middle- and lower-income taxpayers, since state and local taxes are much more regressive than federal taxes. In 2002, Americans in the 20 percent of households with the lowest income paid 11.4 percent of their income in state and local taxes, while those in the top one percent paid less than half the rate of the poorest fifth in state and local taxes -- only 5.2 percent of their income.<sup>7</sup>

<sup>5</sup> Citizens for Tax Justice, "New CTJ Estimates: State-by-State Impact of Bush Tax Cuts." February 21, 2006.

<http://www.ctj.org/pdf/gwbst06.pdf>

<sup>6</sup> AFSCME legislation department.

<sup>7</sup> United for a Fair Economy, "Shifty Tax Cuts: How They Move the Tax Burden off the Rich and onto Everyone Else," By Chuck Collins, Chris Hartman, Karen Kraut, and Gloribell Mota, April 20, 2004.

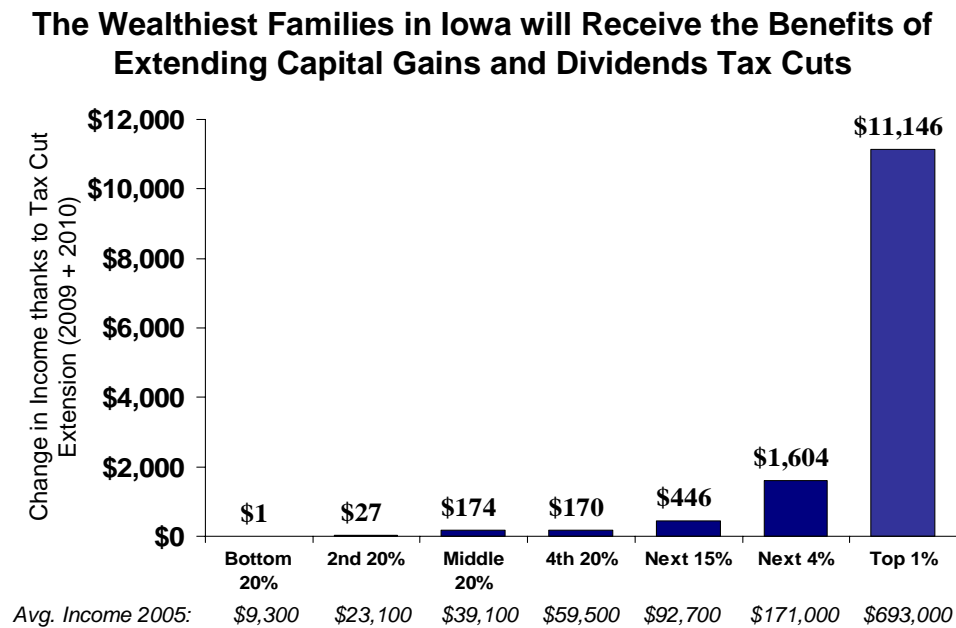
[http://faireconomy.org/Taxes/HTMLReports/Shifty\\_Tax\\_Cuts.html](http://faireconomy.org/Taxes/HTMLReports/Shifty_Tax_Cuts.html)

**Extension of the capital gains and dividend tax cuts would disproportionately benefit millionaires, exacerbating inequality.**

The capital gains and dividend tax cuts, which primarily benefit the wealthiest Americans, will not expire until 2008. The Bush administration and Republican leaders in Congress however are attempting to extend those tax cuts now as part of tax reconciliation. Most of the benefits of these tax cuts would go to the wealthiest one percent of Americans, with an average income of over \$1 million. Most Americans have their investments in retirement accounts like IRAs and 401ks that are not subject to these taxes. In fact, only 30 percent of American households hold accounts subject to capital gains and dividend taxes and more than half of all capital gains and dividend income flows to the 0.2 percent of households with annual incomes over \$1 million<sup>8</sup>.

In Iowa, 71.9 percent of all filers had annual income below \$50,000 in 2003; but this group received only 10.4 percent of the benefits from the capital gains tax cut that year. In contrast, those with incomes above \$200,000 represented 1.2 percent of all filers, but received 57.3 percent of the capital gains tax-cut benefits.<sup>9</sup>

**Chart 6 – Extension of Capital Gains and Dividends Tax Cut will only benefit the wealthiest in Iowa**



Source: Citizens for Tax Justice <http://www.ctj.org/pdf/cg1105.pdf>

The top one percent of earners in Iowa would get an average two-year tax cut of \$11,146. The middle 20 percent of earners would get an average cut of \$174 and the bottom 20 percent of earners would see an average cut of a mere \$1.<sup>10</sup> In total, the top five percent of Iowa earners would reap 55 of all benefits to Iowa households.

<sup>8</sup> Center on Budget and Policy Priorities, "Capital Gains And Dividend Tax Cuts: Data Make Clear That High-Income Households Benefit The Most," By Joel Friedman and Katharine Richards, January 30, 2006. <http://www.cbpp.org/1-30-06tax2.htm>

<sup>9</sup> Center on Budget and Policy Priorities, "IRS Data on the Capital Gains Tax Cut in Each State: Data Show Benefits Sharply Skewed To High-Income Filers," By Joel Friedman and Katharine Richards, November 7, 2005. <http://www.cbpp.org/11-7-05tax.htm>

<sup>10</sup> Citizens for Tax Justice, "Extending Capital Gains and Dividends Loopholes Would Mostly Benefit the Wealthiest one percent" November 18, 2005. <http://www.ctj.org/pdf/cg1105.pdf>

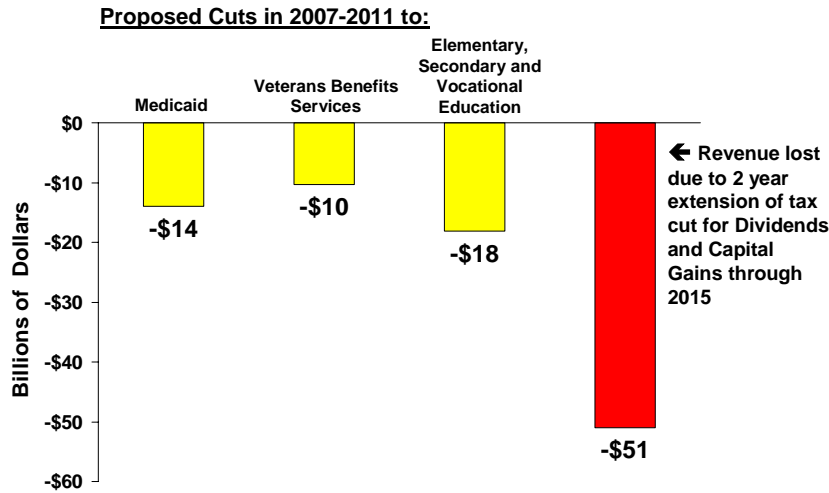
**The extension of capital gains and dividend tax cuts does not come without cost.**

In early February, Congress passed a bill that protected wealthy special interests and slashed healthcare for the poor, student loans, child support and childcare by some \$40 billion. Meanwhile the President released his Fiscal Year 2007 budget, proposing further cuts to programs such as Medicaid, veterans’ health benefits, and education. In its new budget, the Administration calls for additional net Medicaid funding cuts equal to \$14 billion over the next five years and \$35.5 billion over ten years through a combination of legislative changes and regulatory action.<sup>11</sup> The budget would also cut programs that primarily provide healthcare to veterans by some \$10 billion and elementary, secondary and vocational education by \$18 billion.<sup>12</sup> The \$51 billion the Bush administration and Republican leaders in Congress wish to give to the wealthiest Americans could have prevented many of the aforementioned cuts.<sup>13</sup>

Republican supporters claimed these cuts to services for the poor and middle class were vital to achieving fiscal discipline, but their actions in the following days belie this motive. Just days later, the Republican leadership is pushing to spend billions more on tax cuts that primarily benefit the extremely wealthy, resulting in a net increase in the deficit.

**Chart 7 – Misguided Priorities- Revenue lost through two-year extension of capital gains and dividends could be used to guarantee funding for vital programs.**

**Congress has a Choice**  
Loss in Revenue from 2 year extension of Capital Gains and Dividends Tax Break is **larger** than the proposed 2007-2011 cuts to Medicaid, Veterans Benefits, and Education



Source: Center on Budget and Policy Priorities

**The extension of capital gains and dividend tax cuts would devastate the United States economy for years to come.**

<sup>11</sup> Center on Budget and Policy Priorities, “The Administration’s Medicaid Proposals Would Shift Federal Costs To States,” By Andy Schneider, Leighton Ku, and Judith Solomon, February 14, 2006. <http://www.cbpp.org/2-14-06health.htm>

<sup>12</sup> Center on Budget and Policy Priorities, “The Hidden Cuts In Domestic Appropriations: OMB Data Reveal Deep Funding Cuts After 2007,” By Richard Kogan, Isaac Shapiro, and Katharine Richards, February 9, 2006. <http://www.cbpp.org/2-9-06bud.htm>

<sup>13</sup> Of course, all Iowa citizens, including the wealthiest, do benefit from some of the programs slated for cuts in the president's proposal.

Passage of these tax cuts for the wealthy would be detrimental to the economy and add to our nation's deficit. The tax cuts failed to produce the surge of economic activity the Bush administration promised. In fact, the economy has grown at a much slower rate than in the past. The Gross Domestic Product (GDP) grew only 13.8 percent since the president's 2001 tax cuts were passed, an average of 2.7 percent per year. Similar cycles in the past grew at a much faster rate of 16.3 percent or 3.2 percent per year.<sup>14</sup>

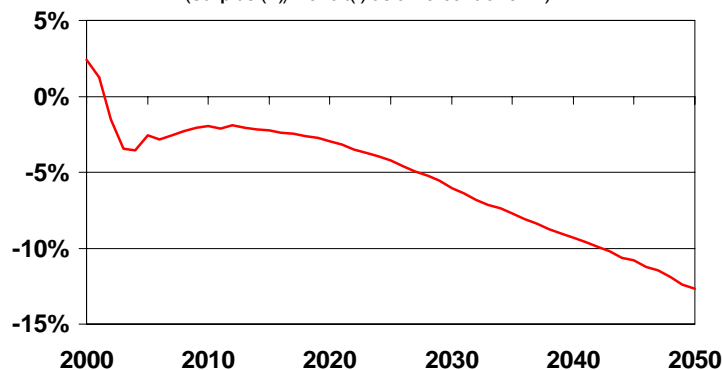
The extension of capital gains and dividend tax cuts would jeopardize the United States economy for future generations. In addition to shifting resources from middle class and poor Americans to the wealthy, this tax policy would shift the economic burden to future generations in order to benefit today's millionaires.

Republican leaders are looking to extend cuts that expire years down the road. Meanwhile the increased deficit would threaten the nation's economic growth immediately. Future generations would pay the price for these proposed tax cuts that primarily benefit the wealthy. In fact, extending the capital gains and dividend tax cuts for two years would mean huge costs to our nation's economy – \$51 billion by 2015, according to the Joint Committee on Taxation. This means that even after cutting programs for the poor and middle class to help pay for these tax breaks for the wealthy, the cuts would still cause a net increase in deficits. Even worse, the Bush administration has called for making these tax cuts permanent. The Joint Committee on Taxation estimates that continuing the cuts for each year through 2015 would cost \$148 billion.<sup>15</sup> This is not a fiscally responsible policy.

**Chart 8 – Fiscally Irresponsible. The extension of Capital Gains and Dividends will worsen an already troubling deficit picture.**

**We can't afford more Tax Breaks for Millionaires**

Under Current Policy, Deficits Would Grow Deeper in Future Decades  
(Surplus (+)/Deficit(-) as a Percent of GDP)



Source: Center on Budget and Policy Priorities long-term deficit estimates assuming continuation of current policy including extension of the tax cuts and continuation of AMT relief.

<sup>14</sup> Center for American Progress and the Economic Policy Institute, "Bush's Tax and Budget Policies Fail to Promote Economic Growth," By John Irons and Lee Price, February 16, 2006. [http://www.epinet.org/policy/20060216/bush\\_growth.pdf](http://www.epinet.org/policy/20060216/bush_growth.pdf)

<sup>15</sup> Center on Budget and Policy Priorities, Capital Gains And Dividend Tax Cuts: Data Make Clear That High-Income Households Benefit The Most, By Joel Friedman and Katharine Richards, January 30, 2006. <http://www.cbpp.org/1-30-06tax2.htm>

Conservative claims that these tax cuts will raise the values of stocks are not corroborated by a recent study by Federal Reserve economists. Similarly, an analysis by the Urban Institute-Brookings Institution Tax Policy Center found that capital gains tax rates and stock market values have been only weakly correlated over time.<sup>16</sup>

### **Conclusion**

The extension of capital gains and dividend tax cuts would escalate the growing gap between the wealthiest Americans and the middle class and poor, ravage the economy, and rob Iowa and vital programs of valuable resources. The allocation of \$51 billion for a tax cut that would primarily benefit the wealthiest Americans at the expense of so many poor and middle class Americans and already struggling states makes little sense from a policy standpoint. Whether one is among the relatively few American households affected by the capital gains and dividend tax cuts or not, the damage wreaked by the \$51 billion loss of revenue seems to overpower the benefits of these cuts. The passage of capital gains and dividend tax cuts would devastate Iowa for years to come.

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<sup>16</sup> Ibid.