



JOINT ECONOMIC COMMITTEE

CONGRESSMAN JIM SAXTON
RANKING REPUBLICAN MEMBER

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TAXPAYERS MISCLASSIFIED IN TAX DISTRIBUTION ANALYSIS

Most taxpayers know that tax burdens often differ between families with the same income. This can be due to family size, filing status, whether a family itemizes their deductions or takes the standard deduction, whether a family rents or deducts home mortgage interest payments, the source of a family's income and many other factors. Additionally, some families are more aggressive at reducing their tax liabilities than others. For example, this can be done legally by contributing to a 401(k) plan, an individual retirement account or a medical savings account, and in many other ways as well. However, this variability is not the picture portrayed in tax distribution tables, which usually group taxpayers solely by income without consideration of economic or demographic factors.

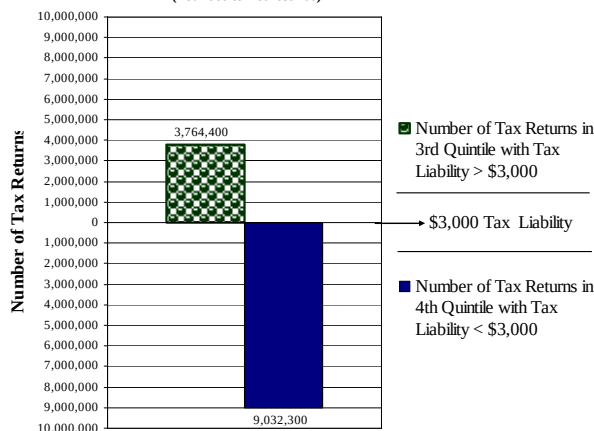
To illustrate this unevenness, consider the third and fourth income quintiles. In 2003, there were 3.8 million tax returns in the third quintile that paid more than \$3,000 in federal income taxes (Chart 1). Conversely, 9.0 million returns from the fourth quintile paid less than that amount. Despite being in a higher income

group, these returns actually paid less in income taxes than 3.8 million households in the lower-income third quintile.

Chart 2 reveals a similar pattern in the fourth and fifth quintiles. Even though they were in a lower income quintile, 2.7 million returns in the fourth quintile paid over \$7,000 in federal income tax in 2003, compared with 6.4 million tax returns in the fifth and "richest" quintile that paid less than \$7,000.

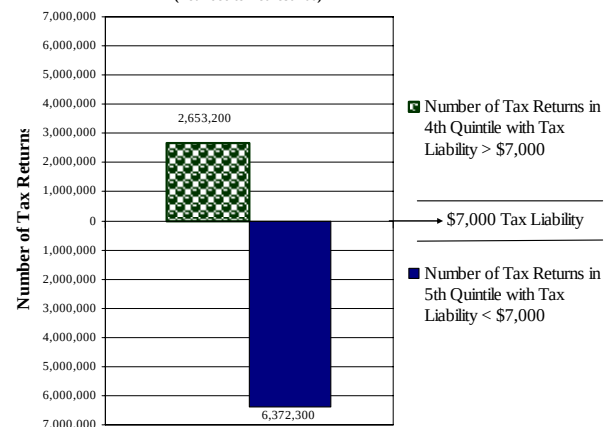
The chief lesson of Charts 1 and 2 is that in terms of tax liability, millions of taxpayers have more in common with members of a different income quintile than they do with their own, suggesting that grouping people by income can result in significant misclassification. For example, Chart 1 suggests that based on tax liability, 9.0 million taxpayers in the fourth quintile have more in common with 22.8 million taxpayers in the third quintile than they do with the other members of the fourth quintile. This contradiction cautions against using static income quintiles as the basis for measuring tax equity.

Chart 1 - Misclassified Taxpayers in the 3rd Quintile?
(Rounded to Nearest 100)



JEC Estimates based on SOI Public Use File Tax Year 2003 - Tax Liability includes AMT and refundable credits

Chart 2 - Misclassified Taxpayers in the 4th Quintile?
(Rounded to Nearest 100)



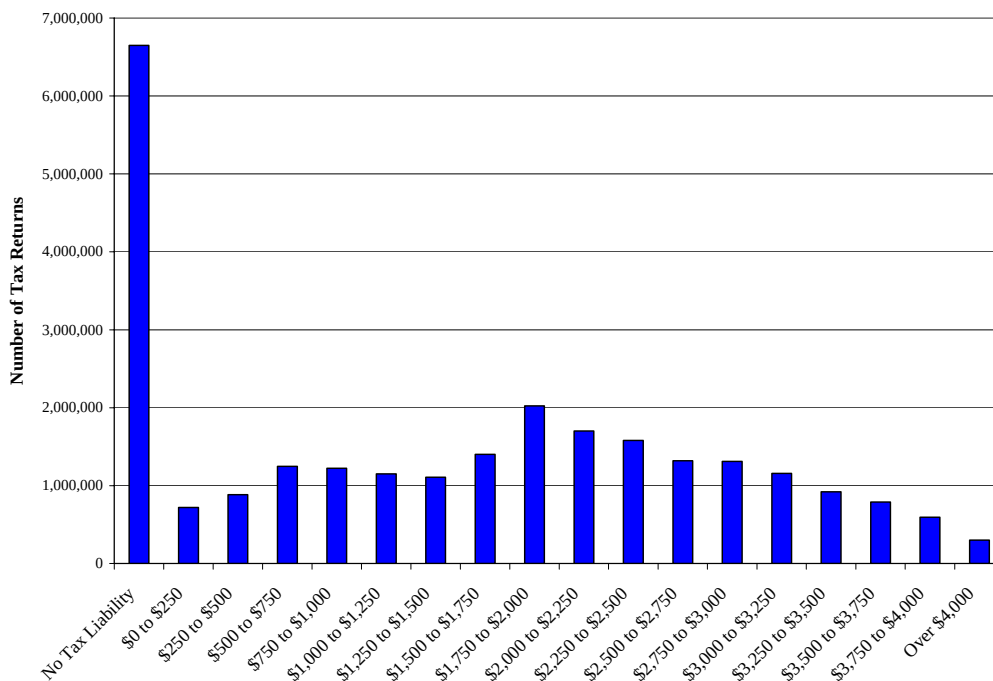
JEC Estimates based on SOI Public Use File Tax Year 2003 - Tax Liability includes AMT and refundable credits

Chart 3 further expands on the pattern of misclassified taxpayers by displaying the distribution of 2003 income tax liabilities for the middle AGI (Adjusted Gross Income) quintile. As the chart shows, tax returns in this middle income quintile had wide-ranging tax liabilities. More than one-quarter of taxpayers in this group had no income tax liability at all, while others paid amounts exceeding \$4,000. Such broad dispersion begs the question: what constitutes an accurate measure of the “average” effect of a tax change? Millions of taxpayers across this income quintile alone could be considered misclassified when grouped by AGI, because the variance in tax liability is so extreme.

Ultimately, since tax distribution tables are concerned with the amount of tax currently paid and the amount of tax that is to be paid after proposed tax legislation is enacted, it is questionable whether policy makers and the public are best served by classifying taxpayers into rigid income categories. This is especially the case when, based on actual tax payments, millions of taxpayers are more similar to taxpayers in other income categories.

The use of income categories without detailed descriptive language detailing their limitations can mislead the public by suggesting that the numbers detailed in tax distribution tables are accurate, precise and reflect a representative picture of the American taxpaying population.

Chart 3 - Dispersion of Tax Liability[†] for the Middle Quintile



Source: IRS-SOI 2003 Public Use File.

[†] Tax liability as reported on federal income tax returns, including refundable credits and AMT.

For further information, please see the following Joint Economic Committee studies by visiting the JEC website www.house.gov/jec, or contacting the JEC at (202) 226-3234.

For further information please see:

- [Tax Distribution Tables Can Be Misleading](#) (September 2007)
- [Tax Distribution Analysis and Shares of Taxes Paid – Updated Analysis](#) (October 2005)
- [The Misleading Effects of Averages in Tax Distribution Analysis](#) (September 2003)
- [A Guide to Tax Policy Analysis: Problems with Distributional Tax Tables](#) (January 2000)