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Budget Model

President Trump's Payroll Tax Holiday: Alternative Distributional Analysis

Summary: We expand our previous analysis of President Trump's proposed payroll tax holiday by considering two scenarios for how the *employer* side of the tax cut would be distributed: either to the full benefit of business owners and corporate equity holders ("profits rise") or to the full benefit of workers ("wages rise"). When profits rise, the top 1 percent of families by income receive about 29 percent of the total payroll tax cut, compared to about 4 percent of the total cut when wages rise.

Last week, PWBM analyzed President Trump's proposal for a payroll tax holiday that would suspend all payroll taxes for the remainder of 2020. Our analysis showed that the $807 billion in tax cuts would be distributionally progressive: the percent change in average after-tax incomes would be higher for lower-income groups than for higher-income groups.

Our previous analysis of the payroll tax holiday followed the budget scoring convention of assuming that cuts to the payroll tax liability of employers would pass through to workers in the form of increased wages. This assumption is based on empirical evidence showing that workers, not capital owners, bear the long-run economic burden of employer-side payroll taxes in the form of lower wages.

However, the payroll tax holiday is a temporary, short-run policy and thus the *employer*-side of the proposed payroll tax cut might not be fully distributed to workers. Businesses might be unwilling to raise wages this year only to cut them nine months later when the policy expires. The benefits of the payroll tax holiday's employer-side tax cuts would then accrue to capital (business equity) owners rather than employees.

Table 1 presents distributional measures of the payroll tax holiday's total tax change under the two opposing scenarios: one in which wages immediately rise ("wages rise") and another in which wages remain fixed ("profits rise"). We assume that any new profits are distributed in proportion to realized corporate income, and that new corporate tax liabilities associated with new profits are borne exclusively by corporate equity holders.[1]

Table 1. Distribution of Federal Tax Change, Calendar Year 2020

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- (●) Wages rise
- ( ) Profits rise

Wages rise

Income group	Average tax change	Share with a tax cut	Percent change in after-tax income	Share of tax change	Share of federal taxes paid	
					Under current law	Under the proposal
Bottom quintile	-$320	32.9%	10.7%	1.9%	0.1%	-0.6%
Second quintile	-$2,185	88.3%	9.6%	10.1%	2.3%	-0.6%
Middle quintile	-$4,240	91.4%	9.9%	18.8%	10.3%	7.1%
Fourth quintile	-$6,790	86.2%	8.8%	26.0%	19.1%	16.5%
80-90%	-$11,270	92.0%	9.4%	17.7%	14.9%	13.9%
90-95%	-$14,455	94.1%	8.5%	10.7%	10.9%	11.0%
95-99%	-$17,245	94.1%	6.1%	10.3%	16.4%	18.6%
99-99.9%	-$23,065	94.3%	2.8%	3.1%	12.7%	16.3%
Top 0.1%	-$70,175	92.7%	1.0%	1.1%	13.0%	17.5%

Profits rise

Income group	Average tax change	Share with a tax cut	Percent change in after-tax income	Share of tax change	Share of federal taxes paid	
					Under current law	Under the proposal
Bottom quintile	-$215	34.5%	7.2%	1.2%	0.1%	-0.4%
Second quintile	-$1,420	92.3%	6.2%	6.1%	2.3%	0.7%
Middle quintile	-$2,690	95.1%	6.3%	11.2%	10.3%	9.9%
Fourth quintile	-$4,860	94.2%	6.3%	17.4%	19.1%	19.9%
80-90%	-$8,625	98.3%	7.2%	12.7%	14.9%	15.9%
90-95%	-$12,795	99.1%	7.6%	8.9%	10.9%	11.9%
95-99%	-$23,235	99.4%	8.2%	13.0%	16.4%	17.7%
99-99.9%	-$82,120	99.6%	10.1%	10.2%	12.7%	13.7%
Top 0.1%	-$1,295,115	99.9%	17.9%	18.5%	13.0%	10.7%

Note: “Income” is defined as AGI plus: above-the-line deductions, nontaxable interest income, nontaxable Social Security benefits, nontaxable pensions and annuities, employer-side payroll taxes, and corporate liability. For this short-run analysis, the corporate income tax is assumed to be borne entirely by the owners of corporate equity. Federal taxes included are individual income, payroll, and corporate income taxes.

Because capital income is more concentrated than wage income, the scenario in which profits rise results in higher tax cuts for the top end of the income distribution compared with the conventional assumption that wages would rise.[2] As seen in Table 1, *average* tax liabilities would still fall for all income groups, but the average tax cut would be smaller at the bottom ($215 vs $320 for the lowest quintile) and much larger at the top ($1.3 million vs $70,000 for the top 0.1 percent) under the assumption that profits rise. The share of the tax change accruing to the top one percent of the income distribution would be just 4 percent if wages rise, but about 29 percent if profits rise. Figure 1 illustrates the difference in how *total* after-tax incomes for each income group change under the two scenarios.

Figure 1. Percent Changes in After-Tax Income, Calendar Year 2020

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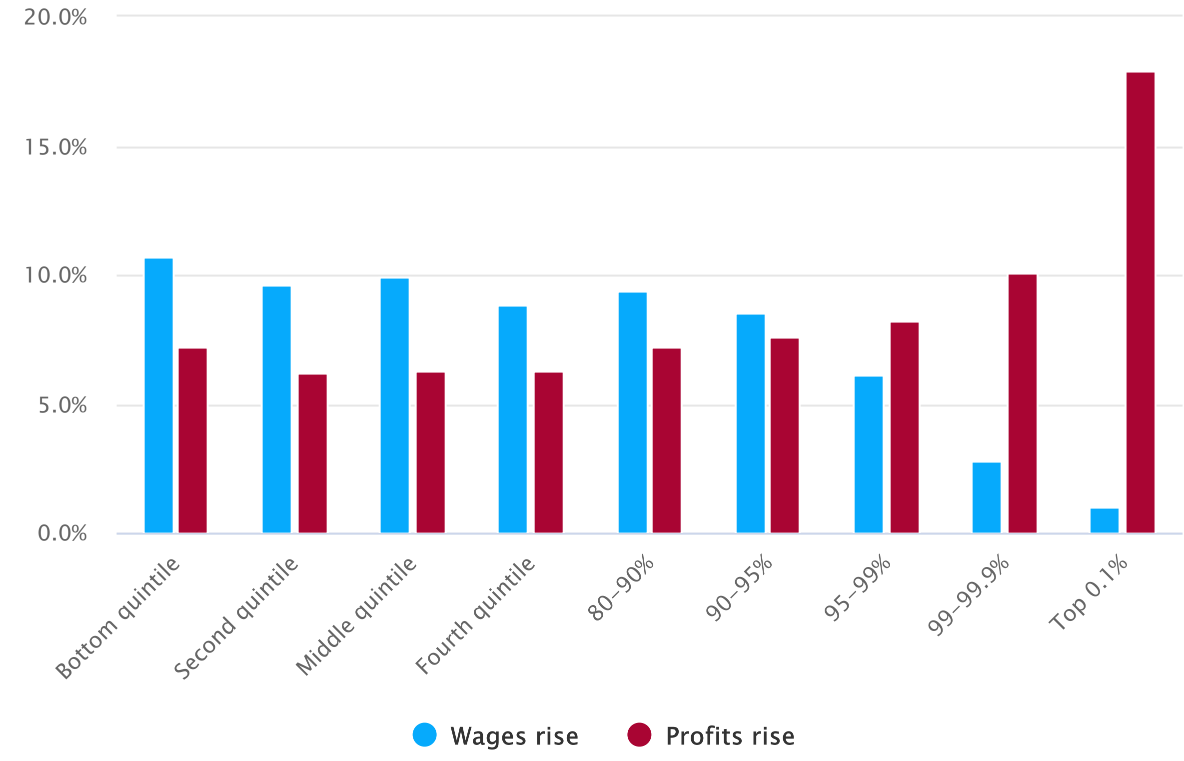

Whether the employer-side payroll tax cut is passed along to workers does not significantly affect our conventional estimates of the payroll tax holiday's budgetary impact, presented in Table 2. If employers respond to the policy by increasing wages, individual income tax revenues would rise and thus offset some of the lost payroll tax revenue. If business profits rise instead, the offset would operate through business taxes. We find that the difference in revenue raised under each scenario is close to zero.

Table 2. Conventional Revenue Estimates, Fiscal Years 2020-2029

Billions of Dollars, Change from Current-Law Baseline

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Scenario	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Total
Wages rise	-563	-244	0	0	0	0	0	0	0	0	-807
Profits rise	-593	-221	0	0	0	0	0	0	0	0	-814

John Ricco produced this analysis with writing support from Kody Carmody and Diane Lim.

1. Following recent research, we trace the ownership of corporate equity on tax data according to dividends and 25 percent of net capital gains. For sensitivity analysis, we distributed the new profits in proportion to all business income, but the results do not materially change. For corporate tax incidence, we depart from our usual 75 percent capital income/25 percent wage earnings split to emphasize the short-run nature of this policy. ↩

2. See Table 1.4 from the IRS's Statistics Of Income Tax Stats for a comparison of income composition by AGI group. ↩