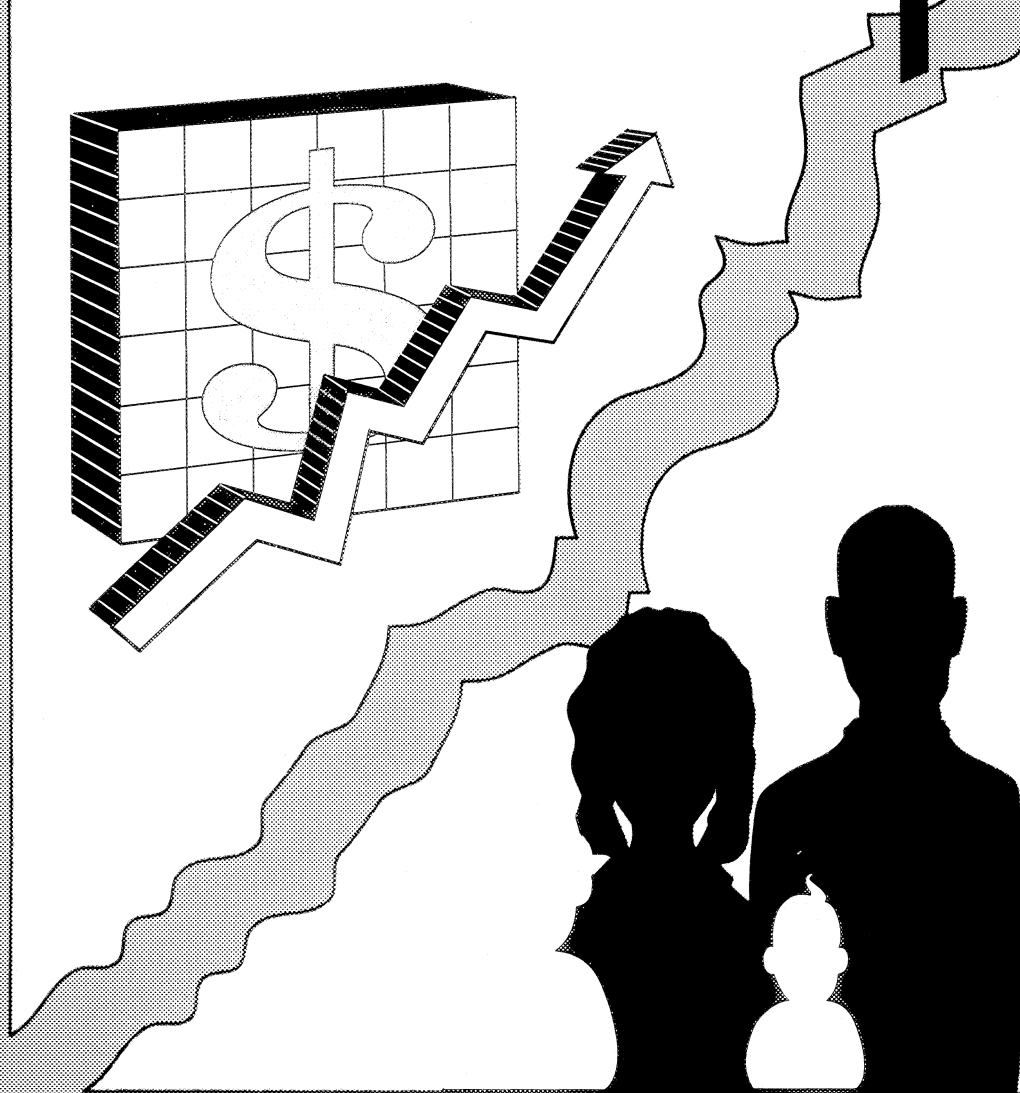


Burden or Relief?



**The Impact of Tax Policy on
Hispanic Working Families**

State of Hispanic America 1996

The National Council of La Raza (NCLR)

The National Council of La Raza (NCLR), the largest constituency-based Hispanic organization in the nation, exists to improve life opportunities for the more than 28 million Americans of Hispanic descent. A nonprofit, tax-exempt organization incorporated in Arizona in 1968, NCLR serves as an advocate for Hispanic Americans and as a national umbrella organization for more than 200 formal “affiliates,” community-based organizations serving Hispanics in 37 states, Puerto Rico, and the District of Columbia. NCLR seeks to create opportunities and address problems of discrimination and poverty through four major types of initiatives:

- ❖ Capacity-building assistance to support and strengthen Hispanic community-based organizations;
- ❖ Applied research, public policy analysis, and advocacy on behalf of the entire Hispanic community, designed to influence public policies and programs so that they equitably address Hispanic needs;
- ❖ Public information efforts to provide accurate information and positive images of Hispanics in the mainstream and Hispanic media; and
- ❖ Special catalytic efforts which use the NCLR structure and reputation to create other entities or projects important to the Hispanic community, including international projects consistent with NCLR’s mission.

NCLR is headquartered in Washington, D.C. and has program offices in Chicago, Illinois; Los Angeles, California; Phoenix, Arizona; and San Antonio, Texas.

The Poverty Project

The Poverty Project serves as NCLR’s base for information and advocacy regarding Hispanic poverty in the United States. The Poverty project develops and conducts research and policy analysis, monitors social policy and legislation, houses and maintains a Census Information center, and disseminates information and data about Latino poverty and related issues to legislators, national and local organizations, the public and private sectors, and the media.

Funding for this report was provided by the Ford and Rockefeller Foundations through their support of the Poverty Project.

BURDEN OR RELIEF?

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STATE OF HISPANIC AMERICA 1996

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Foreword

There has been much discussion recently about the financial status of American families, particularly in light of the nation's economic growth over the last few years. While many American, and Hispanic-American, families have benefited during this expansion, a large proportion of Latino families has fared quite poorly.

To our dismay, the average Hispanic family in this country is not "better off" than it was at the beginning of the decade; real earnings and income remain stagnant or are declining, and poverty rates are steadily rising. Relative to that of their White and Black counterparts, Hispanic real median family income has declined 10.1% since 1990, the number of Hispanic families in poverty has increased 36.3% over this period, and Latino families now have the lowest income levels and highest poverty rates of any major ethnic/racial group in the country. These data are especially troubling given that Hispanic men are more likely than White or Black men to be working or looking for work, and Hispanic women are increasingly likely to be business owners and hold managerial jobs.

Since the majority of Latinos are actively participating in the workforce, different public policy approaches to enhance their earnings and income levels should be identified and explored. In fact, most "traditional" anti-poverty programs do not entirely address the low income and high poverty levels our community currently experiences, and have thus not served Hispanics well. One federal initiative that has had a significant impact on Hispanic economic status is the Earned Income Tax Credit (EITC); in 1995, one-third (33.7%) of Hispanic households received the EITC, and, as a result, the after-tax poverty rate for Hispanic families was reduced by 2.9 percentage points. Such outcomes led NCLR to explore tax policy and tax reform as one means of enhancing the economic well-being of Hispanic families.

Such a strategy is also quite timely given that recent discussions on the economy have been intertwined with calls for tax cuts for "middle class" American families. In particular, this message was sounded during the 1996 presidential and congressional campaigns as candidates touted a range of plans based on the claim that families pay too much in taxes and, therefore, have less money to spend, save, or invest. Most of these plans targeted middle-income families with children; low-income families would have received few of the benefits. Moreover, the interests of working poor Hispanic families – who are especially in need of tax relief – have not been included in these debates.

To address this issue, NCLR has produced this report which we believe examines, for the first time ever, the impact that taxes at all levels of government have on Hispanic families and the potential consequences that recent tax reform proposals would have on the Latino community. We seek to include and incorporate a Hispanic perspective in discussions of economic well-being and tax reform, not only because the Latino population is benefiting least in today's economy, but also because a large and growing segment of the population, labor force, and economy is Hispanic. In fact, Hispanics are projected to be the largest U.S. minority group by 2005; two-fifths of net new entrants into the U.S. workforce in 1996 were Latino;

and the purchasing power of the Latino community is projected to be \$350 billion in 1997. Such compelling data suggest that, with each passing year, the economic well-being of Hispanics is becoming an even more decisive factor in the overall economic status of the nation. It is critical and necessary, then, to promote a Latino voice in specific tax policy debates, as well as in broader economic policy discussions.

This report advances NCLR's work to date on the issues of Latino poverty and economic status by taking a comprehensive look at the effect of tax policy on Hispanic working families. It also suggests that such an approach can be useful in building on, and expanding the values of, work and family at the core of the Latino community. Finally, it can and should serve as an initial guide on how progressive public policy can have a positive impact on Hispanic income and poverty levels, and help to eliminate the economic disparity between Hispanics and other Americans.

Raul Yzaguirre
President

Executive Summary

The following report represents one of the first efforts to document the burden taxes place on Hispanic families; analyze the fairness of individual taxes and tax systems; and identify the interests of the Latino community in tax policy and tax reform discussions. In order to determine the tax burden for Hispanic families, the National Council of La Raza (NCLR) estimated the tax liability for five different Hispanic families (separated by income level and demographic characteristics) located in California, Texas, and New York, the states which have the largest Hispanic populations. Based on this analysis, NCLR finds that for Hispanic working families:

- ◆ **Federal taxes, individual income taxes, and the Earned Income Tax Credit (EITC) are the most progressive, equitable, and least burdensome elements of the overall tax system.** The federal tax system is more progressive than state and local tax systems because both the federal individual income tax structure and the federal payroll tax overall are progressive. More specifically, federal, and state, individual income taxes are progressive because of adjustments to the tax base, i.e., deductions, exemptions, and credits, which help to lessen the burden for lower-income families. The EITC, in particular, makes the federal individual income tax the most progressive aspect of the overall tax system because it significantly reduces, or eliminates, individual income tax liability and helps offset payroll tax liability.
- ◆ **State and local taxes, the federal payroll tax, and consumption taxes are the most burdensome components of the overall tax system.** While state and local tax systems in California (Los Angeles) and New York (New York City) were progressive because of progressive income taxes, they were much less progressive than the federal system because of regressive consumption taxes. In fact, state and local sales taxes and federal and state excise taxes are the most regressive taxes overall because they are levied at flat rates on goods and services which are purchased in comparable quantities by lower- and higher-income families. However, the most burdensome tax levied on lower-income families is the federal payroll tax, which garnered the largest share of income of any tax at any level.

In accordance with these findings, to have a positive impact on the income of Hispanic workers, tax reform proposals should:

- ◆ **Reward work.** Because Latinos have both the highest labor force participation rates and lowest income levels of any racial/ethnic group, tax reform proposals should seek to strengthen the financial value or rewards that employment can offer.
- ◆ **Reach lower-income families.** While lower-income families generally are not overly burdened by the federal tax system, tax policy can be used to help raise the income levels of these families and, in the process, move many out of poverty.

-
- ◆ **Move toward greater progressivity.** The federal tax system is more progressive than state and local tax systems primarily because of the federal individual income tax; however, while the federal tax system is progressive overall, there are aspects which could be reformed, such as the federal payroll tax and federal excise taxes.

In assessing a variety of pending tax reform and tax-related policy proposals, NCLR found that:

- ◆ **A flat-rate federal individual income tax would eliminate the progressive aspects of the current federal individual income tax; increase federal, and overall, tax burdens for low-income, working Hispanic families; and could jeopardize spending on effective entitlement and discretionary programs.**
- ◆ **The adoption of a child tax credit would benefit lower-income, working Hispanic families only if the proposed change made the federal individual income tax structure more progressive.**
- ◆ **Reducing the capital gains tax rate is likely to have a negative effect on lower-income Hispanic families.**
- ◆ **Education tax credits are unlikely to benefit Hispanics substantially.**

Consistent with the principles above, NCLR believes that **policy makers** should:

- ◆ **Maintain, strengthen, and expand the Earned Income Tax Credit.** Specifically:
 - ◇ **Congress should consider increasing EITC benefits for larger families,** which are currently capped at families with two or more children.
 - ◇ **State policy makers should enact state EITCs,** which would help to lift families with year-round, full-time workers above the poverty level.
- ◆ **Resist attempts to increase payroll taxes as part of entitlement reforms.** An increased payroll tax would punish work, have its greatest negative effects on those with the lowest incomes, and would decrease progressivity in the tax system overall; moreover, it could also provide disincentives to job creation.
- ◆ **Assure that any tax credits enacted are refundable and targeted to low-income and working poor families.** To be effective, education and other tax credits should be refundable so that poor and working poor families benefit from the assistance such a credit can provide.

Furthermore, to ensure a Latino perspective in upcoming tax policy debates, NCLR recommends that:

- ◆ **Latino advocates and researchers target tax policy issues to strengthen understanding of the relationship between tax policy and the economic status of Hispanic families.**

-
- ◆ **Hispanic researchers and policy analysts:**
 - ◇ **Carry out analyses on the effects of existing and proposed tax policies by comparing Hispanic to non-Hispanic families.**
 - ◇ **Construct models which will permit analyses of aggregate effects of various policy options on Latino and non-Latino families.**
 - ◆ **Researchers carry out Hispanic-specific, “dynamic” vs. “static” analyses of proposed growth-oriented tax policies, to quantify in specific terms the purported benefits of such growth-oriented tax policies for Latinos in general and lower-income Hispanics in particular.**

The impact of proposed tax measures on Hispanics — one of the most significant segments of U.S. workers — is especially timely and warranted given that the Hispanic population is projected to become the largest U.S. minority group in approximately ten years. In addition, nearly two-thirds (65.8%) of Hispanics were in the labor force in 1995 and three-fifths (59.7%) were employed. Moreover, Hispanic families had the lowest income levels (\$24,570), and highest poverty levels (27.0%), of any major population group in the country in 1995. This report suggests that fair and progressive tax policies are one approach that policy makers at all levels can use to enable hardworking Hispanic families to increase their income, move out of poverty, and improve their economic status.

Introduction

Almost every individual in the United States pays taxes, and there have been numerous studies which have attempted to assess the impact of taxes on various populations, e.g., lower- and higher-income families. These and other studies have also sought to determine which taxes are the most equitable as they relate to specific populations. However, while a small portion of the research has focused more specifically on the Hispanic population, the income and distributional effects of federal, state, and local taxes on Latino families has rarely been addressed.* This report represents one of the first attempts to ascertain, through an analysis of average tax rates, the effect of taxes and tax policy on Hispanics – soon to become the nation's largest "minority."

In addition, there has been a heightened focus on tax issues in recent years. During the 1997 legislative session, there has already been a great deal of talk about tax reform. In particular, the Administration and/or the U.S. Congress have proposed a capital gains tax cut, targeted tax cuts, and tax credits. Many of the comments may prove to be political rhetoric, just as any combination of these ideas may be adopted. Yet, to date, the impact of tax policy on Hispanic workers and their families has not been assessed. As this report underscores, however, it is critical to consider the interests of Hispanics in these and future tax policy discussions.

Taxes, or the "revenue" side of government fiscal policy, represents a relatively new area of focus for the National Council of La Raza (NCLR). In the past, NCLR has focused principally on the "spending" side of government activity, advocating for legislation and programs which equitably serve Hispanics and against those which fail to meet the community's needs. While NCLR has been broadly active in the areas of education, poverty, immigration, housing, and civil rights, its work in the area of tax policy has been limited and includes supporting the 1986 Tax Reform Act, advocating for the expansion of the Earned Income Tax Credit (EITC), and supporting the 1993 Clinton budget and tax package. With this report, NCLR moves its economic policy work forward, and attempts to lay the groundwork for future public policy work with regard to the effect of taxes on the Hispanic community.

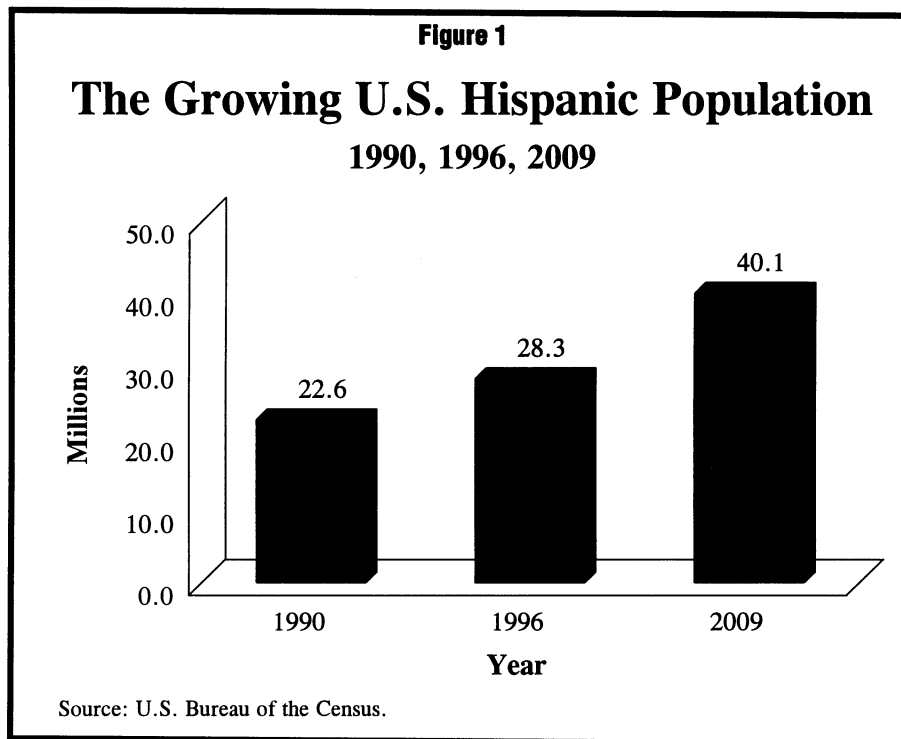
To that end, this study includes a profile of the Hispanic population and factors which affect income; an analysis of Hispanic family tax burdens; and an evaluation of the fairness of individual taxes and tax systems. The final section enumerates broad areas where future legislation would be effective in addressing the needs of Hispanics; comments on the effectiveness of current tax reform proposals; and makes tax policy recommendations. This study does not attempt to cover all aspects of tax policy as it relates to Hispanics; rather, it is an initial foray into the area. It is ultimately intended to make policy makers aware of the interests and needs of Hispanics as they relate to tax policy and tax reform, and to be a catalyst which will lead to further research, analysis, and action on related issues for Hispanics.

* The term "Hispanic" is used by the U.S. Bureau of the Census to identify Americans of Mexican American, Puerto Rican, Cuban, Central and South American, and Spanish descent. Hispanics may be of any race, and thus, White and Black families may also be Hispanic. The terms Hispanic and Latino will be used interchangeably throughout this report.

Population/Income Profile

Overview

The Hispanic population was estimated to total 28.3 million in 1996, which constituted 10.7% of the United States population.¹ The Hispanic population has grown faster than the overall U.S. population since 1990 and is projected to become the largest U.S. minority group by 2009 (see Figure 1).² The number of Hispanics increased 25.4% from 1990 to 1996, compared to 6.4% for the overall U.S. population, and Hispanics have accounted for over one-third (36.1%) of the U.S. population growth since 1990. This extreme growth in the Hispanic population is largely attributable to increased birth rates and a rise in the level of immigration. From 1990 to 1996, Hispanic women were estimated to average 106.3 births per 1,000 women age 15-44 per year, compared to 67.7 births for the total population over the same period. Immigration rates were also higher for Hispanics than for the total population from 1990 to 1996, with an estimated average of 15.1 immigrants for every 1,000 Hispanic persons per year, compared to 3.1 immigrants for all persons.^{*3}



* Percentages and rates were computed by NCLR using Census numbers in thousands.

The brief profile that follows illustrates the diversity of the U.S. Hispanic population, as well as their overall depressed economic status:

- ◆ **The Hispanic population is concentrated in certain areas of the country.** Based on U.S. Bureau of the Census population projections for 1995, approximately three-quarters (74.0%) of U.S. Hispanics resided in five states: California (34.1%); Texas (19.6%); New York (8.9%); Florida (7.3%); and Illinois (4.1%).⁴ The five cities with the largest Hispanic populations in 1990 were: New York, NY (1.8 million); Los Angeles, CA (1.4 million); Chicago, IL (0.5 million); San Antonio, TX (0.5 million); and Houston, TX (0.5 million), which constituted 20.8% of the total Hispanic population in 1990.⁵
- ◆ **The Hispanic population is very diverse, and lives primarily in central cities and in renter-occupied dwellings.** In 1994, 64.1% of the Hispanic population was of Mexican origin, 10.4% of Puerto Rican origin, 4.2% of Cuban origin, and 14.0% of Central and South American origin.⁶ Furthermore, in 1994 more than one-half (51.1%) of Hispanic families were located in central cities, and 92.4% were located in metropolitan statistical areas (MSAs), the majority (63.0%) with populations greater than 2.5 million.⁷ In addition, Hispanics are more likely to rent, and less likely to be homeowners, than White households. In 1995, 55.9% of Hispanic dwellings were renter-occupied, compared to 29.6% of White dwellings.⁸

The following section closely examines Hispanic earnings and income levels, and the factors which determine and help to explain their continued decline (see box on next page).⁹ The data reveal that while Hispanics have made significant advances in the past decade, large discrepancies in the areas of education, employment, and wages continue to exist in comparison to other major population groups; the data also suggest that these gaps tend to aggravate and perpetuate each other. Overall, data indicate that higher levels of education, expanded employment in managerial and professional occupations, and more equivalent wages would lead to increased income levels.

The following is an overview of earnings and income-related data for Hispanics:

- ◆ **The median income of both Hispanic households and families remains well below that of White households and families.** In 1995, Hispanic median *household* income (\$22,860), and Black median household income (\$22,393), was nearly two-thirds of White household income (\$35,766). Similarly, the median income of Hispanic *families* was \$24,570, and the median income of Black families was \$25,970 in 1995, compared to \$42,646 for White families.¹²
- ◆ **The median income of both Hispanic households and families has risen only slightly since 1990, and has decreased when excluding increases due to inflation.** Hispanic

* City population data broken out by race and ethnicity are only available for 1990.

** A Metropolitan Statistical Area is defined as a city with a population of at least 50,000, or a Census Bureau-defined urbanized area with a population of at least 50,000 and a total metropolitan population of at least 100,000. Hispanic origin and MSA data are only available for 1994.

*** Since earnings, which includes wages and salaries, comprised 86.1% of total Hispanic income in 1995, an analysis of contributing factors for either are applicable for both.

Income and Earnings

There are many different types and definitions of income. The definition most widely used is cash income, which includes labor income, capital income, government cash benefits, and other income, e.g., child support received. The Glossary provides a more detailed definition of each income classification. A more extensive definition of income is economic income, which incorporates not only cash income, but also government noncash benefits, and increases in wealth from the appreciation of financial assets, such as stocks and bonds, and physical assets, such as houses and land.¹⁰ The data presented in this report focus mainly on cash income, or "money income before taxes" as termed by the U.S. Bureau of the Census (the source of most of the income statistics in the report), along with earnings, principally wages and salaries. For the most part, cash income is also the definition of income used in the calculation of federal individual income taxes. The federal individual income tax definition of income includes wages and salaries; interest, dividends, and rent; unemployment compensation, and, if over a certain level, pension and Social Security benefits. When the term "income" is used in this report, it refers to cash income. In addition, when the term "earnings" is employed, it essentially refers to wages and salaries, by far the largest component of earnings.

When evaluating the earnings or income of a particular group it is necessary to find an average, with the most common being per capita (per person), mean, or median. When analyzing income or earnings by race/ethnicity, as this report does, it is better to use the median because it removes outliers and is more representative of the population as a whole. "Median income — the income of the middle family or individual in a ranking by income of all families or individuals — is usually preferred over mean (or average) income as an indicator of family well-being because it gives less weight to very large or very small incomes."¹¹

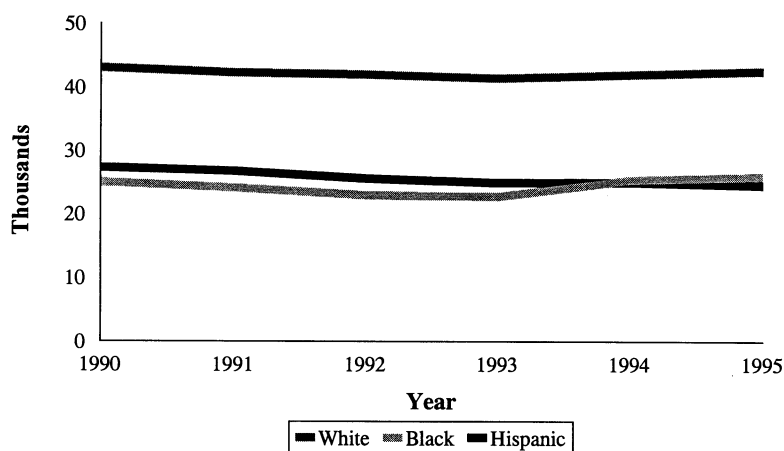
Median income can also be broken down by households, families, or total persons. This report primarily examines median household and median family income because the household or family unit is also a better indicator of economic well-being since the income levels and composition of households and families, rather than persons, better assesses the needs of the population (see Glossary for a definition of household and family). However, it should be noted that family size is still variable among families at similar income levels, and since Hispanics often have larger families than non-Hispanics (see p. 8), even median income levels fall short in measuring economic well-being, and comparing it across races/ethnicities.

median household income rose 2.4% from 1990 (\$22,330) to 1995, while median income rose 14.5% for White households and 19.9% for Black households.¹³ Hispanic median family income increased 4.9% (\$23,431 to \$24,570) over that same period, compared to a 15.5% increase for White families and a 21.2% increase for Black families.¹⁴ However, as shown in Figure 2, when accounting for inflationary increases in income, median income levels declined for Hispanic and White households and families from

1990 to 1995, while Black median income levels increased only slightly. Real median household income fell 12.2% for Hispanics and 1.8% for Whites, and rose 2.8% for Blacks between 1990 and 1995, while the percent changes in real median family income were -10.1%, -0.9%, and 4.0%, respectively.¹⁵

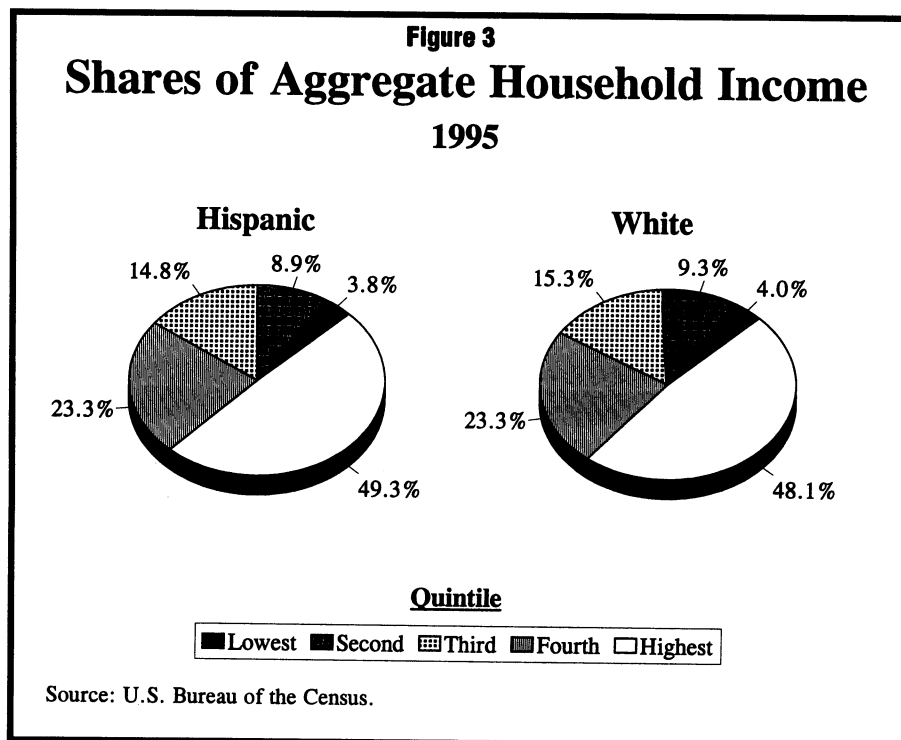
Figure 2

Falling Hispanic Real Median Family Income 1990-1995



Source: U.S. Bureau of the Census.

- ◆ **Hispanics receive a larger share of their income from earnings and wages and salaries, and less from assets, than non-Hispanics.** Earnings accounted for 86.1% of total Hispanic income, and wages and salaries 83.1%, in 1995, compared to 79.9% and 75.0%, respectively, of total White income, and 82.1% and 79.3%, respectively, of total Black income. In contrast, Social Security payments; pensions; and interest, dividends, and rent comprised a smaller share of total Hispanic income, 4.5%, 1.6%, and 2.0%, respectively, than White income, 6.5%, 3.7%, and 6.1%, and Black income, 6.1%, 2.6%, and 2.0%, respectively.¹⁶
- ◆ **While a substantial gap exists between Hispanic and White household income overall, the inequality in distribution of aggregate Hispanic household income and aggregate White household income is nearly identical.** In 1995, as Figure 3 shows, 3.8% of aggregate Hispanic household income, and 4.0% of aggregate White household income, was held by the lowest quintile for both Hispanic and White households, respectively. In contrast, 49.3% of aggregate Hispanic household income, and 48.1% of aggregate White household income, was held by the highest quintile for both Hispanic and White households, respectively, meaning aggregate income is concentrated at the highest income levels within both populations.^{*17}



* A study of income distribution is conducted as follows: first, the total number of households is divided into fifths (quintiles); second, the upper income limit is determined for each quintile; and third, total income for each quintile is computed and divided by the total income for all households to arrive at percent distribution of household income by quintile.

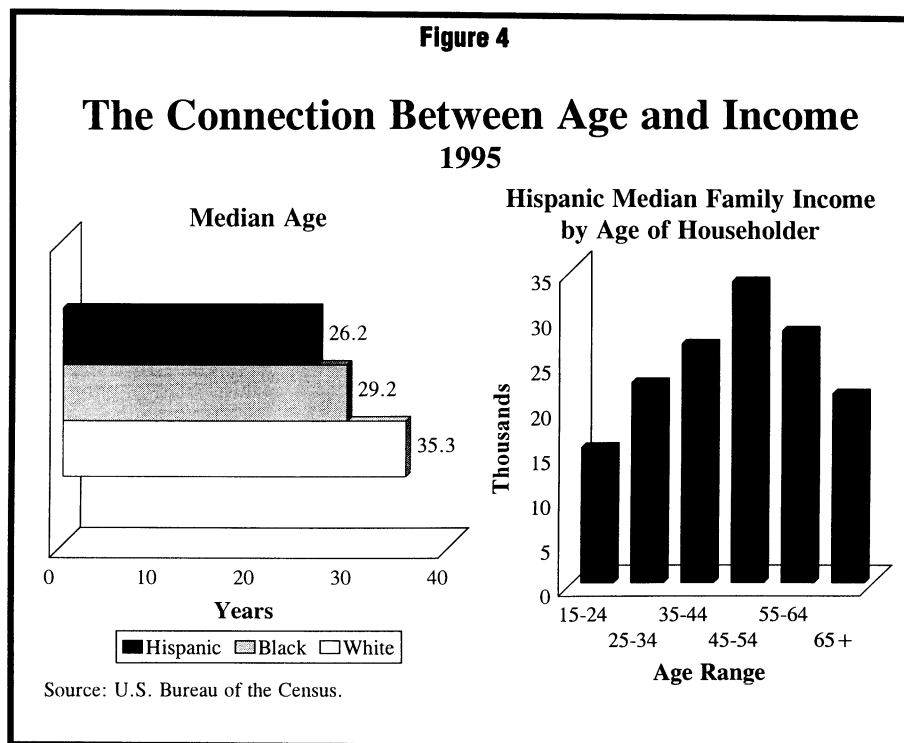
- ◆ **Poverty rates — closely related to earnings and income — for Hispanic families, and especially Hispanic families with children, remain disproportionately high.** In 1995, more than one-quarter of both Hispanic and Black families lived in poverty (27.0% and 26.4%, respectively), while the poverty rate for White families was 8.5%. Also, over one-third of Hispanic (33.2%) and Black (34.1%) families with children under 18 were poor, compared to 12.9% of comparable White families in 1995. The disparities are even more stark when comparing Hispanic and non-Hispanic married-couple families with children. In 1995, 22.6% of Hispanic married-couple families with children were poor, compared to 9.9% of comparable Black families and 7.0% of comparable White families.¹⁸

Factors Affecting Income

There are a number of factors, outlined in detail below, which determine and help explain Hispanic earnings and income levels.¹⁹

Family Characteristics

- ◆ **The Hispanic population is the “youngest” of all major racial/ethnic groups, which helps to explain their low income levels.** The median age for Hispanics was estimated to be 26.2 years in 1995, while the median age for Whites and Blacks was estimated to be 35.3 and 29.2 years, respectively. In addition, more than one-third (35.2%) of Hispanics were estimated to be under age 18 in 1995, compared to one-quarter (24.9%) of Whites and nearly one-third (32.2%) of Blacks.²⁰ Furthermore, income rises as the age of the house-



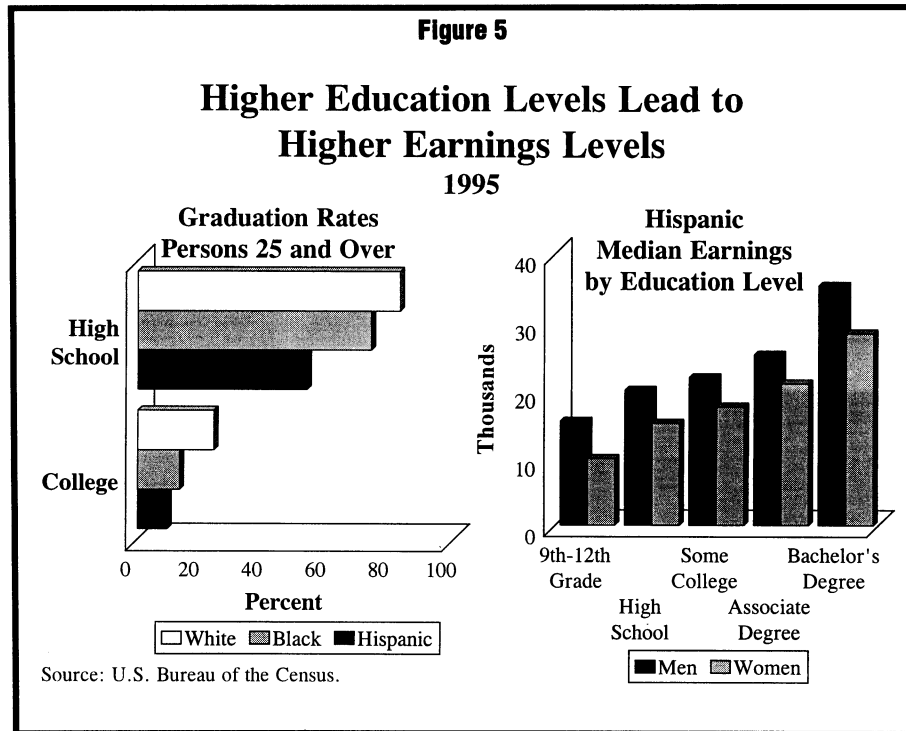
holder increases. As shown in Figure 4, in 1995, Hispanic median family income rose steadily with age, from \$15,184 for householders age 15-24, to \$33,611 for householders age 45 to 54, before it began to decline. These trends were also true of Hispanic median household, and White and Black median household and family, income.²¹

- ◆ **The majority of Hispanic households are family households, specifically married-couple families, but a significant number are also female-headed families with comparatively lower income levels.** Four-fifths (80.2%) of Hispanic households were family households in 1995, and the median income for Hispanic family households (\$25,491) was 85.0% greater than the median income for Hispanic non-family households (\$13,780). Additionally, while over two-thirds (68.3%) of Hispanic families were married-couple families in 1995, nearly one-quarter (24.0%) were female-headed families, and the median income for Hispanic married-couple families (\$30,195) was more than twice that of Hispanic female-headed families (\$14,755).²²
- ◆ **Hispanics have slightly larger families than Blacks and Whites and larger families generally have lower income levels.** In 1994, the average size of Hispanic families was 3.93 persons, compared to 3.50 persons for Black families and 3.14 persons for White families.²³ Furthermore, Hispanic median family income was much higher for Hispanic families without children than for families with children. In 1995, the median income for Hispanic married-couple families with two or more children under 18 years was \$28,962, compared to \$10,709 for comparable female-headed families, and \$21,111 for comparable male-headed families. The median income for Hispanic families without children was \$30,265 for married-couple families, \$24,679 for female-headed families, and \$25,727 for male-headed families.²⁴ Income levels may be higher for families without children than families with children because larger families usually have younger heads of household (see data above), and higher for married-couple families than single-headed families because the latter have fewer earners. However, larger families certainly strain income levels.

Education Levels

- ◆ **Hispanics have a smaller percentage of graduates than Whites or Blacks.** As Figure 5 illustrates, in 1995, over one-half (52.9%) of Hispanic men 25 years old and over had graduated from high school, compared to over four-fifths (83.0%) of White men and nearly three-fourths (73.4%) of Black men. Likewise, the percentages of Hispanic, White, and Black women high school graduates were 53.8%, 83.0%, and 74.1%, respectively, that same year. Furthermore, 10.1% of Hispanic men 25 years old and over had completed college (Bachelor's degree or more) in 1995, compared to 27.2% of White men and 13.6% of Black men; and 8.4% of Hispanic women were college graduates, compared to 21.0% of White women and 12.9% of Black women.²⁵

* Data on size of family are only available for 1994.



- ◆ **Higher levels of educational attainment correlate with higher earnings levels.** As shown in Figure 5, Hispanic male workers with a high school diploma had median earnings of \$19,862 in 1995, while Hispanic male workers with a Bachelor's degree or more had median earnings of \$35,223. Similarly, the median earnings of Hispanic female high school and college graduates were \$13,522 and \$27,167, respectively, in 1995. However, median earnings also differ between races with the same educational background. For instance, White high school graduates had median earnings of \$26,135 (male) and \$15,133 (female), and White college graduates median earnings of \$45,228 (male) and \$28,492 (female), higher than the earnings for respective Hispanic male graduates, but not necessarily for Hispanic female graduates.*²⁶

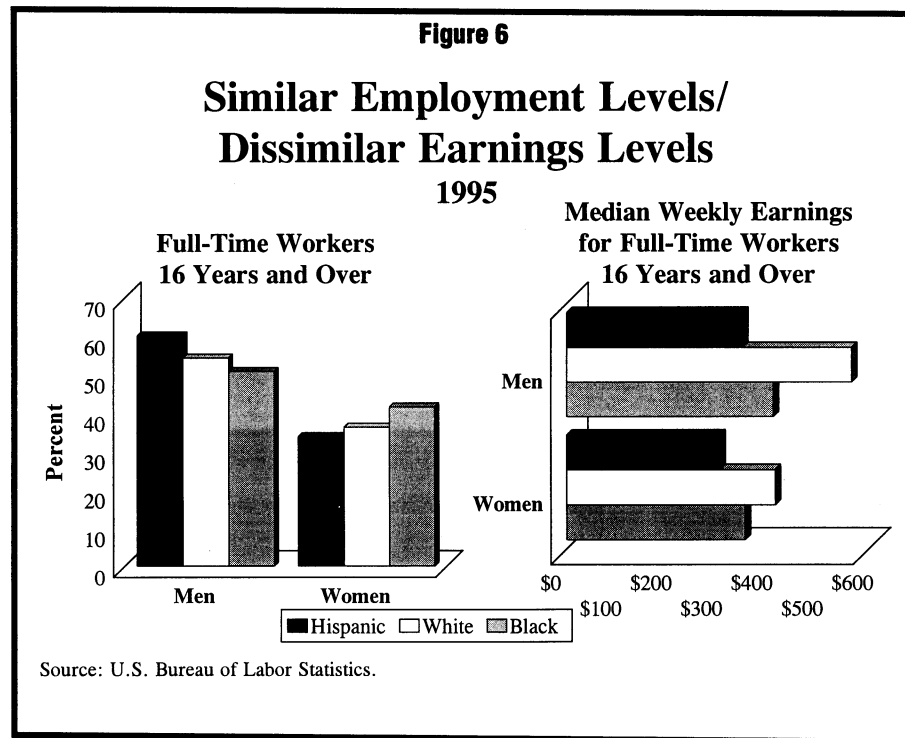
Labor Market Status

- ◆ **Hispanics comprise a significant portion of the labor force, yet continue to experience sizable gender differences in rates of workforce participation.** Nearly two-thirds (65.8%) of the Hispanic population 16 years old and over, or 12.3 million persons, were in the civilian labor force in 1995, which was comparable to Whites (67.1%), and slightly more than Blacks (63.7%). In fact, a greater percentage of Hispanic men 16 years old and over were in the labor force than either White or Black men in 1995, 79.1% compared to 75.7% and 69.0%, respectively. Conversely, a smaller percentage of Hispanic women 16

* Part of this disparity may reflect demographic differences, e.g., the fact that the White population is older, and, therefore, has higher income levels. The differences may also reflect disparities in educational quality. In addition, research has shown that some significant proportion of the earnings gap is attributable to discrimination.

years old and over were in the labor force than White and Black women, 52.6% compared to 59.0% and 59.5%, respectively.²⁷

- ◆ **Hispanic workers earn much less than either White or Black workers even though a similar proportion are employed.** In 1995, as Figure 6 shows, 72.1% of Hispanic men 16 years old and over were employed, compared to 72.0% of White men and 61.7% of Black men. Despite



equivalent employment levels, the median earnings of Hispanic men were \$15,654 in 1995, compared to \$25,840 for White men and \$18,578 for Black men. Similarly, while a smaller percentage of Hispanic women 16 years old and over were employed compared to White and Black women, 47.3%, 56.1%, and 53.4%, respectively, the median earnings for Hispanic female workers were also less than their White and Black counterparts in 1995, \$11,339 compared to \$15,441 and \$14,543, respectively.²⁸

- ◆ **The unemployment rate gap between Hispanics and Whites is growing.** While the unemployment rate for all Hispanic workers increased from 8.2% in 1990 to 9.3% in 1995, the rate for White workers increased only slightly during that time, from 4.8% to 4.9%. The increasing gap is especially glaring between Hispanic and White women; it was 3.7 percentage points in 1990 (8.4% compared to 4.7%) and 5.2 percentage points in 1995 (10.0% compared to 4.8%). The unemployment rate gap between Hispanic and White men increased from 3.1 (8.0% compared to 4.9%) to 3.9 percentage points (8.8% compared to 4.9%) between 1990 and 1995.²⁹
- ◆ **Hispanics in the labor force are generally employed in low-wage occupations.** As Figure 7 indicates, in 1995, almost one-half (48.4%) of Hispanic men 16 years old and over

* The difference between Hispanic and White unemployment rates is linked in part to the differences in educational attainment documented earlier. An examination of persons age 25 and over reveals that unemployment rates are considerably lower for Hispanics, Whites, and Blacks with higher levels of education. For example, 10.4% of Hispanics 25 years old and over with less than a high school diploma were unemployed in 1995, compared to 6.8% with a high school diploma, 6.1% with some college, 5.5% with an associate degree, and 3.5% for college graduates. Unemployment rates for comparable White and Black persons also decreased as educational attainment increased.

were employed in either precision production, craft, and repair occupations (19.1%) or as operators, fabricators, and laborers (29.3%). The majority (61.5%) of Hispanic women were employed in either sales and administrative support occupations (35.9%), or service occupations (25.6%), in 1995. In comparison, both White men and women were concentrated in managerial and professional specialty occupations (28.4% and 30.6%, respectively), and sales and administrative support occupations (17.1% and 39.1%, respectively). In 1995, the median weekly earnings for Hispanic men in their primary occupations were \$405 (precision production, craft, and repair) and \$313 (operators, fabricators, and laborers), while the median weekly earnings for Hispanic women in sales; administrative support; and service occupations were \$277, \$358, and \$230, respectively. Conversely, the median weekly earnings for Hispanic men and women in managerial and professional specialty occupations, in which White men and women were principally employed, were \$666 and \$513, respectively. Black men and women were employed in similar occupations as Hispanic men and women in 1995.³⁰

Figure 7

**Hispanic Employment and Earnings
by Type of Occupation
1995**

Type of Occupation	Men		Women	
	Percent Employed	Median Weekly Earnings	Percent Employed	Median Weekly Earnings
Managerial and professional specialty	12.0%	\$666	16.9%	\$513
Technical, sales, & administrative support	15.2%	\$432	38.5%	\$343
Service occupations	15.9%	\$284	25.6%	\$230
Precision production, craft, and repair	19.1%	\$405	3.3%	\$306
Operators, fabricators, and laborers	29.3%	\$313	13.7%	\$244
Farming, forestry, and fishing	8.5%	\$266	2.0%	\$221

Source: U.S. Bureau of Labor Statistics.

- ◆ **The earnings differential between Hispanics and Whites also exists within the same occupations.** Although a similar proportion of Hispanic and White women are employed in sales and administrative support occupations, for example, a comparison of the median weekly earnings for each reveals earnings discrepancies. In 1995, Hispanic women in sales and administrative support occupations had median weekly earnings of \$277 and \$358, respectively, compared to \$347 and \$384, respectively, for White women in the same occupations. This discrepancy is further exposed by looking at Hispanic and White earnings for both men and women in managerial and professional specialty occupations. Hispanic men in managerial and professional specialty occupations had median earnings of \$666 per week in 1995, while White men in the same occupations had median earnings of \$844 per week. Similarly, while the difference is not as great, Hispanic women in managerial and professional specialty occupations still earn less weekly than their White counterparts, \$513 to \$608, respectively.³¹

Government Cash Benefits

- ◆ **Hispanics benefit significantly from the Earned Income Tax Credit (EITC).** In 1995, the EITC lifted nearly 800,000 Hispanics out of poverty; as a result, the poverty rate for Hispanics dropped by 2.8 percentage points. The effect of the EITC was greater for Hispanics than for poor Blacks and Whites. After accounting for the EITC, approximately 680,000 fewer Blacks and 2.4 million fewer Whites lived in poverty in 1995, and Black and White poverty rates declined by 2.0 and 1.1 percentage points, respectively.³²
- ◆ **Despite high unemployment rates, Hispanics do not especially benefit from unemployment insurance.** Hispanics have historically had much higher unemployment rates than Whites. In 1989, the unemployment rate for Hispanics was nearly twice that of Whites, 8.0% compared to 4.5%. However, less than one-fifth (18.0%) of unemployed Hispanic workers received unemployment insurance benefits in 1989, compared to two-fifths (40.0%) of non-Hispanic Whites. In the three states with the largest Hispanic populations, overall unemployment insurance reception rates varied widely in 1989, from 44.9% in California and 40.1% in New York to 19.5% in Texas. The overall unemployment rates in California, New York, and Texas were 5.1%, 5.1%, and 6.7%, respectively, in 1989.^{*33}
- ◆ **Hispanic families comprised a sizeable portion of Aid to Families with Dependent Children (AFDC) recipients, and the greatest share in each of the three states with the largest Hispanic populations.** In 1995, Hispanic families constituted 20.7% of AFDC recipients nationwide, compared to 37.2% for Black families and 35.6% for White families. Hispanic families accounted for the largest share of AFDC recipients in California, Texas, and New York, 40.0%, 44.5%, and 36.3%, respectively. While the precise measurements of impact are not available, AFDC benefits surely helped raise the income levels of lower-income Hispanic families in these and other states.^{**34}

Summary

Family characteristics, education levels, labor market status, and the use and effectiveness of government cash benefits, all help determine and explain Hispanic household and family income levels, although research suggests that discrimination is another explanatory factor.³⁵ The gap in income and earnings between Hispanics and Whites is partly explained by the fact that Hispanics are younger; have a higher proportion of female-headed families; have fewer high school and college graduates, which may also be linked to age; have lower female labor force participation rates and higher unemployment rates for both genders; and are employed in lower-wage occupations, which is further linked to educational attainment. The relationships between all of these factors indicate where policy, and in particular tax policy, may be effective in closing the income and earnings gaps which currently exist between both Hispanics and Whites, and between lower- and higher-income Hispanics.

* Unemployment insurance data are only available for 1989.

** The AFDC program has been eliminated and states will receive funding under the Temporary Assistance for Needy Families (TANF) block grant.

Endnotes

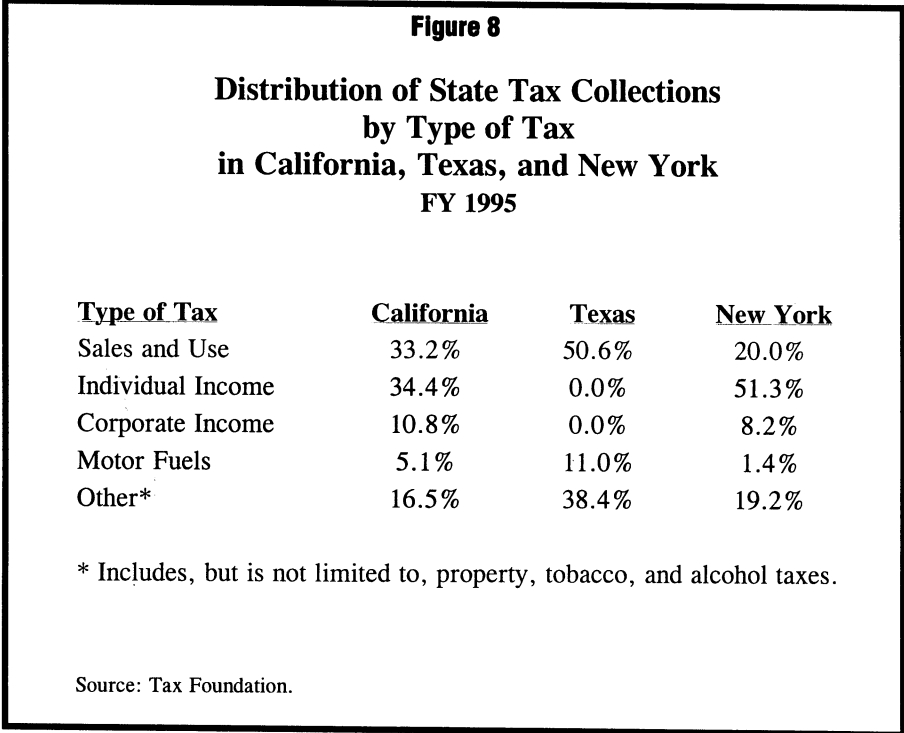
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Tax Burdens

Overview

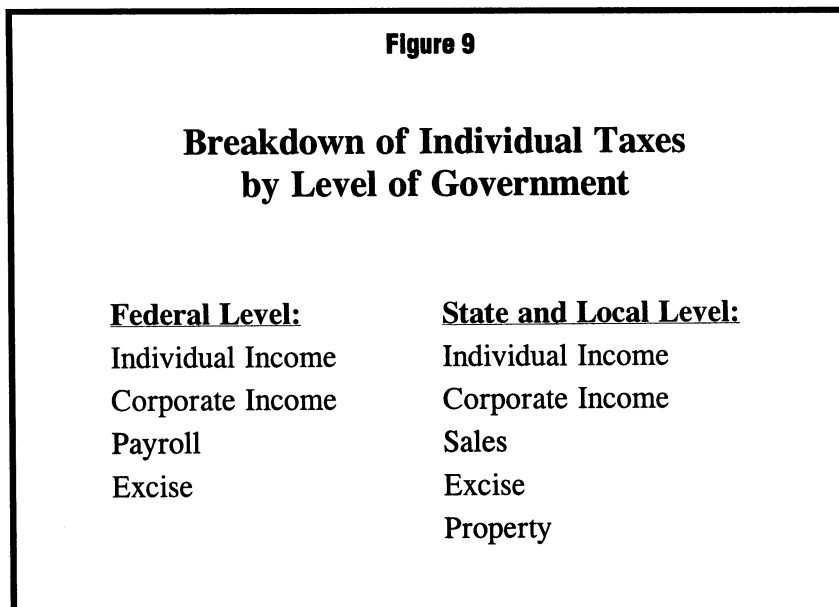
Factors related to demographics, education, employment, and government cash benefits undeniably affect Hispanic earnings and income levels; however, there are other factors which impact income, including federal, state, and local government fiscal policy, i.e., revenue and expenditure decisions. Federal outlays (expenditures) totaled \$1,519.1 billion in 1995 and federal receipts (revenues) \$1,355.2 billion, resulting in an estimated deficit of \$163.9 billion, effectively raising the gross federal debt to \$4,921.0 billion.¹ In 1995, federal revenues were basically derived from three sources: individual income taxes (43.6%), social insurance payroll taxes (35.8%), and corporate income taxes (11.6%).² See Figure 8 for a summary of tax collections in California, Texas, and New York, the three states with largest Hispanic populations in 1995.



The following two sections focus on the revenue side of federal, state, and local government fiscal policy, i.e., tax policy. The first section measures Hispanic family tax burdens and the second section addresses progressivity, equity, and fairness issues with respect to both individual taxes and tax systems. Federal, state and local tax liabilities and average tax rates (the amount by which tax liability reduces total income) for Hispanic families at different income levels in California, Texas, and New York, will be analyzed throughout both sections (summary tables are included in the Appendix).

Every person earning significant income owed federal individual income taxes in 1995, and paid federal payroll taxes, which are levied on wages and salaries. In addition, individual income taxes were levied in all but seven states (Alaska, Florida, Nevada, South Da-

kota, Texas, Washington, and Wyoming) in 1995, and all but five states (Alaska, Delaware, Montana, New Hampshire, and Oregon) also imposed sales taxes.³ The result is that every household pays taxes on income they earn and on goods and services they consume. The major taxes at the federal and state and local levels are summarized in Figure 9.



Measuring Family Tax Burdens

Several measures are used to assess the effect of federal, state, and local taxes on family income, including statutory, marginal, and average tax rates (see Glossary for a definition of tax terms). However, while statutory and marginal tax rates provide some insight into the effect of taxes on income, the most accurate measure is average tax rates because the actual impact of taxes on income is thereby considered.

Statutory tax rates

Statutory tax rates are the nominal rates families encounter. The following example will help define statutory tax rates. A Latino married-couple family with total income of \$25,000, slightly higher than Hispanic median family income in 1995 (\$24,570), living in Los Angeles, California confronted the following tax rates in 1995: federal individual income tax, 15.0%; federal payroll tax, 15.3%; federal cigarette excise tax, 9.6%; federal gasoline excise tax, 14.2%; federal telephone excise tax, 3.0%; state individual income tax, 1.0-2.0%; state sales tax, 6.0%; state cigarette excise tax, 14.8%, state gasoline excise tax, 13.9%; local sales tax, 2.25%; and a range of other federal, state, and local taxes.⁴ While these tax rates only pertain to residents of Los Angeles, California, they are representative of the kind of rates facing most families whenever they earn income, or consume goods or services. However, while statutory tax rates give an indication of how taxes affect family income, they neither reflect how

* The employee and employer share of the federal payroll tax are both 7.65%, but the employer share is included in the employee share because in the long run the employer will either reduce wages or increase prices, meaning the entire burden ultimately falls on the employee/consumer (see Tax Fairness section, p. 27).

taxes impact on economic decisions, or the actual tax rates, or tax burdens, families encounter.

Marginal tax rates

Marginal tax rates are the effective rates on increases in family income. The study of marginal tax rates, i.e., the incentives and disincentives of taxes, is important because “[i]t is at the margin that people decide whether or not it is worthwhile to work more or less. People also decide at the margin how much of their additional income to consume and how much to save.”⁵ For example, if a family with an income of \$25,000 and a total tax liability of \$5,000 earns an additional \$5,000, and their total tax liability increases to \$6,250, the family’s marginal tax rate would be 25.0%, the increase in tax liability divided by the increase in income.⁶ The high marginal tax rate would clearly be a hindrance if the family were to increase its income.

Average tax rates/Tax burdens

Average tax rates, or tax burdens, are the actual tax rates facing families. Average tax rates denote the exact amount by which income is reduced by taxes, while statutory rates are the nominal rates applied to income. In addition, while marginal tax rates are the rates of taxation on each extra dollar earned, average tax rates are the rates of taxation on all income earned. For example, if a Hispanic family with an income of \$25,000 owed \$2,800 in federal payroll taxes, their average federal payroll tax rate would be 11.2% (payroll tax liability divided by total income). Thus, one-ninth of their income would go to pay one tax, which more explicitly reveals the impact of the tax on the family than stating that the family encounters a nominal payroll tax rate of 15.3%. Furthermore, if one member of the family received a pay raise of \$3,000, and the family’s federal payroll tax liability rose to \$3,259, their marginal tax rate would be 15.3%, but their average payroll tax rate would increase to 11.6%, which more clearly discloses the impact of the raise.

Marginal Tax Rates and Politics

Marginal tax rates center on growth (income and economic), which is why the issue of marginal tax rates, and particularly marginal *income* tax rates, is raised in most political discussions of tax policy. Wages and salaries, the most common type of income, had the lowest total, federal, and state and local effective marginal income tax rates in FY 1993 at 27.4%, 22.7%, and 4.7%, respectively; business and dividend income, which is primarily held by higher-income families, had the highest effective marginal income tax rates at 39.9%, 34.6%, and 5.3%, respectively.⁷ Therefore, many argue that higher marginal income tax rates hamper higher-income taxpayers (i.e., savings, investment, and, as a result, economic growth), and thus advocate for flatter rates.

* Marginal income tax rates are higher for certain types of income because as increases in income push people into higher tax brackets, a greater proportion of each extra dollar of income earned is paid in taxes. And since wages and salaries comprise a greater share of income for a lower-income family, and dividends and business income a greater share of income for a higher-income family, marginal income tax rates on wage income are significantly lower than those on dividend or business income.

Variations in Family Tax Burdens

Tax burdens vary between families when income levels and/or tax liabilities differ, the latter implying differences in sources or uses of income.⁸ Average tax rates vary initially depending on total family income. For example, if one Hispanic family residing in New York City has a total income of \$25,000 and a total tax liability of \$5,000, while another Hispanic family has a total income of \$40,000 and a total tax liability of \$10,000, their total average tax rates would be nearly the same, 20.0% and 25.0%, respectively. Not only do average tax rates differ by level of income, but disparities are also due to differences in sources of income. For example, assuming that wages and salaries account for three-fourths of one Hispanic family's income of \$25,000, and two-thirds of another Hispanic family's income of \$25,000 (with more received from returns on investments), since the federal payroll tax is only levied on wages and salaries, the average payroll tax rate would be 11.5% for the first family, and 10.2% for the second family. Finally, average tax rates also differ based on uses of income, i.e., consumption patterns. For example, two Hispanic families with incomes of \$25,000 living in New York City are subject to the same nominal state and local sales tax rates whenever they purchase non-exempt goods and services; however, their consumption patterns would most certainly differ, thus subjecting both to different average state and local sales tax rates. Numerically, if one of the Hispanic families in New York City spends one-third of its income on sales taxable items, and the other family two-fifths, the first family would have an average state and local sales tax rate of 2.8%, and the second family a higher rate of 3.4%.⁹

Variations in Tax Burdens by State Tax System

A review of tax burdens by state shows wide variations in average tax rates and rankings between states and by level of government. The combined federal and state and local average tax rates (overall U.S. ranking) in FY 1993 for California, Texas, and New York were: 35.5% (11); 31.1% (36); and 39.1% (2), respectively. However, when broken down by level of government, the figures change dramatically. For instance, while the federal average tax rate in Texas in FY 1993 was near the median at 20.4%, ranking 26th nationally, their state and local average tax rate was one of the lowest at 10.7%, ranking 47th. The opposite was true of New York, which had the highest state and local average tax rate in the country in FY 1993 at 16.8%, and a higher federal average tax rate of 22.3%, ranking 11th. California had comparably higher federal and state and local average tax rates than Texas, and lower than New York, ranking 15th at 21.5% and 13th at 14.0%, respectively.¹⁰

Variations in total average tax rates are primarily due to disparities in state and local tax systems. For example, while the federal average tax rate in Texas is similar to that of other states (ranking 26th), Texas' state and local average tax rate is one of the lowest in the country (ranking 47th), and, as a result, its total average tax rate ranks 36th. Texas had one of the lowest state and local average tax rates in FY 1993 primarily because the state does not levy an individual income tax.

Variations in Family Tax Burdens by Hispanic Origin

While the impact of taxes on Hispanics can be illuminated through a review of average tax rates across states with large Latino populations, **in order to be more comprehensive, an analysis conducted by NCLR estimated total, federal, and state and local average tax rates for Hispanic families at five different income levels in Los Angeles, California; San Antonio, Texas; and New York, New York** (see Appendix for the methodology employed in the NCLR Hispanic family and tax profiles). There are three reasons why the analysis conducted by NCLR can be viewed as a study of Hispanic, as opposed to non-Hispanic, families: geographic location; income level; and demographic characteristics.

Geographic location

As noted in the Population/Income Profile, over three-fifths (62.6%) of the U.S. Hispanic population was estimated to reside in the three states of California (34.1%); Texas (19.6%); and New York (8.9%) in 1995. Furthermore, Los Angeles, California; San Antonio, Texas; and New York, New York were three of the five cities with the largest Hispanic populations in 1990, rankings which, most likely, are still pertinent today. Therefore, employing the tax rates and tax bases in these states and localities to calculate Hispanic family tax burdens increases the likelihood that the results will be fairly indicative of a large number of Hispanic families.

Income level

Hispanic families, like all families, differ in two basic ways, income level and demographic characteristics; hence, tax liabilities, and average tax rates, vary between families in the same state and city. In order to further isolate the effect of taxes on Hispanic families, NCLR separated Hispanic families into five groups based on mean income level by quintile. As revealed in the Population/Income Profile, Hispanic income levels are lower than those for White or Black families and, thus, taxes have a much different impact on generally lower-income Hispanic families than generally higher-income White families.

Demographic characteristics

Under the criteria defined thus far, Hispanic and non-Hispanic families at the same income level would have the same tax burden. Therefore, in order to distinguish further Hispanic families from non-Hispanic families, NCLR constructed a “typical” demographic profile for each of the families at the five different income levels. As documented in the Population/Income Profile, on average, Hispanics have larger families, more married-couple families, fewer earners in the family, and are employed at disparate occupational and earnings levels than non-Hispanics. Therefore, while the family profiles do not necessarily define the majority of Hispanics at that income level, they do provide a fairly accurate representation of the typical Latino family.

When combined, geographic location, income level, and demographic characteristics can be used to determine the effect of total, federal, and state and local taxes on Hispanic families as described in this report. Additional study might seek to refine this idea further, by constructing models including the characteristics of Hispanic families at the different income quintiles within the three states and cities. Furthermore, while a comparison to national average families will be made in the next section, the construction of non-Hispanic, or national average, family profiles would serve to differentiate further Hispanic families from non-Hispanic, or all, families. While both are important criteria, they were beyond the scope of this analysis. Based on NCLR's analysis, the total, federal, and state and local average tax rates for the five Hispanic families in California, Texas, and New York are presented in Figure 10 below.

Figure 10

**Total, Federal, and State and Local Average Tax Rates for Hispanic Families
in California, Texas, and New York
by Income Quintile
1995**

	CALIFORNIA			TEXAS			NEW YORK		
	Total	Federal	State/Local	Total	Federal	State/Local	Total	Federal	State/Local
Lowest	* -4.1%	-9.8%	5.7%	* -2.8%	-9.8%	7.0%	* -4.4%	-9.8%	5.4%
Second	* -6.0%	-9.8%	3.8%	* -5.2%	-9.8%	4.6%	* -6.1%	-9.8%	3.7%
Third	13.1%	9.8%	3.3%	13.6%	9.8%	3.8%	13.9%	9.8%	4.1%
Fourth	24.1%	20.2%	3.9%	23.5%	20.2%	3.3%	27.2%	20.2%	6.9%
Highest	30.7%	24.9%	5.8%	28.2%	26.0%	2.2%	34.0%	23.6%	10.5%

* Average tax rates are negative due to the refundable federal EITC.

Source: NCLR.

Summary

Taken together, an analysis of statutory, marginal, and average tax rates all help to determine the burden taxes place on Hispanic families. Statutory tax rates provide an initial understanding of the tax rates Hispanic families face; marginal tax rates give an indication of how taxes affect the economic decisions of Hispanic families; and average tax rates reveal the actual impact of taxes on Hispanic family income. In addition, average tax rates can be used to compare tax burdens for Hispanic families with different levels, sources, and uses of income; Hispanic families in different states; and Hispanic families with varying demographic, economic, and geographic profiles. Furthermore, in contrast to marginal tax rates which focus on growth, average tax rates can be employed to test the progressivity and equity of individual taxes and tax systems, as the following section documents.

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Tax Fairness

OVERVIEW

This section analyzes the progressivity and equity of taxes at the federal and state and local levels. Determining the fairness of individual taxes and tax systems necessitates a closer examination of tax liability, i.e., tax rates and tax bases, along with average tax rates.¹

Tax rates

One indicator of the fairness of individual taxes is whether the tax is levied at graduated or flat rates. The federal individual income tax, for example, is levied at graduated rates, which means higher-income families pay a higher percent of income in taxes than lower-income families, assuming comparable tax bases (sources of income); this makes the tax more progressive and vertically equitable. Conversely, state and local sales taxes are levied at flat rates, and command a larger share of income from lower-income families than higher-income families, assuming comparable tax bases (consumption patterns); therefore, those taxes are regressive and more burdensome on lower-income families.

Tax bases

Tax bases are also important in analyzing individual taxes, because what is included in, and excluded from, the tax base has an impact on the progressivity and equity of the tax. Continuing with the examples above, the federal individual income tax granted standard deductions for single filers and married-couples filing jointly in 1995, in addition to exemptions for each household member. These adjustments make the federal individual income tax even more progressive and vertically equitable because individual income tax liability is decreased, and, consequently, total income increased, by a larger percentage for lower- and middle-income families than higher-income families. In contrast, while certain goods and services, such as food consumed at home and business services, are exempted from nearly all state and local sales tax bases, items which comprise the sales tax base are purchased in similar quantities by both lower- and higher-income families, and, thus, exact a larger share of income from lower-income families than higher-income families.

Average tax rates

While a comparison of tax rates and bases provides some insight into the progressivity and equity of individual taxes, and tax systems, as with the assessment of Hispanic family tax burdens, a study of average tax rates is the most accurate determination because it moves beyond inferences and looks at the actual tax burdens for lower- and higher-income Hispanic families, considering

differences in tax structures (tax rates and bases). In short, average federal individual income tax rates for the Hispanic families in California, Texas, and New York increase significantly by income quintile, while average state and local sales tax rates decrease steadily, reinforcing the progressivity of the federal individual income tax and regressivity of state and local sales taxes.

This brief analysis suggests that while the federal individual income tax, and, subsequently, federal tax system, is progressive and vertically equitable, state and local sales taxes are regressive and inequitable, which clearly has a negative impact on the fairness of state and local tax systems.

Federal, State and Local Taxes

The study which follows examines the fairness of most federal and state and local taxes for Hispanic families by evaluating the statutory tax rate, tax base, and average tax rate for each.*² The examination of these taxes will subsequently reveal the fairness of federal, and state and local tax systems, and will ultimately show which taxes are effective in closing the income gap and which hinder Latino families from improving their economic situation.

Federal Taxes

Individual income tax

The federal individual income tax is the most progressive and equitable tax levied at either the federal or state and local level for four reasons: the tax rate structure, tax base, adjustments to the tax base, and the Earned Income Tax Credit (EITC).

Tax rate Federal individual income taxes are made more progressive and vertically equitable because they are levied at graduated (marginal) rates, 15.0%, 28.0%, 31.0%, 33.0%, and 39.6% in 1995, which helps to ensure that higher-income families are paying their share in federal individual income taxes and lower-income families are not being overly burdened by them.³

Tax base The federal individual income tax is also progressive and vertically equitable because the tax offered a standard deduction of \$3,900 for single filers, \$6,550 for married persons filing jointly, and an exemption of \$2,500 per dependent in 1995, which helps

* Income is not only reduced by taxes facing a family, but also, indirectly, by taxes on business which are passed on to families through reduced returns to shareholders, lower wages to employees, or higher prices to consumers. Business taxes which effectively reduce family income include: corporate income taxes, payroll taxes, and excise taxes. However, it is important to note that while corporate income taxes further reduce family income, this effect cannot be easily measured, and thus, any analysis will underestimate the total effect of individual taxes on family income.

to lessen the tax burden for lower-income families.⁴ In addition, the federal individual income tax is horizontally equitable because the tax is levied on a family's adjusted gross income (AGI), i.e., wages and salaries; interest, dividends, and rent; and certain investments, sources of income which are typically comparable for families at similar income levels.

EITC

When claimed, the federal EITC completely offsets federal individual income tax liability for many lower-income working families, and, because the credit is refundable, the amount in excess of tax liability is paid back to the family, which lessens their overall tax burden and effectively increases their income. Therefore, the EITC contributes to the progressivity and vertical equity of the federal individual income tax by significantly lowering the tax burden for lower-income working families.

Federal Individual Income Tax Reform

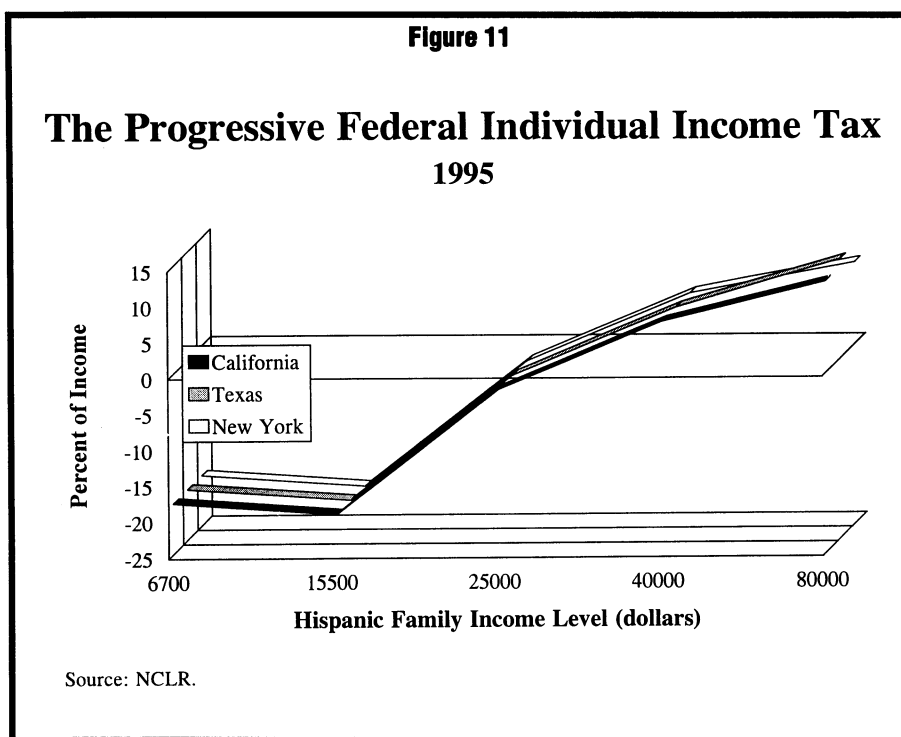
Tax Reform Act of 1986. The federal individual income tax has moved toward progressivity and equity in the last decade due to structural changes brought about by the 1986 Tax Reform Act. Examples of progressive and vertically equitable changes to the federal individual income tax base included raising the personal exemption from \$1,080 to \$2,000 (phased-out at the highest income levels), and increasing the standard deduction for married couples from \$3,670 to \$5,000. However, while the act also improved horizontal and vertical equity by closing corporate tax loopholes, it did not necessarily improve vertical equity by altering the tax rate structure and lowering the top rates. Prior to reform there were fourteen tax rates, graduated from 11.0% to 50.0%, and following reform there were only two, 15% and 28%.⁶ Partially as a result of these tax changes, the total average tax rate for the lowest income quintile decreased from 10.3% in 1985 to 9.3% in 1989 and increased from 24.2% to 25.5% for the highest quintile.⁷

Omnibus Reconciliation Act of 1993. While the 1986 Tax Reform Act did not produce entirely equitable changes, reforms since then, particularly the Omnibus Budget Reconciliation Act (OBRA) of 1993, have resulted in improvements in vertical equity. For example, OBRA of 1993 increased the top federal individual income tax rate, which primarily impacted higher-income families, and expanded the EITC, which positively affected lower-income families. Mainly due to an increase in the top individual income tax rate, the total average federal tax rate for the highest income quintile increased from 26.2% to 27.9% (projected 1996) after OBRA of 1993, and federal tax liability rose from \$31,478 to \$33,520 (a 6.5% increase).⁸ The change which had a direct impact on lessening the federal individual income tax burden for lower-income families was the expansion of the EITC; specifically, there were increases in the EITC credit rates, maximum credits, and phaseout rates for both families with one child and two or more children in OBRA of 1993 (see Methodology section in Appendix for an example which helps to define these terms). The credit was also extended to childless workers.⁹ Primarily due to this expansion, the total average federal tax rate for the bottom income quintile decreased from 7.0% to 5.0% after OBRA of 1993, and federal tax liability declined from \$589 to \$421 (a 28.6% decrease).¹⁰

* The 1986 Tax Reform Act also increased the long-term capital gains rate (top rate) from 20% to 33%.

Average tax rates

A study of average tax rates reaffirms the above. As Figure 11 illustrates, in 1995, the average federal individual income tax rate increased from -18.0% for the Hispanic family in the lowest quintile in California, Texas, and New York, to 12.7% for the Hispanic family in the highest quintile in California, 13.8% in Texas, and 11.4% in New York.* Therefore, the federal individual income tax can be considered progressive, and achieves vertical equity because it adheres to the ability-to-pay principle, that as income increases, the average tax rate increases.⁵



Payroll tax

The federal payroll tax is much less progressive than the federal individual income tax, and more burdensome on lower-income, working Hispanic families, because of both the tax rate and tax base.

Tax rate

The payroll tax is levied at a flat rate, 15.3%, with one-half (7.65%) levied on employees and the other half levied on employers; therefore, when sources of income are similar, lower-income families pay a similar proportion of income in payroll taxes as higher-in-

* Federal individual income tax liabilities and average tax rates are the same for the Hispanic family in the lowest quintile in each of the three states because the family does not itemize its deductions. Furthermore, the family's average tax rate is negative due to the refundable EITC.

An Example of the Effect of Federal Payroll Taxes on Hispanic Working Families

Every Hispanic who is employed, from a construction worker earning \$20,000 to a restaurant manager earning \$32,000, pays federal payroll taxes. However, because the payroll tax is levied at a flat rate, the share of income paid in payroll taxes is similar for both the construction worker and restaurant manager despite different earnings/income levels. Presuming that federal payroll tax liability eventually falls on employees, and wages and salaries comprise the same proportion of income (80%), the construction worker's and restaurant manager's income would ultimately decrease, through reductions in wages and/or increased prices, by \$3,060 and \$4,896, respectively. However, the construction worker's and restaurant manager's average federal payroll tax rate would be the same, 12.2%, and the amount of income which would remain for consumption, saving, and other taxes would vary significantly, \$21,940 and \$35,104, respectively.

come families, which makes the tax less progressive and vertically equitable.*¹¹

Tax base

The payroll tax is levied on employees' wage and salary income, and not on interest, dividend, or investment income, and there are no adjustments to the payroll tax base; thus, the tax affects families at dissimilar income levels differently depending on their sources of income, which diminishes vertical equity and may also have an impact on horizontal equity.** In addition, the old age survivors' and disability insurance portions of the payroll tax (6.2% for both employees and employers) is not applied to wages above a certain level (\$61,200 in 1995), further diminishing vertical equity.¹²

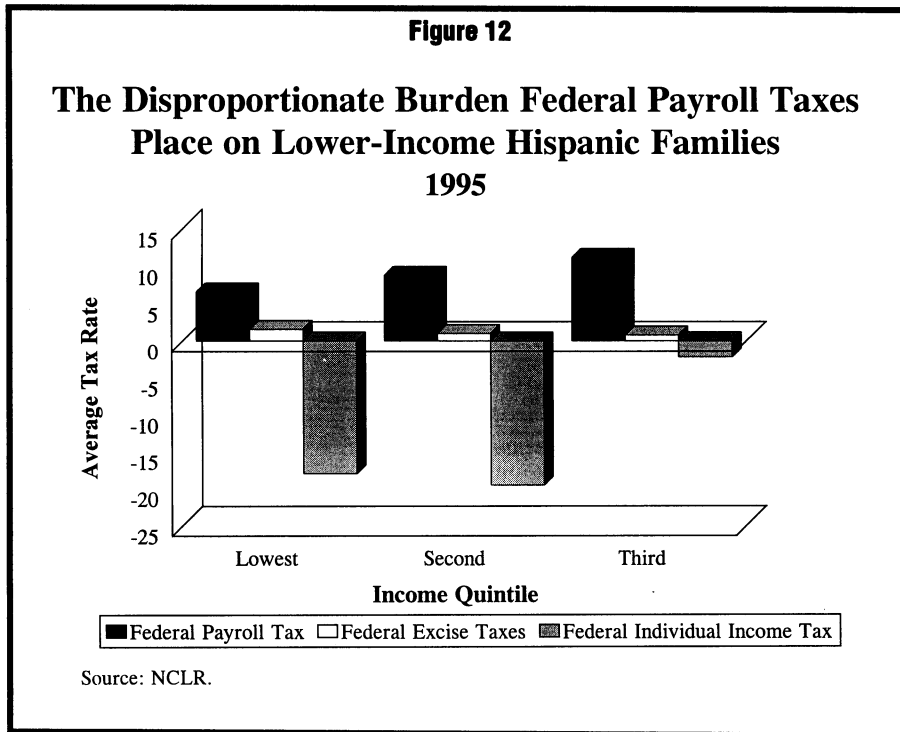
Average tax rates

The average payroll tax rates for Hispanic families in California, Texas, and New York by income quintile were 6.6%, 8.8%, 11.2%, 12.5%, and 11.8% in 1995. As shown in Figure 12, even though the tax is progressive, and when accounting for the redistributive effects of the federal payroll tax (see footnote below), the tax still provides a significant contrast to the federal individual income tax in terms of its effect on lower-income families.***¹³

* While the federal payroll tax is imposed on both employees and employers alike, most economists agree that tax incidence, i.e., who ultimately bears the burden of the tax, falls totally on employees. This assumption is supported by studying both the short- and long-run effects of the employer share of the federal payroll tax. In the short run, the employer share of the payroll tax either reduces employer profits or increases consumer prices; but over the long-run, either employee wages are reduced or consumer prices increased. Therefore, since the employer share of the federal payroll tax eventually decreases employee wages, either directly or indirectly (through increased prices), it can be assumed that the entire federal payroll tax burden falls on employees/consumers.

** While there are no specific payroll tax deductions or exemptions, the EITC helps offset payroll tax liability.

*** Lower-income families may disproportionately benefit from the revenue the payroll tax generates. Specifically, the federal payroll tax funds three federal programs: old age survivors' insurance (OASI), which provides benefits for retired workers, disability insurance (DI), and hospital insurance (HI), which provides Medicare health benefits to retired workers. And "[s]ince retirement benefits are redistributed in a progressive manner (less wealthy retirees receive more benefits than they contributed over their lifetime, while the most wealthy receive fewer benefits than they put in), the benefit structure counteracts the regressive nature of the tax."¹³ According to the 1994 Consumer Expenditure Survey, Social Security benefits comprised 16.3% of income in the third quintile, and 4.2% in the highest. However, the number of beneficiaries is currently rising faster than the number of workers, a trend likely to continue in the future, which means the progressive benefit structure is less of a counterweight to the regressive payment structure.



Excise taxes While not overly burdensome on lower-income families, excise taxes at both the federal and state and local levels are regressive and lack horizontal and vertical equity because of their tax rates and bases.

Tax rate The federal government does not levy a sales tax, but it does impose another type of consumption tax, excise taxes, on gasoline, tobacco, and alcohol (liquor, wine, and beer) consumption, as do all state governments. The federal government also levies a telephone excise tax.¹⁴ While families do not pay a significant amount in combined federal and state excise taxes, the taxes are levied at flat rates, which impacts negatively on the progressivity and equity of the taxes. The Appendix includes a listing of statutory federal and state excise tax rates.

Tax base Given that tax burdens for each of the different federal and state excise taxes depend on whether the family consumes the product, and there are no exemptions to excise tax bases, the tax is not horizontally equitable. For example, two individuals with identical incomes living in Los Angeles, one of whom drives to work and the other of whom uses public transportation, will obviously have very different average federal and state gasoline excise tax rates. Likewise, in terms of vertical equity, since most families do consume excise-taxable goods, and the amount of excise tax liabilities does not vary significantly between higher and lower-income fami-

lies, excise taxes capture a larger share of income for a lower-income family. As an example, in California, if a family with an income of \$25,000 and a family with an income of \$80,000 both consumed 300 gallons of gas in a year, the average federal and state gasoline excise tax rate would be 0.44% for the first family, and 0.14% for the second family.

**Average
tax rates**

This difference may seem small, but when the average tax rates are added up for all the various excise taxes, the regressivity of excise taxes overall becomes evident. In California, average federal and state excise tax rates for the Hispanic family in the lowest quintile were 1.6% and 1.4%, respectively, compared to 0.4% and 0.3%, respectively, for the Hispanic family in the highest quintile. Both types of families experienced similar average federal and state excise tax rates in Texas and New York.

State and Local Taxes

**Individual
income tax**

Like federal individual income taxes, state individual income taxes are progressive and equitable in California and New York because of reductions to the tax base, which is also true of the New York City income tax. Gradual (marginal) tax rates also contribute to the progressivity of the California income tax; however, New York state and New York City income taxes are less progressive because they are levied at relatively flat rates.

Tax rate

California has probably one of the most progressive and equitable individual income taxes, with eight different marginal rates in 1995, ranging from 1.0% for the first \$9,662 of taxable income (married-couple family), to 11.0% for taxable income over \$439,744. Conversely, New York's individual income tax rate was fairly flat in 1995 (as was New York City's), and less progressive and vertically equitable as a result, with four rates (4.6%-7.6%), and the highest one only applying to incomes over \$25,000. Texas does not levy an individual income tax, which implies that their overall tax system is regressive, since the individual income tax is the most progressive tax levied by any level of government.¹⁵

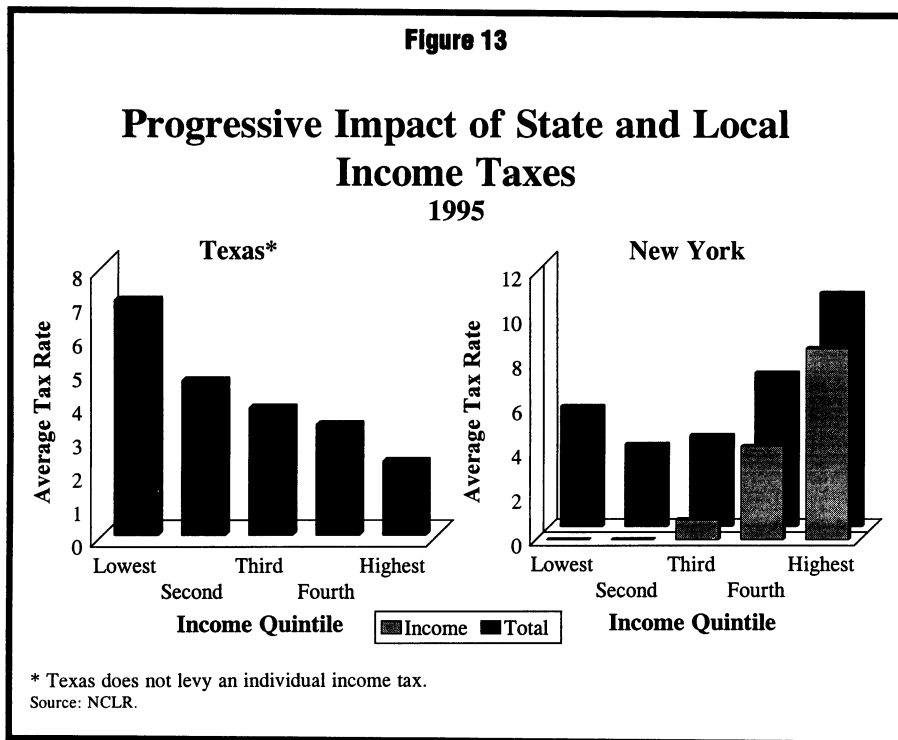
Tax base

California's individual income tax base contributes to the progressivity and equity of the tax, offering large standard deductions, \$2,487 for single filers and \$4,974 for married persons filing jointly, and a personal exemption tax credit, \$66 per dependent in 1995, which helped reduce the burden on lower-income families.

New York's individual income tax base was extremely progressive and vertically equitable in 1995, with standard deductions of \$6,600 for single filers and \$10,800 for married persons filing jointly, as well as personal exemptions of \$1,000 for each dependent. In addition, both New York state and New York City extended household tax credits to eligible families, which also helped to counter the regressive tax rate and make the tax progressive and equitable overall.¹⁶

Average tax rates

As Figure 13 illustrates, primarily because the state does not levy an individual income tax, the total average state tax rate in Texas decreased from 7.0% for the Hispanic family in the lowest quintile to 2.2% for the Hispanic family in the highest quintile. In contrast, average state and local individual income tax rates in California and in New York ranged from 0.0% for the Hispanic family in the lowest quintile in both states to 3.8% for the Hispanic family in the highest quintile in California, and 8.6% for the comparable Hispanic family in New York.* In conjunction, total average state tax rates in California and New York were 5.7% and 5.4%, respectively, for the Hispanic family in the lowest quintile, and 5.8% and 10.5%, respectively, for the Hispanic family in the highest quintile.



* For the purposes of this analysis, average state tax rates are combined with average local tax rates; however, the impact does not significantly alter the data or conclusions.

The Absence of Property Taxes

Besides federal and state corporate income taxes, state and local property taxes were the only major individual tax not analyzed by NCLR. While 42.2% of Hispanic households were owner-occupied in 1993, and a large number of Hispanic families are assuredly overburdened by property taxes, an adequate measurement of property tax liabilities and average tax rates for the five Hispanic families in California, Texas, and New York was beyond the scope of this study. Since only the Hispanic families in the fourth and highest income-quintiles lived in owner-occupied housing in NCLR's analysis, property tax liabilities would have had to have been estimated for the Hispanic families in the first three quintiles, who certainly pay property taxes in the form of higher rent payments, but which would have been very difficult to measure accurately. Moreover, even an estimation of property tax liabilities for the Hispanic families in the highest two quintiles is extremely difficult when attempting to incorporate real property values and homestead exemptions and credits in the calculations. Nevertheless, most studies indicate that property taxes are extremely regressive and overly burdensome for lower-income families. For example, a 1996 study by Citizens for Tax Justice (CTJ), *Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States*, reveals average property tax rates in California decreased from 4.3% for the family in the lowest quintile (average income, \$12,600) to 2.7% for the family in the fourth quintile (average income, \$67,400) in 1995. Similarly, average property tax rates in Texas and New York decreased from 4.2% (\$10,900) to 2.5% (\$59,200), and from 6.8% (\$16,500) to 4.1% (\$71,100), respectively. Furthermore, the 1994 Consumer Expenditure Survey shows that property taxes on owned dwellings comprised 4.6% of average income in the lowest quintile, 3.4% in the second quintile, 2.6% in the third quintile, 2.3% in the fourth quintile, and 2.0% in the highest quintile. These studies essentially prove that the inclusion of state and local property taxes in NCLR's analysis would have diminished the progressivity, and/or increased the regressivity, of the overall tax system in each of the three states.

Sales tax

While federal, state, and local individual income taxes are the most progressive and equitable taxes levied at any level, sales taxes are the most regressive and least equitable for two reasons: the tax base and the tax rate.

Tax rate

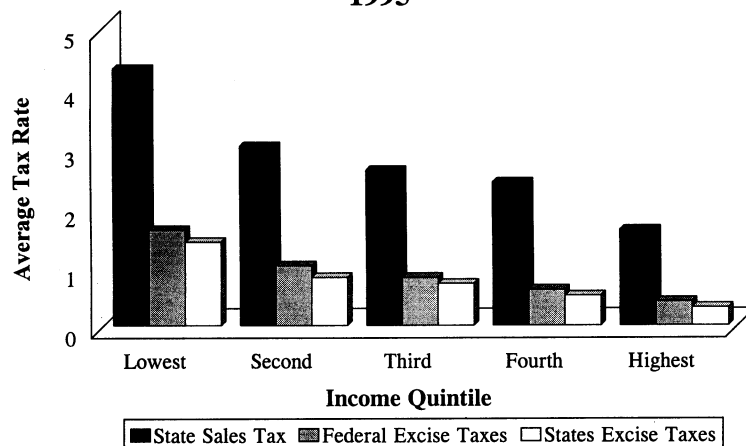
In 1995, 46 states and the District of Columbia levied a sales tax. Statutory sales tax rates varied by state, from 3.00% in Colorado to 7.00% in Mississippi and Rhode Island, and the average statutory sales tax rate for states levying a sales tax was 5.15%. The statutory sales tax rates in California, Texas, and New York were 6.00%, 6.25%, and 4.00%, respectively, in 1995.¹⁷ Many county and city governments and transit districts in the largest population centers also levy sales taxes, and, therefore, the combined state and local sales tax rates in the three cities with the largest Hispanic populations in each of the above three states were 8.25% in Los Angeles, California; 7.75% in San Antonio, Texas; and 8.50% in New York, New York. Sales taxes at both the state and local level are levied at flat rates, which effectively diminishes the progressivity and vertical equity of the tax, no matter the tax base.¹⁸

Tax base

Sales taxes are levied on goods or services consumed by a family, although every state exempts certain goods and services from taxation.*¹⁹ For example, if a Hispanic family living in Los Angeles, California bought a television set valued at \$250.00, the family would owe 7.25% in combined state and county sales taxes, or \$18.13, bringing the total sales price to \$268.13. While it appears that all consumers are effected equally by the sales tax, the tax base is neither horizontally nor vertically equitable. First, sales tax bases mainly include items which are necessities for all families, and not items which are consumed in greater quantities by higher-income families, which causes the tax to lack vertical equity, even though higher-income families have larger sales tax liabilities. Second, sales tax bases differ by consumption patterns (uses of income), which are variable between families at similar and dissimilar income levels, rather than by sources of income, which are relatively constant. As a result, both horizontal and vertical equity are reduced, although the lack of vertical equity would more likely be due to differences in income level than in consumption patterns.

Figure 14

Regressive State Sales Taxes and Federal and State Excise Taxes in California 1995



Source: NCLR.

* California, Texas, and New York exempted food (for home consumption only) and electric and gas utilities (residential use) from sales taxation in 1994; California and New York also exempted most telecommunication and personal services; Texas the rental of rooms and lodging; and New York non-prescription drugs.

**Average
tax rates**

Even though higher-income families consume more sales taxable items, and consequently have larger sales tax liabilities, the sales tax structure results in lower-income families paying a larger proportion of their income in taxes than higher-income families (see Figure 14). The average state and local sales tax rate in California for the Hispanic family in the lowest quintile was 4.3%, compared to 1.6% for the Hispanic family in the highest quintile in 1995; 5.4% compared to 1.9%, respectively, in Texas; and 4.3% compared to 1.7%, respectively, in New York.

Excise taxes See Federal Taxes (p. 28).

Hispanic vs. National Average Family Tax Burdens

The previous two sections analyzed the burden taxes place on Hispanic families and assessed the fairness of individual taxes for Hispanic families based on that analysis. However, a brief look at average tax burdens for *all* families, and subsequent comparison to Hispanic family tax burdens, will help to provide some context to these findings. The studies utilized in this comparison are the Congressional Budget Office's (CBO) 1996 projections of average federal tax rates for all families with children, and CTJ's 1996 study which estimates 1995 state and local average tax rates for non-elderly married-couple families.* Comparing the median national family and median Hispanic family, the CBO projected families with children in the third quintile (average pre-tax income, \$47,501) to have the following average federal tax rates in 1996: individual income, 6.5%; payroll, 12.2%; and excise, 1.3%. In addition, based on NCLR's analysis, average federal tax rates for the Hispanic family in the third quintile (average income, \$25,000) were: individual income, -2.2%; payroll, 11.2%; and excise, 0.8%. First, this short comparison verifies further the progressivity of the federal individual income tax, and, when comparing median family federal excise tax rates to those for families in the fourth quintile, 1.0% (CBO) and 0.6% (NCLR), the regressivity of federal excise taxes. Second, despite the fact that the median national family has a much higher income than the median Hispanic family, both pay a similar proportion of income in federal payroll taxes, which reemphasizes the extreme burden payroll taxes place on Hispanic families. As far as average state and local tax rates, the progressivity of state and local individual income taxes, regressivity of state and local sales and excise taxes, and their combined burden on lower-income families, and, in particular, Hispanic families, becomes apparent when comparing median national and Hispanic families in New York. In 1995, CTJ estimated the following average state and local tax rates for non-elderly married-couple families in the third quintile (average income, \$52,500) in New York: individual income, 5.2%; sales, 2.5%; and excise, 0.6%. In contrast, according to NCLR's analysis, average state and local tax rates for the Hispanic family in the third quintile (average income, \$25,000) in New York were: individual income, 0.9%; sales, 2.7%; and excise, 0.5%. Moreover, average tax rates for families in the fourth quintile in New York also support the progressivity of state and local individual income taxes, 6.1% (CTJ) and 4.2% (NCLR); and the regressivity of state and local sales taxes, 2.1% (CTJ) and 2.4% (NCLR), and excise taxes, 0.5% (CTJ) and 0.4% (NCLR). When combined, state and local individual income, sales, and excise taxes extracted 4.1% of income from the median Hispanic family in New York in 1995, and 8.3% of income from the median national family. Therefore, both the CBO and CTJ studies verify many of the same conclusions with regard to the fairness of federal, and state and local taxes, and confirm that Hispanic families are more burdened by certain taxes, in part, because they are concentrated at lower income levels.

* While the CBO and CTJ studies examine different family types, the majority of Hispanic families are married-couple families with children; furthermore, while NCLR calculated family tax burdens for the 1995 tax year, and the CBO estimated family tax burdens for the 1996 tax year, there was no significant change in federal tax law in the interim.

Report Conclusions

Based on the preceding analysis of individual taxes and tax systems and of Hispanic family tax burdens, this report finds that:

- ◆ **Taxes levied at the federal level are more progressive and equitable than taxes levied at the state and local level.** The federal tax system is relatively progressive and equitable primarily because the federal individual income tax is progressive, as is the federal payroll tax (although overly burdensome on lower-income families). In addition, the EITC helps to offset both federal individual income and payroll tax liability for lower-income families. Accordingly, total average federal tax rates for Hispanic families in the lowest three quintiles in California, Texas, and New York were -9.8%, -9.8%, and 9.8%, compared to 24.9%, 26.0%, and 23.6%, respectively, for the Hispanic family in the highest quintile. At the state and local levels, tax systems are progressive in California and New York, mainly due to progressive individual income taxes. However, the tax systems in California and New York are made less progressive because of regressive state and local sales taxes and state excise taxes. This is also true for Texas, which has a regressive state and local tax system, primarily because the state does not levy an individual income tax. Total state and local taxes reduced income for the Hispanic family in the lowest quintile by 5.7% in California, 5.4% in New York, and 7.0% in Texas. In comparison, the Hispanic family in the highest quintile in California and New York had state and local tax burdens of 5.8% and 10.5%, respectively, and the comparable family in Texas a much lower tax burden of 2.2%.
- ◆ **The individual income tax is the most progressive and equitable tax levied at either the federal or state and local level.** The individual income tax at the federal level is progressive and vertically equitable because it has a graduated tax rate and generous tax base structure (including the EITC). To illustrate, Hispanic families in the lowest two quintiles in California, Texas, and New York had federal individual income tax liabilities of zero in 1995, while the Hispanic family in the third quintile – whose average income is near the median for all Hispanic families – had a tax liability of \$581. However, by claiming the EITC, federal individual income tax liability was completely offset for the Hispanic family in the third quintile, and Hispanic families in the lowest three quintiles received refunds of \$1,206, \$3,033, and \$547, respectively, in 1995, due to the fact that the credit is refundable. In contrast, Hispanic families in the highest quintile in California, Texas, and New York had federal individual income tax rates of 12.7%, 13.8%, and 11.4%, respectively, in 1995. State and local individual income taxes are also fairly progressive and vertically equitable in California and New York due to large adjustments to the tax base, and additionally in California because of graduated tax rates (New York state and New York City have relatively flat income tax rates). Average state and local individual income tax rates for Hispanic families in the lowest three quintiles in New York were 0.0%, 0.0%, and 0.9% in 1995, compared to 8.6% for the family in highest quintile.

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- ◆ **The most regressive and least equitable taxes are:**
 - ◇ **The federal payroll tax.** The federal payroll tax is fairly progressive because wages and salaries comprise a slightly larger share of income for families in the highest two quintiles. However, it is less progressive than the federal individual income tax, and also the most financially detrimental to lower-income families, because the tax is levied at a flat rate and there are no adjustments to the base.* In 1995, Hispanic families in the lowest, second, and third quintiles had their incomes reduced by 6.6%, 8.8%, and 11.2%, respectively, by the federal payroll tax.
 - ◇ **Federal and state excise taxes, and state and local sales taxes.** State and local sales taxes, and federal and state excise taxes, are regressive because they are levied at flat rates on goods and services which are consumed at similar levels by lower- and higher-income families. Average state and local sales tax rates for Hispanic families fell by quintile in each state, in California, from 4.3% in the lowest quintile to 1.6% in the highest quintile; in Texas, from 5.4% to 1.9%; and in New York, from 4.3% to 1.7%. In addition, 1.6% of total income went to pay federal excise taxes for the Hispanic family in the lowest quintile in California, Texas, and New York, compared to 0.4% for the Hispanic family in the highest quintile. Likewise, the average state excise tax rate for the Hispanic family in the lowest quintile in Texas, for example, was 1.6%, and 0.3% for the Hispanic family in the highest quintile.
 - ◆ **Income taxation is progressive and equitable, while consumption taxation is regressive and inequitable.** Taxes on income are progressive, and vertically equitable with a graduated-rate structure and proportional with a flat-rate structure, because sources of income are fairly similar between lower- and higher-income families and the base allows for adjustments. In addition, since sources of income are constant between families at similar income levels, income taxes are also horizontally equitable. In contrast, taxes on consumption are regressive and not vertically equitable because they are levied at flat rates on comparable tax bases. While lower-income families spend less on non-exempt sales and excise taxable items than higher-income families, the differences are not great. Therefore, such taxes exact a larger share of income from lower-income families under a flat tax rate. Furthermore, consumption taxes are less horizontally equitable than income taxes because consumption patterns are variable even among families at similar income levels, which may result in very different tax burdens for those families. As an example of the varying impact of income and consumption taxation, average state and local individual income tax rates in California increased from 0.0% for the Hispanic family in the lowest quintile to 3.8% for the Hispanic family in the highest quintile, while, average state and local sales tax rates decreased from 4.3% to 1.6%, for the respective Hispanic families.

* Payroll tax liability for lower-income families is reduced indirectly through the EITC.

- ◆ **Taxes levied at graduated rates are generally more progressive and equitable than taxes levied at flat rates.** Of all the taxes studied, the federal individual income tax is one of two which has a graduated tax rate structure (the other being California's individual income tax), and, relatedly, the tax is the most progressive tax levied at any level. By contrast, New York state and New York City's individual income taxes, the federal payroll tax, federal and state excise taxes, and state and local sales taxes are levied at flat rates. Assuming comparable tax bases (either sources or uses of income), lower-income families pay a smaller proportion of their income in taxes than higher-income taxpayers under a graduated-rate structure, as opposed to a flat-rate structure. However, many flat-rate taxes are made more progressive by allowing for deductions and exemptions to the tax base, and by tax credits. To contrast the difference, while both are levied on AGI, with similar deductions, the average federal individual income tax rate for the Hispanic family in the lowest quintile in New York was -18.0% in 1995, and 11.4% for the Hispanic family in the highest quintile, compared to an average state and local individual income tax rate of 0.0% and 8.6% for the Hispanic family in the respective quintiles.
- ◆ **Adjustments to the tax base are significant determinants of the progressivity and equity of a tax.** The federal individual income tax and federal payroll tax provide an excellent comparison of respectively more and less progressive and equitable tax base structures. The federal individual income tax and payroll tax have very similar tax bases before adjustments, with the individual income tax levied primarily on wages and salaries and the payroll tax levied solely on wages and salaries. However, the two federal taxes have very different tax bases after adjustments. The federal individual income tax grants both standard deductions and exemptions to the tax base, which essentially exempts most lower-income families from paying individual income taxes. The addition of the EITC is especially beneficial for low-income families. The payroll tax, on the other hand, has no deductions or exemptions; thus, lower-income families pay a comparable percentage of their income in payroll taxes as higher-income families. As a result, the Hispanic family in the third quintile in California had an average federal individual income tax rate of -2.2% and an average federal payroll tax rate of 11.2%, while the Hispanic family in the highest quintile had average federal individual income and payroll tax rates of 12.7% and 11.8%, respectively.
- ◆ **Analyses of the burden individual taxes or tax systems place on families must include a study of average tax rates.** As documented in the previous section, average tax rates are the most accurate measure of the effect of taxes on families. While statutory tax rates show the various tax rates families face, and marginal tax rates help assess the inhibiting effect taxes have on income growth, average tax rates reveal the actual impact of taxes on Hispanic family income. Furthermore, average tax rates are the only measurement which can be used to compare the tax burdens of families at similar or dissimilar income levels, and in the same or different states or cities, as well as the tax systems of different levels of government. Finally, average tax rates are the best measurement of the progressivity and equity of individual taxes, and tax systems. For example, the statutory state and local sales tax rate in California was 8.25% in 1995, but even more revealing the Hispanic family in the lowest quintile had their income reduced by 4.3% (average state and local sales tax rate) in 1995.

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Policy Implications and Recommendations

Overview

Tax policy plays an important — although sometimes neglected — role in the economic well-being of the nation's families. Hispanic families, in particular, stand to gain or lose in tax policy debates because, of all major racial/ethnic groups in the U.S., Latinos have both the highest poverty rate and the largest proportion of married-couple families with at least one worker living below the poverty line. Therefore, when federal lawmakers decide to expand or reduce the Earned Income Tax Credit (EITC), or how to structure child or education tax credits, it has significant implications for Hispanic workers and their families.

Consistent with the preceding analysis, NCLR has developed three basic principles which should guide tax reform efforts. The following section outlines these principles, applies them to several pending tax reform proposals, and lays out specific recommendations for policy makers and Latino organizations and researchers.

Principles

Both the Administration and Congress have proposed a number of changes to the federal tax system over the past few years. These changes include the adoption of a flat-rate individual income tax, a \$500-per-child tax credit, and a reduction in the capital gains tax rate. Furthermore, President Bill Clinton's proposed fiscal year (FY) 1998 budget includes targeted tax cuts and tax credits, while Republican Congressional leaders seek deep tax cuts in the budget package.

Both the Hispanic population's economic profile and this report's analysis suggest that, to have a positive impact on the income of Hispanic workers, tax reform proposals should seek to:

- ◆ **Reward work.** Because Latinos have both the highest labor force participation rates and lowest income levels of any racial/ethnic group, tax reform proposals should seek to strengthen the financial value or rewards that employment can offer. At present, the federal tax code simultaneously hurts and helps low-income Hispanic families; it hurts through the payroll tax and it helps through the EITC. The payroll tax garnered the largest share of federal, state, and local taxes in 1995, reducing income levels for Hispanic families in the lowest three quintiles by 6.6%, 8.8%, and 11.2%, respectively. In contrast, according to the U.S. Census Bureau, 33.7% of Hispanic households received the EITC in 1995 and averaged \$1,515 in EITC benefits per household. As a result, the after-tax poverty rate for Hispanic families was reduced by 2.9 percentage points in 1995. The above example shows how federal tax reform efforts can either hinder low-income, working families or encourage work and foster economic self-sufficiency. Tax reform

proposals, including the capital gains tax cut and the flat tax, may or may not lead to increased growth, but generally do not reward low-wage work or improve the economic status of lower-income, working Hispanic families.

- ◆ **Reach lower-income families.** While lower-income families generally are not overly burdened by the federal tax system, tax policy can be used to help raise the income levels of these families and, in the process, move many out of poverty. Unlike some federal expenditure programs, federal taxes have a direct impact on the income levels of both very low-income and near-poor families. For example, the federal payroll tax and federal excise taxes combined to reduce the income of Hispanic families in the lowest two quintiles by 8.2% and 9.8%, respectively, in 1995 — an enormous amount given mean income levels of \$6,684, and \$15,501, respectively, for the two lowest quintiles. Despite the fact that these lower-income families have the greatest need for tax relief, most of the current tax reform proposals would have no effect on the two lowest Hispanic income quintiles.
- ◆ **Move toward greater progressivity.** The federal tax system is more progressive than state and local tax systems primarily because of the federal individual income tax. However, while the federal tax system is progressive overall, there are aspects that could be reformed. Because Hispanic workers tend to be concentrated in low-wage jobs and Hispanic families, on the whole, have low incomes, the federal payroll tax and federal excise taxes are the most burdensome and regressive federal taxes, respectively, for Hispanic families. Although these federal taxes invite reform, most of the changes being discussed focus on the progressive individual income tax which would primarily benefit higher-income families and widen the already large income gap.

In addition to these broad principles, this analysis suggests that balanced budget proposals which include tax reform initiatives should also seek to maintain essential federal programs. The possibility of major tax cuts being coupled with significant spending cuts should be of concern to Latinos, because many of the programs which serve lower-income Americans have been targeted for spending reductions. While many tax cut proposals would not have significant impacts on lower-income Hispanics, spending cuts in entitlement and discretionary programs serving the poor would have significant adverse consequences for low-income Latinos in need of these services.

Policy Implications

The nation's tax system reflects its economic priorities, as well as its implicit support for social values, such as a strong work ethic, two-parent families, and home ownership. These issues, in particular, are relevant for Hispanic families, given their strong connection to the workforce, their high proportion of family households, and their low rate of home ownership. Additionally, the new welfare reform law and potential employment and training legislation may lead to an increase in the Hispanic working poor population. Within this context, tax reform proposals offer one approach to foster the economic progress of Hispanic and other workers — or curtail economic opportunity. Based on the belief that tax policies should promote both fairness for those workers at the lower end of the economic ladder and possi-

bilities for the nation's fiscal growth and prosperity, the following is a brief description of several pending tax reform proposals, and an assessment of the extent to which each would be harmful or beneficial to Hispanics.

- ◆ **Flat-rate individual income tax.** For the past few years, House Majority Leader Richard Armey (R-TX), and Senator Richard Shelby (R-AL), have been championing a flat-rate individual income tax proposal, which is modeled after the plan first advanced by Robert E. Hall and Alvin Rabushka in their 1985 book, *The Flat Tax*. The Armey-Shelby flat tax plan is also similar to the one embraced by Steve Forbes during the early part of his campaign for the 1996 Republican presidential nomination. Each of these proposals would replace the current graduated-rate federal individual income tax with a flat-rate individual wage tax. Under the Armey-Shelby plan, the flat-rate wage tax would be levied at a rate of 20% for the first two years, declining to 17% in the third year, on wages and salaries and pensions. The Armey-Shelby Flat Tax would provide sizable exemptions for married couples filing jointly, heads of households, single persons, and each dependent, but would offer no deductions for state and local income and property taxes, home mortgage interest, or charitable contributions. Furthermore, the Armey-Shelby flat tax proposal would eliminate the EITC, and capital gains income would not be taxed.
- ◇ **A flat-rate federal individual income tax would eliminate the progressive aspects of the current federal individual income tax; increase federal, and overall, tax burdens for low-income, working Hispanic families; and could jeopardize spending on effective entitlement and discretionary programs.** While the federal individual income tax rate under the 17% Armey-Shelby Flat Tax would remain relatively unchanged for the Hispanic family in the lowest quintile, their total average federal tax rate would increase 18.0 percentage points because individual income, and payroll, tax liability would no longer be offset by the EITC. In contrast, it is estimated that a Hispanic family in the highest quintile living in California, for example, would find its total average federal tax rate decline by 6.6 percentage points under the Armey-Shelby Flat Tax. Furthermore, the U.S. Treasury Department estimates that federal tax revenues would decline by \$186 billion per year with the adoption of a flat-rate individual wage tax, which could bring about cuts in entitlement and discretionary programs, several of which significantly benefit Hispanic working families.
- ◆ **\$500-per-child tax credit.** A \$500-per-child tax credit was included in the seven-year balanced-budget plan passed by Congress in late 1995 and in the FY 1995, FY 1997, and FY 1998 budget plans submitted by the Clinton Administration. The child tax credit was also supported by several Congressional candidates during the 1996 campaign, and is expected to be offered in the next Congressional session, either as an independent proposal or as one piece of a larger plan. President Clinton's initial FY 1998 budget would provide a \$500 child tax credit for dependents, which would be phased out for families at higher income levels. Ultimately, the child tax credit could take several forms: the credit could be a fixed amount per child or vary by family size, and be the same amount at all income levels or differ by income level. In whatever form, the child tax credit would be subtracted from federal individual income tax liability (a tax credit). Under the current federal individual income tax system, tax relief for families with children is provided through the dependency exemption, which is subtracted from adjusted gross income

(AGI) subject to the federal individual income tax (a tax deduction). Tax burdens for lower-income families with children are also reduced by the EITC. The child tax credit could also be incorporated into the federal individual income tax system in a number of ways: the credit could be added to the current sources of tax relief for families with children, i.e., the dependency exemption and the EITC; it could completely replace one or both of these sources of tax relief; or all three sources could be combined. Viewed separately, the \$500-per-child tax credit would be more advantageous to families with children than the dependency exemption, because the former reduces federal individual income tax liability and average tax rates by a larger amount (since it is subtracted directly from tax liability rather than AGI).

- ◇ **The adoption of a child tax credit would benefit lower-income, working Hispanic families only if the proposed change made the federal individual income tax structure more progressive.** If the child tax credit replaced the dependency exemption, in order to remain more beneficial for lower-income, working families, the EITC would have to be maintained. If the dependency exemption, EITC, and \$500-per-child tax credit were combined, the resulting adjustment to tax liability (tax credit) or AGI (tax deduction) would have to be structured carefully, in order to ensure that the progressive and equitable characteristics of the current federal individual income tax system are preserved.
- ◆ **Capital gains tax cut.** While President Clinton's proposed FY 1998 budget would essentially eliminate the capital gains tax on residential home sales, the Republican Congressional leadership is calling for much deeper cuts in the capital gains tax on the sale of assets, proposing to reduce the rate from 28.0% to 19.8%. Since most of the FY 1995 budget reconciliation bills proposed by Congress also contained significant cuts in the capital gains tax rate, the FY 1998 balanced budget proposals advanced by Congress will most likely include such a tax reform proposal.
- ◇ **Reducing the capital gains tax rate is likely to have a negative effect on lower-income Hispanic families.** A cut in the capital gains tax rate appears to be beneficial only to higher-income Americans, unless it is balanced by tax relief targeted to lower-income, working families and spending levels for programs which benefit Hispanics and other lower-income persons are not reduced. While research has repeatedly shown that a capital gains tax cut would solely and significantly benefit higher-income families, proponents argue that a reduction in the capital gains tax rate would spur investment, expand growth, and increase revenue. However, it still remains unclear if, or by how much, a capital gains tax cut would stimulate investment. Moreover, rarely do cuts lead to expected levels of growth, and, at least in the short term, revenues would decline, which could lead to decreases in spending in order to maintain deficit reduction levels. Furthermore, since a capital gains tax cut benefits higher-income families and not lower-income families, and White more than Hispanic families, the gap between lower- and higher-income families, and Hispanic and White families, would increase. A capital gains tax cut would be especially detrimental to economic parity since Hispanic and White families in the highest quintile held nearly one-half (49.3% and 48.7%, respectively) of aggregate income in 1995, and income levels for Hispanics are either declining or increasing slightly.

- ◆ **President Clinton's targeted tax cuts and credits.** President Clinton's proposed FY 1998 budget includes a number of different tax credits and tax deductions to further two goals: improving access to a college education and moving people from welfare to work. First, the President's proposed budget contains the following adjustment to the federal individual income tax: a \$1,500 non-refundable HOPE scholarship tax credit for first- and second-year college students, and a \$5,000 tax deduction, increasing to \$10,000 in 1999, per family, for higher education and/or training. Second, the President proposes a tax subsidy to employers who hire certain qualified welfare recipients in his initial FY 1998 budget plan. Employers would receive a 50% credit on the first \$10,000 of a former welfare recipient's wages for up to two years.
- ◇ **Education tax credits are unlikely to benefit Hispanics substantially.** Most lower-income, working Hispanic families would not benefit from the \$1,500 tax credit because they have little or no federal individual income tax liability, and the credit would not be refundable, like the EITC. These families would also not benefit from the \$10,000 tax deduction because, at present, virtually no income is subject to the federal individual income tax. Therefore, both the broad, non-refundable tax credit and tax deduction would be targeted to middle- and higher-income families, even though lower-income families are least able to bear the burden of rising college tuition and need the most assistance in accessing and affording a college education.
- ◇ **The efficacy of the Administration's welfare-to-work strategy is questionable.** While the aim of maximizing employment opportunities for welfare recipients is commendable, particularly given the time limits imposed by the new welfare reform law, the majority of research suggests that tax-based subsidies are not likely to be effective in creating net, new jobs, or in significantly increasing the employment of former welfare recipients. Such a subsidy is likely to encourage competition between welfare recipients and low-income workers without expanding the pool of jobs.

Recommendations

Consistent with the principles identified above, NCLR believes that **policy makers** should:

- ◆ **Maintain, strengthen, and expand the Earned Income Tax Credit.** It is difficult to identify any public policy which has a more profound, positive impact on Hispanics in general, and working poor families in particular, than the EITC. It rewards work, reaches the lowest-income working families, and promotes progressivity. Although the Congress, for the most part, has defeated attempts in recent years to cut the EITC, more needs to be done to strengthen its beneficial effects. Specifically,
 - ◇ **Congress should consider increasing EITC benefits for larger families** (it is currently essentially "capped" at two children).
 - ◇ **State policy makers should enact state EITCs** designed to guarantee that no family with a year-round, full-time worker is poor.
- ◆ **Resist attempts to increase payroll taxes as part of entitlement reforms.** Just as the EITC meets each of the three principles outlined by NCLR, a payroll tax increase, from a Latino

perspective, would be the worst of all possible worlds. It would punish work, have its greatest negative effects on those with the lowest incomes, and would decrease progressivity in the tax system overall; moreover, it could also provide disincentives to job creation. There are few or no substantive policy objectives which would justify a major tax increase on the working poor, notwithstanding the potential political attractiveness of “saving” Social Security or Medicare through a “modest” payroll tax hike.

- ◆ **Assure that any tax credits enacted are refundable and targeted to low-income and working poor families.** The lowest-income Hispanic families profiled in this report would receive essentially no benefit from any of the proposed children’s tax credits or President Clinton’s proposed education tax credits. To the extent such proposals are adopted, they should be made refundable, even if this means reducing the size of the credit. Moreover, such credits could be made more affordable and targeted to low-income and working poor families by phasing them out at higher income levels.

NCLR also believes that this analysis demonstrates the need for **Hispanic advocacy organizations and researchers** to focus greater attention on tax policy; specifically, NCLR recommends that:

- ◆ **Latino advocates and researchers should target tax policy issues.** Few public policy issues affect the economic well-being of Latinos more than tax policy, and the virtual absence of an Hispanic perspective in tax policy debates is unacceptable.
- ◆ **Hispanic researchers and policy analysts should:**
 - ◇ **Carry out analyses on the effects of existing and proposed tax policies by comparing Hispanic to non-Hispanic families.** NCLR’s analysis largely compares the effects of taxes on various Latino families to each other. The next generation of research should compare effects on Hispanic families vs. non-Hispanic families.
 - ◇ **Construct models which will permit analyses of aggregate effects of various policy options on Latino and non-Latino families.** In preparing this report NCLR constructed a simple “model” to calculate tax burdens on hypothetical Latino families. Future research should expand this model to allow analysts and policy makers to assess the distributional effects of existing and proposed policies on the entire Latino community; these models should be “matched” with standard income quintile analyses now carried out for the whole U.S. population.
- ◆ **Researchers should carry out Hispanic-specific, “dynamic” vs. “static” analyses of proposed growth-oriented tax policies.** As noted above, NCLR is not persuaded that flat taxes, capital gains cuts, or tax-based employer subsidies will significantly improve economic opportunity for lower-income Latinos, and, in the absence of such evidence, is disinclined to support such measures which tend to have negative distributional income effects. Proponents of such measures, however, argue that the economic growth and job creation resulting from enactment of such measures — using a “dynamic” economic growth model — would more than offset any negative income effects for Hispanics. NCLR believes these proponents should take their research to another level, and attempt to quantify in specific terms the purported benefits of such growth-oriented tax policies for Latinos in general and lower-income Hispanics in particular.

NCLR hopes that this report stimulates further research on tax policy and tax reform, and on Hispanic workers, who represent a significant and growing segment of the U.S. labor force. Despite their strong work ethic, Latinos have the lowest income levels of any racial/ethnic group in the country and thus bear the brunt of the regressive and inequitable elements of federal, state, and local tax systems. In the future, policy makers should seek to support the efforts of hard-working, lower-income families by choosing to reform these systems in ways which increase progressivity, reward work, and reduce tax burdens on low-income families.

Additionally, for Hispanics in particular, studies are needed on the macroeconomic effects of tax policy and tax reform, as well as on how certain tax initiatives affect Hispanic versus non-Hispanic family tax burdens. This initial report should provide a foundation for further research in these areas. It should also serve as a guide to inject a Hispanic perspective into upcoming tax reform debates, in order to improve the status of Hispanic workers and their families, as well as to promote the economic growth of the nation.

Appendix

Glossary*

Ability-to-pay principle — A means used to achieve vertical equity by increasing the average tax rate as income increases.

Average tax rate — The actual tax rate, for individual or total taxes; computed by dividing tax liability by total income.

Benefits-received principle — A means used to achieve vertical equity by setting tax liability in proportion to benefits received.

Capital income — Interest; dividends; and rents, royalties, estates, and trusts.

Cash income — Wages and salaries; self-employment income; unemployment compensation; workers' compensation; Social Security; Supplemental Security Income (SSI); public assistance; veterans' payments; survivor benefits; disability benefits; pension or retirement income; interest; dividends; rents, royalties, and estates and trusts; educational assistance; alimony; child support; and financial assistance from outside of the household, and other periodic income.

Family — A group of two or more persons related by birth, marriage, or adoption who reside together; all such persons are considered as members of one family.

Family Household — A household maintained by a family (see definition above); members of family households include any unrelated persons who may be residing there.

Government cash benefits — Unemployment compensation; workers' compensation; Social Security; SSI; public assistance; veterans' payments; survivor benefits; disability benefits; and educational assistance.

Government noncash benefits — Food stamps; rent subsidies; Medicaid; Medicare; and employer-provided health benefits.

Horizontal equity — When taxpayers with the same income are taxed the same regardless of how their income was earned.

Household — All persons who occupy a housing unit; a house, an apartment or other group of rooms, or a single room is regarded as a housing unit when it is occupied or intended for occupancy as separate living quarters.

Labor income — Wages and salaries and self-employment income.

* Source: U.S. Bureau of the Census, Current Population Reports, Series P60-193, *Money Income in the United States: 1995 (With Separate Data on Valuation of Noncash Benefits)*, U.S. Government Printing Office, Washington, D.C., 1996; U.S. Congressional Budget Office, *The Changing Distribution of Federal Taxes: 1975-1990*, Washington, D.C., October, 1987; Thomas, Robert P., *Microeconomics: Principles and Applications*, Orlando, Florida: The Dryden Press, 1990, p.219-221; Hall, Arthur P., "Individual Effective Tax Rates in the United States," *Tax Foundation*, Washington, D.C., June 1994.

Marginal tax rate — The tax rate on an increase in income, for individual or total taxes; computed by dividing the change in tax liability by the change in income.

Other income — Pension or retirement income; alimony; and child support.

Progressive taxation — When the percentage of a person's income paid in taxes increases as personal income increases, i.e., higher-income taxpayers pay a greater percentage of income in taxes than lower-income taxpayers; the marginal tax rate is greater than the average tax rate.

Proportional taxation — When an individual's taxes change in direct proportion to a change in income, i.e., all taxpayers pay the same proportion of their income in taxes.

Regressive taxation — When the percentage of income paid in taxes actually declines as income increases, i.e., lower-income taxpayers pay a greater percentage of income in taxes than higher-income taxpayers; and the average tax rate is greater than the marginal tax rate.

Statutory tax rate — The tax rate established by law.

Vertical equity — When higher-income taxpayers are taxed differently from lower-income taxpayers.

Hispanic Family Profiles
by Income Quintile
1995

	Lowest Quintile	Second Quintile	Third Quintile	Fourth Quintile	Highest Quintile
Mean income:	\$6,700	\$15,500	\$25,000	\$40,000	\$80,000
Type of family:	Female-headed	Married-couple	Married-couple	Married-couple	Married-couple
Age of householder:	25	30	35	40	50
Size of family:	3	5	4	4	5
Number of children:	2	3	2	2	3
Number of earners:	1	1	2	2	2
Educational attainment:	Less than 12th grade	High school graduate	High school graduates	College graduate/High school graduate	College graduates
Labor force participation:	Worked part-time	Worked full-time	Worked full-time/part-time	Worked full-time/full-time	Worked full-time/full-time
Type of Occupation:	Cleaner	Machine operator	Construction worker/Sales worker	Restaurant manager/Administrative assistant	Physician/Marketing manager
Type of housing:	Rented	Rented	Rented	Owned	Owned

**Federal Tax Liabilities and Average Tax Rates for Hispanic Families
in California, Texas, and New York
by Income Quintile
1995**

	CALIFORNIA, TEXAS, NEW YORK 1/					
	Tax	Average				
	Liability	Tax Rate				
LOWEST QUINTILE						
Total	(\$657)	-9.8%				
Individual income tax	\$0	0.0%				
EITC	(\$1,206)	-18.0%				
Payroll tax	\$440	6.6%				
Excise taxes	\$110	1.6%				
SECOND QUINTILE						
Total	(\$1,523)	-9.8%				
Individual income tax	\$0	0.0%				
EITC	(\$3,033)	-19.6%				
Payroll tax	\$1,356	8.8%				
Excise taxes	\$153	1.0%				
THIRD QUINTILE						
Total	\$2,452	9.8%				
Individual income tax	\$581	2.3%				
EITC	(\$1,128)	-4.5%				
Payroll tax	\$2,797	11.2%				
Excise taxes	\$203	0.8%				
FOURTH QUINTILE						
Total	\$8,089	20.2%				
Individual income tax	\$2,862	7.2%				
Payroll tax	\$4,984	12.5%				
Excise taxes	\$244	0.6%				
	CALIFORNIA		TEXAS		NEW YORK	
	Tax	Average	Tax	Average	Tax	Average
	Liability	Tax Rate	Liability	Tax Rate	Liability	Tax Rate
HIGHEST QUINTILE						
Total	\$19,923	24.9%	\$20,784	26.0%	\$18,859	23.6%
Individual income tax	\$10,161	12.7%	\$11,022	13.8%	\$9,097	11.4% 2/
Payroll tax	\$9,478	11.8%	\$9,478	11.8%	\$9,478	11.8%
Excise taxes	\$284	0.4%	\$284	0.4%	\$284	0.4%

1/ Federal tax liabilities and average tax rates are the same for the family in the first four quintiles in each of the states because it was assumed they would not itemize their deductions.

2/ State and local individual income taxes; real estate and personal property taxes; mortgage interest; and charitable contributions were all deducted from adjusted gross income.

Source: NCLR. See Appendix for methodology employed in tax liability and average tax rate calculations.

**State and Local Tax Liabilities and Average Tax Rates for Hispanic Families
in California, Texas, and New York
by Income Quintile
1995 1/**

	CALIFORNIA		TEXAS		NEW YORK	
	Tax Liability	Average Tax Rate	Tax Liability	Average Tax Rate	Tax Liability	Average Tax Rate
LOWEST QUINTILE						
Total	\$379	5.7%	\$469	7.0%	\$363	5.4%
Individual income tax	\$0	0.0%	N.A.	N.A.	\$0	0.0%
Sales tax	\$287	4.3%	\$364	5.4%	\$291	4.3%
Excise taxes	\$92	1.4%	\$105	1.6%	\$72	1.1%
SECOND QUINTILE						
Total	\$593	3.8%	\$710	4.6%	\$571	3.7%
Individual income tax	\$0	0.0%	N.A.	N.A.	\$0	0.0%
Sales tax	\$462	3.0%	\$561	3.6%	\$471	3.0%
Excise taxes	\$131	0.8%	\$149	1.0%	\$101	0.6%
THIRD QUINTILE						
Total	\$820	3.3%	\$948	3.8%	\$1,024	4.1%
Individual income tax	\$0	0.0%	N.A.	N.A.	\$235	0.9%
Sales tax	\$649	2.6%	\$755	3.0%	\$663	2.7%
Excise taxes	\$170	0.7%	\$194	0.8%	\$127	0.5%
FOURTH QUINTILE						
Total	\$1,559	3.9%	\$1,310	3.3%	\$2,775	6.9%
Individual income tax	\$408	1.0%	N.A.	N.A.	\$1,661	4.2%
Sales tax	\$944	2.4%	\$1,074	2.7%	\$966	2.4%
Excise taxes	\$207	0.5%	\$236	0.6%	\$148	0.4%
HIGHEST QUINTILE						
Total	\$4,617	5.8%	\$1,795	2.2%	\$8,379	10.5%
Individual income tax	\$3,072	3.8%	N.A.	N.A.	\$6,875	8.6% 2/
Sales tax	\$1,319	1.6%	\$1,537	1.9%	\$1,349	1.7%
Excise taxes	\$226	0.3%	\$257	0.3%	\$155	0.2%

1/ Tax liabilities and average tax rates are based on 1995 tax rate and tax base data, except for state and local sales tax bases which were based on 1994 data.

2/ California: Real property tax and state personal property tax, mortgage interest, and charitable contributions were all deducted from adjusted gross income; New York: Real property tax, mortgage interest, and charitable contributions were deducted.

N.A. = Not Applicable

Source: NCLR. See Appendix for methodology employed in tax liability and average tax rate calculations.

**Federal Tax Rates and Adjustments
1995**

Individual income tax

Marginal rates:

Married filing jointly:

\$0-39,000 15.00%

\$39,001-\$94,250 28.00%

Standard deductions:

Single \$3,900

Married filing jointly \$6,550

Exemptions \$2,500

Earned Income Tax Credit:

1 child

Credit rate 34.00%

Phaseout rate 15.98%

2 or more children

Credit rate 36.00%

Phaseout rate 20.22%

Payroll tax 1/ 15.30%

Old Age Survivors' Insurance 11.20%

Disability Insurance 1.20%

Hospital Insurance 2.90%

Excise taxes

Alcohol:

Liquor 30.00%

Wine 2/ 2.68%

Beer 8.29%

Cigarette 9.60%

Gasoline 14.15%

Telephone 3/ 3.00%

1/ The employee and employer share are both 7.65%, but the employer share is included in the employee share because in the long run the employer will either reduce wages or increase prices, meaning the entire burden ultimately falls on the employee/consumer.

2/ Not over 14% alcohol.

3/ Local telephone and long-distance service.

Source: U.S. Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, Vol.I: Budget Processes and Tax System, Washington, D.C., September 1995; Internal Revenue Service; and Storey, James R., The Earned Income Tax Credit: A Growing Form of Aid to Low-Income Workers, Congressional Research Service, April 13, 1995.

State and Local Tax Rates and Adjustments 1995				
	California (Los Angeles)		Texas (San Antonio)	New York (New York)
Individual income tax				
Marginal rates:				
State			N.A.	1/
Married filing jointly				
\$0-9,662	1.00%			
\$9,663-22,898	2.00%			
\$22,899-36,136	4.00%			
\$36,137-50,166	6.00%			
\$50,167-63,400	8.00%			
\$63,401-219,872	9.30%			
\$0-12,999				4.55%
\$13,000-18,999				5.55%
\$19,000-24,999				6.55%
Over \$25,000				7.59%
Local	N.A.	1/	N.A.	1/
Single				
\$0-7,999				2.57%
Married filing jointly				
\$0-14,399				2.57%
\$14,400-26,999				3.83%
\$27,000-44,999				4.39%
\$45,000-107,999				4.40%
Standard deductions:				
State				
Single	\$2,487			\$6,600
Married filing jointly	\$4,974			\$10,800
Personal exemptions:				
State				
Single	\$66	3/		\$1,000
Married filing jointly	\$132	3/		\$2,000
Dependents	\$66	3/		\$1,000
Sales tax				
Rates:				
State	8.25%		7.75%	8.50%
Local:	6.00%		6.25%	4.00%
County	1.25%			
City			1.00%	4.25%
Other	1.00%		0.50%	0.25%
Excise taxes (State)				
Alcohol:				
Liquor	7.33%		5.33%	19.08%
Wine	0.50%		0.51%	0.47%
Beer	2.86%		2.77%	3.00%
Cigarette	14.80%		16.40%	22.40%
Gasoline	13.85%		16.15%	6.15%

1/ Texas does not levy an individual income tax nor do any Texas localities. Los Angeles businesses pay the greater of the corporate income tax or payroll tax, and, in most cases, it is the former.
2/ New York state and New York City also offer household tax credits.
3/ Credit.
4/ Metropolitan Commuter Transit District tax.

Source: U.S. Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, Vol. I: Budget Processes and Tax System, Washington, D.C., September 1995; Hall, Arthur P., State Tax Rates and 1994 Collections, Tax Foundation, Washington, D.C., June 1995; and 1995 state and local income tax forms and instructions.

Hispanic Family Profiles

Methodology

Hispanic family profiles by quintile were constructed in order to gain an understanding of the “typical” Hispanic family in each quintile, and then to determine how federal, state, and local taxes affect each of those families. Hispanic families were separated into quintiles based on 1995 Hispanic mean family income data obtained from the U.S. Bureau of the Census. The U.S. Bureau of the Census calculated Hispanic mean family income for each quintile by first dividing the total number of families (6,287) by five to arrive at an approximate number of families per quintile (1,257). Then, aggregate, or total, income in each quintile was divided by 1,257 to reach mean income per quintile.*

The next step in the process was determining the demographic characteristics of each of the five Hispanic families. The characteristics which were assessed were: type of family; age of householder; size of family; number of children; number of earners; educational attainment; labor force participation; type of occupation; and type of housing. Since the U.S. Bureau of the Census does not break down families by demographic characteristics, quintile, and race/Hispanic origin, four sources were utilized in the process: “Percent Distribution of Families, by Selected Characteristics Within Income Quintile and Top 5 Percent in 1995” (U.S. Bureau of the Census table); *Income, Poverty, and Valuation of Noncash Benefits: 1994* (U.S. Bureau of the Census report); *Household and Family Characteristics: March 1994* (U.S. Bureau of the Census report); and *Fact Sheet on Black and Hispanic Workers: April 1996* (U.S. Bureau of Labor Statistics report).** For example, the Hispanic family in the third quintile in NCLR’s analysis is a married-couple family with two children, the householder is age 35, both parents are high school graduates, the father is working full-time as a construction worker and the mother part-time as a sales worker, and the family lives in rental housing.***

* Hispanic mean family income levels were rounded to the nearest 100, 1,000, or 10,000 for tax calculation purposes. *Median* income is usually employed when analyzing family income data because it is the middle income level; however, the U.S. Bureau of the Census does not possess median income data by quintile. *Mean* income is generally not used because it gives more weight to higher, or lower, incomes, and, therefore, is not truly representative of the typical family income in each quintile. For example, the mean and median income in a neighborhood with household incomes of \$10,000, \$12,500, \$15,000, \$17,500, \$20,000, \$35,000, and \$40,000 would be \$21,429 and \$17,500, respectively. While the difference is not great, the median income in the area is more indicative of the average income than is the mean income.

** In constructing the Hispanic family profiles by quintile, it was necessary to adjust U.S. Bureau of the Census data on families by demographic characteristics by quintile to represent Hispanic families more accurately because the U.S. Bureau of the Census data were more representative of White families, who constituted 84.6% of all families in 1995.

*** Each of the profiles is an estimate of the typical Hispanic family within each quintile and in no way typifies the majority of families in the quintiles.

Hispanic Tax Profiles

Methodology

The purpose of the tax profiles was to estimate what the typical Latino family in each income quintile pays in federal, state, and local taxes in California, Texas, and New York, and, more specifically, Los Angeles, San Antonio, and New York City. Tax liabilities and average tax rates (tax liability divided by total income) were estimated for the following federal taxes: individual income tax, payroll tax, and certain excise taxes, including taxes on alcohol, cigarette, gasoline, and telephone consumption. At the state and local level, the following tax liabilities and average tax rates were calculated: individual income tax, sales tax, and excise taxes levied on the consumption of alcohol, cigarettes, and gasoline.

The following set of sources contributed the tax rate and tax base information needed to calculate tax burdens for each of the individual taxes listed above: *Significant Features of Fiscal Federalism (September 1995)*, a compilation of tax rates and tax bases at the federal, state, and local levels, published by the Advisory Commission on Intergovernmental Relations (ACIR), which provided the majority of the data; federal tax rate and tax base information from the Internal Revenue Service (IRS); and Earned Income Tax Credit (EITC) rates from a Congressional Research Service (CRS) report entitled *The Earned Income Tax Credit: A Growing Form of Aid to Low-Income Workers*. A special report by the Tax Foundation, *State Tax Rates and 1994 Collections (June 1995)*, and state and local 1995 income tax forms and instructions downloaded from the Internet, supplied additional state and local tax rate and tax base data to ensure that all data pertained to the 1995 tax year. A complete listing of federal and state and local tax rates (for each of the three states and cities) is located earlier in the Appendix.

Before proceeding with a discussion of exactly how tax liabilities were calculated, additional comments should be made concerning a few of the tax rates which were utilized. First, while the employee and employer shares of the federal payroll tax are both 7.65%, a combined rate of 15.3% was used because most economists believe the total tax burden falls on employees. Second, with respect to federal and state excise taxes, since alcohol, which includes liquor, wine, and beer, and gasoline excise tax rates are listed in dollars per gallon, and cigarette tax rates in dollars per pack of twenty, tax rates per dollar had to be estimated for each. For alcohol excise tax rates, the first step in the process was to estimate an average price per gallon of liquor, wine, and beer. Since liquor, wine, and beer are not sold to the average consumer in gallon containers, an estimated price per liter for liquor and wine, and an estimated price per ounce for beer, were converted into an estimated price per gallon. For example, a liter of liquor costs approximately \$12, and since there are 3.785 liters in a gallon, the average price per gallon of liquor was estimated to be \$45. Wine and beer were valued at \$10.50 per liter (\$40 per gallon) and \$0.06 per ounce (\$7 per gallon), respectively, and a gallon of gasoline and a pack of cigarettes currently cost approximately \$1.30 and \$2.50,

respectively. The second step in the process was to divide the per-gallon, or per-pack, tax rate by the per-gallon, or per-pack, price to arrive at a percentage tax rate. For example, the federal per-gallon tax rate for liquor was \$13.50 in 1995, and thus the federal percentage tax rate for liquor was estimated to be 30% (\$13.50/45.00).

Another primary source employed in the estimation of tax liabilities was the 1994 Consumer Expenditure Survey (CES), and specifically the table which breaks down average annual expenditures of all consumer units by quintile of income before taxes. While these CES income quintiles are not broken down by race or Hispanic origin, both the source of income and average annual expenditures are fairly representative of the Hispanic population in each quintile because the quintiles are based on average income before taxes, which closely compares to Hispanic mean income levels.* Mean income levels for the lowest, second, third, fourth, and highest quintiles in the CES were \$6,748, \$15,906, \$27,511, \$43,421, and \$90,390, respectively, compared to actual Hispanic family mean income levels of \$6,684, \$15,501, \$24,566, \$37,940, and \$78,580 in 1995. While the majority of CES consumer units made up the White and other category, and the average age of the CES reference person was higher for the lowest, second, and third quintiles as compared to the respective Hispanic family householders in the NCLR profiles, the CES reference person was more likely to be female in the lowest quintile, and male in the second through highest quintiles, which was also true of the Hispanic family householders in those quintiles.** Furthermore, the reference person in the lower quintiles tended to be a high school graduate and live in renter-occupied housing, and the reference person in the higher quintiles tended to be a college graduate and reside in owner-occupied housing, which also closely compared to the Hispanic householders in each of those quintiles.

The CES also breaks down money income before taxes, or average income, for each of the quintiles. The categories of income include: wages and salaries; self-employment income; Social Security, private and government retirement; interest, dividends, rental income, and other property income; unemployment and workers' compensation and veterans' benefits; public assistance, Supplemental Security Income (SSI), and food stamps; regular contributions for support, including child support; and other income. For the purposes of NCLR's analysis, the CES sources of income were reduced to four categories: wages and salaries; interest, dividends, and rent; public benefits and other non-taxable income (Social Security; workers' compensation and veterans' benefits; and public assistance, SSI, and food stamps); and other income (self-employment income; unemployment compensation; regular contributions for support; and other income). The only adjustments to the CES distribution of income were increasing adjusted gross income (AGI) for the consumer units (families) in the lowest two quintiles, to one-half and two-thirds of income, respectively, to represent more

* It should be noted that while CES average income levels and Hispanic mean income levels are comparable, the former apply to households and the latter to families, which complicates the comparison somewhat because household income levels include single persons, and so are generally lower than family income levels.

** Consumer unit is defined as all related members of a particular household; persons living alone or sharing a household; or two or more persons living together who use their incomes to make joint expenditure decisions. The reference person is the individual in the consumer unit who responds to the survey. The consumer unit is comparable to the household, and the reference person to the householder, terms employed by the U.S. Bureau of the Census.

accurately the family's actual distribution of income.

Percentages for each source and expenditure of CES average income were figured for each consumer unit and those percentages were multiplied by rounded Hispanic mean family income to arrive at income and expenditure levels for the Hispanic family in each quintile. These income and expenditure totals were then used, along with the tax rate and tax base data, to calculate the tax liabilities, then average tax rates, for the Hispanic family in each quintile within each state and city.

Federal Taxes

Individual income tax

First, NCLR's categories of wages and salaries; interest, dividends, and rent; and other income were added together to arrive at AGI. Unemployment compensation and regular contributions for support were subtracted out of AGI for families in the highest two quintiles, and it was also assumed that those families would not have yet received Individual Retirement Account (IRA) distributions, pension payments, or Social Security benefits. Deductions and exemptions were then subtracted from AGI to reach taxable income. Under the federal individual income tax structure, taxpayers either take the larger of the standard deduction, which varies depending on filing status, (single, \$3,900; head of household, \$5,750; married filing jointly, \$6,550 in 1995), or itemized deductions. The following expenditures can be itemized and deducted from AGI: medical and dental expenses; taxes paid (state and local income taxes, real estate taxes, and personal property taxes); interest paid (home mortgage interest and investment interest); gifts to charity, i.e., charitable contributions; casualty and theft losses; job expenses; and miscellaneous deductions, e.g., tax preparation fees and moving expenses. In addition to standard or itemized deductions, \$2,500 is also subtracted from AGI for each exemption claimed on a family's tax return. The allowable standard deduction was subtracted from AGI for each of the first four families, as was an exemption amount based on the number of exemptions claimed by the families. Assuming that the family in the highest quintile would itemize its deductions, state and local individual income taxes, property taxes, mortgage interest, and charitable contributions were deducted from AGI for that family.* Finally, taxable income was multiplied by the 1995 tax rate, for married persons filing jointly, 15.0% for taxable incomes up to \$39,000, and 28.0% for taxable incomes between \$39,001 and \$94,250. Calcu-

* Medical expenses and casualty losses were not deducted from AGI for the family in the highest quintile because neither exceeded the federal floor for deductibility, 7.5% and 10.0% of AGI, respectively.

lated tax liabilities were verified using the federal tax table. Families in the lowest and second quintiles had zero tax liabilities after deductions and exemptions were subtracted from AGI.

EITC

After applying tax rates to taxable income, the resulting tax liability was reduced for families in the lowest, second, and third quintiles by the federal EITC. The EITC is a “refundable” federal individual income tax credit, meaning it is subtracted from federal individual income tax liability, and the difference is either paid by the taxpayer to the IRS, if positive, or paid by the IRS to the taxpayer, if negative. In either case, federal individual income tax liability is reduced. The credit rates, phaseout rates, and income ranges for each vary depending on the number of children and income level for each family. For example, the credit for the family in the third quintile was figured as follows: the maximum credit for families with two or more children in 1995 was \$3,033 [\$8,425, maximum creditable earnings, multiplied by 36.0%, the credit rate], but the family’s income level lies in the phaseout range, so the maximum credit was reduced by \$1,905 [AGI (\$20,422) less income where phaseout begins (\$11,000) multiplied by the phaseout rate (20.22%)], so the resulting credit is \$1,128. The same process was utilized for the families in the lowest and second quintiles, except different credit and phaseout rates were applied to their respective income levels.

Payroll tax

Federal payroll tax liabilities for Hispanic families in the first four quintiles were computed by multiplying wages and salaries by 15.3%, the combined employee and employer federal payroll tax rate. Since maximum taxable earnings for the Old Age Survivors’ Insurance (OASI) and Disability Insurance (DI) portions of the payroll tax were \$61,200 in 1995, and wages and salaries for the Hispanic family in the highest quintile were \$65,120, federal payroll tax liability for the family was reached by adding \$61,200 multiplied by the combined employee and employer OASI and DI payroll tax rate (12.4%) and \$65,120 multiplied by the combined employee and employer Hospital Insurance (HI) payroll tax rate (2.9%), which had no limit in 1995.

Excise taxes

Alcohol excise tax liability is a combination of excise tax rates for liquor, wine, and beer. Expenditures for liquor, wine, and beer were multiplied by their respective tax rates (explained above), to determine federal alcohol tax liabilities. Federal cigarette, gasoline, and telephone excise tax liabilities were calculated in the same manner.

State and Local Taxes

Individual income tax

State individual income tax liabilities for each family were computed in nearly the same manner as were federal individual income taxes. Only California and New York were analyzed because Texas does not levy an individual income tax. First, NCLR's categories of wages and salaries; interest, dividends, and rent; and other income were added together in order to arrive at AGI. Unemployment compensation and regular contributions for support were subtracted out of AGI for families in the highest two quintiles in California, and it was assumed that those families, and comparable families in New York, would not have yet received either IRA distributions, pension payments, or Social Security benefits. Second, taxable income was reached by subtracting standard or itemized deductions, and exemptions, from AGI. In California, families received a standard deduction of \$2,487 in single returns and \$4,974 in married-joint returns in 1995, or the following itemized deductions: real property tax; state personal property tax; mortgage interest; and charitable contributions. New York, on the other hand, offered a much higher standard deduction for both single returns (\$6,600), and married-joint returns (\$10,800) in 1995, or the same itemized deductions as in California, and a \$1,000 exemption for each dependent.* The allowable standard deduction was subtracted from AGI for families in the first four quintiles and property taxes, mortgage interest, and charitable contributions were itemized and deducted from AGI for the family in the highest quintile. The applicable number of exemptions was also subtracted from AGI for families in each of the five quintiles in New York. The resulting taxable income was then multiplied by the appropriate marginal individual income tax rate, and the accompanying dollar amount was added to the total to reach tax liability (which was confirmed by the California or New York tax table). The last step in the process was to subtract tax credits, \$66 per exemption in California and a household credit based on the number of exemptions for families in the first three quintiles in New York, from calculated tax liability to arrive at final state individual income tax liability. Individual income tax rates by income range for both California and New York are found earlier in the Appendix.

* Medical expenses and casualty losses can also be itemized in both California and New York, but were not deducted from AGI for the family in the highest quintile because neither exceeded the federal floor for deductibility, which most states follow, 7.5% and 10.0% of AGI, respectively.

Local individual income tax liabilities were estimated and added to the state total for the respective families in each quintile in New York. The cities of San Antonio and Los Angeles did not levy an income tax in 1995, thus only New York City was analyzed. The New York City individual income tax is levied on New York state taxable income. Therefore, state taxable income was multiplied by the applicable New York City marginal income tax rate, ranging from 2.6% on the first \$14,399 of taxable income to 4.4% between \$45,000 and \$107,999, and the corresponding dollar amount was added to the total, to reach local individual income tax liability (which was checked with the New York City tax table). Household tax credits were subtracted from calculated tax liability for families in the first three quintiles which either eliminated or reduced their final tax liability.

Sales tax

The following goods and services were exempt from sales taxation in California in 1994: food; prescription drugs; telecommunications services; electric and gas utilities-residential use; personal services; rental of rooms and lodging; custom computer programs; and sales of materials to manufacturers, producers, and processors. The same goods and services were also exempt from sales taxation in New York, except the rental of rooms and lodging, in addition to nonprescription drugs. Texas had a much broader sales tax base than either California or New York in 1994, taxing nonprescription drugs and both telecommunication and personal services, and exempting all other goods and services as in California. Total expenditures on sales-taxable goods and services were multiplied by the combined state and local sales tax rate (listed earlier in the Appendix) to reach total state and local sales tax liability in each state.

Excise taxes

See how federal excise taxes were computed (p. 60).