

President Trump’s Latest Federal Income Tax Proposal

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The Trump administration has recently floated the idea that Americans earning less than \$150,000 per year should be exempt from paying federal income taxes. Specific details are pending, but it is worth exploring the implications of his proposal. It looks promising.

Each year, the IRS reports anonymized data on all federal income tax filers, ranking them from the lowest to highest by adjusted gross income (AGI) groups. Table 1 below reveals the IRS cumulative data for tax filers in the 50th, 75th, 90th, 95th, and 99th percentiles of AGI.

Table 1. Federal Income Tax Data, IRS (2022)

	Top 1%	Top 5%	Top 10%	Top 25%	Top 50%	Bottom 50%	All Taxpayers
<i>Income Split Point</i>	\$663,164	\$261,591	\$178,611	\$99,857	\$50,339		
<i>AGI earned (\$ billions)</i>	\$3,310	\$5,648	\$7,282	\$10,310	\$13,061	\$1,691	\$14,752
<i>Taxes Paid (\$ billions)</i>	\$864	\$1,303	\$1,538	\$1,862	\$2,073	\$63	\$2,136
<i>Average Tax Rate</i>	26.1%	23.1%	21.1%	18.1%	15.9%	3.7%	14.5%
<i>Share of All Taxes Paid</i>	40.4%	61.0%	72.0%	87.2%	97.0%	3.0%	100.0%

The data from 2022, the latest year available, indicate that 75% of all federal tax filers earned an AGI of less than \$100,000. Further, 90% of filers reported an AGI of less than \$179,000. A simple extrapolation between these income points implies that about 85% of all federal income tax filers earned less than \$150,000 AGI that year.

If the entire income tax burden were shifted to the richest 15% of all American income tax filers earning more than \$150,000 AGI, this would likely garner the support of a super-majority of American voters. Whether this is feasible—or even desirable—is the issue.

How much of the total federal income tax would be shifted under Trump’s proposal?

The IRS data in Table 1 reveal that the federal government collected a total of \$2.14 trillion in federal income tax revenues in 2022. All tax filers with an annual AGI of less than \$100,000 contributed 12.8% of the total revenues, or \$274 billion. All tax filers with an AGI of less than \$179,000 contributed 28% of the total, paying just under \$600 billion.

Another simple extrapolation implies that all filers earning less than \$150,000 AGI contributed about 22% of the total federal income tax revenue collected in 2022, or about \$477 billion. This means those tax filers who earned more than \$150,000 AGI paid \$1.66 trillion in federal income taxes, or about 78%

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of the total income tax burden in 2022. Thus, under Trump's proposal, the nation would lose \$477 billion in income tax revenues.

Can the lost \$477 billion in tax revenues be replaced with other tax revenue sources?

The federal government collected an estimated \$5 trillion in total tax revenues across all sources in 2022. To avoid adding to the growing federal debt, the Trump administration will be under pressure to either raise the tax rates on those earning more than \$150,000 or replace the lost revenues using other tax sources.

President Trump has repeatedly pushed against raising the federal income tax rate schedule higher than the one passed under his first administration. He has also pushed for lowering the corporate tax rates from 21% to 15%. This may appear to be an unsolvable puzzle. Or is it?

Dynamic versus static tax estimates of federal tax revenue analysis

Federal corporate tax revenues are the second largest source of federal tax revenues, estimated to be a total of \$440 billion in 2022, and were collected through a flat 21% tax rate. Could reducing this rate to 15% raise total corporate tax revenues? Yes, if the rate spurred significant growth in corporate capital investment and the repatriation of international business profits currently made by American corporations abroad.

Trump's proposal for a minimum \$150,000 income before facing any income tax exposure implies that his proposal for a six-point reduction in the corporate tax rate would need to at least *double* current corporate tax revenues to replace the entire \$477 billion in lost federal income tax revenues.

That achievement may not be feasible. Yet, a doubling of corporate income tax revenues may not

be required, either. Here's why.

The perceived need to find alternate sources of tax revenue for total federal tax revenues to remain unchanged is based on a naïve assumption. This view presumes the behavior of 85% of American workers (and many of the unemployed) would remain unchanged if they could pay zero federal income taxes.

The impact on labor supply from Trump's federal income tax proposal

Under Trump's latest proposal, 85% of workers would be motivated to work more hours—and seek more demanding and productive jobs—because their potential take-home pay would increase at *all* levels of work. Similarly, many idle workers would be motivated to join the workforce for a higher level of prospective take-home pay.

While the resulting increase in middle-income labor supply might not directly increase federal income tax revenues under Trump's new proposal, the surge in the quantity and quality of total labor hours supplied would certainly boost the nation's economic output. Specifically, it would lift the rate of return on capital investment and increase corporate profits. Both would increase the level of exposure of upper-income earners to federal income taxes.

Can the richest 15% of federal income taxpayers cover the entire revenue gap?

It is worth returning to the insights gleaned from the 2022 federal income tax data in Table 1 above. The data reveal how the vast majority of the federal income tax burden is shouldered by a rather small percentage of the highest income earners in the country.

President Trump has proposed no income tax for people earning less than \$150,000.

The richest 1% of AGI earners paid a total of \$863.6 billion in federal income taxes and earned \$3.3 trillion in AGI. This means they faced an average income tax rate of 26.1%. The richest 10% paid an average tax rate of 21.1%. The richest 25% paid an average rate of 18.1%.

Indeed, the bottom half of all tax filers faced an average income tax rate of just 3.7% and paid only 3% of all federal income tax revenues collected.

Simple extrapolation implies that tax filers making over \$150,000 AGI per year paid a total of \$1.74 billion in federal income taxes while earning a total of \$8.40 trillion AGI, which is an average income tax rate of 20.7%. Trump's proposal of shifting the entire federal income tax burden to all tax filers earning more than \$150,000 AGI would increase their average income tax rate to 25%.

This would be nearly as high as the 26.1% average tax rate paid by the richest 1% of tax filers. This may not be a feasible option. But it, too, may not be required.

Is there a plausible plan for retaining revenue neutrality under Trump's new tax proposals?

President Trump's recent proposal to shift the entire federal income tax burden away from those

making less than \$150,000 AGI may not be feasible on its own. And we don't know whether Trump's other proposal to lower the corporate tax rate to 15% would truly double tax revenues to make up for the lost federal income tax revenues. But if

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The question is whether the income tax revenue replacement burden can be split between raising income

taxes on the richest 15% of American taxpayers and expanding the domestic corporate profits tax base through a reduction in the corporate profits tax. Further research is needed to determine if the combined impacts from Trump's income tax and corporate tax policy proposals can sufficiently stimulate the economy to create a revenue-neutral impact on total federal tax revenues in the long run

A cursory analysis of the latest IRS data indicates that there is a reasonable chance.



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