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TAX·FEATURES

Overall Tax Burden Proportional To Income, New Study Confirms

Cost of Congress Passes $2 Billion, Dwarfing $29 Million Savings On Recently Rejected Pay Raise

Recent debate over a $29 million pay raise for members of Congress created a firestorm. That raise is a drop in the bucket compared to the more than $2 billion taxpayers will shell out to fund the operations of the nation's legislative body during fiscal year 1989, according to economists at the Tax Foundation, a Washington-based tax research organization.

Overall spending on the Legislative Branch is estimated to rise $381 million in FY 1989, hitting an all-time high of over $2.2 billion. That 21 percent jump far surpasses the estimated 7 percent increase in total Federal spending for FY 1989.

The cost of Congress itself, now at nearly $1.1 billion, has risen a whopping 81 percent since 1980. To run the Senate and House of Representatives will top the $1 billion mark this year—six times the cost in 1970. The Senate will run taxpayers $356.6 million ($3.6 million per Senator), while the House will require $565.4 million ($1.3 million per Representative). Joint activities of the

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Seminar Proceedings Available

The Tax Foundation has published the proceedings of the seminar on *The U.S. Stake in U.S. Foreign Investment* held last September. Members of the business community, media, government, and academia examined the critical role of U.S. investment abroad and the need for a more competitive national policy, particularly in view of the economic harmonization of Europe in 1992. A copy is $10 ($5 for TF members), plus $2 p/h.

In a related development, the Institute for Research on the Economics of Taxation (IRET) has released a survey of Fortune 500 companies and members of the American Business Conference on the value of operating abroad for international competitiveness and assessing U.S. foreign tax policy. It reveals that U.S. businesses would often have to **reduce** their domestic employment, investment, R&D, and exports if they were unable to operate abroad. Entitled *A survey of American Business on American Foreign Tax Policy*, it is available from IRET at 1331 Pennsylvania Avenue, N.W., Suite 515, Washington, DC 20004, 202-347-9570.

The overall U.S. tax burden's distribution is roughly proportional, although families at the very top and bottom of the economic ladder bear a disproportionate share of the tax load. This is the conclusion of the *Tax Burden by Income Class, 1986-1987,* a major study recently conducted by Tax Foundation economists. Foundation analysis also shows that different types of taxes impose heavier burdens on families at the ends of the income scale.

"Individuals and policy makers must understand clearly how the tax burden affects households of various income levels in order to approach any tax modifications equitably and efficiently," the study states.

The study points out that "the current demand for increased government services, combined with a severe Federal budget deficit and budgetary problems in numerous states, creates a fiscal environment ripe for revenue enhancement." Before such increases are proposed, the study cautions, policy makers must ask what types of taxes could be implemented to most effectively address these fiscal demands and who will bear the burden.

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Overall Tax Burdens as a Percent of Income By Income Class, 1986

Income Class[a]	All taxes	Federal taxes	State and local taxes
Less than $10,000	49.54%	23.74%	25.80%
$10,000 to $14,999	34.38	18.55	15.82
$15,000 to $19,999	34.04	19.28	14.76
$20,000 to $29,999	32.86	19.58	13.28
$30,000 to $39,999	32.14	19.87	12.27
$40,000 to $49,999	32.89	20.63	12.26
$50,000 to $59,999	31.44	19.60	11.84
$60,000 to $69,999	35.02	22.77	12.26
$70,000 to $89,999	31.28	19.82	11.46
$90,000 and over	51.59	37.93	13.66
All income classes	35.53%	21.89%	13.64%

[a] Money income before personal taxes.

THIS ISSUE:

Moderate Income American Family Will Pay Total Federal Taxes of $14,068 in Fiscal 1989

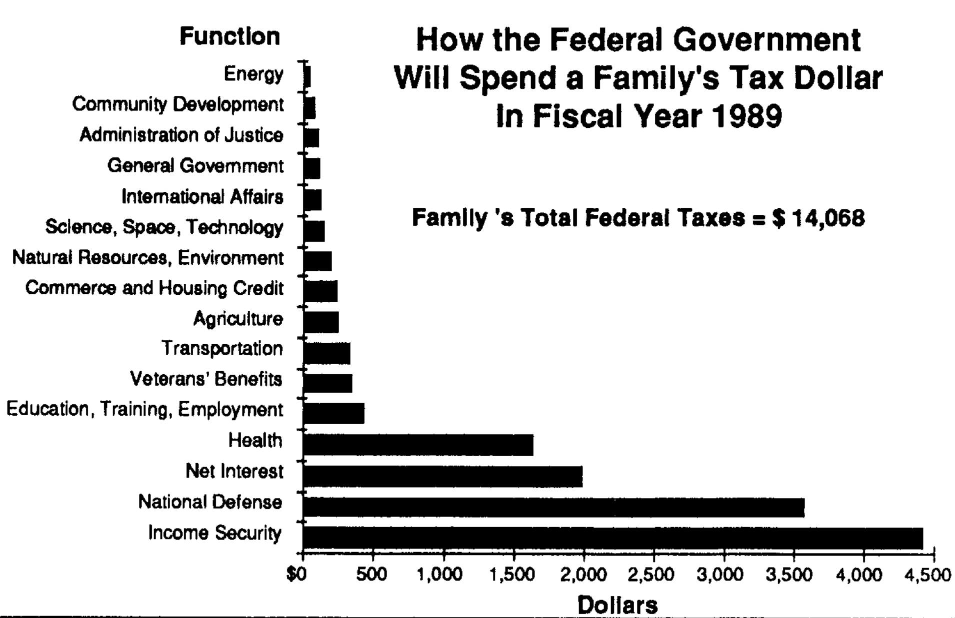
A moderate-income family—two workers earning $45,000 with two dependent children—faces a tax bill of $14,068 for fiscal year 1989. That covers the family's direct and indirect Federal taxes. Add to this its $2,391 "share" of the Federal deficit, and the family would contribute $16,495 to support the estimated $1.1 trillion Uncle Sam plans to spend in fiscal year 1989.

Economists at the Tax Foundation use this prototypical family to show where the average American household's Federal tax dollars will go. Assuming that the $14,068 tax bill is allocated to cover the family's entire share of Federal spending, the following expenditures stand out:

How the Federal Government Will Spend A Family's Tax Dollar in 1989[a]

Function	Family's Share: Amount	Family's Share: Percent of Total	Total Spending (Millions)
Income Security[b]	$ 4,426	31.46%	$ 369,281
National Defense	3,573	25.40	298,255
Net Interest	1,985	14.11	165,704
Health[c]	1,636	11.63	136,495
Education, Training, Employment, Social Services	436	3.10	36,351
Veterans' Benefits and Services	350	2.49	29,218
Transportation	336	2.39	28,027
Agriculture	250	1.78	20,903
Commerce and Housing Credit	241	1.71	20,040
Natural Resources and Environment	197	1.40	16,487
General Science, Space and Technology	151	1.07	12,593
International Affairs	129	0.92	10,748
General Government	120	0.85	9,990
Administration of Justice	113	0.80	9,428
Community and Regional Development	76	0.54	6,303
Energy	49	0.35	4,137
Total[d]	$ 14,068	100.00%	$ 1,137,030
Exhibit:			
Payments for Individuals	$ 6,405	45.53%	$ 534,473

[a] This example uses a two-earner family earning $45,000 per year with two dependent children.
[b] Includes social security, Federal employee retirement, unemployment compensation, housing assistance, and food and nutrition assistance; excludes veteran's income security.
[c] Includes Medicare, Medicaid, and others; excludes veterans' hospital and medical care.
[d] After deducting $36,931 million in undistributed offsetting receipts not classified by function.
Source: Tax Foundation computations based on Fiscal Year 1990 U.S. Budget presented in January 1989, and tax laws for 1989 from the Treasury Department.



■ Income security tops the list at $369.3 billion. This comprises Social Security, Federal retirement, unemployment compensation, housing assistance and nutrition assistance and will extract 31 cents for each $1 this family sends to Washington, or $4,426.

■ National defense will cost $298.3 billion—or 25 cents out of each tax dollar. For the moderate-income family, this amounts to $3,573.

■ Interest on the public debt ranks third at $165.7 billion, costing a family over 14 cents of its tax dollar, or a whopping $1,985.

■ Health outlays, mainly Medicare and Medicaid, will take 12 cents of each tax dollar. The typical family will send Uncle Sam $1,636 to pay for the $136.5 billion national health bill.

These four programs alone will claim almost 83 percent of all Federal spending and will cost this moderate-income family $11,620, or 83 cents of each tax dollar. With the remaining 17 cents, Uncle Sam will, among other things, spend approximately 3 cents on education and less than 3 cents each on transportation, agriculture, and administration of justice.

The Family Tax Bill

Direct Federal taxes—individual income and personal social security taxes—will cost this family $8,760 in 1989. However, direct levies do not explain the whole tax picture, accounting for only about three-fifths of the

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Tax Features

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Budget Watch By Allen Schick

George Bush's First Budget Is Not the Last Word on the Subject

Less than three weeks after he took office, Gorge Bush presented his budget plans for the next (1990) fiscal year to Congress. The new President's budget was distinguished both by the speed with which it was prepared and the lack of concrete information on how more than one trillion dollars of Federal money would be spent. Almost 40 of the 190 pages in the budget document were completely blank and another 30 pages had only a few words. No details were provided on how the $300 billion proposed for defense would be allocated, or on how more than $10 billion would be squeezed out of domestic programs.

This article fills in some of the blanks by discussing five issues that will determine what happens in the next year and beyond. These are relations between the President and Congress, the "no new taxes" pledge, the drive to cut Federal spending, the need to meet deficit reduction targets, and the outlook for the economy.

"The new President's budget was distinguished both by the speed with which it was prepared and the lack of concrete information on how more than one trillion dollars of Federal money would be spent."

(1) The real budget will be negotiated with Congress, not dictated by the White House.

The gaps in the budget were put there on purpose. Bush's new style budget is only the opening round in a series of negotiations that might eventuate in decisions that will shape national priorities for the remainder of the 20th century. It reflects a transformation in Federal budgeting that began before the Reagan presidency and is continuing afterwards. At one time, not very long ago, the President's budget was the authoritative benchmark against which Congress measured all its revenue and spending actions. This is no longer the case. Today, the President prepares a budget with an eye on the ensuing negotiations and he does not, therefore, reveal his true preferences in the figures submitted to Congress.

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Budgeting-by-negotiation has occurred several times in the 1980s, most recently after the stock market crash in October 1987. It is the nature of these negotiations that neither the process nor the outcome can be scripted in advance. The rules are made up as the discussions proceed, and the pace depends on the tactics used by the two sides. The first half year or longer of the Bush presidency might be dominated by deficit worries and budgetary conflict with Congress. The betting this year is that an agreement will be reached before any Gramm-Rudman-Hollings cuts are made. When an agreement comes, it is likely to be a multi-year package that covers taxes, spending priorities, and deficit targets.

(2) Bush means what he said about taxes during the campaign, but taxes still might rise.

For many months, Bush has insisted that Americans "read my lips"; now they can read his words as well. If Bush has his way, taxes will not be increased in 1989, though there might be some new user charges and other "revenue enhancements." Congressional Democrats are beginning to believe Bush's "no new taxes" message, but they are not convinced that he will be able to stay with it when the Gramm-Rudman-Hollings process is activated this summer. Bush's proposal for a reduction in capital gains taxes might provide maneuvering room for a deal in which a preferential rate on this source of income is coupled with some tax increases.

"Congressional Democrats are beginning to believe Bush's 'no new taxes' message . . . ."

Bush's budget repeatedly emphasizes that even without a tax increase, Federal revenue would rise some $80 billion next year if the economy performs as projected. The point to keep in mind is that a healthy economy adds more to Federal revenue than a tax increase; a weak economy takes away revenue even if Congress enacts a tax increase.

(3) Spending priorities will be the major budget conflict.

The new President's budget is faithful to another campaign pledge: a flexible spending freeze. The basic concept of the freeze is that total spending should rise no more than the rate of inflation, but that within this total, some programs might have bigger increases and other would have smaller ones. For bargaining purposes (and also to show compliance with the deficit targets) the Bush budget purports to constrain total spending well below freeze levels. His budget, the

(Continued on page 4)

(BUDGET WATCH, *from page 3*)

table accompanying this article shows, calls for barely a one percent rise in spending, which would be well below the rate of inflation projected for next year. Some modest spending increases are sprinkled throughout the budget for space exploration, education, the environment, the war on drugs, and a few other high-priority areas. To offset these increases, Bush identifies a number of cuts, the biggest one being in Medicare. However, another $10 billion, or more, in unidentified savings

> ***"Bush identifies a number of cuts, the biggest one being in Medicare."***

will have to be made if the spending target is to be reached. These unidentified cuts are a throwback to the "magic asterisk" which hobbled Ronald Reagan's commitment to balance the budget eight years ago.

The difficulty—some might say impossibility—of meeting the spending targets is evident from the entries in the table. The four biggest chunks in the budget (defense and international programs, social security and Federal pensions, interest payments, and Medicare/Medicaid) account for 80 percent of total outlays. The cost of these programs is likely to grow at least $40 billion next year. This means that spending in the remainder of the budget will have to be cut substantially below the fiscal 1989 level in order to meet the spending target. One of the tricks used to show a sizeable reduction in FY 1990 spending is to load virtually all of the cost of the savings and loan crisis on the 1989 budget and on the 1991 and subsequent fiscal years. According to official budget figures, the savings and loan crisis will actually "save" $10 billion in the next fiscal year.

The overwhelming odds are that total spending will end up well above the projected level. Some of the unbudgeted rise might be due to economic conditions, some to the evaporation of unidentified cuts, and some to congressional actions. The President will blame Congress for the add-ons, but this won't stop Capitol Hill from negotiating a budget agreement with the White House.

(4) If the spending target is unreachable, the deficit target will also be beyond reach.

President Bush managed to shoehorn his budget into the $100 billion GRH deficit target for fiscal 1990. This was no easy feat because the latest estimates are that the 1989 deficit will exceed $160 billion. In fact, 1989 will be the second consecutive year of rising deficits. While it is unlikely, one should not be surprised if 1990 makes it three years in a row.

In the arcane world of Federal budgeting, all it takes to avoid sequestration under the Gramm-Rudman-Hollings law is to project a declining deficit. It is not necessary to actually produce any deficit reduction. With a little luck and a lot of deception, it might be possible to avoid a GRH sequester this summer. The task will be much harder a year from now because GRH calls for the 1991 deficit to be no higher than $64 billion. This is where the budget summit mentioned earlier might come to the rescue. As part of a package deal, the GRH targets might be stretched out to require less deficit reduction in the years immediately ahead. Instead of schedul-

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ing a balanced budget in 1993, as the law now provides, Americans might have to wait until the year 2000 when tomorrow's politicians will be blaming today's leaders for their budget woes.

(5) The economy will have the last word.

The performance of the economy will exert more influence over the fate of the budget than will presidential and congressional negotiators. The Bush budget is predicated on continuing vigor in the economy, falling interest rates, moderate inflation, and rising productivity. At present, interest rates appear to be the most vulnerable projection. Any variance from the projected level will have a direct and immediate impact on total outlays and the deficit.

With the economy enjoying the 7th consecutive year of expansion, President Bush does not want to make jarring policy changes that might risk a downturn. He wants to stay on the Reagan budget course but temper it with kinder and gentler social policies. If he succeeds, we might be entering a new era of good feeling in Washington with declining deficits and more money for domestic needs; if he doesn't, the budget will be as contentious in the 1990s as it has been in the 1980s.

Comparison of Fiscal 1989 and 1990 Estimated Outlays
(billions of dollars)

	1989	1990
Defense/International Programs	$ 309	$ 318
Social Security/Federal Pensions	284	299
Interest Payments	169	173
Medicare/Medicaid	121	132
Subtotal	883	922
Savings and Loan and Bank Insurance	15	[a]
Everything Else[b]	285	278
Offsetting Receipts	-40	-40
Total Outlays	1,143	1,160

[a] Less than $500 million.
[b] Everything else includes space, science, energy, agriculture, housing, employment, community development, environment, nutrition, education, social services, transportation, law enforcement, welfare assistance, medical research, veterans benefits, and the operations of most Federal agencies.
Source: Building a Better America, February 9, 1989.

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FEDERAL TAX POLICY MEMO

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Cautions on the Tax "Gap"

Summary

■ IRS estimates of a huge income tax compliance gap between what is voluntarily paid and what is owed may be used by Congress and the new Administration to frame deficit reduction proposals. This is likely even though the Commissioner of the Internal Revenue Service has cautioned that the estimates should not be measures of the "potential for additional enforcement yields." The gap estimates include amounts eventually collected through audit and amounts "not cost effective to collect." The latter comprise a large segment of the individual income tax compliance gap.

■ The gross income tax gap estimates clearly overstate the compliance problem to the extent they are based on IRS examiners' recommendations rather than actual assessed amounts.

■ The official tax gap estimates may greatly exaggerate the compliance problem in the corporate sector, particularly for large corporations. The methodology of projecting the gap statistics with respect to large corporations is suspect. More importantly, much of the large corporate sector is subject to near 100 percent audit coverage anyway. Whether these factors will be recognized in any Congressional consideration of deficit reduction is unknown.

Last year there was considerable publicity about the $84.9 billion tax compliance "gap" as estimated by the Internal Revenue Service for 1987. The gross tax gap is the amount of *income tax* owed but not voluntarily paid because of understatement of income, overstatement of deductions and credits, or simply nonfiling. As such, it does not reflect IRS enforcement actions which would tend to lower the reported gap. Nor does the compliance problem with employment and excise taxes or taxes lost in the illegal sector of the economy, both of which would tend to raise the gap.

The 1987 income tax gap was estimated at $63.5 billion for individuals (75 percent), and $21.4 billion for corporations (25 percent). The individual tax gap was the equivalent of $642 per individual tax return with taxable income. In other words, *if* the legal sector individual tax gap were totally eliminated somehow, individuals who did report taxable income correctly theoretically could pay an average of $642 less and the Treasury would still receive the same net revenue.

During the Presidential campaign the tax gap concept became something of an issue because Governor Dukakis repeatedly called attention to it as a source of additional Federal revenue not requiring higher rates or other new tax burdens. He also touted the revenue raising potential of a Federal tax amnesty, citing the very "successful" tax amnesty program in Massachusetts several years ago.

Because Governor Dukakis was not successful in his presidential bid does not mean the issue will go away. President Bush's well-known aversion to new taxes and looming Gramm-Rudman-Hollings deficit reduction deadlines could lead his Administration to new proposals to recapture part of that $85 billion. Furthermore, Congress on its own has shown no hesitancy to plunge into compliance improvement schemes at least when the prospect of additional dollars can be danced in front of it.

Questioning the Dollar Yield

For many years the IRS simply refused to attach any dollar estimates to the compliance problem. To admit that a substantial gap existed might be counterproductive of voluntary compliance by honest tax payers. Also it implied a failure of tax administration, which was, undoubtedly, the more important reason for not publicizing any gap.

However, prodded by Congressional pressure, the IRS had a change of heart in 1979, and then Commissioner Jerome Kurtz initiated the tax gap studies. There have been three basic studies done — in 1979, 1983 and 1988. The first was limited to unreported income of individuals including an attempt to measure income taxes lost because of illegal activities. The study was expanded to corporations and overstated deductions in 1983. The 1988 study updated the figures and refined the methodology used in 1983. Also, it was deemed impractical to try gauge any part of the tax gap from illegal activity.

In describing the 1988 study to the House Ways & Means Subcommittee on Oversight, Commissioner Lawrence Gibbs emphasized that the tax gap estimates "are not intended to be measures of the potential for additional enforcement yields.: This is because the gap includes amounts which are ultimately collected under the audit and other enforcement actions and amounts which would not be "cost effective" to collect. In the latter case, he is referring to such long recognized practices as "working off the books" whereby craftsmen and entrepreneurs of all stripes may supplement their incomes by occasional "cash only" jobs. Without any paper trail, there is simply no effective way to levy income taxes on these transactions, which are typically small individually but could be vast collectively. In fact, the taxes lost in unreported income in the categories of "informal suppliers" and other non-farm proprietor income were estimated at $24.4 billion in 1987 or 51 percent of the total tax loss in individuals' unreported income, which, in turn, accounted for 57 percent of the total income tax gap. Obviously, therefore, a significant part of the latter is not collectable and cannot be considered a potential deficit reduction source.

Recommended vs. Assessed

Another uncertainty in the revenue raising potential with regard to the tax gap is the fact that the gross estimates are based on the *recommendations* of IRS examiners in the audit process. But in cases where the appeals process *reverses* the examiners' recommendations in whole or in part, the real tax gap obviously should shrink. The service has presented some alternative gap estimates based on *assessed* amounts of additional tax after appeals rather than the recommended amounts. These are quite revealing. As indicated in the table below, the gross tax gap for 1987 would shrink from $84.9 billion to $71.2 billion with the drop split about evenly between individuals and corporations. As a result the voluntary compliance rate for corporations would improve approximately five percentage points to 87.0 in 1987, above that reported for individuals. Reversals of examiners' recommendations are proportionately more significant in the corporate sector where decisions involve substantial sums.

It would seem logical to use the assessment basis for more realistic tax gap estimates. However, the IRS claims that the alternative assessment-based estimates are not available by source and that they cannot account for cases where the Service will settle for less than full liability — or the taxpayers may not appeal — simply to avoid litigation "hazards and costs."

In any event, the featured tax gap estimates continue to be based on examiner recommendations which clearly overstate the true gap.

Controlling Assumptions

All tax gap data ultimately depend on the audit system. In the case of individuals and small corporations (under $10 million in assets), sample audit data is collected and processed through the Tax Compliance Measurement Program (TCMP). For individuals this is conducted every three years using a probability sample of approximately 50,000 returns. For large corporations there is no TCMP data, but for virtually all of them over $100 million in assets there is close to 100 percent audit coverage anyway.

Audit data, whether through the TCMP samples or direct, is not very timely. The 1988 tax gap study uses TCMP data for individuals only through 1982. The Statistics of Income and Estimates of the Treasury's Office of Tax Analysis are used to extend reported individual tax liabilities through 1985 and to project them to 1992. The Service must then assume a very critical voluntary compliance rate to apply to the reported

Gross Tax Gaps and Voluntary Compliance Rates
1973-1992

	1973	1976	1979	1982	1985	1986	1987	1988	1992
				Gap Based on Examiners' Recommendations					
Tax Gap ($billion)									
Total	$ 28.4	$ 40.7	$ 61.7	$ 62.6	$ 87.8	$ 95.0	$ 84.9	$ 87.1	$ 113.7
Individuals	19.7	29.6	46.8	51.9	73.3	79.3	63.5	64.3	82.6
Corporations	8.8	11.1	15.0	10.7	14.4	15.6	21.4	22.8	31.1
Voluntary Compliance Rate (percent)									
Total	83.7%	82.4%	81.7%	83.4%	81.6%	81.1%	83.2%	83.6%	84.2%
Individuals	84.6	82.6	81.8	83.7	81.6	81.0	83.5	84.0	84.9
Corporations	81.3	81.6	81.3	81.8	81.7	81.7	82.5	82.4	82.5
				Gap Based on Assessed Amounts					
Tax Gap ($billion)									
Total	$ 23.7	$ 34.2	$ 52.0	$ 53.9	$ 75.5	$ 81.1	$ 71.2	$ 72.8	$ 95.0
Individuals	17.5	26.3	41.4	46.3	64.8	70.1	56.1	56.8	73.1
Corporations	6.2	7.8	10.6	7.6	10.7	11.0	15.1	16.0	21.9
Voluntary Compliance Rate (percent)									
Total	86.0%	84.8%	84.1%	85.3%	83.8%	83.4%	85.6%	85.9%	86.6%
Individuals	86.1	84.3	83.6	85.2	83.4	82.9	85.1	85.6	86.4
Corporations	85.9	86.2	86.0	86.3	85.8	86.4	87.0	86.9	87.1

Source: Income Tax Compliance Research, Internal Revenue Service, March, 1988.

liability figures to come up with estimates of the post-1982 tax gap. The estimating process is different for large corporations but with similar time lags between actual audit data and gap estimates.

Such assumptions can make a big difference in the published figures. In the 1983 study it was assumed that the overall voluntary compliance rate would decline in the future and this would result in a total gap of $115 billion by 1987, over $25 billion higher than now estimated for that year. Legislative changes in tax liabilities and other factors also affected the outcome, but the compliance rate assumption was critical. In the 1988 study the IRS basically assumed there would be no change in compliance rates across types of return or types of income. Holding the compliance rates constant means that the gap estimates for the future depend almost entirely on changes in tax liability by sector (although changes in the composition of income types also could change the rate slightly).

This has implications for the distribution of the gap estimates because the Tax Reform Act of 1986 loaded an estimated $120 billion of additional liabilities on the corporate sector. That sector, therefore, automatically is assumed to have a lot bigger compliance problem. In fact, the 1986 Act was by far the biggest factor in the $10 billion increase in the reported corporate sector tax gap for 1987 as between the "old" 1983 study estimate and the "new" 1988 study estimate. Conversely, because individual tax liabilities were reduced by the 1986 Act, the individual gap estimates were reduced.

There is something troubling about this link-up. The IRS claims that data limitations force it to use rather arbitrary compliance rates for long periods. The implication, however, of the published figures is that there is growing noncompliance wherever liabilities enlarge. In other words, if you have incurred increased tax burdens, from increased income and/or legislative penalties, you have more opportunity to "not comply voluntarily" and you will do so regardless of other factors.

One of those factors was the 1986 repeal of the investment credit which was estimated to increase corporate tax liabilities by $113 billion over five years. (Recall that the net increase in total corporate liabilities under the 1986 Act was $120 billion.) Logic would indicate certainly that this would not cause an increase in noncompliance. Quite the contrary, voluntary compliance should improve without all the extensive past disputes between business taxpayers and the Service as to qualification for the credit, etc. Yet the arbitrary compliance assumptions allow no recognition of this for current and future corporate gap estimates.

There is yet another twist to the estimating procedure that seems to stack the deck against the corporate sector. As noted before, the individual and small corporation gap estimates are derived from the TCMP data of earlier years. To arrive at a compliance rate the Service first calculates what it calls "voluntary reporting percentages" for each tax return line item. It is these reporting percentages which are held constant based on 1982 experience. Then for the individual sector some adjustments were made to reflect the legislative changes under the Tax Reform Act of 1986 on each item reported, and adjustments also were made for compliance improvement provisions under other legislation. This tended to increase the reported compliance rate in the individual sector. Even though the voluntary reporting percentages do not change, the overall individual compliance rate is expected to increase slightly further because of changing composition of individual items and the legislative adjustment.

For large corporations with over $10 million in assets, the service claims that voluntary reporting percentages for income and deduction items cannot be calculated. Therefore, it applied a "composite" estimated compliance rate for all years with no adjustment for any compliance improvement provisions. The Service admits this is not a satisfactory procedure and that the corporate estimates therefore are "particularly subject to uncertainty." In fact, in footnotes and in a chapter on methodology the Service's 1988 study appears to concede that an alternative calculation would be more realistic. This would result in a rise in the corporate compliance rate and a narrowing of a corporate tax gap. But the alternative calculation did not make it into the published figures.

Large Corporation Audit Coverage

Finally, there is an overriding question about the large corporation tax gap, reported to be $15.8 billion or about 75 percent of the total corporate sector gap in 1987. Recall that the "gap" consists of taxes owed but not voluntarily paid. But for corporations with assets over $100 million — which must comprise a very large portion of the large corporation category in both dollar volume of liabilities and estimated tax gap — audit coverage is very close to 100 percent. Whether audit adjustments involve correction of errors or different interpretation of tax provisions, the Treasury ultimately will be paid what is owed with interest. Yet the published figures show the corporate sector gap rising from $9 billion in 1973 to $21.4 billion in 1987, and projected at $31.1 billion in 1992. Part of the growth in the tax gap here is simply in the economy and corporate profits. But year-after-year listing of a generally expanding corporate tax gap may be misleading when the amounts recovered through the audit process are not reflected. There doesn't appear to be any recognition of this in the published reports.

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Tax gap statistics may be useful for a general understanding of the extent of the compliance problem. To be sure, we do have a very significant compliance problem. Some further selective enforcement programs probably could help to reduce it. However, the gap data have severe limitations and, particularly in the case of the corporate sector, there is significant question as to what the published figures really mean. It is not just an academic exercise. Congress may look at these large figures and their distribution with the budget deficit very much in mind despite Commissioner Gibbs' admonition not to do so.

1989 TAX INCREASES HAVE ARRIVED!

Those who believe they will not see Federal tax increases in 1989 are apparently unaware that such increases are already here. Thirteen separate tax bills passed since the major Reagan tax cut under the Economic Recovery Tax Act (ERTA) in 1981 will pull $146.6 billion from taxpayers' pockets in FY 1989.

Over $95 billion will come from individual income taxes and corporate income taxes alone. The remaining $52 billion will come primarily from increased social insurance taxes, excise taxes, customs duties, and miscellaneous fees. The table below breaks down the revenue by legislation.

Federal Revenue Impact of Revenue Raising Legislation, 1982-1988
Individual, Corporate, and Total Impact in 1989[a]
(Budget Effect in Billions of Dollars[b])

Legislation	1989
Tax Equity and Fiscal Responsibility Act of 1982 - Total	$ 55.7
Individual Income Tax	15.9
Corporate Income Tax	38.5
Highway Revenue Act of 1982 - Total	5.1
Social Security Amendments of 1983 - Total	30.9
Railroad Retirement Revenue Act of 1983 - Total	1.1
Deficit Reduction Act of 1984 - Total	27.7
Individual Income Tax	16.0
Corporate Income Tax	10.6
Consolidated Omnibus Budget Reconciliation Act of 1985 - Total	3.0
Individual Income Tax	0.2
Corporate Income Tax	-0.1
Omnibus Budget Reconciliation Act of 1986 - Total	2.0
Individual Income Tax	0.7
Corporate Income Tax	0.1
Superfund Amendments and Reauthorization Act of 1986 - Total	0.8
Individual Income Tax	-0.2
Corporate Income Tax	0.4
Continuing Resolution for 1987 - Total	3.0
Individual Income Tax	1.4
Corporate Income Tax	1.4
Omnibus Budget Reconciliation Act of 1987 - Total	13.9
Individual Income Tax	0.4
Corporate Income Tax	6.0
Continuing Resolution for 1988 - Total	2.7
Individual Income Tax	1.1
Corporate Income Tax	1.6
Medicare Catastrophic Coverage Act of 1988 - Total	0.6
Individual Income Tax	0.6
Family Support Act of 1988 - Total	0.1
Total Tax Increases[c]	$146.6
Individual Income Tax	36.1
Corporate Income Tax	58.5
Social Security, Excise, Customs, and Misc.	52.0

[a] Totals include the effect on all tax sources, i.e. individual income, corporate income, Social Security, excises, estate and gift, customs and miscellaneous receipts.

[b] Budget effect revenue estimates are prepared by the Office of Management and Budget for the purposes of the budget presentation. They measure only the direct effect of tax legislative changes on receipts with feedback effect limited to the overall income forecast and its impact on receipts by major source. Budget estimates reflect actual economic experience or revisions in the economic forecast; the original legislative intent estimates do not.

[c] Presents post-1981 legislation that, in total, increases FY1989 tax revenues. Not included are: Interest and Dividends Tax Compliance Act of 1983 (-2.0 billion); Federal Employees' Retirement System Act of 1986 (-0.2 b.); Tax Reform Act of 1986 (-24.4 b.); and Technical and Miscellaneous Revenue Act of 1988 (-0.4 b.).

Source: Office of Management and Budget, Budget of the United States Government for fiscal years 1981 through 1990.

(TAX BURDEN STUDY, *from page 1*)

While the overall tax burden is roughly proportional, with an average tax burden of 35.53 percent, the study notes, "both the lowest and highest income classes absorb a greater total tax burden at 49.54 percent and 51.59 percent, respectively."

Income Taxes Hit the Wealthy

Raising a specific type of tax dramatically affects the tax burden of particular income classes. As might be expected, families with the most income pay a much larger share of the income taxes to Federal, state and local governments. In fact, their Federal individual income tax burden is almost eleven times greater than the lowest.

Excise Taxes Target the Poor

Low-income families pay out a much larger share of income as excise taxes, social insurance and property taxes than do the average or high-income families. The Federal tobacco tax burden for low-earning families is over five times greater than for the highest. "In total," the study observes, "the sales and excise tax burden is over five times greater for the lowest income families than for the highest."

Tax Burden by Income Class, 1986-1987 expands upon an earier tax burden analysis presented in the Tax Foundation's 1981 study *Allocating Tax Burdens and Government Benefits by Income Class, 1972-73 and 1977.* The new study focuses exclusively on tax burdens and is the first such study to be done using comprehensive and detailed 1986 Consumer Expenditure Survey data on family income and consumption. It summarizes the results of a detailed analysis of the distributional impact of Federal, state, and local taxes by income class. A detailed breakdown by type of tax illustrates the tax burden of each tax by income class.

Copies of *Tax Burden by Income Class, 1986-87* are available from the Tax Foundationfor $10.00, plus $2.00 postage and handling. An expanded version containing all exhibits, alternative assumptions, and bibliographic data is also available for $20, plus $2.00 postage and handling.

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Who Pays the Taxes?"

Ours is a moderately progressive income tax system—for the most part. This fundamental premise of the convential wisdom has been pretty well borne out by a major research undertaking just completed by Tax Foundation economists and reported on elsewhere in this issue.

There has long been a tacit understanding among Americans that those who benefit more from our society should lend a helping hand to those further down the ladder by paying a progressively larger share of the costs of government. At times, in the post World War II era, that progressivity got out of hand with rates on top earners that approached the confiscatory. During the current decade, the White House and the Congress have made important strides in redressing that balance. True, much of the burden of paying for the rate cuts under the Tax Reform Act of 1986 was shifted to the business community. True, major issues remain to be resolved, among them our national blindness to the need to promote savings, capital formation and international competitiveness.

Still, most unbiased observers will concede that the Federal tax system is more balanced today than it has been in a long time. The question is, where do we go from here?

For one thing, the study makes it clear that we cannot continue a policy of "rich bashing" in the income tax code. Top earners are already taking the largest hit in the amount of income pre-empted for taxes. Tax writers, like bankrobber Willie Sutton, always go where the money is. And when it comes to income taxes, there just isn't enough money at the top to do the job.

At the other end of the spectrum, we must, as a nation, address the concerns of those families whose income is so heavily eroded by sales and excise taxes and by the ever-burgeoning costs of social insurance programs. It's always easier to pass "sin" taxes. But is it wiser? Is it good policy? Advocates of big government see no problem in siphoning off the earnings of the working poor and near poor to fund costly, wasteful, ineffective and obsolete programs under the questionable assumption that Big Brother knows our needs and will take care of us.

For all the "reform" we have seen during the current decade, all too often, rational tax policy and sound long-term planning for government's revenue requirements go out the window when the need to fund programs comes in the door. This kind of nonsense must stop. There is no longer an economic cushion to compensate for sloppy thinking, porkbarrel politics or poor planning.

The agenda is there for the new Administration and the new Congress. A nation grown increasingly cynical waits and watches to see how that agenda will be adressed in the coming months.

(MEDIAN FAMILY, *from page 2*)

total Federal tax take. To these must be added such indirect taxes as the employers' share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor and tobacco; and miscellaneous levies. These will take another $5,308 from the moderate-family's income.

Direct and indirect Federal taxes claim over 31 percent of this family's annual income, but even that does not tell the whole story. All told, current Federal taxes and borrowing add up to nearly 37 percent of the moderate-income family's earnings.

The table and chart on page 2 provide further details.

(COST OF CONGRESS, *from page 1*)

House and Senate will cost an additional $127.8 million.

The proposed $29 million in congressional pay hikes that made voters howl would have represented only 1.3 percent of the FY 1989 cost of Congress and Legislative Branch agencies. Tax Foundation analyts point out that Congressmens' cost hardly stops with their $89,500 current salary. They will be spending an average $100,000 each in postal expenses alone in 1989.

Congress also maintains a number of legislative agencies, such as the Congressional Budget Office, General Accounting Office, and the Architect of the Capital, each of which has its own budget. These will cost taxpayers $1.2 billion in 1989, 38 percent more than last year.

What exactly does all this money buy? Taxpayers are primarily paying for three things: Congressional leadership and administration; committees and subcommittees; and Congressional office staff.

The U.S. Office of Personnel Management reports that the Legislative Branch now employs over 37,500 workers. Congress itself has 19,200 on the payroll—7,200 in the Senate and 12,000 in the House.

Congress runs on a committee system, with 20 committees and 87 subcommittees in the Senate, employing 770 key staff personnel, and 28 committees and 160 subcommittees in the House, employing over 1,271 key staffers. Including the joint committees, the congressional bureaucracy is currently comprised of over 50 committees with over 250 subcommittees paying a key staff of over 2,100 people.

See table at left for further detail.

Outlays for the Legislative Branch of the Federal Government by Unit

Selected Fiscal Years 1970-1989ª

(Thousands)

Unit	1970	1980	1988	1989
Total	$ 343,147	$ 1,217,985	$ 1,851,958	$ 2,233,439
Congress, total	179,159	581,543	993,367	1,049,816
Senate	57,585	183,890	335,235	356,570
House of Representatives	108,279	324,569	566,542	565,423
Joint activities	13,295	73,084	91,590	127,823
Legislative agencies, total	163,988	636,442	858,591	1,183,623
Architect of the Capitol	18,797	89,496	118,821	167,361
Botanic Garden	620	1,583	2,091	2,613
Congressional Budget Office	-	12,101	17,199	18,382
General Accounting Office	69,857	201,192	326,316	338,477
Government Printing Office	34,141	115,747	78,207	121,613
Library of Congress	49,804	192,740	283,235	492,235
Office of Technology Assessment	-	11,131	16,905	17,638
U.S. Tax Court	2,972	9,703	24,342	29,356
Other	-	13,675	1,973	7,040
Deductions for offsetting receipts	–12,203	–10,926	–10,498	–11,092

ª Data for 1989 are estimates from the FY 1990 Budget presented in January, 1989.
Source: Office of Management and Budget

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