TAX FOUNDATION

# TAX FEATURES

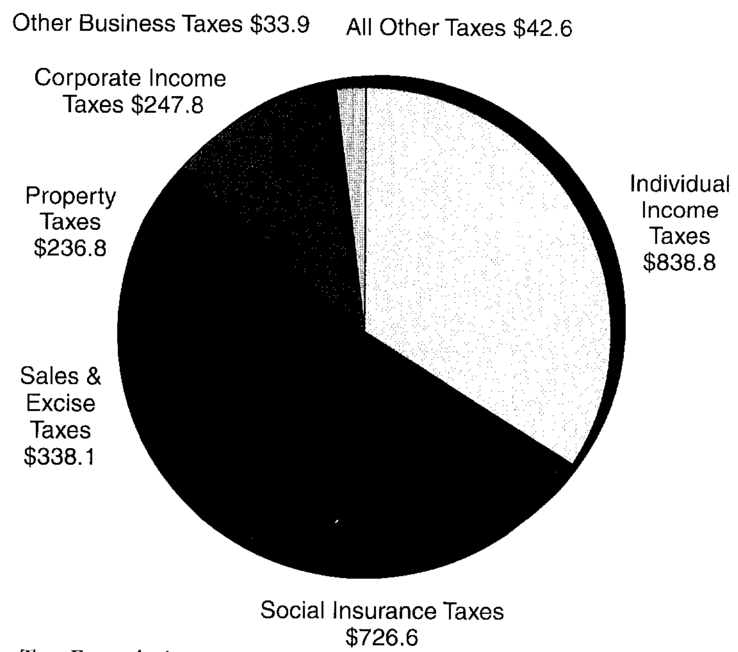
*May 1997 Volume 41, Number 5*

# Total Tax Collections to Top $2.46 Trillion in 1997

## *Governments Will Collect $24,357 for Every U.S. Household*

Total tax collections in the U.S. are expected to equal $2.465 trillion in 1997, according to an analysis by the Tax Foundation. That represents a 5.3 percent increase over 1996 total tax collections and a 46.4 percent rise over the 1990 level, says Tax Foundation Economist Patrick Fleenor.

**Chart 1: Total U.S. Taxes by Source ($Billions), 1997**




Source: Tax Foundation.

To put this figure into perspective, federal, state, and local governments will collect an average of $24,357 in taxes for every household in the country, or an average of $9,205 for every U.S. resident.

The analysis shows that the federal government is expected to collect 67 percent of this total, or $1,640.5 billion. State and local governments will collect another $824.0 billion.

The accompanying charts, on this page and page 3, illustrate that these funds stem from a variety of sources.

The two levies extracted from Americans' paychecks, individual income taxes and social insurance taxes, are the two largest sources of revenue. Individual income taxes at the federal, state, and local levels will represent 34 percent of all tax receipts in 1997, or $838.8 billion. Of this, 82 percent (roughly $689 billion) will be collected at the federal level. On a per capita basis, this means that 1997 federal income taxes will constitute over $2,500 of the $9,205 total per capita tax load, with state income taxes adding another $560 to the total per capita load.

Social insurance taxes, which fund programs such as Social Security and Medicare, will provide governments with 29.5 percent of total tax revenue, or $726.6 billion. The vast

**Total Tax Collection** *continued on page 3*

1937 TAX FOUNDATION ANNIVERSARY 1997

## FRONT & CENTER

### Comprehensive Capital Gains Reduction

*Rep. Peter Deutsch (D-Florida)*

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# A Surprise for Many in "Low Tax" States

## *Without Federal Taxes, They're High Tax States*

A closer look at the Tax Foundation's latest analysis of total tax burdens by state contains a surprise: Many states with low overall tax burdens, relative to other states, actually rank fairly high when judged by their state and local taxes alone.

As the accompanying table shows, New York's average effective tax rate for federal, state, and local taxes (38.9%) and for state/local taxes (15.3%) are tops in the nation.

But remove federal taxes from the mix, and Connecticut, the No. 2 state for total tax burden (38.8%), falls to No. 6 for state/local taxes (13.1%). Illinois, which with a total tax burden of 36.2% ranks 8th this year among the states, ranks only 27th when state and local taxes alone (11.4%) are considered. Without its federal tax burden, New Jersey falls from 11th overall (with an average rate of 35.8%) to 33rd in the nation with an average tax rate of 11.0%. And remove Wyoming's federal taxes from the calculations, and that state plummets in the rankings from 10th (with an average rate of 35.9%) to 45th in state/local tax burden (with a rate of 9.8%).

On the other hand, Iowa, ranked No. 19 on total tax load (35.2%), comes in at No. 7 when its residents are measured solely by their state and local taxes as a percentage of income (12.7%). Utah, ranked 27th for its federal, state, and local tax burden, rises to No. 9 when state and local taxes become the only yardstick. And Mississippi, with one of the lowest overall tax burdens (33.8%) relative to other states, comes in at No. 12 when measured only by the level of state and local taxes as a percentage of income.

The reason for the dramatic change in the fortunes of some states' residents: Federal income taxes place such a proportionaly greater burden on America's affluent that when these taxes are removed from the calculation, less affluent states with relatively high state taxes, local taxes, or combined state and local taxes soar toward the top of the list.

Some states, when compared with their fellow states, see little or no change in their ranking after federal taxes are removed from the mix. As noted before, New York is tops in the nation whether federal taxes are included or not. Wisconsin and Oregon also remain near the top when measured only on a state and local basis. And, at the other end of the tax burden spectrum, Tennessee ranks 49th in the nation, with or without federal taxes in the calculation. ●

### Average Effective Total and Combined State/Local Tax Rates by State, 1997

| | State/Local Taxes as % of Income | State/Local Rank | Total Taxes as % of Income | Total Rank |
|---|---|---|---|---|
| United States | 11.75% | – | 35.15% | – |
| New York | 15.33% | 1 | 38.93% | 1 |
| Hawaii | 13.35 | 2 | 36.25 | 7 |
| Wisconsin | 13.30 | 3 | 36.51 | 3 |
| Minnesota | 13.22 | 4 | 36.34 | 6 |
| Oregon | 13.09 | 5 | 36.37 | 5 |
| Connecticut | 13.07 | 6 | 38.79 | 2 |
| Iowa | 12.74 | 7 | 35.13 | 19 |
| Montana | 12.42 | 8 | 35.87 | 9 |
| Utah | 12.41 | 9 | 34.47 | 27 |
| Kansas | 12.39 | 10 | 35.81 | 12 |
| Maine | 12.35 | 11 | 35.11 | 21 |
| Mississippi | 12.22 | 12 | 33.80 | 37 |
| Washington | 12.22 | 13 | 36.48 | 4 |
| Nebraska | 12.15 | 14 | 34.61 | 26 |
| Arizona | 12.13 | 15 | 34.22 | 32 |
| Kentucky | 11.99 | 16 | 34.20 | 33 |
| North Dakota | 11.95 | 17 | 35.62 | 15 |
| Ohio | 11.94 | 18 | 35.00 | 23 |
| Nevada | 11.85 | 19 | 35.71 | 14 |
| Maryland | 11.71 | 20 | 35.75 | 13 |
| Idaho | 11.61 | 21 | 33.93 | 36 |
| Michigan | 11.60 | 22 | 35.39 | 16 |
| Colorado | 11.53 | 23 | 35.13 | 20 |
| Pennsylvania | 11.50 | 24 | 35.23 | 18 |
| New Mexico | 11.47 | 25 | 34.01 | 35 |
| Rhode Island | 11.45 | 26 | 35.34 | 17 |
| Illinois | 11.37 | 27 | 36.18 | 8 |
| Virginia | 11.36 | 28 | 35.01 | 22 |
| Vermont | 11.32 | 29 | 34.19 | 34 |
| California | 11.19 | 30 | 34.37 | 29 |
| Missouri | 11.19 | 31 | 34.29 | 31 |
| North Carolina | 11.11 | 32 | 33.10 | 41 |
| New Jersey | 10.98 | 33 | 35.82 | 11 |
| Florida | 10.92 | 34 | 34.69 | 25 |
| Arkansas | 10.87 | 35 | 32.65 | 47 |
| West Virginia | 10.86 | 36 | 32.92 | 44 |
| Massachusetts | 10.84 | 37 | 34.88 | 24 |
| Georgia | 10.75 | 38 | 33.08 | 42 |
| Texas | 10.68 | 39 | 33.62 | 38 |
| South Dakota | 10.64 | 40 | 32.74 | 46 |
| Oklahoma | 10.62 | 41 | 32.90 | 45 |
| Delaware | 10.56 | 42 | 33.41 | 40 |
| Indiana | 10.52 | 43 | 34.34 | 30 |
| South Carolina | 10.44 | 44 | 33.01 | 43 |
| Wyoming | 9.82 | 45 | 35.86 | 10 |
| Louisiana | 9.80 | 46 | 31.66 | 50 |
| Alabama | 9.48 | 47 | 32.13 | 48 |
| New Hampshire | 9.37 | 48 | 33.48 | 39 |
| Tennessee | 8.90 | 49 | 31.89 | 49 |
| Alaska | 8.25 | 50 | 34.38 | 28 |
| District of Columbia | 12.76 | – | 36.57 | – |

Source: Tax Foundation.

# Total Tax Collections Near $2.5 Trillion

*Continued from page 1*

majority of these dollars (about 90 percent) will be collected at the federal level, through withholding.

While income taxes and social insurance taxes combined represent close to two-thirds of the nation's tax burden, 36 percent of the total 1997 load will still stem from other assorted taxes.

Sales and excise taxes will account for an additional 13.7 percent of tax revenue, or $338.1 billion. Over three-fourths of these will be collected at the state and local levels — in fact, past Tax Foundation research has shown that state tax collectors rely more on general sales taxes than on individual income taxes to fill their coffers. Mr. Fleenor projects that Americans on average will pay $1,263 each in 1997 for these taxes, at all levels of government.

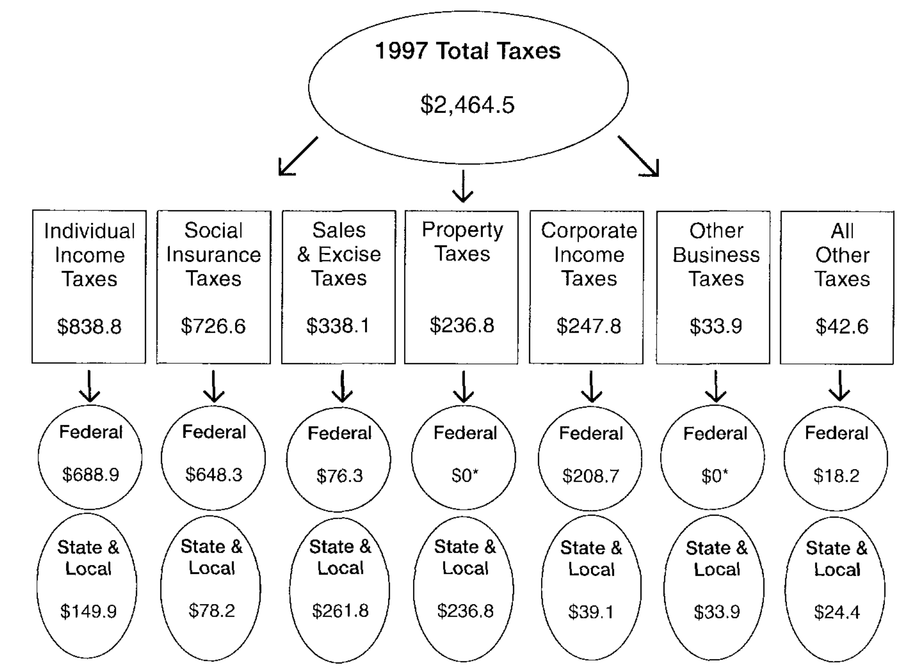
Property taxes, including those paid by businesses, will generate 11 percent of total 1997 tax receipts, or $270.7 billion. Americans on average are projected to pay about $884 each in this category of levies, virtually all of which will be collected at the state and local levels.

Corporate income taxes will account for 10.1 percent of the nation's total tax bill in 1997, or $247.8 billion. While corporate accounts initially pay these taxes, they ultimately must be borne by individuals in one form or another. While it's difficult to determine accurately who pays corporate income taxes, economists are in general agreement that the costs probably get passed on to corporate shareholders (in the form of lower dividends), employees (in the form of lower wages), or consumers (in the form of higher prices). The Tax Foundation projects that Americans on average will each pay $926 in these levies in 1997.

Other business and personal taxes are projected to constitute $76 billion in 1997, or an average of approximately $285 for each American.

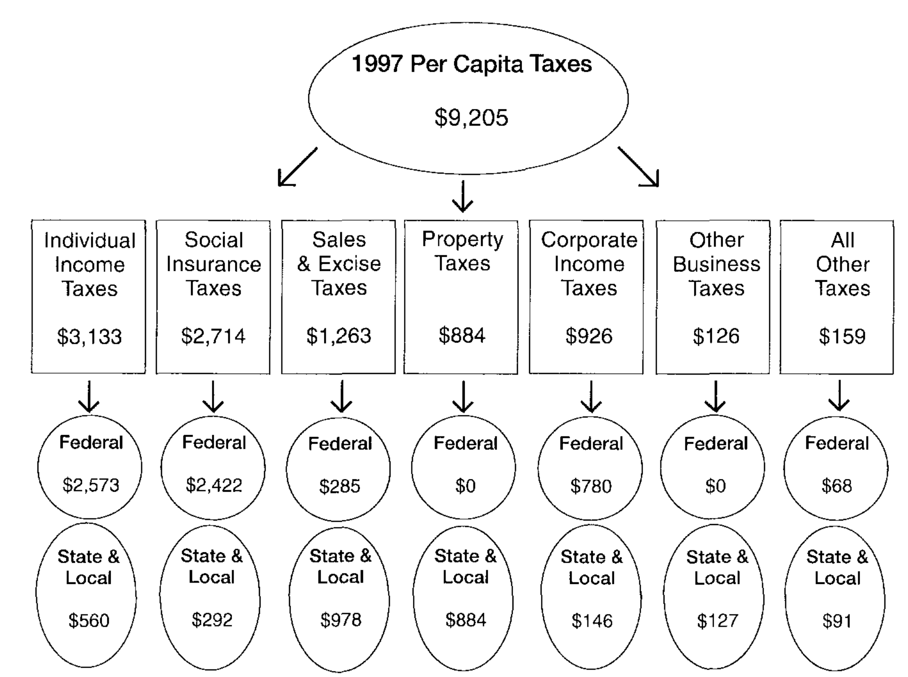
The $9,205 per capita tax bill represents 35.2 percent of the projected 1997 per capita income of $26,187.●

## Chart 2: Total Taxes by Type of Tax and Level of Government, 1997 ($Billions)




* Less than $500 million.
Source: Tax Foundation.

## Chart 3: Per Capita Taxes by Type of Tax and Level of Government, 1997




Source: Tax Foundation.

# Congress Should Act Now to Cut the Capital Gains Tax

*By Rep. Peter Deutsch (D-FL)*

When the dust settled around the historic agreement to balance the budget, negotiators accomplished a feat which once seemed nearly impossible. - After years of bitter debate and class warfare rhetoric, Congress is finally moving toward cutting the punitive tax on capital gains. This new consensus stems from a growing acknowledgment that capital gains reform will expand the economy, increase middle class income, and encourage more savings and investment. As Congress now begins work on the details of the balanced budget agreement, a reduction in the capital gains tax should remain an important part of the package.

For too long the benefits of capital gains reform got lost in misleading partisan rhetoric about the rich and the poor. In reality, the facts show that a capital gains cut will benefit all Americans — especially the middle class. First and foremost, capital gains reform is a direct and fair way to stimulate economic growth and protect against future downturns in the economy.

> ***For too long the benefits of capital gains reform got lost in misleading partisan rhetoric about the rich and the poor. In reality, the facts show that a capital gains cut will benefit all Americans — especially the middle class.***

Approximately $7 trillion is currently invested in taxable entities like homes, factories, mutual funds and stocks. Yet the high rate on capital gains creates a powerful "lock-in" effect that discourages individuals, small businessmen, and companies from selling and reinvesting their resources. The current tax system reduces the amount of capital available for other investments with greater potential, such as new start-ups and companies in emerging sectors. As a result, the capital gains tax slows the flow of capital and has become a direct tax on entrepreneurship that is essential for economic growth.

But a study by the Institute for Policy Innovation found that if the current 28 percent rate were reduced to 15 percent, the resulting stimulus would increase domestic output by $1.3 trillion and create one million new jobs over a seven year period. In real terms, capital gains reform will unlock the resources needed to fuel economic growth, thereby increasing manufacturing, productivity, employment, and real income. This would be a major boon for all Americans.

While the very nature of any capital gains tax will always hinder economic growth, a major shift in individual savings habits now makes the tax a direct penalty on the personal savings of the middle class. Over the past 15 years, middle class Americans have favored mutual funds as their preferred vehicle for savings. As a result, investment in mutual funds has increased by 25 percent over the last two years and by 800 percent since 1980. Today, over 63 million Americans invest in mutual funds. These are the middle class Americans who are hit hardest by the capital gains tax.

A capital gains cut will dramatically increase the real income of middle class Americans who are saving for a new home, their children's education, and their family's future. Consider a mutual fund shareholder with a $25,000 investment who this year earns a modest capital gain of $2,000. Under the current system, he would owe $560 in capital gains taxes. Under legislation I support to halve the tax, he could keep an additional $280 to reinvest and accumulate over time. If this same person used his savings for his daughter's college education and invested an additional $1,500 every year for eighteen years, his investment would grow to more than $113,000. However, the reformed capital gains tax would allow this family to save over $133,000 — an additional savings of nearly $20,000 over the present system.

Even more pernicious is the middle class tax on "phantom in-

FRONT & CENTER

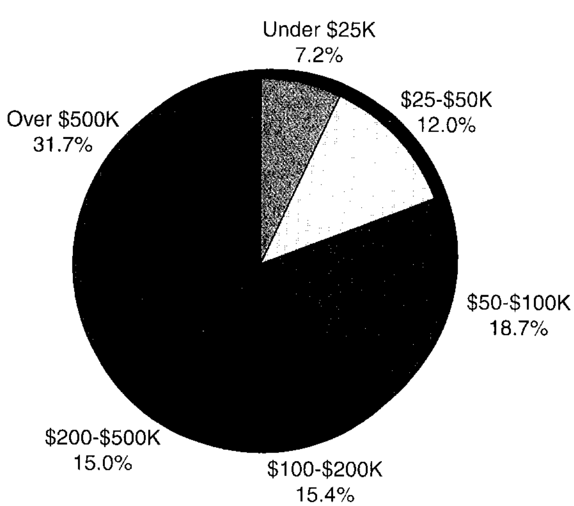
***Instead of discouraging saving and investment, Congress should create new incentives to help families plan for their future. Capital gains reform will provide immediate relief and will reward individuals for taking investment risks.***

come." Each year, a mutual fund must distribute to its shareholders the capital gains it received during the course of the year, and the shareholder must pay capital gains taxes even when the amounts are simply reinvested into the fund. These investors are really taxed three times — once when they earn the income in the first place, a second time on "phantom income" they never receive, and a third time when they sell shares in order to use their savings.

New savings habits now make the capital gains tax a burden on middle class savings. Instead of discouraging saving and investment, Congress should create new incentives to help families plan for their future. Capital gains reform will provide immediate relief and will reward individuals for taking investment risks. By restoring the opportunity for rewards, Congress will create a powerful incentive for more Americans to increase their savings.

The current capital gains tax punishes American families for preparing for the future. The tax forces them to pay more to the government, and leaves less for savings and investment. At the same time, the tax stymies economic growth needed to sustain the real income of every American. Congress owes it to hard working American families to find better ways to expand the economy, increase income, and balance the budget. The new budget agreement broke the gridlock over fundamental issues that divided decision makers for years. Rather than getting bogged down in partisan bickering, Congress should seize the historic opportunity to pass capital gains reform. •

**Income Groups' Shares of Total Taxable Capital Gains, 1942-1992**




Source: Tax Foundation.

*The Tax Foundation invites a national leader to provide a "Front and Center" column each month in* Tax Features*. The views expressed in these columns are not necessarily those of the Tax Foundation.*

# New Foundation Analyses Explore Role of Excise Taxes in Sound Federal and State Tax Policy

Do excise taxes represent good or bad tax policy? The Tax Foundation recently published the first two in a series of five Background Papers focusing on this and other questions relating to the role excise taxes play in our economy. The studies evolved out of a two-day Tax Foundation conference earlier this year, titled "Tax Reform and Excise Tax Policy Fundamentals."

In "Excise Taxes and Sound Tax Policy," Dr. John R. McGowan, Associate Professor of Accounting at Saint Louis University's School of Business, provides an overview of how and why the federal excise system evolved.

Excise taxes have always played a large role in the federal government's revenue collections, forming the bulk of total revenues in the early years of the republic.

While excise taxes constitute under five percent of total revenues today, the federal government still imposes excises on a wide variety of goods and services, including gasoline and diesel fuel, tobacco and alcohol products, airline tickets, firearm sales and firearm dealers, heavy trucks and trailers, large tires, coal, vaccines, fishing equipment, and even bows and arrows. Federal excise receipts recently approached $60 billion.

Today, about 70 percent of excise revenues come from the taxes on alcohol, tobacco, and gasoline and diesel fuel, says Dr. McGowan. The accompanying charts shows that federal excises on distilled spirits, beer, and wine, raised about $7.2 billion in 1995, while the tobacco excise raised about $5.9 billion, and gasoline and diesel fuel taxes raised over $22.6 billion.

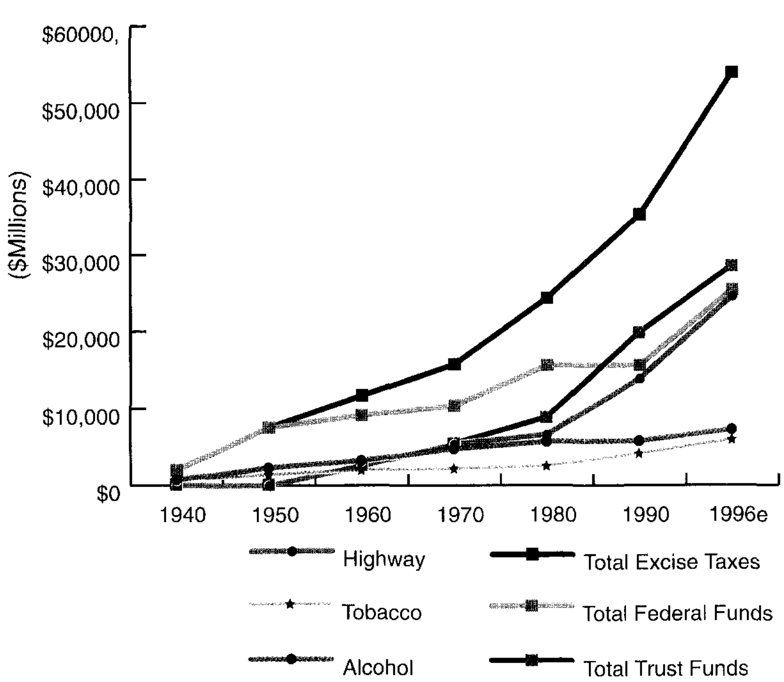
Dr. McGowan concludes that while excise taxes are relatively easy for governments to impose, they generally do not represent sound tax policy. Excise taxes can introduce significant amounts of inefficiencies into the economic marketplace and create a net reduction of benefits for consumers. Most significantly, excise taxes are widely believed to be regressive and therefore contrary to long-held concepts of fairness in the United States tax system.

In "The Use and Abuse of Excise Taxes," Dr. Dwight R. Lee, of the University of Georgia, examined the ineffiencies of the excise tax. While he acknowledged that inefficiencies are inherent in any taxation, because taxes distort the economic choices that people make, Dr. Lee observed that the most efficient tax system minimizes this type of distortion.

Excise taxes, however, are conspicuously at odds with the goal of reducing tax distortions, says Dr. Lee. They are the most distorting of all taxes per dollar raised. Instead of spreading the tax burden as neutrally as possible over a broad tax base, excise taxes single out a few products for a high and discriminatory tax burden. This motivates consumers to avoid that burden by shifting away from products that provide them with the greatest value per unit of production cost. Corresponding to this consumption distortion are production distortions as productive resources are shifted out of higher-valued employments and into lower-valued employments.

Only in a very few situations — where the consumption of a product is complementary to the use of some other good that cannot easily be priced directly — can earmarked excise taxes be efficient. But even here the efficiency of the excise tax depends upon the revenues being unconditionally allocated to the complementary use to reduce the cost of rent seeking. The greater the rent seeking over the allocation of the revenues from a potentially efficient excise tax, the less efficient it is and the lower the efficient rate of taxation (under reasonable assumptions about the relevant elasticity of demand). ●

**Total and Select Federal Excise Tax Collections, 1940–1996**




Source: Tax Foundation, Office of Management and Budget.

# FOUNDATION MESSAGE

## Of Budget Deals and Dealers

*J.D. Foster*
*Executive Director*
*& Chief Economist*

At this time, all the parties to the budget negotiations are negotiating furiously to get a "deal" done. Taking a step back, it's really hard to know what to make of it all.

A first reaction might be to wonder why, and if, even the most basic budget processes are so broken down that the normal committee system and public debate which should produce a budget have been cast adrift. While it's easy to get bogged down in process questions, it has become too easy to ignore matters of process altogether. This is unfortunate, and possibly dangerous, in a democratic society.

And how did we find ourselves at this lucky crossroads? The economy just keeps on going, throwing off unanticipatedfederal revenues to the tune of some $225 billion over the next five years. To a large extent, the deficit reduction elements of the budget deal merely codify what would happen anyway — revenues go up when the economy grows.

Medicare is in real trouble, so any budget deal must cut Medicare spending to save the program from bankruptcy. Indeed, the deal calls for $115 billion in cuts, or so they say. Actually, over half this amount represents a typical shell game as some benefits are shifted from Part A, which is paid out of the Trust Fund, to Part B, which is paid out of general revenues.

The dealers boast of $85 billion in net tax relief over five years, contingent upon the tax committees coming up with $20 billion in supposed loophole closers. What are we to make of this? On the one hand, this is probably the first deficit reduction plan that doesn't increase taxes. There is surely goodness in that.

Another $26 billion of "spending reduction" derives from the sale of spectrum. There's nothing wrong with such a sale as it's another form of deregulation. But to call this a spending reduction is absurd. If you sell an heirloom, would you call the receipts a cut in your spending?

Tax cutters have always argued that any tax cut is better than no tax cut (hence the remaining support for the family tax credit, I suppose), and $85 billion in tax relief is nothing to sneeze at. But it's less than 1 percent of the taxes the government would otherwise collect over those same years, a far cry from the amounts originally envisioned by Republicans. And remember, these tax cuts are financed by tax growth, not by spending cuts.

In fact, aside from Medicare, spending increases over what would otherwise be the case by about $30 billion thanks to the President's demands that he get something out of the deal. Reminiscent of the roundly blasted original Clinton budget, must of what few cuts are made would occur in the last two years of the deal. So much for ending the reign of big government as we know it. It might not be unfair to call this budget "Clinton plus Capital Gains".

Is there nothing good to be said about the budget deal? It does slow the growth of tax collections. Tax Freedom Day 1997 is May 9. Thanks to the expected revenue growth and net tax cuts, by 2002 Tax Freedom Day may only be May 12 instead of May 15. At least we slow the climb.

And some of those tax cuts will help the economy. Capital gains relief will help the economy continue to generate a healthy revenue flow. Estate tax relief and expansions of Individual Retirement Accounts are likewise highly worthwhile.

Probably the best that can be said about this deal, assuming it gets enacted pretty much as announced, is what it portends for the debates in 1998 and beyond. For the first time in many years, politicians can debate the size and role of government on their merits and without a river of red ink clouding the issues. And Republicans can get the full benefit of their proposed spending cuts in terms of dollar-for-dollar tax cuts. Today, when a spending cut is proposed, the fiscal and political benefit gets bled away as the savings are applied to deficit reduction. No more. Henceforth, taxpayers get the benefits, which should make spending cuts an easier sell. ●

## You Could Be A Supply-Sider If:

Ever since the early 1980s, "supply-side economics" has been about the most misunderstood and maligned expression in tax policy. In fact, however, a great many people who deride supply-side economics are closet supply-siders themselves, and don't even know it. Are you a supply-sider? Take the following test:

• If you believe you're likely to buy less beer over time if they double the sales tax on beer, then you could be a supply sider.

• If you believe you would save more for retirement if the government expanded the Individual Retirement Account and similar savings incentives, then you could be a supply sider.

• If you believe you could lose your job if the government raised the payroll tax, then you could be a supply sider.

• If you think rich people will try to leave the country to escape income or estate taxes, then you could be a supply sider.

• If you think your neighbor is more likely to cheat on his taxes if tax rates were higher, then you could be a supply sider.

• If you think you or your spouse would be more likely to stay home with the kids if income tax rates were higher, then you could be a supply sider.

• If you would give more to charity if tax rates were higher, or would give less if the charitable deduction were eliminated, then you could be a supply sider.

• If you think the loss of the mortgage interest deduction would hurt housing values, then you could be a supply sider.

• If you believe that you know better what to do with your own money than does the government, then you could be a supply sider.

Supply-side economics in a nutshell simply says that the more you tax something, the less of it you'll get. If you answered in the affirmative to two or more of the questions above, then you, too, could be a supply side nut. ●

# Tax Freedom Day Continues Inching Its Way Into America's Culture

**TAX FEATURES©**

**Tax Features© (ISSN 0883-1335) is published monthly by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia. Annual subscriptions to the newsletter are $15.**

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**Co-Chairman, Policy Council**
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**Executive Director and Chief Economist**
J.D. Foster, Ph.D.

**Administrator and Director, Foundation Development**
C. Gaye Bennett

**Tax Counsel**
Lynda K. Walker

**Director, Corporate Development**
Renée Nowland

**Editor and Associate Director/ Communications Director**
Stephen Gold

**Tax Foundation**
**(202) 783-2760 Tel**
**(202) 942-7675 Fax**
**www.taxfoundation.org**
**taxfnd@intr.net**

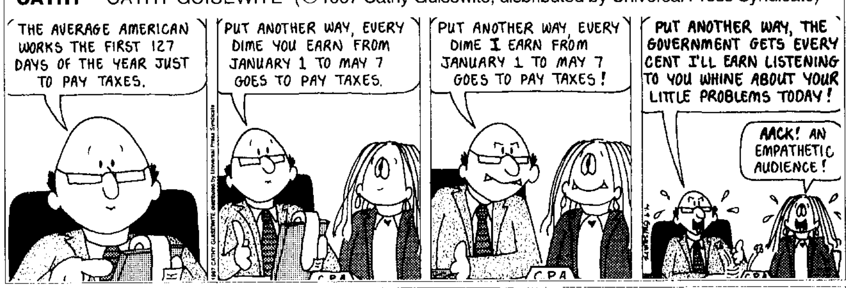
Events revolving around this year's 25th anniversary of the original Tax Freedom Day pronouncement showed once again how far this symbolic date has worked its way into America's mainstream culture.

Two nationally syndicated comic strips, "Cathy" by Cathy Guisewite and "The Born Loser" by Art Sansom, dedicated a strip to the concept of Tax Freedom Day this year. The former strip appeared in newspapers nationwide on April 9, prior to the Tax Foundation's 1997 announcement, while the latter was circulated for publication May 9 — Tax Freedom Day.

In addition, aside from numerous editorial pages and radio programs spotlighting the date, the Senate Finance Committee focused congressional attention with a special "Tax Freedom Day" hearing on April 14. Executive Director J.D. Foster and Economist Patrick Fleenor testified before the Committee, telling members that — without change — the progressive nature of the current tax system ensures continually later Tax Freedom Days.●

*Foundation Executive Director J.D. Foster (right) and Economist Patrick Fleenor testify before the Senate Finance Committee on April 14.*

**CATHY** CATHY GUISEWITE (©1997 Cathy Guisewite, disbributed by Universal Press Syndicate)




**THE BORN LOSER** ART SANSOM (©1997 by NEA, Inc.)


Tax Foundation
1250 H Street, NW
Suite 750
Washington, DC 20005-3908