TAX FOUNDATION

TAX FEATURES

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Comparison of Tax Plans from Bush and McCain Shows Great Similarities, Great Differences

Bush and McCain's tax plans differ most in their effect on elderly single filers at both ends of the income spectrum.

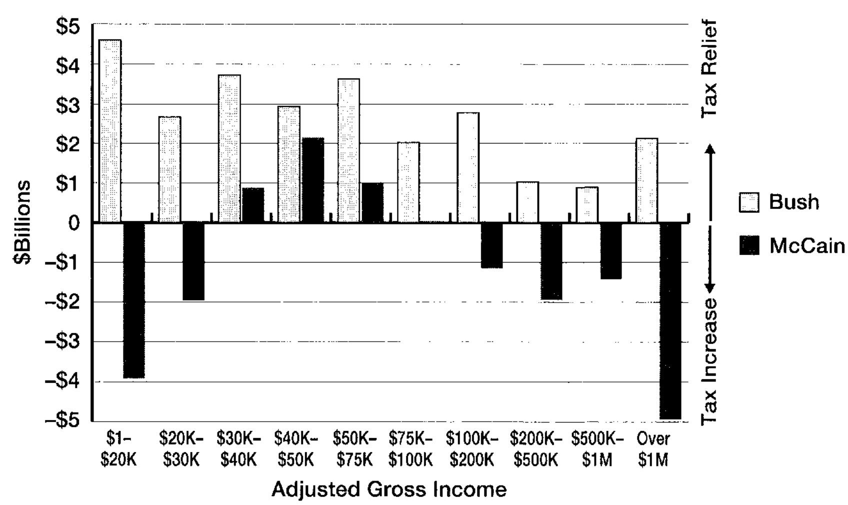
A Tax Foundation analysis of how the Bush and McCain tax plans would affect taxpayers once the plans were fully effective in 2006 shows some similarities, and some striking differences. Both would provide significant tax relief to millions of middle-class taxpayers, and both would increase the proportion of the total tax burden paid by the taxpayers who earn the most.

The great difference between the two plans is that Senator McCain provides virtually no net tax relief to the lowest income married taxpayers, and effectively levies a large tax increase on low-income single retirees. The source of this tax hike is the set of corporate tax breaks McCain would eliminate.

As is common practice, the Tax Foundation attributes the burden of corporate taxes, and therefore corporate tax hikes, to the owners of the companies. A recent study by the Federal Reserve Board showed that 48.8 percent of families own stock and that the median value of their holdings is $25,000. Many low-income elderly taxpayers receive a large share of their livelihood from pensions and other saving they did throughout their working lives. Much of this saving is invested in corporate equities, either directly, through mutual funds, or through their pensions. Increasing corporate income taxes reduces the value of these companies and reduces the after-tax income received by the companies' owners.

Said J.D. Foster, Executive Director and Chief Economist of the Tax Foundation, "I'm sure Senator McCain didn't intend this, but his

Figure 1: Total Income Tax Relief for Single Filers by Income Class in Tax Year 2006



Note: Totals don't add to one because taxpayers with zero AGI and heads of households are omitted.
Source: Tax Foundation

See Candidates *on page 8*

FRONT & CENTER

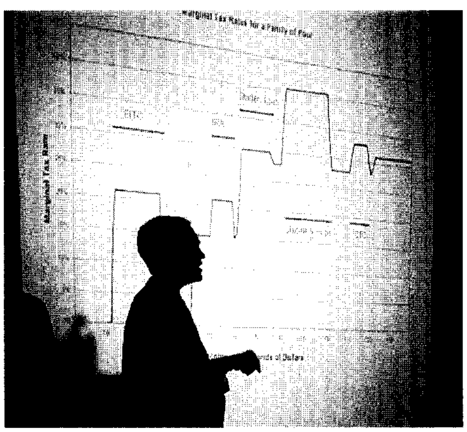
The Federal Income Tax Law: A Code At War with Itself

U.S. Senator Pete Domenici (R-NM)

6-7

National Conference Focuses on Marginal Tax Rates

Executive director and chief economist, J.D. Foster, Ph.D., introduces the theme, "Do Marginal Tax Rates Matter?" and the speakers at the Tax Foundation's 62nd National Conference.



Columbia University Professor Glenn Hubbard is silhouetted against his chart of marginal tax rates.

At noon on November 18th, J.D. Foster, Ph.D., the Tax Foundation's Executive Director and Chief Economist, welcomed the crowd at the 62nd National Conference and introduced the keynote speaker, Wayne Struble, Staff Director of the House Committee on the Budget, who spoke on "Statutory vs. Effective Tax Rates—The Reality and How We Got There."

The first panel of speakers then took the stage to address "Marginal Tax Rates and Investment." Moderator J.T. Young, Ph.D., Chief Economist/Budget & Tax Policy Analyst with the Senate Republican Policy Committee introduced panelists Stephen J. Entin, Executive Director and Chief Economist, Institute for Research on the Economics of Taxation; R. Glenn Hubbard, Ph.D., Russell Carson Professor of Economics and Finance, Columbia University; and Margo Thorning, Ph.D., Senior Vice President and Chief Economist, American Council for Capital Formation.

After a break, the second panel was introduced by moderator Peter M. Taylor, Ph.D., Senior Economist with the Joint Committee on Taxation, to speak on "Incentives to Work/Incentives to Hire."

The three panelists were Robert Carroll, Ph.D., Economist, Office of Tax Analysis, Department of the Treasury; David R. Malpass, Chief International Economist and Senior Managing Director, Bear Stearns & Co., Inc.; and Jane G. Gravelle, Ph.D., Senior Specialist in Economic Policy, Congressional Research Service.

With Congressman Phil Crane (R-IL) scheduled to give the closing remarks, a long series of roll call votes was held on the floor of the House, preventing him from appearing in person. His remarks were sent by courier, and J.D. Foster closed the conference by reading them.

Several Tax Foundation donors made special contributions to sponsor the Foundation's 62nd National Conference: Arthur Andersen LLP; Baker & Hostetler, LLP; Bell Atlantic Corporation; Caterpillar Inc.; Citibank, N.A.; Distilled Spirits Council of the United States; Ernst & Young, LLP; Exxon Corporation; General Motors Corporation; Georgia-Pacific Corporation; Household International, Inc.; Koch Industries, Inc.; KPMG Peat Marwick LLP; Metropolitan Life Insurance Company; Microsoft Corporation; Miller & Chevalier, Chartered; Northrop Grumman Corporation; Mr. and Mrs. George A. Peterkin, Jr.; Philip Morris Management Corp.; Praxair, Inc.; PricewaterhouseCoopers LLP; Mr. James Q. Riordan; R.J. Reynolds Tobacco Company; Sears, Roebuck and Co.; 60 Plus Association; Skadden, Arps, Slate, Meagher & Flom LLP; Texaco Inc.; John E. and Fran Thomson; TRW Inc.; UST Public Affairs Inc.; USX Corporation; Washington Counsel, P.C.; and the Wine and Spirits Wholesalers of America.

At center, Tax Foundation co-chairman and former Director of OMB Jim Miller talks with two college students who attended the conference thanks to the Foundation's College Classroom Project.

From left: Tony Saggese of Texaco, Mike DeLuca of Household International, Catherine Porter of Miller & Chevalier, and Dave Williams of BellSouth.

Tax Foundation Celebrates 62nd Annual Dinner While Honoring Kerrey and Feldstein

The Tax Foundation celebrated its 62nd annual dinner on November 18, 1999, at the Four Seasons Hotel in Washington, DC.

Senator Bob Kerrey, recipient of the Tax Foundation's Distinguished Service Award for the Public Sector.

Earlier in the day, the Foundation's National Conference revisited the importance of marginal tax rates (story on page 2), and during a reception before the dinner, the Foundation held a silent auction (sidebar on page 4).

Each year the Tax Foundation honors two people who have distinguished themselves in the field of tax policy, one from government and one from the private sector. This year those two people were United States Senator Bob Kerrey (D-NE) and Dr. Martin Feldstein, President and CEO of the National Bureau of Economic Research (NBER).

Senator Bob Kerrey's service on the Finance Committee has shown him to be a man of unwavering principle. Widely respected on a bi-partisan basis for his vision, Senator Kerrey brings to tax policy a common-sense approach and a rare ability to work well with

Martin and Kate Feldstein at the Tax Foundation's annual dinner where Dr. Feldstein received the Foundation's Distinguished Service Award for his private sector contributions to tax policy as president of the National Bureau of Economic Research.

College Classroom Project Brings Students Together with Corporate And Capitol Hill Tax Policy Community at National Conference

Thanks to the Tax Foundation's College Classroom Project, students and professors attended the Tax Foundation's 62nd National Conference, "Do Marginal Tax Rates Matter?" on November 18, 1999, at the Four Seasons Hotel in Washington, DC.

The conference gave students the opportunity to meet business leaders, well-known analysts, and other prominent policymakers who shape tax policy.

Donors who made earmarked contributions to sponsor students from all over the east coast to come to Washington were: The Air Products Foundation; Bechtel Group, Inc.; Cabot Oil & Gas Corporation; Celanese Americas Corporation; Chevron Corporation; Coors Brewing Company; Johnson & Johnson; PricewaterhouseCoopers LLP; Telephone and Data Systems, Inc.; Texaco Inc.; and Westvaco Corporation.

Please contact Jan Rogers (jrogers@taxfoundation.org) about becoming a sponsor next year.

In the front row, Professor George Agbango (far left), Tax Foundation Executive Director J.D. Foster (third from left) and Tax Foundation Co-Chairman Jim Miller (far right) are surrounded by Professor Agbango's students from Bloomsburg University who came from Pennsylvania to Washington, DC, for the Tax Foundation's National Conference. The Foundation's donors made special contributions to sponsor the trip as part of the annual College Classroom Project.

Members on both sides of the aisle.

His co-chairmanship of the Bipartisan Commission on Entitlement and Tax Reform led to a final report, released in January 1995, that is often cited as the definitive analysis of the nation's entitlement system.

His recent work as co-chairman of the National Commission on Restructuring the Internal Revenue Service has established Kerrey as a national leader in efforts to reform our nation's tax collection system, enhance its efficiency, and increase protections against taxpayer abuse.

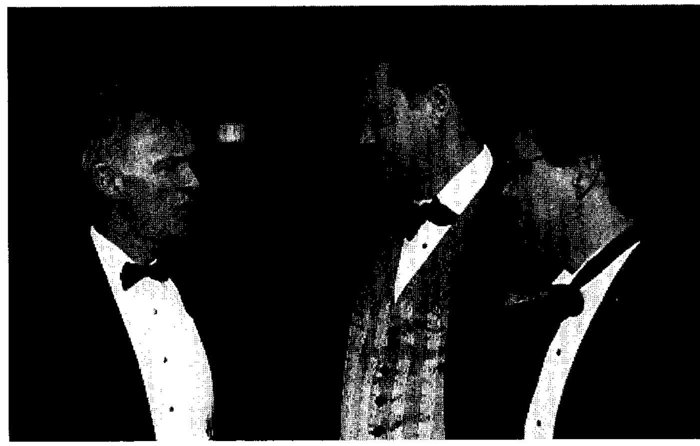
Martin Feldstein is George F. Baker Professor of Economics at Harvard University, and NBER is a private, non-profit research organization that has specialized for more than 75 years in producing nonpartisan studies of the American economy.

Dr. Feldstein had received the Tax Foundation Distinguished Service Award for his public sector accomplishments in 1983 during his tenure as head of President Reagan's Council of Economic Advisors. His selection as recipient of the Private Sector award for his 16 years of work at NBER makes him the only person to win both awards.

A graduate of Harvard College and Oxford University, Dr. Feldstein is a Fellow of the Econometric Society and the National Association of Business Economists.

Dr. Feldstein and Senator Kerrey joined a long and distinguished list of American business and political leaders.

Two U.S. Presidents have been so honored: Herbert Hoover in 1948 (for his role as head of the Commission on Organization of the Executive Branch) and Dwight Eisenhower in 1960. Numerous



Wayne Gable (right) and Rob Hall (center) of Koch Industries chat with Senator Kerrey at the reception.

Silent Auction Added to Annual Dinner Festivities

The 62nd Annual Dinner was the first year that the Foundation held a silent auction as part of the event. Guests participated by donating items in advance and coming prepared to bid on the wonderful items that others had donated.

The money raised from the auctioned items expands the Foundation's research and educational programs at the local, state and federal levels.

The generous donors were Brunswick Corporation; Circuit City Foundation; Congressman Bill Archer; Coors Brewing Company; Distilled Spirits Council of the United States; Four Seasons Hotel; General Motors Corporation; Law Firm of Herman B. Bouma; Hershey Foods Corporation; National Fruit Product Co.; Nestle USA; Northrop Grumman Corporation; On the Border Mexican Café; Philip Morris Management Companies Inc.; Philip Morris Management Corp.; Saint-Gobain Corporation; Sears, Roebuck and Co.; Southwest Airlines Co.; Tupperware Corporation; United Parcel Service, Inc.; UST Public Affairs Inc.; Vinson & Elkins LLP; and The Washington Redskins.

At right, Tom Herman of the Wall Street Journal points Fred Goldberg of Skadden, Arps, Slate, Meagher & Flom to one of the gifts that Tax Foundation donors provided for the silent auction while Mr. and Mrs. George Peterkin look on.

From left: Enjoying the silent auction are Richard Belas of Davis Harman with Tim Tammany of CIGNA, and Barbara Washburn and Bill Latinen of General Motors.

Secretaries of Treasury have been honored, George Shultz (1974), William Simon (1975), and James Baker III (1985). Some of the most notable congressional leaders to accept the Tax Foundation award include Senator Robert Taft (1949), Chairman of the House Ways & Means Committee Wilbur Mills (1958, 1968), Senator Everett Dirksen (1965), and the father-son team of Senator Harry F. Byrd (1941, 1955) and Senator Harry F. Byrd, Jr. (1973).

In addition, four chairmen of the Federal Reserve System have been honored by the Tax Foundation at its annual dinner: William McChesney Martin, Jr. (1961), Paul McCracken (1971), Paul Volcker (1980), and Alan Greenspan (1992).

Many members of the private sector have also taken leadership positions in promoting sound tax policies, thereby earning the esteem of the Tax Foundation. AT&T Chairman Frederick Kappell (1967), GM Chairman Richard Gerstenberg (1972), and GE Chairman Reginald Jones (1977) have been recognized at the annual dinner. In recent years, such distinguished business leaders as Alcoa Chairman Paul O'Neill (1991), Mobil Chairman Alan Murray (1992) and Hewlett-Packard Chairman John Young (1994) have been honored for their contributions to the national fiscal policy discussion. In 1996, the Tax Foundation chose to honor Dr. Norman Ture, long one of the nation's most respected public policy analysts, and a driving force behind the 1981 tax cut.

Smiles all around as Tax Foundation Co-Chairman Jim Miller (right) and Executive Director J.D. Foster (left) present Dr. Martin Feldstein his award.

Executive Director J.D. Foster (right) presents Senator Bob Kerrey the Tax Foundation's award for Distinguished Service in the Public Sector.

Tax Foundation Distinguished Service Award Winners
Selected Years

1941	U.S. Senator Harry F. Byrd
1948	President Herbert C. Hoover
1949	U.S. Senator Robert A. Taft
1954	Sec. of Agriculture Ezra Taft Benson
1956	White House Chief of Staff Sherman Adams
1960	President Dwight D. Eisenhower
1961	Fed Chairman William McChesney Martin, Jr.
1962	Gov. Nelson A. Rockefeller
1965	U.S. Senator Everett M. Dirksen
1968	U.S. Rep. Wilbur Mills
1971	CEA Chairman Paul W. McCracken
1973	U.S. Senator Harry F. Byrd, Jr.
1974	Sec. of Treasury George P. Schultz
1975	Sec. of Treasury William E. Simon
1976	U.S. Senator Russell B. Long
1977	GE Chairman Reginald H. Jones
1980	Fed Chairman Paul Volcker
1981	Sec. of Defense Caspar W. Weinberger
1982	U.S. Rep. James R. Jones
1983	CEA Chairman Martin Feldstein
1985	Sec. of Treasury James A. Baker III
1987	U.S. Senator Daniel Patrick Moynihan
1988	U.S. Rep. Bill Archer
1989	USX Chairman David Roderick
	U.S. Senator Lloyd Bentsen
1990	Young & Co. Chairman William S. Kanaga
	U.S. Senator Bob Packwood
1991	Alcoa CEO Paul H. O'Neill
	U.S. Senator Max Baucus
1992	Mobil Chairman Allen E. Murray
	Fed Chairman Alan Greenspan
1993	USX Chairman Charles A. Corry
	U.S. Rep. Sam M. Gibbons
1994	Hewlett-Packard Chairman John Young
	U.S. Senator William Roth
1995	Texaco Chairman Alfred C. DeCrane, Jr.
	U.S. Senator Sam Nunn
1996	Dr. Norman Ture
	U.S. Rep. Phil Crane
1997	GTE Chairman Charles R. Lee
	U.S. Senator John Breaux
1998	CSX Chairman John Snow
	U.S. Rep. Bill Archer
1999	NBER President Dr. Martin Feldstein
	U.S. Senator Bob Kerrey

FRONT & CENTER

The Federal Income Tax Law: A Code at War with Itself

By U.S. Senator Pete Domenici (R-NM)

The federal income tax law is a code at war with itself. It is a war between chapters and subchapters, titles and subtitles, parts and subparts, sections and subsections. The baffling complexity of the code and the growing angst it fosters for families and American businesses only underscores the need for Congress to reform the tax code. We simply cannot go on with a tax code that, in the end, is at war with American families.

The tax code is replete with inexplicable contradictions. The code, for example, provides a $500 child credit to help a family afford raising children. At the same time, it imposes an average $1,400 marriage penalty on the mother and father for getting married and staying married while raising the supposed beneficiaries of the federal child tax credit.

Sixty-three provisions in the code penalize couples for being married, two of the most prominent being the standard deduction and the tax bracket structure. The dependent credit, the elderly credit, the IRA deduction, and education loan interest expense deductions are phased out based on income, and therefore, are marriage penalties for modest income couples. In fact, Congress contributes to the marriage penalty every time it enacts income phase-out provisions—some of which start as low as $10,000 of income.

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The federal tax code diminishes a working wife's contributions to her family's finances by taxing her income at the highest rate imposed on her husband's income. This is hard to justify under any circumstances, but it is unconscionable when the federal government is collecting record surpluses from taxpayers.

The tax code war with itself is perpetuated by the Alternative Minimum Tax (AMT), which Congress enacted to ensure everyone pays their fair share. Intended to affect only a few thousand taxpayers, it could penalize an estimated 33 million Americans by 2009. More and more taxpayers are already experiencing the pain of the AMT, which could stand for the "Awful Monstrosity of a Tax."

Every tax credit Congress enacts pushes more families into the AMT. Prior to enactment of last year's tax extenders bill, the AMT was projected by 2009 to force three in four families to receive less than the full HOPE education, child, or other tax credits. To address this tax code inconsistency, Congress passed a stopgap exemption to protect most families from the AMT. But this action begs the obvious: why not just repeal the AMT, revenues from which rose 39.2 percent in 1997, the largest increase since 1993? Or why not enact a simple and fair tax system that does not need an AMT?

The tax code war against itself also extends into the various Individual Retirement Account (IRA) and pension provisions that encourage people to save for retirement, first home purchases, and college educations. These "worthy purposes" provisions are battlegrounds in the conflict between the subsections. If the rollover and distribution rules are not strictly followed, up to 70 percent of the retirement savings could be lost to taxes.

Americans are living and working longer, yet the war between the tax code sections ignores this biological fact. It penalizes people for staying in the work force. Taxable Social Security benefits have increased each year since 1988. It is bad tax and Social Security policy to require up to 85 percent of Social Security benefits to be included in taxable income for some beneficiaries.

Our gift and estate taxes, with rates ranging from 18 to 55 percent, are another vicious front in the tax code war. Milton Friedman summed up the gift and estate tax when he said, "The estate tax sends a bad message to savers, to wit: that it is O.K. to spend your money on wine, women and song, but don't try to save it for your kids. The moral absurdity of the tax is surpassed only by its economic irrationality." When the generation skipping tax is also triggered, the combined gift and estate tax rates can reach

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Pete Domenici is a Republican United States Senator from New Mexico and the chairman of the Senate Budget Committee.

80 percent. For this reason, the estate tax is often called the most confiscatory tax of all. It is one of the greatest burdens on our most successful small businesses. It is a tax on job creation. The Heritage Foundation found that over a 10 year period, economic output would increase $11 billion per year on average, and create 145,000 new jobs if the estate tax were repealed.

To arrive at good tax policy and find tax code peace, we need to ask the right questions. Policy makers, news makers and others tend to start each tax debate with the same questions: "Who benefits? What percentage of the benefit goes to the top 1 percent or 5 percent?"

We cannot ignore that our current code is a progressive tax rate system. Under our progressive rate structure, any tax cut is going to give the biggest savings to those who pay the largest tax bills. It is unavoidable that the biggest tax cut goes to those who shoulder the heaviest tax burden. Asking the wrong question leads to the wrong tax policy. Let me repeat the tax burden facts.

According to 1997 IRS data, the top 10 percent of taxpayers shoulder 60 percent of the federal income tax burden. Two percent of taxpayers (those with adjusted gross incomes of more than $200,000) paid more than 37 percent of all federal income taxes. The bottom 50 percent of taxpayers paid only 5 percent. And 50 million Americans pay no federal income tax at all.

The question of "who benefits?" shifts the focus to wealth redistribution instead of wealth creation. It furthers class warfare instead of advancing good economic and tax policy.

Tax revenues have grown by 7.6 percent annually since 1992, nearly 250 percent faster than the 2.2 percent annual rate of inflation. High federal taxes seize nearly 40 percent of the wealth added to the U.S. economy by America's most productive individuals. When combined with state and local income taxes, this represents government's power to control half of the additional income earned by entrepreneurs and other high-income taxpayers, dramatically reducing their incentives to build businesses and create jobs.

Total taxable income and total income tax increased faster than AGI in

1997. Net capital gains increased over 40 percent for the second consecutive year, with $356.1 billion being realized for 1997.

We should consider lowering the capital gains rate. Some advocate lowering it to zero. I am not sure I would go that far, but the capital gains tax is a tax

American workers now work until May 11 every year just to pay their taxes. This is the highest tax burden since WWII. People are paying more in taxes than they spend on food, shelter and education, pouring more revenue into the federal coffers than is needed to fund current government services. The tax burden is too high, and taxes should not be collected for more government services that are not needed, wanted or even created yet.

To end the tax code battle, we must simplify a code that is too complicated. There are 7 million words in the Federal Internal Revenue Code and regulations related to its 703 accompanying tax forms. When *Money* magazine asked 46 professional tax preparers to calculate a hypothetical family's tax return, each professional arrived at a different answer.

We need to move toward a simpler, lower and flatter tax system. We need a tax system that moves toward taxing income that is consumed and not income that is earned, saved and invested. We need a tax system that recognizes that not all family spending is equal. It should appreciate the importance of investing in education.

We need tax equity so that everyone

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on capital formation. It is a tax on risk taking, and it should be applied prudently so that our economy can function more efficiently.

In conclusion, marriage, saving for retirement, risk taking, and dying should not be taxable events as we begin the new century. The AMT should not turn the child care, education, and foster care tax credits into worthless and useless credits.

The price of civilization has become dramatically more expensive since Justice Oliver Wendell Holmes called taxes the price we pay for a civilized society.

will get a tax break for health care regardless of who they work for—a big company, small business or one-man shop.

We need generational equity, including tax credits for child care as well as long term care credits for the elderly.

Finally, and probably most importantly, Americans need a tax cut.

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

Candidates

from page 1

tax plan would really hurt many low-income retirees."

The Tax Foundation examined the tax plans advanced by Governor Bush and Senator McCain in terms of the shares of total federal taxes (individual and corporate income) paid by single and by married taxpayers, and in terms of the amount of tax relief or tax increase for both groups, and presented the analysis by standard income ranges.

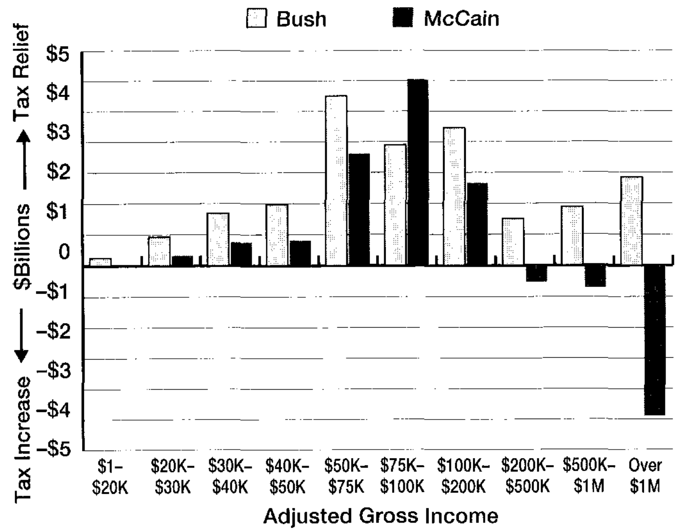
In dollar terms, Figure 1 on page 1 shows that for single taxpayers the Bush plan gives most of the tax relief to individuals with incomes below $75,000. As shown in Figure 3A below, the Bush plan shows a slight reduction in the share of taxes paid by single filers with incomes below $20,000 and minor changes for higher income levels, and a modest increase for tax filers with incomes over $200,000.

In contrast, while the McCain proposal does provide significant relief for single taxpayers with incomes between $30,000 and $75,000, the plan's corporate income hikes would hit single taxpayers hard at both ends of the income spectrum (see Figure 1). The plan's effect on the income distribution of the tax burden would be similar. The share of total federal income taxes paid by single taxpayers with incomes below $30,000 or above $100,000 would rise (see Figure 3A).

As shown in Figure 2, the Bush plan provides married filers most of its tax relief in dollar terms to those with incomes between $50,000 and $200,000, with more modest tax relief going to married filers with higher and lower incomes. The McCain plan would also provide most of its relief in the $50,000 to $200,000 range, though much more of it would be concentrated in the $75,000 to $100,000 range.

The McCain plan departs from the Bush plan, however, in that his tax relief going to married filers with incomes below $50,000 would be slight, and he would increase the tax burden on married filers with incomes in excess of $200,000. This tax increase, like the others in the McCain plan, results from in-

Figure 2: Total Income Tax Relief for Married Filers by Income Class in Tax Year 2006

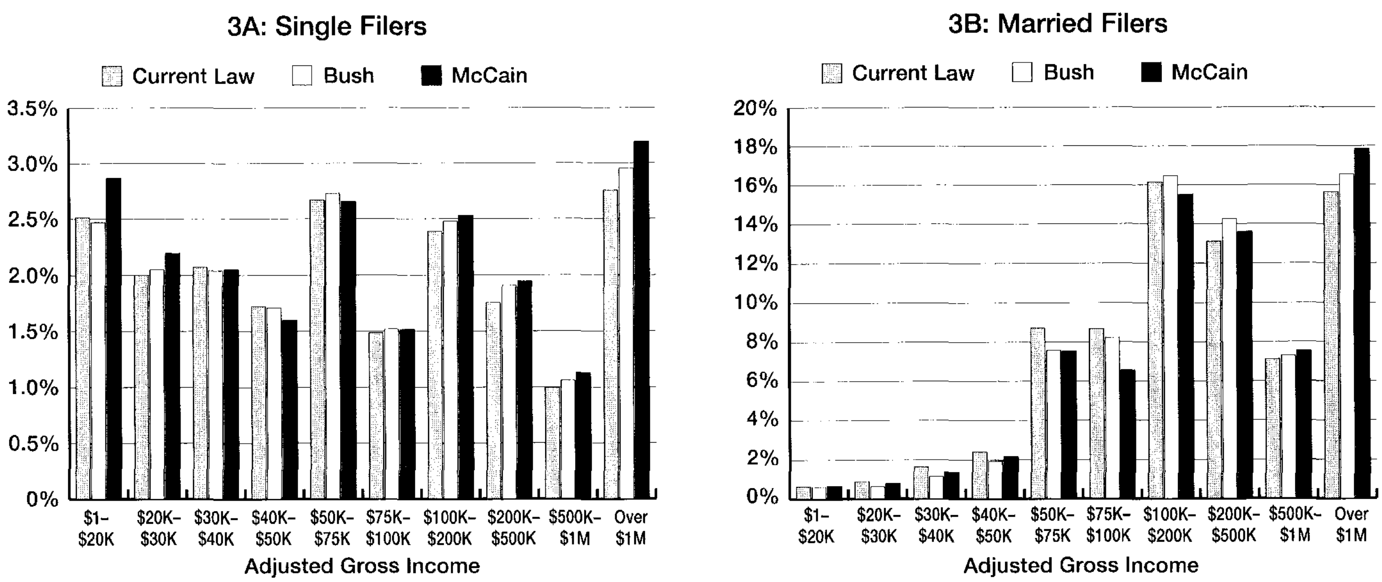


Note: Totals don't add to one because taxpayers with zero AGI, married filing separately, and heads of households are omitted.

Source: Tax Foundation

Figure 3: Share of Total Income Taxes Paid by Income Class, Single Filers and Married Filers

Calendar Year 2006



Note: Shares do not sum to one because taxpayers with no adjusted gross income and heads of households, and married taxpayers filing separately are omitted from the data.

creasing corporate income taxes at the expense of the shareholders. As with single filers, the McCain tax increase on low-income married filers would apply almost exclusively to retirees. Low-income working families would see a tax reduction or no tax change.

The great difference between the two plans is that Senator McCain provides virtually no net tax relief to the lowest income married taxpayers, and effectively levies a large tax increase on low-income single retirees.

In terms of how the tax burden would be shared across the income spectrum, both the McCain and Bush plans would reduce the share of taxes paid by married filers with incomes below $100,000, though the McCain plan would slightly increase the share of taxes paid by married filers making less than $20,000.

Both the Bush and McCain plans would increase the share of taxes levied on married taxpayers with incomes above $200,000. Considered broadly, the Bush and McCain plans both increase the progressivity of the total federal income tax system.

The Bush tax plan analyzed here was released December 1, 1999, and includes reductions in statutory marginal tax rates, marriage penalty relief, a doubling of the per child tax credit and other changes to the credit, among other provisions, for a total five year tax cut of $483 billion and a tax cut in 2006 estimated to be $162.16 billion.

The McCain plan includes a widening of the 15 percent tax bracket, doubling the per child tax credit, an increase in the standard deduction for couples, and other tax cuts, and a lengthy list of tax increases, primarily though not exclusively on businesses. The net tax cut under the McCain plan over five years is $85.6 billion and the net tax cut in 2006 is estimated to be $30.31 billion.

Both the Bush and McCain plans would increase the share of taxes levied on married taxpayers with incomes above $200,000.

Tax Data on the Bush and McCain Tax Plans

Calendar Year 2006

Adjusted Gross Income	Number of Filers (Thousands)	Share of Taxes Paid under Current Law	Share of Taxes Paid under Bush Plan	Share of Taxes Paid under McCain Plan	Net Tax Relief from Bush Plan ($billions)	Net Tax Relief from McCain Plan ($billions)
Single Filers						
$1 Under $20,000	31,421	2.5%	2.5%	2.9%	$4.60	– $3.93*
$20,000 under $30,000	7,517	2.0%	2.0%	2.2%	$2.67	– $1.97*
$30,000 under $40,000	5,146	2.1%	2.0%	2.1%	$3.72	$0.86
$40,000 under $50,000	2,654	1.7%	1.7%	1.6%	$2.95	$2.14
$50,000 under $75,000	2,576	2.7%	2.7%	2.7%	$3.63	$0.98
$75,000 under $100,000	938	1.5%	1.5%	1.5%	$2.02	$0.03
$100,000 under $200,000	861	2.4%	2.5%	2.5%	$2.79	– $1.16*
$200,000 under $500,000	226	1.8%	1.9%	1.9%	$1.03	– $1.95*
$500,000 under $1,000,000	51	1.0%	1.1%	1.1%	$0.89	– $1.43*
$1,000,000 and over	36	2.8%	3.0%	3.2%	$2.13	– $4.95*
Married Filers						
$1 Under $20,000	9,176	0.6%	0.6%	0.6%	$1.28	– $0.06*
$20,000 under $30,000	6,405	0.9%	0.6%	0.8%	$4.66	$1.66
$30,000 under $40,000	7,504	1.6%	1.1%	1.4%	$8.46	$3.78
$40,000 under $50,000	7,621	2.4%	1.9%	2.2%	$9.84	$4.10
$50,000 under $75,000	15,567	8.7%	7.6%	7.5%	$27.52	$18.06
$75,000 under $100,000	8,640	8.7%	8.2%	6.6%	$19.48	$30.24
$100,000 under $200,000	8,070	16.2%	16.5%	15.5%	$22.30	$13.29
$200,000 under $500,000	2,078	13.1%	14.3%	13.6%	$7.55	– $2.66*
$500,000 under $1,000,000	413	7.1%	7.3%	7.6%	$9.44	– $3.52*
$1,000,000 and over	232	15.6%	16.6%	17.8%	$14.23	– $24.49*

*Negative numbers in the "Tax Relief" column mean that a tax hike results for this income range.

Note: Shares and totals do not sum to one because taxpayers with no adjusted gross income and heads of households, and married taxpayers filing separately are omitted from the data.

Source: All figures are Tax Foundation estimates.

Inland Waterways Tax Hurts Economy and Environment, According to New Study

The inland waterways tax is economically and environmentally destructive, according to a new Tax Foundation Background Paper titled *The Unintended Consequences of the Inland Waterways Excise Tax.*

The study's author is John Dunham, Manager of Fiscal Issues for Philip Morris Management Corp., whose recent studies include "The Creation of Impossible Markets," published in *Business Economics* and "The Effects of Smoking Laws on Seating Allocations of Restaurants and Bars," published in *Economic Inquiry.*

What Is the Inland Waterway?

The inland waterways system in the United States is made up of over 25,000 miles of lakes, rivers, and canals as well as the infrastructure needed for ships to traverse them. The system reaches from the ocean into 35 states, to points as far inland as Oklahoma.

The inland waterways excise tax either reduces interstate trade and commerce, or moves that trade to truck and rail modes, resulting in more pollution and a more hazardous transportation system.

In 1997, the last year for which comprehensive data are available, over 2.2 billion tons of cargo were carried on barges over the nation's inland waterways. Also, thousands of passengers were carried on river cruise vessels, and countless individuals used the waterway system for recreational pursuits.

According to the Army Corps of Engineers, water transportation is the most efficient and cost effective way to transport large amounts of goods from one place to another. For example, one standard 1,500-ton barge can transport as much wheat as 15 rail cars or 58 tractor trailer trucks. Barges are much more energy efficient than these other means of transportation and create less air pollution per ton mile carried.

How Is the Waterway Taxed?

In 1978, Congress passed the first excise tax on users of the nation's inland waterway system—a fuel tax that took effect in October 1980. The rate was 4 cents per gallon then but has risen steadily and now exceeds 24 cents per gallon. In FY 1997, the tax generated $108 million which the federal government earmarked toward the Inland Waterways Trust Fund.

Though governments find excise taxes easier to impose than other taxes, that doesn't mean they're part of a wise economic policy. In fact, the imposition of an excise tax has a number of unexpected, unwelcome implications for the economy. Excise taxes can introduce inefficiencies into the economic marketplace, reducing net consumer benefits. In addition, these taxes may influence consumer and business decisions, often discouraging them from pursuing their best options.

Is the Inland Waterway Tax a Proper Excise Tax?

Some proponents of excise taxes view the inland waterways tax as a user fee; but the justifications most often cited for user fees do not apply to the inland waterways tax.

There are no "negative externalities" to account for; that is, the money collected does not redress some negative side effect of transporting cargo on the waterway. Also, the market is not dominated by a monopoly supplier or monopsony buyer, and the tax is collected from only certain users of the system. Therefore, the imposition of the inland waterways tax simply reduces interstate trade and commerce, or moves that trade to truck and rail modes. There appear to be no offsetting benefits.

Empirical analysis finds that for a nominal increase of one cent in the tax rate there would be a 15,000 ton drop in cargo volumes. This leads to unintended consequences such as increased air pollution, higher energy use, and more traffic accidents.

Publication Summary

General: Background Paper No. 33; ISSN 1527-0408; 12pp.; $25 or $60/yr. for 6 issues on varied fiscal topics

Title: The Unintended Consequences of the Inland Waterways Excise Tax

Author: John Dunham

Date: February 2000

Subject: Clarifies misconceptions about user fees in general, and in particular how a user fee is unjustified in the case of the inland waterways system. Argues that the tax has only succeeded in transferring cargo from barges to rail and trucks, with a host of negative consequences including environmental degradation, higher energy use and more traffic accidents.

Other Papers in the Tax Foundation's Excise Tax Research Program

- The Telephone Excise and the E-Rate Add-on Tax
- How Excise Tax Differentials Affect Cross-Border Sales of Beer in the United States
- Federal Excise Taxes and the Distribution of Taxes Under Tax Reform
- How Excise Tax Differentials Affect Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States
- Burning Issues in the Tobacco Settlement: An Economic Perspective
- How the McCain Bill Would Affect Smokers' Wallets and the Underground Cigarette Market
- My Favorite Tax Hike, by G.O.Party
- The Regressivity of Sin Tax: The Lifetime Tax Burden of Taxes on Alcohol and Cigarettes
- The Use and Abuse of Excise Taxes
- Excise Taxes and Sound Tax Policy

FOUNDATION MESSAGE

Humility As Trade Policy

J.D. Foster, Ph.D.
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Tax Foundation

The United States government has adopted a public attitude towards the economic policies of our largest trading partners that is simultaneously obnoxious and contrary to the best interests of our own economy.

At the recently concluded World Economic Forum in Davos, Switzerland, U.S. representatives once again told everybody else what to do to get their economies moving smartly. The rest of the world is surely tired of this by now, since the U.S. government has taken to lecturing at almost every opportunity.

To be sure, we have reason to crow. We are breaking records for economic growth, inflation is negligible, and projected budget surpluses run into the trillions of dollars. And for their part, the Europeans and Japanese should think back to the 1970s and 1980s before they complain about our high-toned lectures. They didn't hesitate then to lecture us about our budget deficits and high inflation, or about their own economic wisdom and short-lived "miracles."

Even so, public admonitions and proddings by the Yankees are not appreciated. As Bundesbank President Ernst Welteke is quoted in the *Wall Street Journal*, "In Europe, we discuss the problem of disequilibrium in the U.S., but we don't tell the U.S. what to do about it." The disequilibrium he was referring to is the huge U.S. trade deficit. It's small wonder the Europeans keep their opinions to themselves on this score, since fixing our trade deficit might require breaking down trade barriers into, say, Europe, or cutting imports from, say, Europe, which would certainly not help the German economy.

Nevertheless, there are four good reasons the U.S. should tone down its rhetoric. First, it's arrogant. It's surely galling for the rest of the world to watch American popular culture become their own, as their children eat McDonald's Happy Meals, watch American movies and speak American slang. It's irksome to our allies that they rely on the U.S. military to put out European fires and provide stability in Asia. And it's bad enough for them to have their economies struggle without watching the United States post a 5.8 percent growth rate in the fourth quarter. Humility has never been an American forté, but now would be a good time to try.

A second reason the United States should be more circumspect in its opinions is that we cannot be sure that what works here will work as well abroad. Deregulation, relatively low marginal tax rates, and stiff competition work in the United States. It should work equally well in Western Europe and Japan, but who can say for sure? We thought it would work equally well in Russia, and eventually it will, but we found our initial prescriptions to be naïve.

Economic policy is about choices. Many Europeans place a high premium on social justice while fearing the rough and tumble of American-like markets. Most Europeans want far more vacation than Americans would typically take, and they want to work far fewer hours than Americans with no loss in pay. The Japanese, for their part, want a more rigid society than Americans would tolerate. These are not unreasonable choices, but they come with a cost. We should not lecture others for making reasonable choices unless those choices impose costs on Americans.

Finally, why should we cajole our trading partners into adopting more pro-growth policies when it's probably not in our best interest economically?

The classic answer is that if our trading partners grow more rapidly, their demand for our products and services will grow, and our exports will surge. Given the size of our trade deficit, this seems reasonable, but it misses the point. The goal of trade policy isn't just to raise exports, but to increase what we can buy abroad for a given amount of what we can sell abroad. No one works just for wages. We work so that we can buy goods and services. If the other guy is willing to give us more for our wages, why should we complain?

In the old days, some would say that the trade deficit depresses domestic employment. Domestic employment is now so strong that the unemployment rate has dropped to levels unimaginable in the old days, and the economy is so strong the Federal Reserve is sure to raise interest rates to knock it down a peg. Encouraging stronger economies abroad to increase our exports to expand domestic employment doesn't seem a very pressing issue.

While some of the recent U.S. growth is due to increases in employment, much of it is due to rapid and sustained increases in labor productivity commonly attributed to new technologies and the rapid pace of U.S. capital formation. If labor productivity growth in the United States continues to outstrip that of our trading partners, then eventually the underlying terms of trade between the United States and the rest of the world must shift in our favor. U.S. workers will be able to buy more goods, both domestic and foreign, per hour of work, which is as good a definition as any of greater prosperity.

The United States certainly should not inhibit better economic policies among our trading partners. But we should not forget that the pre-eminent goal of U.S. policy should be to enhance the lives of U.S. citizens. One way to do this is to encourage policies that allow Americans to buy more for less. There's an old saying that goes, if someone insists on being a fool, make sure there's only one. If our trading partners insist on maintaining anti-growth economic policies, we should just make sure we don't follow suit.

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Tax Foundation Schedule of Events and Research

February
- 18-26 Latin American International Tax Conference
- *Background Paper* on the Inland Waterways Tax
- *Special Report* on the President's FY 2001 Budget
- *Special Report* on State Tax Rates and Collections

March
- 9th Tax Policy Conference co-sponsored with PricewaterhouseCoopers LLP and Baker & Hostetler, LLP (see article below)
- *Special Report* on Government Spending in the 20th Century
- *Background Paper* on Telephone Excises
- *Background Paper* on the Smuggling and Cross-Border Sales of Cigarettes in New York City

April
- 14th Tax Freedom Day Announcement
- Publication of *Facts & Figures on Government Finance*, 34th Edition

May
- European International Tax Conference
- Publication of *Taxpayer's Guide to Federal Spending, FY 2001*
- Annual Report

June
- Excise Tax Conference

July
- *Special Report* on Federal Tax Burdens and Spending by State
- *Background Paper* on the Economic Costs of Smoking

August
- *Background Paper* on the Economic Cost of Beer

September
- *Special Report* on the Price of Civilized Society

October
- *Special Report* on State and Local Property Tax Collections

November
- 16th Annual Dinner and National Conference
- *Special Report* on the Distribution of the Federal Individual Income Tax

Research in the works
- Individual Tax Compliance
- Corporate Tax Compliance
- The Estate Tax
- The Regressivity of the Tax on Capital
- The Taxation of Human Capital

Tax Foundation Co-Hosts Tax Policy Conference With Baker & Hostetler and PricewaterhouseCoopers

On March 9, 2000, the Tax Foundation will co-host the eleventh annual Tax and Budget Policy Seminar with Baker & Hostetler LLP and PricewaterhouseCoopers LLP. A sophisticated analysis of the regulatory, budgetary, and legislative forces that will shape federal tax and budget policy in the coming years, the seminar will once again take place at the Hyatt Regency Capitol Hill, 400 New Jersey Avenue, NW, Washington, DC (202-737-1234). The program will run from 8:00 a.m. to 4:00 p.m., and the cost including continental breakfast and lunch is $285.

To register or get more information, please contact Sarah McKittrick at (202) 861-1747, or print the registration form located on the web at www.taxfoundation.org/bhformfax.html and fax it to Ms. McKittrick at 202/861-1783.

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