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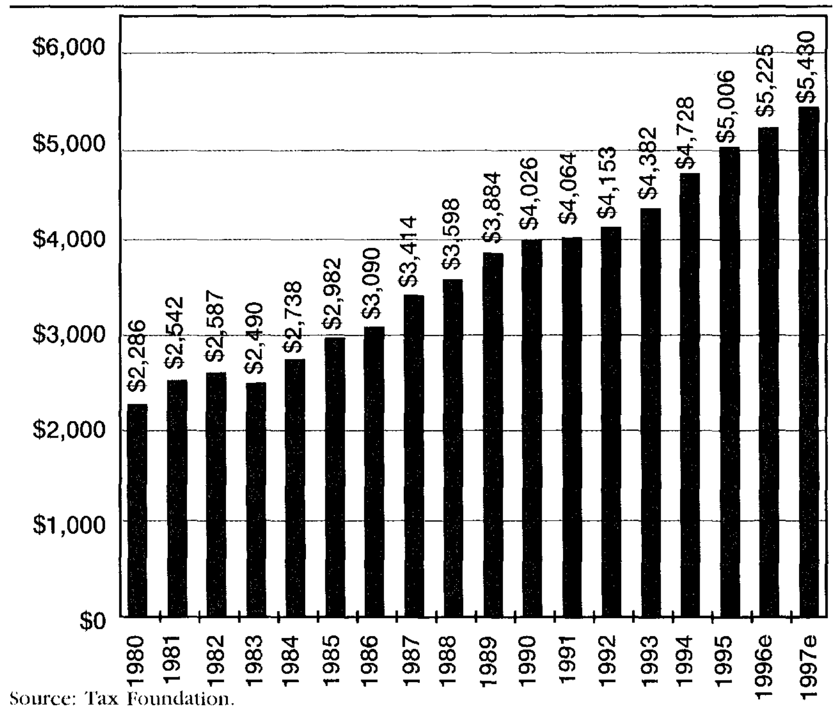
Federal Tax Burdens Continue Steady Rise, But Many States Get Back More Than They Give

While federal tax burdens continue to rise, with this year's average federal tax bill of $5,225 an increase of 4.4 percent over last year's level of $5,006 (see Chart 1), residents of some states will see far higher tax bills than others.

Chart 1: Per Capita Federal Tax Burden, FY 1980–1997e



Source: Tax Foundation.

In addition, the "return" on Americans' tax dollars — in the form of various federal payments, goods, and services — also varies widely by state. Some, such as Alaska, Virginia, and Maryland, receive high levels of per capita federal spending, while others, such as Wisconsin, Indiana, and Utah, receive considerably less.

In his annual *Special Report* on the "1996 Federal Tax Burden by State," Tax Foundation Economist Patrick Fleenor observes that the average American will pay $5,225 in fiscal 1996 to Uncle Sam (see Chart 1). However, the average federal tax bill will range from a high of $8,096 in Connecticut to a low of $3,413 in Mississippi (see Chart 2).

Federal taxes are collected in many forms, including individual and corporate income taxes, social insurances taxes (such as payroll collections for Social Security and Medicare), a variety of excise taxes, custom duties, and estate and gift taxes. But, as Chart 3 shows, over three-quarters of the $1.39 trillion collected in federal tax revenue this fiscal year will come from just two sources: individual income taxes ($630.9 billion, or 45.4 percent of the total), social insurance taxes ($503.0 billion, or 36.2 percent).

After Connecticut, residents of New Jersey will be next hardest hit by federal taxes, with an average federal tax bill of $7,159. The average resident of Massachusetts will pay $6,409

Federal Tax Burden *continued on page 2*

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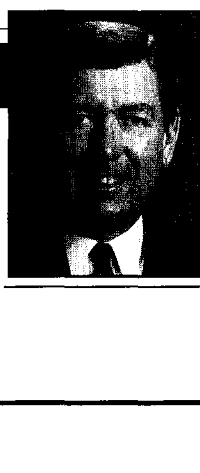

Working Americans Wage Restoration Act

Senator John Ashcroft (R-Mo.)

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Tax Dollars Enter Revolving Door of Federal Treasury

Federal Tax Burden

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this year, the third highest federal tax burden in the nation.

At the other end of the spectrum, after residents of Mississippi, those living in West Virginia ($3,702) and Utah ($3,823) will have the next lightest federal tax loads in the country.

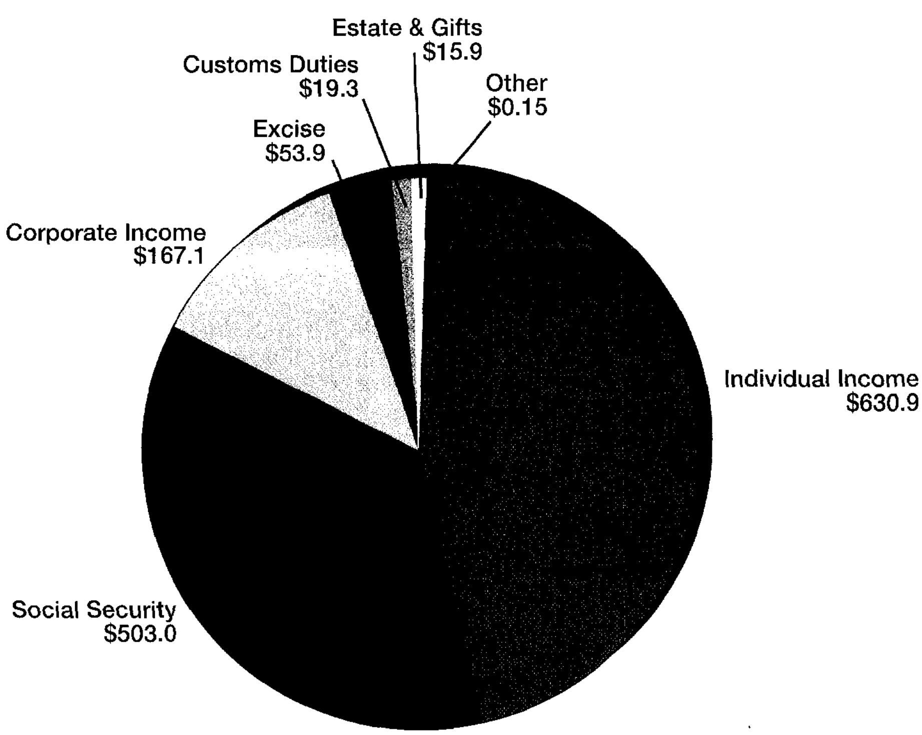
Mr. Fleenor notes that this variation in per capita federal tax burden by state is primarily due to differences in per capita income among the states. Since the federal government's primary revenue raisers, individual income and payroll taxes, are levied as a percentage of income, states with high per capita income will also tend to have high per capita federal tax collections. This effect is exacerbated by the progressivity of the federal tax system which causes tax burdens to rise more than proportionally with income.

In the study, Mr. Fleenor compares the Foundation's federal tax burden analysis of 1995 with the Census Bureau's annual study of federal expenditures by state for fiscal 1995, the most recent data available from the government. Expenditures include such large-scale outlays as Social Security, Medicare, welfare, federal payroll expenses, defense procurement, and transportation funding.

As might be expected, states with either low federal tax burdens and/or high federal expenditures tend to benefit most, on net, from federal fiscal operations. The most obvious example

Federal Tax Burden *continued on page 6*

Chart 3: Federal Tax Collections by Type of Tax, FY 1996 ($Billions)



Source: Tax Foundation.

Chart 2: FY 1996 Per Capita Federal Tax Burden by State

U.S. Average	$5,225
Connecticut	8,096
District of Columbia	7,518
New Jersey	7,159
Massachusetts	6,409
New York	6,352
Delaware	6,179
Illinois	6,046
Nevada	5,965
Maryland	5,958
Alaska	5,939
New Hampshire	5,836
Minnesota	5,556
Michigan	5,539
Colorado	5,532
Washington	5,519
Rhode Island	5,437
Pennsylvania	5,340
Hawaii	5,337
Virginia	5,334
Florida	5,218
California	5,212
Wyoming	5,115
Ohio	5,076
Wisconsin	5,037
Kansas	4,963
Oregon	4,916
Nebraska	4,866
Missouri	4,842
Indiana	4,829
Georgia	4,744
Texas	4,689
Iowa	4,684
Vermont	4,674
Tennessee	4,606
South Dakota	4,573
North Carolina	4,464
North Dakota	4,443
Arizona	4,369
Idaho	4,270
Maine	4,242
Montana	4,168
Alabama	4,105
Louisiana	4,104
Kentucky	4,028
Arkansas	4,007
South Carolina	4,000
Oklahoma	4,000
New Mexico	3,904
Utah	3,823
West Virginia	3,702
Mississippi	3,413

Source: Tax Foundation.

Travel Levies Make American Vacations More Taxing

Travelers to the Democratic National Convention in Chicago this summer had better bring along some extra money: Of 50 major American destination spots, the Windy City has the highest level of "travel taxes" in the country. Republicans fare better: San Diego, the site of the GOP convention, is ranked 37th.

Travel taxes are state and local levies on services traditionally offered to out-of-towners. The taxing plight of the American tourist was examined earlier this year in a survey of 50 cities by the Travel Industry Association of America (TIA). Not only do tourists get hit with higher-than-expected levies on travel-related activities, such as lodging and automobile rentals, but a fair amount of the revenues collected from out-of-towners gets deposited into general funds instead of being channeled back into local travel and tourism efforts.

Using TIA survey results, the Tax Foundation ranked the 50 cities in each individual tax category — lodging, restaurant, car rental (base rate), car rental (base rate plus off-site levy), and gasoline — and in terms of overall travel taxes. As the accompanying chart shows, Chicago was joined by Seattle, Houston, New York, and Dallas in the top five. At the other end of the scale, Honolulu, Boston, Cincinnati, Atlanta, and Fort Lauderdale have the lowest tax rates in terms of travel taxes.

The average lodging tax in the 50-city survey, levied on overnight guests at hotels and motels alike, is about 12%, including various sales taxes and the local "occupancy" tax. Tourists who made their way to the Olympics in Atlanta paid lodging tax rates of 13%, the same as visitors to the nation's capital. An overnight visitor in Detroit, Los Angeles, and San Francisco will find a levy of 14% on his or her hotel bill. And those travelers who request overnight accommodations in Houston, Anaheim, and Seattle will pay a tax of 15% and more.

Another tax targeted at tourists is the automobile rental levy. Tourists renting automobiles are subject to an intricate tax system that can include up to three different local levies. First there's the base tax rate on auto rentals, which averages 8.24% nationwide, according to the TIA survey. But the average is misleading — the range of rental tax rates is quite wide. While new arrivals in Atlanta and Honolulu will pay a modest 4% tax on their car rentals, those driving in New York will pay an added 13.25%, and those visitors to Chicago will be burdened with an 18% levy.

Many localities also hit the unsuspecting traveler with an "off airport" fee, for renting a car outside the boundaries of the airport. These range from 4% of the total rental cost in Washington, D.C., to 10% in Raleigh, Sacramento, and Atlantic City. In addition, a third of the cities surveyed by TIA also include an auto rental surcharge, which usually amounts to several dollars per day or per rental.

Not that all travel-related taxes are disproportionately paid by out-of-towners. Tourists traveling by car face the same gasoline tax rates that local residents face — an average of 37.7¢ per gallon nationwide this year, according to Tax Foundation research. San Diegans, for instance, must pay the same 18.3¢ per gallon in federal excises, 18¢ per gallon in state excises, and 1/2¢ per gallon in local taxes as those visitors attending the Republican National Convention this August. For San Diego residents and visitors alike, each fill-up of a mid-sized car with a 15-gallon tank will cost $5.50 extra due to taxes.

The same holds true for another travel-related activity, dining out. TIA's industry survey of 50 cities suggested an average restaurant tax of 7.26%, including whatever state, city, and county taxes that an establishment may be subject to. The range of rates is significant: Restaurant-goers in Portland, Ore., are not burdened by such taxes, but diners in almost every other city face a dining-out surcharge of between 6% and 8.25%.

While tourism is targeted for extra revenue, cities tend not to pump those dollars back into that industry, choosing instead to place the money in general funds.

Ranking of Cities by Level of Overall Travel Taxes

1	Chicago
2	Seattle
3	Houston
4	New York
4 (tie)	Dallas
6	Reno
7	Wash., DC
8	Austin
9	Minneapolis
10	Las Vegas
11	San Francisco
12	Pittsburgh
13	Knoxville
13 (tie)	Memphis
15	San Antonio
16	Miami
16 (tie)	Nashville
18	Los Angeles
18 (tie)	Philadelphia
20	Denver
21	New Orleans
22	San Jose
23	Baltimore
24	Tampa
25	Charlotte
25 (tie)	Cleveland
27	Norfolk
28	Anaheim
29	Jacksonville
30	Phoenix
31	Raleigh
32	West Palm
32 (tie)	Orlando
34	Sacramento
35	Columbus
36	Oakland
37	San Diego
37 (tie)	Indianapolis
39	Atlantic City
40	St. Louis
41	Riverside
42	Daytona
43	Portland
43 (tie)	Kansas City
45	Detroit
46	Ft. Lauderdale
47	Atlanta
48	Cincinnati
49	Boston
50	Honolulu

Source: Tax Foundation ranking based on Travel Industry Association survey.

Working Americans Wage Restoration Act

By Senator John Ashcroft (R-Mo.)

On May 22, the United States Senate voted on a pro-growth amendment to the 1997 Budget Resolution. This measure garnered 43 Republican and Democratic votes — the largest number of Senate votes cast for a single major pro-growth tax cut since President Clinton took office. This pro-growth proposal is the Working Americans Wage Restoration Act, a bill that Congressman George Nethercutt of Washington and I have introduced in Congress.

This amendment drew unusually strong support because Republican tax cuts are typically attacked on two principal grounds: they benefit the rich and big business and they will balloon the deficit. Earlier this year, the Kemp Tax Commission endorsed a tax cut for working families that is inoculated ideally against these two charges. Most importantly, this tax cut provides real relief for America's workers. The Working Americans Wage Restoration Act is based on this Kemp Commission proposal.

The Working Americans Wage Restoration Act is a payroll tax deduction that eliminates an unfair and burdensome tax on a tax. Right now, working Americans must pay income tax on the Social Security taxes already taken from their wages, while corporations can deduct their share of Social Security taxes as a business expense.

The Working Americans Wage Restoration Act is a payroll tax deduction that eliminates an unfair and burdensome tax on a tax. Right now, working Americans must pay income tax on the Social Security taxes already taken from their wages, while corporations can deduct their share of Social Security taxes as a business expense. This bill would let 77 million working families subtract their Social Security taxes from their total income so they no longer pay income tax on the taxes taken from their paychecks — money they never see. Furthermore, this proposal would have absolutely no effect on the Social Security trust fund. In fact, it would benefit Social Security recipients in the long term by giving individuals more money with which to save for retirement.

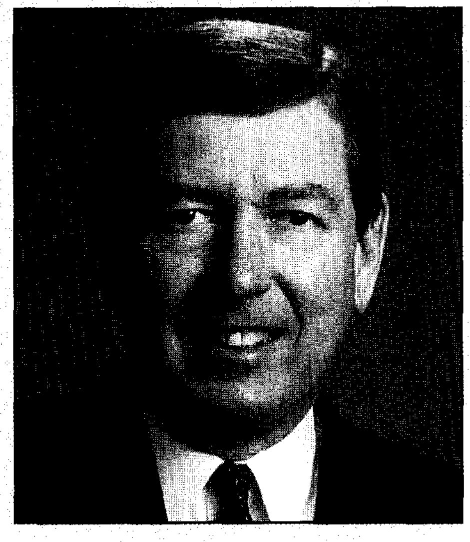
Big Business Benefits?

This bill ameliorates a politically potent Democratic attack: Republicans are genetically predisposed to granting tax breaks for big business. Currently, corporations can deduct their share of payroll taxes as a business expense, but workers must still pay income taxes on their payroll taxes. This proposal will allow workers to deduct fully their share of Social Security payroll tax from their income taxes just as corporations do — extending a valuable tax benefit to working Americans that is now available only to business. Tax cut opponents would have a difficult time explaining why workers shouldn't receive the same tax breaks as corporations.

The Rich Get Richer?

The proposed payroll tax deduction benefits substantially every American who pays income taxes, yet it ceases to be of additional benefit after the first $62,700 earned since Social Security is not taken from paychecks past this income level. For this reason, this proposal is naturally tailored to the middle class, hence it won't ignite the class warfare rhetoric associated characteristically with Republican tax cuts. Yes, the wealthy would receive some tax relief, but middle-income workers would receive proportionally more in relation to their income.

Furthermore, this bill would mitigate the regressive nature of Social Security payroll taxes for the middle class. Most workers now pay the same Social Security tax rate on the first dollar they earn up to $62,700. So people at lower income levels pay proportionally more of their income to Social Security. As a result, 72.6% of all families who pay taxes end up paying more in Social Security taxes than they do in income taxes. This bill would reduce that tax burden, particularly on the middle class.



Deficit Defense

We all agree that we have to reduce the deficit. But in order to do this, is it really necessary to double-tax working Americans — forcing them to pay income tax on their Social Security tax? It is unjust and unfair to levy a tax on money that never passed through a worker's hands. A myopic fascination with deficit reduction will do little to improve Americans' lives, unless we get spending under control. Theoretically, we could confiscate 80% of workers' paychecks to pay off the deficit, but this won't grow the economy, improve our standard of living, or make it easier for families to buy homes.

Since the payroll tax deduction eliminates an unfair tax on a tax it seems an obvious exception to the "deficit first" rule that has taken root in many public policy circles. Furthermore, although this bill reduces government revenues according to static analysis, budget savings have been targeted which offset all revenue lost. This tax cut will be paid for in budget savings. It will not increase the deficit.

The growth effects of this bill should serve further to quiet deficit concerns. The payroll tax deduction is projected to increase the GDP by 0.5% annually. According to the Office of Management and Budget, a 0.5% rise in GDP would expand the tax base and increase federal receipts by $30 billion per year — more than enough to pay for the payroll tax deduction in the first year.

The Dream Deduction

Throughout the 1990s, workers' real after-tax take-home pay has stagnated and in many cases even declined. In many two-parent families, mothers are entering the workforce not by choice, but by necessity. Working families are insecure about their futures. The federal government — through mounting taxation — has stolen workers' pay raises.

The Working Americans Wage Restoration Act could reverse the trend of overtaxing and underpaying American workers. Specifically, this bill provides an above-the-line income tax deduction for the employee share of the Social Security portions of the FICA and SECA taxes. Therefore, in calculating their income taxes, workers would be able to lower their taxable income by the 6.2% of their paychecks confiscated by the federal government in Social Security taxes.

Under this bill, the middle class — the group shouldering the greatest burden of taxes on labor — gets the tax relief it needs. For middle-income taxpayers hit the hardest by Social Security taxes and income taxes, this tax deduction reduces their overall effective tax rate by approximately 1 percentage point. This means the average two-income American family would save $1,770 in taxes annually. Again, these changes have absolutely no effect on the Social Security trust fund.

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Growth and a Dole White House

A deficit-cutting mantra alone will not win elections this fall. I believe a growth agenda is the key to unleashing American ingenuity and opportunity. To win in 1996, we must tailor the Republican agenda to address the economic and cultural insecurities of working families and allow Americans to keep more of what they earn. And President Clinton must be held accountable for the harm his tax increases have inflicted on the economy, smothering economic growth. We have to refocus the country's attention on a federal government that is not only taxing American families too much, but taxing them unfairly — taxing them on their taxes — and stealing more of their take-home pay. We can do this by continuing to incorporate the Working American Wage Restoration Act into the House and Senate budget debates and as a campaign agenda item.

From a political and public policy perspective, the Working Americans Wage Restoration Act is a near-perfect tax cut proposal. It eliminates a tax on a tax, it is targeted to the middle class, it extends to individuals a tax benefit only available to businesses, it will be paid for by offsets, and it will grow the economy. It advances the GOP's pro-growth agenda while providing an effective defense against antitax cut and class warfare attacks. Lastly and most importantly, the payroll tax deduction offers real relief to 77 million American working families by letting them keep more of what they earn. It is a tax cut structured to be nearly impossible to oppose.

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.*

Tax Dollars Enter Revolving Door of Federal Treasury

Federal Tax Burden

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of this is New Mexico, the state with the highest federal expenditure/tax ratio of 1.86 (or $1.86 of federal spending for every $1 of federal taxes). Other states with high federal expenditure/tax ratios include Mississippi, West Virginia, and Virginia (see Chart 4).

On the other hand, those states that do not benefit, on net, from federal fiscal operations will have either high per capita federal tax burdens and/or low federal expenditures. The state with the lowest federal expenditure/tax ratio was Connecticut, with a ratio of 0.68 (or 68¢ of federal spending for every $1 of federal taxes). Other states with low ratios in fiscal 1995 were New Jersey, Illinois, and New Hampshire.

Some states have seen their ratios change dramatically over the past decade. The state which has benefited the most from such changes is Oklahoma, where the federal expenditure/tax ratio rose from 0.93 in fiscal 1985 to 1.27 in fiscal 1995. In addition, Louisiana has seen its federal expenditure/tax ratio rise from 0.97 to 1.31.

Connecticut, on the other hand, has seen its federal expenditure/tax ratio fall from 0.94 in fiscal 1985 to 0.68 in fiscal 1995, the lowest in the nation.

Chart 4: FY 1995 Expenditures per Dollar of Taxes, Ranked by State

	FY85	FY95	'95 Rank
United States	$1.00	$1.00	
New Mexico	1.80	1.86	1
Mississippi	1.47	1.61	2
West Virginia	1.12	1.53	3
Virginia	1.45	1.50	4
Montana	1.26	1.39	5
North Dakota	1.33	1.38	6
Alabama	1.29	1.35	7
Kentucky	1.07	1.34	8
Louisiana	0.97	1.31	9
Maine	1.35	1.28	10
Oklahoma	0.93	1.27	11
Maryland	1.28	1.27	12
Missouri	1.48	1.26	13
South Carolina	1.24	1.24	14
Arkansas	1.28	1.23	15
Hawaii	1.43	1.22	16
South Dakota	1.31	1.19	17
Utah	1.26	1.19	18
Alaska	1.00	1.18	19
Arizona	1.13	1.18	20
Tennessee	1.09	1.13	21
Idaho	1.23	1.13	22
Rhode Island	0.99	1.09	23
Wyoming	0.94	1.06	24
Florida	1.05	1.05	25
Pennsylvania	0.96	1.03	26
Iowa	0.88	1.01	27
Vermont	1.05	1.01	28
Georgia	1.06	1.01	29
Kansas	1.08	1.01	30
Nebraska	1.00	1.00	31
Washington	1.17	1.00	32
North Carolina	0.92	0.99	33
Texas	0.81	0.99	34
Colorado	0.90	0.97	35
Massachusetts	1.06	0.95	36
California	1.06	0.95	37
Oregon	0.95	0.93	38
Ohio	0.87	0.92	39
Indiana	0.90	0.85	40
New York	0.89	0.84	41
Wisconsin	0.81	0.80	42
Michigan	0.79	0.77	43
Delaware	0.80	0.77	44
Nevada	0.96	0.77	45
Minnesota	0.88	0.76	46
New Hampshire	0.93	0.75	47
Illinois	0.69	0.74	48
New Jersey	0.69	0.68	49
Connecticut	0.94	0.68	50
District of Columbia	5.06	5.26	

Source: Tax Foundation, Bureau of Census.

FOUNDATION MESSAGE

J.D. Foster
Executive Director
& Chief Economist

Social Security reform has gone from the third rail of American politics to the third ring, right beside tax reform and health care reform, and it could very well overwhelm both.

For years retirees and their Washington representatives have proclaimed Social Security fit as Nero's fiddle, while various experts, and a few courageous politicians, predicted its certain demise. The tide is now beginning to turn, as bipartisan reform legislation has been introduced in the Congress centered around elements of privatization, and even President Clinton has an advisory panel working on recommendations for overhauling the system along the same lines.

Social Security has two central problems. The first, and best known, is the fact that Social Security will plunge into bankruptcy in about 30 years, at which point payroll taxes would need to be increased by over a third to cover promised benefits. Social Security's most ardent defenders don't dispute this and recognize that change is inevitable.

If this were Social Security's only problem, then solutions would abound, even after setting aside increasing payroll taxes. Policy makers have known for years that as people live longer the age at which one qualifies for Social Security must increase in step. A steady increase in the qualification age to match the increase in longevity, over and above the paltry increases already scheduled, would significantly reduce the fiscal pressure. Means-testing benefits and indexing benefits to an inflation measure other than the Consumer Price Index, which has been shown to overstate inflation consistently, would also restrain outlays substantially.

But bankruptcy isn't the only problem. As a pension surrogate, Social Security remains a lousy deal for its younger participants. Tax Foundation research shows, for example, that an average wage couple retiring in the year 2023 can expect to receive a negative real return on their "investment" of about 1.3 percent if the benefit structure remains unchanged. So even if Social Security didn't face financial implosion, it should still be overhauled because today's workers are getting a raw deal.

It is unfair and unwise to ask current workers to continue to pay high payroll taxes and accept much smaller Social Security checks in the future, while not asking current retirees to shoulder some of the burden through reduced Social Security outlays today. But reducing benefits would reduce the retirement income of today's workers, as well, making a lousy deal worse. To compensate, they should be allowed to invest some portion of their payroll tax contributions in the private sector.

Bankruptcy isn't the only problem. As a pension surrogate, Social Security remains a lousy deal for its younger participants.

Social Security is currently running a surplus of about $60 billion. This amount, plus the additional savings from reduced Social Security outlays, could be turned over to today's workers for deposit in a dedicated account and invested to earn market returns.

Opponents of reform based on partial privatization will point to a number of potential problems and concerns. One such concern is the possible need to monitor the investments individuals are allowed to make within their dedicated pension savings accounts, which, of course, raises the specter of a whole new dimension of government regulations. These kinds of concerns reflect real issues that need to be addressed, but are essentially matters of implementation and administration and in no way derail the basic thrust of reform.

Social Security reform must eliminate the prospect of a fiscal calamity; it must offer today's workers a return on their Social Security taxes as close as possible to what they could earn in the private sector; it must be fair to current retirees and those about to retire; and it must maintain a basic safety net for future retirees who, for one reason or another, retire with insufficient resources to maintain an acceptable standard of living. But for the requirement that today's workers should be able to earn a fair return, all of these criteria could be met within the framework of Social Security as we now know it. But Social Security cannot provide a reasonable return on investment.

The greatest miracle in American politics may be that the baby-boomers and those who followed haven't revolted at the rip-off that's been foisted on them by their parents and grandparents. Even after Social Security reform, workers will continue to have a large share of their wages taken to benefit current retirees. A solution must compensate them by allowing workers to invest some of their government-mandated pension money on their own while cutting current and future Social Security benefits, something President Clinton's advisory panel reportedly recognizes.

Social Security started out as an income supplement program for the elderly intended mostly to lift low-income retirees out of poverty. Reform should return Social Security to its roots. The big question now is whether we go down this road following a reasoned debate, or a nasty taxpayer revolt pitting one generation against another. This question will be answered mainly by today's retirees and their willingness to contribute to a solution.

Dole Campaign's Proposed Tax Packages Would Have Varied Effects on Average Taxfiler's Tax Bill

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Tax Foundation
(202) 783-2760 Tel
(202) 942-7675 Fax

http://www.taxfoundation.org
taxfnd@intr.net

Of the various tax plans currently being considered by the Dole campaign — an across-the-board income tax rate cut, a repeal of the income tax rate hikes of 1990 and 1993, and a payroll tax deduction — the former would have the greatest impact on more people.

An across-the-board federal income tax rate cut of 15 percent, as proposed by Senator Spencer Abraham (R-Mich.), would lower tax liabilities for filers in all income groups and would lessen the average taxfiler burden by almost $800 (see table). However, such a tax reduction would initially cost the Treasury Department close to $100 billion annually unless offset by spending cuts. (But many economists project that the resulting economic growth would make up for some of this loss in subsequent years.)

Avg. 1997 Individual Income Tax Estimates Based on Proposed Changes

AGI	Current Law	15% Rate Cut	'90 & '93 Repeal*	Payroll Deduction
$1 under $25,000	$206	$121	$206	$166
$25,000 under $50,000	3,734	3,174	3,734	3,317
$50,000 under $75,000	7,480	6,358	7,480	6,574
$75,000 under $100,000	13,413	11,406	13,389	11,833
$100,000 under $200,000	24,877	21,356	24,808	22,761
$200,000 or more	162,282	141,702	134,790	159,080
All Taxpayers	5,354	4,572	5,001	4,924
Total Revenue ($Mils.)	$662,254	$565,560	$618,560	$609,109

*Calculations do not include projections on the impact of reinstating the pre-1990 tax "bubble" which included a 33% statutory rate bracket on certain taxpayers.
Source: Tax Foundation.

Repealing the 1990 and 1993 income tax-rate hikes, along with the 1993 increased taxes on Social Security beneficiaries, would only affect on average Americans with earnings of over $75,000. Such a repeal would provide tax relief for the average filer of about $300. Nonetheless, such a change would probably eliminate three of the five current income tax brackets, leaving only the 15% and 28% rates that existed prior to the Omnibus Budget Reconciliation Act (OBRA) of 1990. This, tax reform proponents note, would be an important step toward creating a flatter tax system.

The payroll tax deduction, as proposed by Sen. John Ashcroft (R-Mo.) [see Front and Center, this issue], would provide an average of about $430 in tax relief for the average taxfiler. This reduction would touch taxfilers in all income groups, though those in the lower income groups would see a greater percentage of savings.

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