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TAX FEATURES

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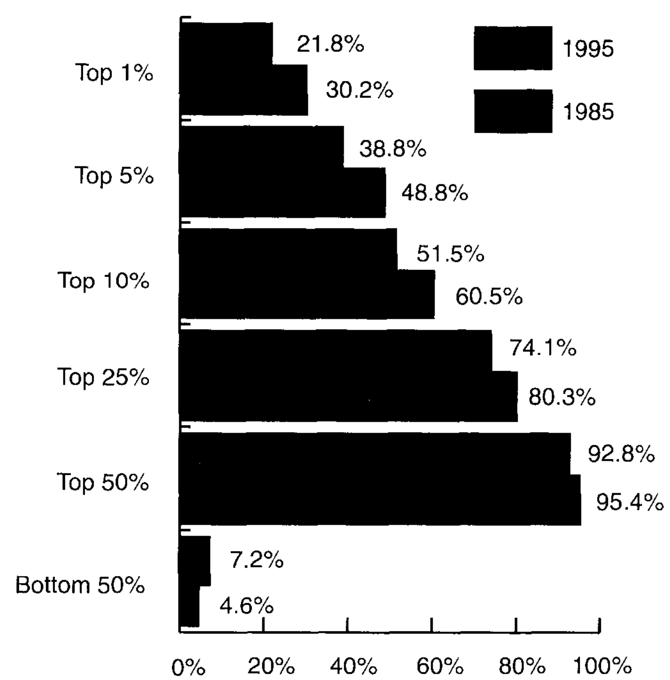
Latest Income Data Shows Top 1% Paying Over 30% of Federal Personal Income Taxes

Chart 1: Percent of Federal Individual Income Taxes Paid by Income Group, 1985 & 1995



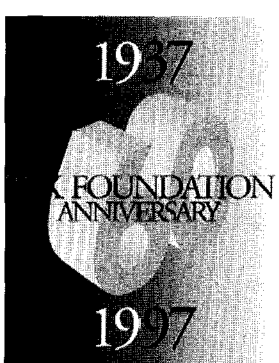
Source: Tax Foundation calculation based on preliminary IRS data.

According to preliminary data released by the Internal Revenue Service, the top 1 percent of U.S. income earners bore slightly more than 30 percent of the total federal individual income tax burden in 1995, up from 28.7 percent in 1994. Chart 1 shows that a decade earlier, the top 1 percent's share of the overall tax burden was 21.8 percent. (1995 is the latest year for which such data is available.)

"Americans at the upper end of the income scale bear an increasingly large share of the total federal individual income tax burden," observed Tax Foundation Economist Patrick Fleenor, who compiled the data. "Continued strong economic growth and a very progressive tax system are the primary causes."

As Chart 1 illustrates, the top 5 percent of income earners (with annual income over $96,104) and the top 10 percent (with annual income over $72,092) both pay a significantly greater portion of federal individual income taxes than they did a decade ago. In fact, whereas a decade ago approximately half of all federal income tax collections came from the top 10 percent of income earners, the tax load

Tax Burden *continued on page 2*



FRONT & CENTER

'Scrap the Code' Show Goes on the Road

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IRS's Latest Tax Data Shows Top 1% Paying Nearly One-Third of Federal Individual Income Tax Collections

Tax Burden

Continued from page 1

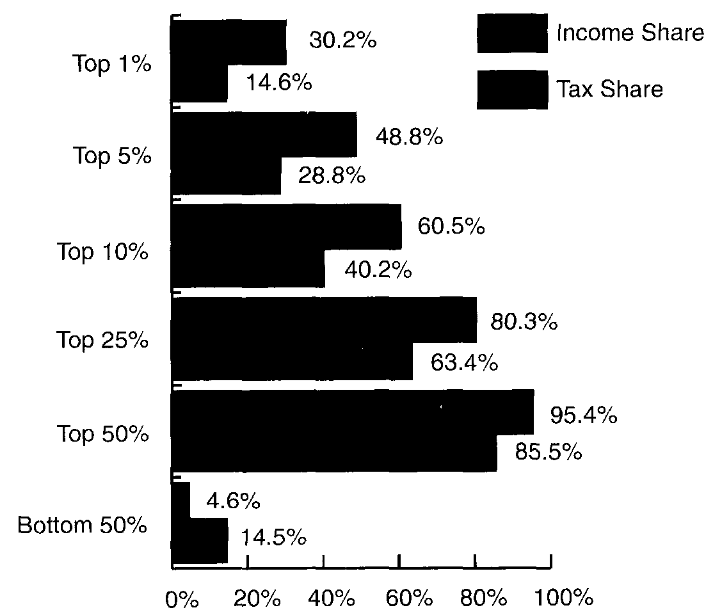
has since shifted dramatically — so that, by 1995, nearly half of all federal individual income taxes were derived from only the top 5 percent of income earners.

Chart 2 contrasts income shares (measured by adjusted gross income) and tax shares for different income groups, and further demonstrates the progressivity of the federal individual income tax system. While high-income earners earn a large share of the nation's total income, they pay an even greater share of the total federal individual income tax burden.

For example, the top 1 percent of income earners made 14.6 percent of all income in 1995, but paid 30.2 percent of all federal individual income taxes. (In comparison, the top 1 percent of income earners in 1985 made

Tax Burden *continued on page 3*

Chart 2: Income and Federal Individual Income Tax Shares of Income Groups, 1995



Source: Tax Foundation calculation based on preliminary IRS data.

Chart 3: Who Pays Federal Individual Income Taxes, 1985 and 1995

1985

	Number of Returns (000)	AGI ($000,000)	Income Taxes Paid ($000,000)	Group's Share of Total AGI	Group's Share of Total Taxes	Income Split Point	Average Tax Rate	Average Tax Paid
All Taxpayers	100,625	2,343,989	321,916	100.0%	100.0%	-	13.7%	3,199
Top 1%	1,006	235,095	70,209	10.0%	21.8%	above $108,134	29.9%	69,773
Top 5%	5,031	531,372	124,850	22.7%	38.8%	above $58,883	23.5%	24,815
Top 10%	10,063	791,481	165,652	33.8%	51.5%	above $46,322	20.9%	16,462
Top 25%	25,156	1,358,860	238,419	58.0%	74.1%	above $30,928	17.6%	9,477
Top 50%	50,313	1,939,351	298,842	82.7%	92.8%	above $16,688	15.4%	5,940
Bottom 50%	50,313	404,638	23,074	17.3%	7.2%	below $16,688	5.7%	459

1995

	Number of Returns (000)	AGI ($000,000)	Income Taxes Paid ($000,000)	Group's Share of Total AGI	Group's Share of Total Taxes	Income Split Point	Average Tax Rate	Average Tax Paid
All Taxpayers	117,274	4,244,607	586,128	100.0%	100.0%	-	13.8%	4,998
Top 1%	1,173	619,651	176,836	14.6%	30.2%	above $209,105	28.5%	150,788
Top 5%	5,864	1,222,682	285,904	28.8%	48.8%	above $96,104	23.4%	48,758
Top 10%	11,727	1,704,512	354,747	40.2%	60.5%	above $72,092	20.8%	30,249
Top 25%	29,319	2,689,803	470,560	63.4%	80.3%	above $44,147	17.5%	16,050
Top 50%	58,637	3,627,540	559,045	85.5%	95.4%	above $22,361	15.4%	9,534
Bottom 50%	58,637	617,067	27,083	14.5%	4.6%	below $22,361	4.4%	462

Source: Tax Foundation calculation based on preliminary IRS data.

Virginia Governor's Race Focuses on Dueling Tax Plans

The temptation was too great for the Tax Foundation to resist: a gubernatorial race focusing almost exclusively on alternative tax cut plans — and right at our doorstep, in the neighboring Commonwealth of Virginia.

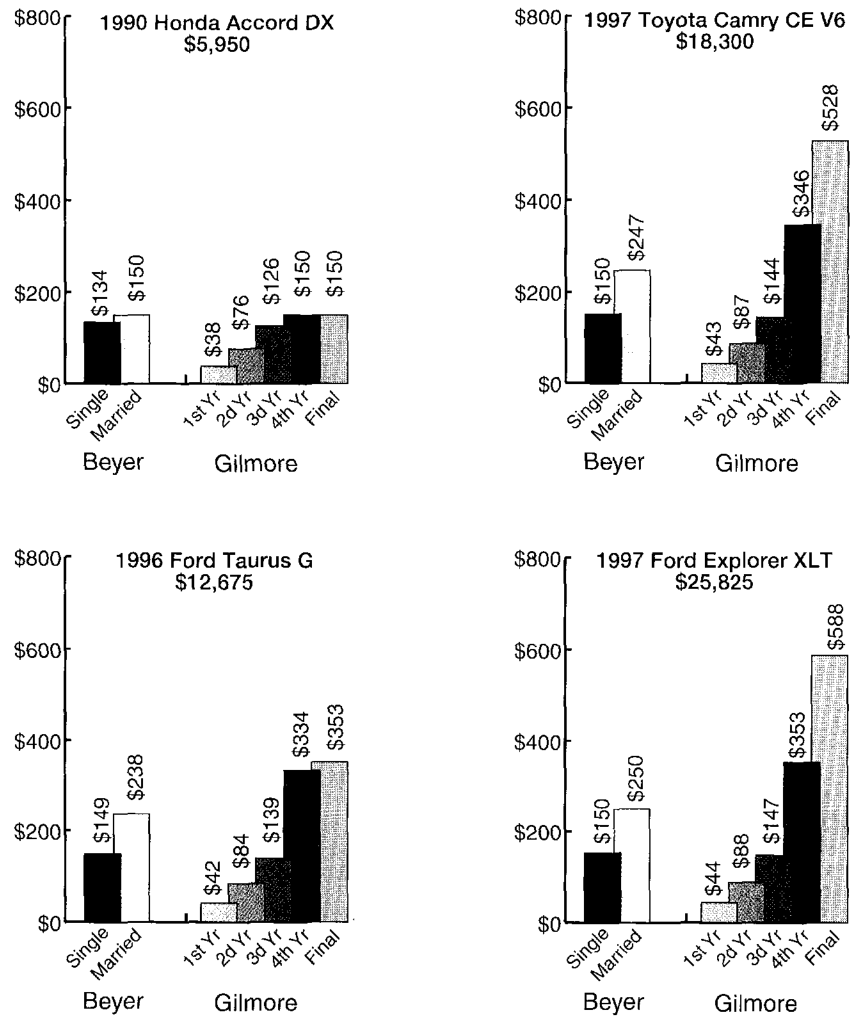
In mid-October, the Tax Foundation undertook an analysis of dueling tax-relief proposals offered by Republican James Gilmore and Democrat Don Beyer, both of which provide for changes in the state's least favorite tax: the personal property tax on automobiles.

In his analysis, Economist Patrick Fleenor measure the impact of the two tax-cut provisions by county, city, and town. As the accompanying charts show, he calculated the effects on owners of four different kinds of automobiles, representing a range of $6,000 to $26,000 in value.

The Beyer plan extends immediate tax relief to single individuals earning less than $40,000 in adjusted gross income and to married couples with AGI of less than $75,000. The Gilmore tax-relief plan is phased in during fiscal years 1999-2003, but has no income cap.

The analysis shows that while the Beyer plan offers more up-front tax relief, the Gilmore plan offers at least as much savings, and in many cases considerably more, over the longer term.●

Tax Savings Under Alternative Plans, Statewide Averages



Source: Tax Foundation.

Rich Still Pick Up Federal Income Tax Tab for Rest of Nation

Tax Burden

Continued from page 2

10 percent of all income while paying 21.8 percent of all income taxes.)

Similarly, the top 10 percent of earners made 40.2 percent of all income in 1995 but paid 60.5 percent of all federal individual income taxes. (In 1985, the top 10 percent of earners made 33.8 percent of all income while paying 51.5 percent of all federal personal income taxes.)

In contrast, the bottom 50 percent earned 14.5 percent of all income in 1995 but paid only 4.6 percent of federal individual income taxes that year.

Mr. Fleenor notes that in light of the fact that the top marginal rate fell from 50 percent in 1985 to its present rate of 39.6 percent, many observers may find it surprising that top earners are shouldering a larger share of the overall tax burden. But, he states, the data tend to support the notion that "lowering high marginal tax rates on upper income earners may increase, not decrease, total tax revenue." In effect, as marginal tax rates fall, high-income earners are encouraged to earn more and shelter less, which increases the amount of taxes paid.

In fact, as Chart 3 shows, average federal income taxes paid for income earners in the top 1 percent skyrocketed from $69,773 to $150,788 over the decade. Personal income taxes for those in the top 5 percent doubled in that time period, from $24,815 to $48,758.●

FRONT & CENTER

'Scrap the Code' Show Goes on the Road

By Rep. Dick Armey (R-Texas) and Rep. Billy Tauzin (R-La.)

"Congress shall have the Power to lay and collect Taxes..." How, from these ten simple words in our Constitution, did we arrive at today's confusing, complicated and contradictory income tax code with its hundreds of sections, 6,439 pages of regulations, 2,000 pages of law and 480 tax forms?

The current tax code is indefensible. The average American family today pays more in taxes than it spends on food, clothing, and shelter combined. The IRS is twice as large as the CIA and five times the size of the FBI. In other words, we spend more time and resources harassing taxpayers than we do tracking down hardened criminals.

Even those who call themselves tax experts can't figure out the current code. Last November, Money magazine gave 45 accountants nationwide a financial profile of a fictional family and then asked them to prepare a hypothetical tax return. Not only did each of them come up with a different answer, but the computed tax liability ranged from $36,322 to $94,438 — a staggering 160 percent variance.

The current code is a monument to unnecessary waste. It is complex; unfair; inhibits saving, investment and job creation; imposes a heavy burden on families; and undermines the integrity of the democratic process. There is no "quick fix." It cannot be repaired with tinkering or fine-tuning. The income tax code must be torn out by its roots.

Even worse, Americans each year devote 5.4 billion man-hours to comply with the current tax code, more time than it takes to produce every car, truck, and van made in the United States.

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That's why we are participating in the "Scrap the Code Tour," a national campaign to take the tax reform debate directly to the American people. Our first four stops will be Columbus, Ohio; Bakersfield, Calif.; Atlanta, Ga.; and Chicago, Ill.

We hope to unite Americans behind a drive to abolish the current tax code and replace it with a system that is simple, fair, and honest. In each city, we will debate the current tax code and the merits of the tax reform proposals we advocate — the Armey flat tax and the Schaefer-Tauzin national sales tax. Either of these proposals is better, simpler, and more fair than the current system.

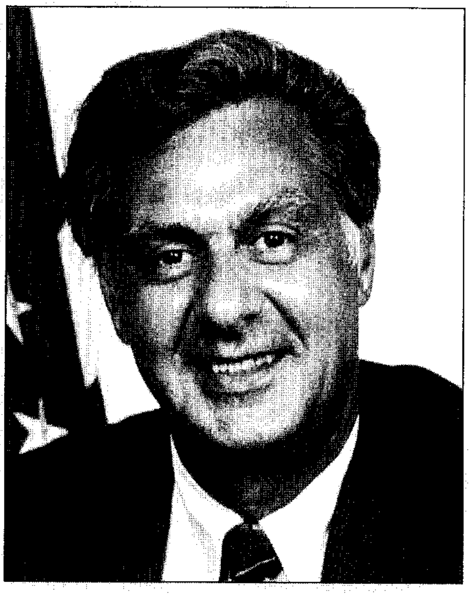
We urge that any new tax system must be governed by the following three principles:

(1) The tax code should have only one rate.

(2) All income should be taxed once, and only once, without punishing or favoring one kind of income over another.

(3) Families must be allowed to provide for themselves before they are forced to provide for the government.

Tax reform is the most important economic issue in America today. Recent polling data is a clear indication of the American people's desire for tax reform: 68 percent of American citizens believe the IRS has too much power; 58 percent believe they pay too much in federal taxes; 69 percent believe we need to fundamentally overhaul and simplify the federal tax code; and 76 percent believe that loopholes allow people with the same income to pay significantly different



Rep. Dick Armey (R-Texas)

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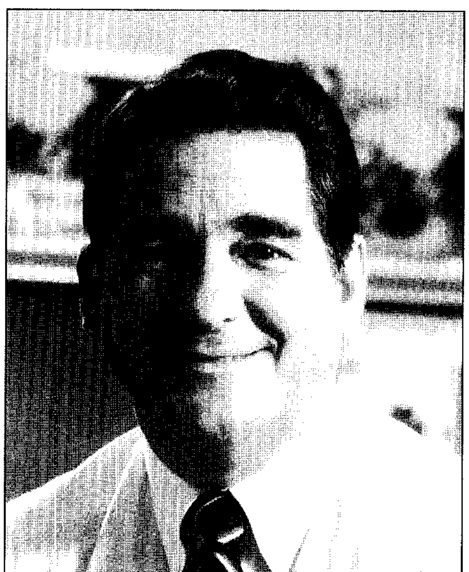

Rep. Billy Tauzin (R-La.)

amounts of taxes. Clearly, America wants sweeping change.

But abolishing the current code won't be easy. We face enormous obstacles to comprehensive tax reform. And almost every one of them can be found in Washington, D.C. There are now more than 20,000 lobbyists in Washington whose sole mission in life is to extract little favors from Congress, at the expense of everyone else. These lobbyists and special interest groups oppose fundamental change because, in many cases, they are getting rich off the current tax code.

To get a fair tax system, Americans must join together to beat Washington. If our efforts to "scrap the code" succeed, every American family wins. Every parent who spent hours filling out forms, or works a second job in order to pay taxes, would have more precious family time. And every company that now hires an army of tax lawyers would instead create jobs. The possibilities are enormous. The American economy will once again reward risk-taking, ingenuity, thrift, and personal effort. Success will not be thwarted and punished, as under the current code, but encouraged for the good of all.

Truth, honesty, and integrity do matter. And we need a tax system that reflects these values. It's time to replace today's complicated maze of politically motivated tax breaks with a simple, honest, fair system that treats everyone the same. This is important, because when the American people know everyone is treated the same, there will be less resentment against the government and against each other. A new tax code would be a big step toward ending class warfare in America.

What's important now is to begin a national dialogue on tax reform. This debate isn't simply about a flat tax versus a national sales tax; rather, our tour is about fundamental tax reform versus preserving the status quo.

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.*

1997 Tax Foundation
60th National Conference and Annual Dinner

Thursday, November 20, 1997
The Four Seasons Hotel
Corcoran Ballroom
2800 Pennsylvania Avenue, NW
Washington, DC 20007

Conference – "A Progress Report on Dynamic Revenue Estimating"

• **Registration**	**11:30 a.m.**
• **Buffet Lunch**	**12 noon**
• **Conference Keynote Address**	**12:35 p.m.**
• **Conference Sessions**	**1:20 – 4:30 p.m.**

Annual Dinner (Black Tie)

• **Dinner Reception**	**6:00 p.m.**
• **Dinner**	**7:00 p.m.**

Private Sector Distinguished Service Award – Charles R. Lee, Chairman and Chief Executive Officer, GTE Corporation

Public Sector Distinguished Service Award – Senator John B. Breaux (D-La.)

• **Post Dinner Reception**	**10:00 p.m.**

•Hotel reservations deadline for the block of rooms reserved by the Tax Foundation is October 31, 1997. Call the Four Seasons direct at 1-800-332-3442.
•Conference and Dinner reservations must be received by November 13, 1997. (Written cancellation for refunds accepted through this date only.)
•Questions about the Conference and Dinner should be directed to Renée Nowland, Tax Foundation, by phone at (202) 942-7653, or by fax at (202) 942-7675.

Conference Program

12:30 p.m.	Welcome	Dr. J.D. Foster, Executive Director and Chief Economist, Tax Foundation
12:35	Keynote Address	TBA
1:20	Session One	Ken Kies, Chief of Staff, JTC: "The View from the Joint Tax Committee"
2:10	Intermission	
2:30	Session Two	"Progress Made, Progress Planned"
3:30	Session Three	"How Should We Proceed?"
4:30	Closing Remarks	Dr. J.D. Foster, Executive Director and Chief Economist, Tax Foundation

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Conference fee:
Donor-$100, Non-Donor-$150
Reception/Dinner fee:
$500/Person, $4000/Table

FOUNDATION MESSAGE

Looking Into IRS Reform

J.D. Foster, Ph.D.
Executive Director
& Chief Economist
Tax Foundation

Windows are wonderful things. When clean, they let the sunshine in. When opened, they let clean air in. They can be decorated to add color to a room. Or they can be closed and covered to prevent anyone from looking inside.

IRS reform is very much like a window.

At the moment, most people would say the window is closed, bolted, curtained, and more than occasionally whitewashed from within and without. Despite the passage of two Taxpayer Bill of Rights packages in recent years, not much has changed, except that, from what little we've been able to glean by hearing from taxpayers and IRS staff alike, it sure looks ugly in there. While the horror stories get the headlines, let's look at the solutions.

Let's start with the proposition that no single change from the status quo will solve the IRS's problems. Without a doubt, for example, a much simpler tax code would ease the administrative and compliance burdens, and would probably reduce the areas of potentially poor performance and dispute. A simpler tax system would certainly ease the fears of taxpayers and reduce the tension between taxpayers and the tax service. But few of the taxpayers who were recently trotted out before the Senate Finance Committee would have escaped their ordeals if Congress had long ago enacted a Flat Tax, for example. Tax reform could help, but it's only part of a solution, and certainly neither necessary nor sufficient.

Other answers proposed thus far can best be understood if the IRS is seen as a business. The Treasury Secretary and Congress (and the four committees with oversight responsibility in particular) should be seen as its board of directors. The Commissioner is the CEO.

The most contentious element of Senator Bob Kerrey's (D-Neb.) and Rep. Rob Portman's (R-Ohio) IRS reform plan is to create an independent body of citizens and government representatives to take over the Treasury Secretary's and Congress's role, i.e., to oversee the IRS and undertake long-term planning. This proposal is curious indeed. Congress has at least four committees with oversight responsibilities — Senate Finance, House Ways and Means, and the House and Senate Appropriations committees. The Kerrey-Portman plan clearly implies Congress has failed to perform its oversight role, and so argues that Congress should abdicate its responsibility by shifting it to some newly created body. Notably lacking in the current debate is any self-criticism by Congress for its failings, not just in creating the impossible tax code, but in establishing the conditions for virtually every one of the IRS's faults, real or imaginary.

The Administration responded with its own proposal to create a body of government officials to act as a board of directors. Currently the IRS Commissioner reports to the Treasury Secretary. The Administration proposal implicitly argues that the Treasury Secretary isn't up to the job. And not just this Secretary, but all past and future secretaries. Under what circumstances is a committee of otherwise-occupied government officials likely to do a better job overseeing the IRS than one powerful and focused individual? This proposal, too, basically says, "Let's get somebody else to do it."

The Administration's second proposal is to create a new bureaucracy of citizen review boards that will sit in counsel to help disgruntled taxpayers deal with their IRS gripes. The idea presumably is to have these citizen review boards somehow buttress the existing taxpayer ombudsman system. In theory, it could help. But if effective reforms were enacted to address the IRS's problems, such review boards would be mostly unnecessary. By making these boards a major part of his IRS reform effort, President Clinton is saying we're going to continue to let the IRS turn taxpayers into roadkill, but we're going to appoint a few local citizens to act as emergency room doctors and help put the taxpayers' lives back together. Bold, very bold.

The central problems at the IRS are issues of responsibility, authority, and determination. The average tenure of commissioners has been short enough that an entrenched bureaucracy can generally wait out any changes it opposes. A commissioner, who is generally neither a manager nor politically adept by training, must navigate some of Washington's trickiest political waters to propose internal reforms. Every move can be and is second-guessed to death by Congress. Every significant upgrade in computer systems, for example, must not only work its way through years of congressional wrangling, but must then go through the government's water torture procurement process.

Consider the following experiment, again based on the idea that the IRS is really a business contracting to provide services to the federal government. What terms would a Jack Welch of General Electric or a Henry Ford demand if they were asked to "fix" the IRS? Would they accept the post if Congress meddled even in emergency decisions to fix the agency's information processing systems? Would they allow career bureaucrats to stifle their efforts? Would they accept the civil service rules making it virtually impossible to discharge poor performance, or to reward properly outstanding performance? Of course not. To do so would invite, nay demand, failure. You have to wonder what form of masochism would induce anyone competent to take this job.

The central problems at the IRS derive from a badly flawed management structure. These problems are exacerbated by the tax code's complexity, Congress's meddling, the Treasury Secretary's neglect, antiquated personnel rules, and a general sense of paranoia in evidence at the IRS. Each of these needs to be corrected immediately. However, until the upper management structure at the IRS is fixed, tweaking the oversight function and building better safety nets for taxpayers does little more than upgrade the window dressing. ●

Half-Day Conference in Atlanta Focuses on "Next Federal Tax Cut"

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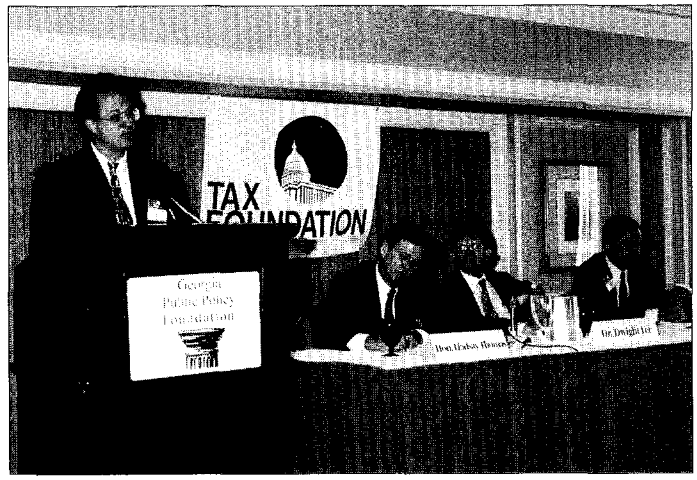
What is the impact of the federal tax burden? Should Congress cut taxes again? What kind of tax system should the U.S. employ? These and similar questions dominated discussion at the Tax Foundation's most recent state tax seminar, held in Georgia in mid-October and co-hosted with the Georgia Public Policy Foundation.

The event, at the Ritz-Carlton Hotel in downtown Atlanta, featured Rep. Mac Collins (R-Ga.), member of the House Ways & Means Committee, as keynote speaker.



Tax Foundation Executive Director J.D. Foster offers the audience his perspective on why another federal tax cut is inevitable. Seated at the table, from left, are former Rep. Lindsay Thomas (R-Ga.); Professor Dwight Lee of the University of Georgia; and Flowers Industries Vice Chairman Robert Crozer.

Session One of the conference focused on "The Growth and Impact of the Federal Tax Burden." Chaired by Sam Williams, President of the Metro Atlanta Chamber of Commerce, the panel included former Rep. Ed Jenkins (D-Ga.), now a practicing attorney with offices in Atlanta and Washington, D.C., and Paul Merski, Chief Economist of Congress's Joint Economic Committee. Rep. Jenkins explored the difficulties in making tax policy in the current environment, considering the pressures on Congress to adopt measures that are beneficial to competing interest groups. Mr. Merski explored the upward trend in the federal tax burden and observed that with federal revenues projected to steadily increase, the government can afford and taxpayers deserve a sizable tax cut that could help economic growth.

Session Two, titled "Sparking the 21st Century Economy: The Next Tax Cut," featured former Rep. Lindsay Thomas, now president of the Georgia Chamber of Commerce, as moderator; University of Georgia Professor Dwight Lee, president of the Southern Economic Association; Flowers Industries Vice Chairman Robert Crozer; and the Tax Foundation's J.D. Foster. While Dr. Lee and Mr. Crozer discussed alternative tax systems that would be more efficient and less costly to society, Dr. Foster walked the audience through a scenario in which taxes could be cut significantly while the economy — and federal revenues — continues to grow. ●

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