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Toward better government Founded 1937

Tax Foundation, Inc.

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May 10 is Tax Freedom Day

May 10 is Tax Freedom Day this year, according to economists at the Tax Foundation, six days later than the revised date for 1980.

Each year, the Foundation calculates how long the average worker would have to labor to finish paying all taxes—Federal, state, and local—if every dollar earned from January 1 went directly to satisfy tax obligations to all units of government. Over the years, the trend has been that the American worker must spend more and more time on the job, just to keep the tax collector happy.

Year	Tax Freedom Day[a]
1930	February 14
1940	March 9
1950	April 4
1960	April 18
1970	April 28
1975	April 29
1976	May 2
1977	May 3
1978	May 3
1979	May 4
1980	May 4[b]
1981	May 10[c]

[a] Recalculated for all years to reflect recent revisions in national income and product accounts by U.S. Department of Commerce.
[b] Revised.
[c] Forecast.

Tax Freedom Day originated in 1948, when Dallas L. Hostetler, a Florida businessman, conceived the idea of a national tax freedom holiday. Then, as now, the day represented the first day of the year when the American taxpayers started working for themselves, instead of for the funding of Federal, state, or local government activities.

The idea caught on. In 1950 the U.S. Senate and House of Representatives passed a Concurrent Resolution which concluded, "Tax Freedom Holiday (may) be symbolized as a day of relief throughout the land, with such demonstrations as may seem appropriate, including prayer for deliverance." The Freedoms Foundation bestowed its George Washington Honor Medal Award on Hostetler in 1953.

In 1974, Hostetler asked the Tax Foundation to carry on his efforts to maintain public awareness of the ever-expanding tax burden. "At age 72," he wrote, "I must forego the an-

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Federal, State, and Local Taxes Take 2 Hours 49 Minutes of 8-Hour Day

More of the average American's 8-hour workday is spent earning money to pay Federal, state, and local taxes, than for any other item in the family budget, according to Tax Foundation economists. This year, that worker will spend 2 hours and 49 minutes on the job to meet tax obligations to some level of government.

Working for the tax collector claims 1 hour and 21 minutes more time on the job than any other expenditure made by the average American family. Federal taxes will claim, in calendar 1981, 1 hour and 56 minutes of that 8-hour day, while state and local government units will receive 53 minutes' worth of earnings.

The next largest item in the household budget—housing and household operation—claims 1 hour and 28 minutes' worth of earnings, while food and beverages can be paid for by 1 hour and 4 minutes' labor. The remaining major family expenditures break down as follows:

Tax Bite in the 8-Hour Day 1981

Item	Hours and Minutes	
Tax, total	2 hours	49 minutes
Federal	1 hour	56 minutes
State and local		53 minutes
Housing and household operation	1 hour	28 minutes
Food and beverages	1 hour	4 minutes
Transportation		43 minutes
Medical care		29 minutes
Clothing		22 minutes
Recreation		19 minutes
All other[a]		46 minutes
TOTAL	8 hours	

[a] Includes consumer expenditures for items such as personal care, personal business, and private education; and savings.
Source: Tax Foundation estimates as of April 14, 1981.

The Front Burner

By Robert C. Brown
Executive Vice President
Tax Foundation, Incorporated

"Why Tax Freedom Day?"

Every year, the Tax Foundation announces Tax Freedom Day, the day the average American would finish paying Federal, state, and local taxes if every dollar earned from January 1 went to the tax collector. Nearly every year the day falls later in the calendar.

Why bother? Isn't computing Tax Freedom Day merely an exercise in futility, another reminder of our powerlessness against the government's ability to tax, to spend, and to incur deficits in our name?

The cynical observer might answer yes. Recently, someone even calculated the year when Tax Freedom Day—given present trends—would fall on December 25; and it wasn't that far in the future.

On past Tax Freedom Days, there have been proposals for a moment of silence on the floor of Congress out of respect for the beleaguered taxpayer. Last year, there was a parade on the Capitol grounds, complete with fife and drum corps in colonial dress. Is Tax Freedom Day, then, simply a chance to tweak the tax collector's nose, a latter-day non-violent Boston Tea Party? I hope not.

While the Tax Foundation is independent and nonpartisan, we certainly acknowledge the right of government to raise through taxation the revenues necessary to conduct the affairs of the nation. However, we also believe, as did the framers of the Constitution, that government has limits; that the wealth of the nation belongs to those who create it, be they coal miners or capitalists; and that the government taxes at the pleasure of, and with the consent of, the citizenry.

On the philosophical level, we refuse to accept the assertion that those in Washington, state capitals, or city halls know how to allocate our resources better than we do. And we challenge the notion that everything a citizen earns belongs to the government, except for that portion which public officials choose to leave in his hands after collecting taxes—the thinking behind the so-called tax-expenditure concept.

Those issues are really what Tax Freedom Day—and most of the other research and public education effort generated by the Foundation—are all about. At times, when announcing these benchmarks of the growth of government, we feel as timid as the little boy who pointed out that the emperor's new clothes were non-existent. But that is our mandate, and we take comfort in trying to live up to it.

We also take hope. For, after all, the little boy stopped the parade. Maybe we can too.

Danforth Makes Strong Argument For Tax Policy to Foster R&D

"The revitalization of American industrial innovation is the key to solving problems of persistent inflation, the inability of American producers to compete in international markets, and most importantly, our falling domestic productivity," Senator John Danforth of Missouri told businessmen attending a seminar sponsored by the Tax Foundation on March 25. In his talk, Danforth, who is fourth ranking Republican on the Senate Finance Committee, emphasized the need for a tax policy which will foster civilian research and development.

"The ability of our economy to carry out technological innovation, to introduce successful new products, services and processes, is the foundation of both our domestic prosperity and our international competitiveness," he said. He emphasized that productivity "supports much of our real economic growth which, in turn, permits a rising standard of living."

The Senator reviewed recent patterns in spending for R&D both in the U.S. and in comparison with West Germany and Japan, noting that current U.S. spending is well below what the nation spent for R&D in 1964 and well below what West Germany and Japan are currently spending as a percentage of Gross National Product. "The result of our decreasing emphasis on R&D," he charged, "has been a decline in our rate of economic growth and in the competitiveness of American products in international markets."

Surveying the current political landscape, Danforth sought to put R&D tax cuts into the context of what can be expected overall this year by way of tax reductions. "It seems likely," he said, "that there will be only one major tax reduction bill this year."

Danforth pointed out that the Democratic-controlled House Ways and Means Committee was unlikely to accept as is the tax package offered by the White House. "The alternative most frequently discussed as the starting point for the Ways and Means Committee," he said, "is the tax reduction bill reported out of the Senate Finance Committee last fall." He pointed out that this bill contained several provisions favoring increased productivity, including a 25 percent tax credit for research and development.

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About Tax Features

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TF Seminar Examines Impact of Tax Policy On R&D Developments

A number of major issues were raised at the Tax Foundation's Seminar on Tax Policy and R&D held on March 25 in Washington, D.C., concerning the impact of tax policy on corporate spending for research and development. This report does not attempt to recount the presentations given by the Seminar's participants but rather draws on the comments and materials prepared for the Seminar to highlight:

(1) the relationship between R&D and economic performance both for the U.S. economy as a whole and for a single company, and

(2) the issues involved in designing a tax policy to encourage R&D.

The first portion of the Seminar addressed an "Economic Overview—R&D and Economic Performance" with presentations by Dr. Kenneth McLennan, Vice President and Director of Industrial Studies, Committee for Economic Development; and Dr. Jay W. Schultz, Director of Research, Sterling Forest Labs, INCO Limited. The second session examined "Tax Policy and R&D—Incentives, Disincentives, and Definitions" with presentations by George Carlson, International Tax Economist, U.S. Department of the Treasury; Edwin S. Cohen, Esq., Covington and Burling; and Peter J. Hart, Price Waterhouse & Co.

Table 1

Ratios: R&D as a Proportion of GNP by Source of Funds and Expenditure by Performer

	Source of Funds						Expenditures by Performer					
	Federal			Non-Federal			Federal			Non-Federal		
Country	1968	1978	Change	1968	1978	Change	1968	1978	Change	1968	1978	Change
U.S.	1.72	1.12	−34.9%	1.11	1.13	1.8%	.40	.31	−22.5%	2.43	1.94	−20.2%
Japan	.40	.50	25.0%	1.21	1.43	18.2%	.40	.23	−42.5%	1.21	1.70	40.5%
W. Germany	.93	1.10	18.2%	1.04	1.18	13.4%	.11	.12	9.0%	1.86	2.16	16.1%

Source: Data compiled from *Science Indicators 1979*, National Science Foundation, "National Patterns of R&D Resources" OECD and raw data provided by countries to NSF staff.

Relation of R&D to Economic Performance

At the company level, an R&D project can roughly be described as compulsory; that is, one required by government regulation or needed to support an existing product or process or as elective, long-range basic research aimed at as yet undiscovered products or processes. The elective R&D is clearly the higher risk for a company to undertake.

Certain factors have operated to reduce the amount of elective R&D undertaken by companies in the last decade. First and foremost, inflation shortens the time period in which a reasonable return must be generated. Generally, elective research does not bear fruit for ten to fifteen years. While inflation interferes with all economic activity to some degree, it takes a greater toll on projects that require steady inflows of funds and attention over long periods of time. Secondly, there has been an increase in the amount of R&D resources mandated to compulsory work for product safety and environmental quality over the last decade. While such compulsory research is undoubtedly of great value, the debilitating effect on elective R&D must be recognized.

In practice, R&D is the first operation cut during downturns in business activity and the last to be returned to full budget.

These factors have, over the last decade or so, led to a decline in the proportion of resources our economy as a whole has devoted to R&D.

Federal government spending on R&D dropped from 1.72 percent of GNP in 1968 to 1.12 percent of GNP in 1978, a drop of nearly 35 percent. Over the same period, non-Federal spending on R&D remained a nearly constant 1.13 percent of GNP.

In Table 1, Dr. McLennan provides a comparison of our performance over the last decade with two of our major competitors: West Germany and Japan.

In Table 2, George Carlson provides a summary of the distribution of R&D spending in the U.S. over the period 1969-1979 classified by the source of funds. Real expenditures on R&D grew at an average annual rate of only 1.05 percent over the period 1968-1978, as compared to real GNP, which grew at an average annual rate of 3.1 percent.

The conclusion drawn from an analysis of the last decade is that U.S. research and development activities

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Table 2

R&D Expenditures by Source of Funds 1968-1979

(1972 $ mils.)

Year	Total	Federal government	Industry	Universities	Other institutions
1968	$29,798	$18,077	$10,506	$474	$341
1969	29,556	17,176	11,543	484	353
1970	28,355	16,055	11,426	505	369
1971	27,697	15,509	11,261	551	376
1972	28,413	15,755	11,698	575	385
1973	28,937	15,415	12,550	581	391
1974	28,214	14,440	12,803	584	387
1975	27,684	14,276	12,416	590	402
1976	29,019	14,674	13,310	614	421
1977	30,374	15,327	13,975	633	439
1978	31,787	16,006	14,638	672	471
1979	33,412	16,641	15,564	718	489

Source: National Science Foundation, *National Patterns of R&D Resources, 1953-1979, Science Indicators 1978*, and *Science Highlights*, May 23, 1980.

Senator Danforth

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Danforth noted that the bill cleared the Senate Finance Committee by a vote of 19 to 1. He predicted, "To the extent the legislation reported out of the House this year resembles the Finance Committee bill, it will be difficult for members of the Senate Finance Committee to turn their backs on it." Conversely, Danforth said, "To the extent the House legislation earmarks large reductions for non-productivity oriented investment such as the above-the-line charitable deduction, tuition tax credits, and more extensive amelioration of the marriage penalty, the Finance Committee and the Senate will probably move closer to the Administration's bill in order to go to a conference with the House in the strongest possible bargaining position."

Danforth claimed it was "virtually certain" that the Congress would not limit itself to across-the-board individual rate cuts and accelerated 10-5-3 depreciation. At the same time, he conceded, "Most people agree that accelerated depreciation will be the centerpiece of the business tax reduction."

Regarding tax treatment of research and development, Danforth said, "If a 15 percent slowdown in our economic growth is attributable to a decreasing emphasis on R&D, shouldn't at least 15 percent of the business tax reductions be aimed at improving this aspect of technological innovation?"

The Senator favored going beyond the R&D proposals in the White House package. "In my opinion," he said, "additional incentives for R&D are needed beyond those proposed by the Administration. I think that last year's Senate Finance Committee provision should be the leading contender for inclusion."

Danforth also faulted the business community for not being "as effective in dealing with tax legislation as it might be." He chided representatives of business for spending time at hearings "attacking all of the details of the bill." They challenge the definition or wording, he said, "and before you know it you're just bogged down."

While conceding that there might be better ways to tune up a bill or make it more effective, he pointed out that "the basic question, the fundamental question is, 'Is this concept right?'"

If the concept is right, he said, "instead of immediately resolving ourselves into a committee of one million to go through the drafting process all over again, let's get on with it."

Now Available

"The Reagan Budget for Fiscal 1982—A Summary," A Tax Foundation Special Report, April 1981, 27 pages, $1.00.

"Tax Policy, The Budget, and Unemployment," Proceedings of Tax Foundation's 32nd National Conference, 64 pages, $5.00.

Tax Freedom Day

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nual promotion of this observance. In the interest of perpetuating the idea, I would like to turn it over, without obligation, to some nationally known and highly respected organization. Obviously, I thought first of your Tax Foundation, Inc."

The choice was a logical one, since Tax Foundation had already highlighted Tax Freedom Day in its publications and Foundation economists had been computing, since 1953, the size of the bite taken by taxes from the average worker's eight-hour day. The Foundation readily accepted Hostetler's offer of the concept which he had registered with the U.S. Copyright Office in 1953.

Over the years, Tax Freedom Day has proven to be among the most popular research efforts of the Foundation. Traditionally, the Tax Foundation times the announcement of Tax Freedom Day to coincide with the date U.S. taxpayers file their income tax returns, April 15.

R&D Seminar

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have stagnated and have narrowed in scope and purpose. Revitalizing R&D is fundamental to improving economic performance, particularly improving productivity—which is one of the best methods of permanently reducing inflation.

Tax proposals have been designed to encourage additional R&D activities, but such a tax policy must overcome two important obstacles: (1) drafting of working definitions of what constitutes R&D, and (2) removing the disincentives that work against R&D from the Tax Code, in particular those housed in Section 861.

The drafting of a workable set of definitions is an obstacle common to all tax proposals for R&D. Currently, there is not a great deal of need for thorough definitions for tax purposes, although a very general definition now exists in Section 174 of the IRC and the Financial Accounting Standards Board has issued Statement #2 entitled "Accounting for Research and Development Costs." These two sources are a good beginning to a practical set of definitions, but it will take much more if the Congress decides to provide a tax credit for R&D expenditures.

The other principal issue for tax policy and R&D is the disincentive that results from application of Section 861 of the IRC. Briefly, Section 861 requires corporations to allocate a portion of domestic R&D expenses to foreign source income on the rationale that the results from R&D help all worldwide operations, not just those in the U.S. While there may be sound logic behind accounting for R&D this way, Section 861 can and has forced some companies into the position where the next dollar spent *in the U.S.* on R&D will receive no tax benefit—it will not be deductible for tax purposes because of the foreign tax credit limitation. In any event, Section 861 can be a major hindrance to the expansion of R&D and should be modified to remove R&D from this allocation process.