WINTER 2013

# TAX Watch

## Celebrating 75 Years of the TAX FOUNDATION

Since 1937

Tax Watch (ISSN 1552-924X) is published four times per year by the Tax Foundation in Washington, D.C., a nonprofit, nonpartisan research organization that has monitored tax policy at the federal, state, and local levels since 1937.

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# MESSAGE FROM THE PRESIDENT

As I reflect on the Tax Foundation's 75th anniversary, I'm reminded of what late Apple founder Steve Jobs told his biographer was his most important creation. Was it the Macintosh? The iPhone? The iPad? No, Jobs said, it was Apple the company. "Making an enduring company was both far harder and more important than making a great product."

Jobs was right. And that is why we are so grateful for those who founded the Tax Foundation in 1937 and built it into the premier research organization that it is today. You won't find biographies of Fred Eldean, Charles Bauer, Herbert Miller, or Alfred Parker on the shelves. But each of the early executive directors of the Tax Foundation deserves credit for shaping the legacy of this enduring institution.

They built the Tax Foundation on a rock solid foundation based on principle and fact. The immutable principles of sound tax policy—neutrality, simplicity, transparency, stability, and economic growth—still guide our work today. But we are also guided by facts and hard data, unlike so many groups in Washington that thrive on partisan rhetoric alone.

We've tried our best to summarize some of the highlights of our past 75 years in this edition of Tax Watch. A lot of our publications have been preserved on our website, starting with the earliest studies from 1940. Yet we still have a mountain of publications to digitize and upload, a testament to our prolific researchers.

Sadly, we don't know a lot about the people who worked at the Tax Foundation over the years, since most of the personnel records were not kept. Few of the early publications included the byline of the economists who wrote them; these were simply Tax Foundation studies meant to stand on their own.

We do occasionally hear from the "Old Timers." Years ago I got a note from Gordon Paul Smith who landed his first job out of graduate school in the mid-1940s as a junior analyst at the Tax Foundation. Like so many of our young scholars today, he cut his teeth working on the annual publication of *Facts and Figures on Government Finance*. Gordon said "it was the Foundation who, without any doubt, truly set the course for my career in business and government ever since. I am grateful. Always have been."

With Washington abuzz with speculation about the prospect of major tax reform, we are already hard at work preparing to contribute to that debate. As the late Nobel Laureate James M. Buchanan wrote us on our 65th Anniversary: "The Foundation has continued to serve the indispensable function of providing unbiased tax information. Keep up the good work. And, who knows, we may, once again, someday get meaningful tax reform."

Someday, Jim. Someday.

Sincerely,

**Scott A. Hodge**
*President*

# TAXWatch

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The Tax Foundation is an independent, nonpartisan and nonprofit research institution founded in 1937 to educate taxpayers, policymakers and the courts on sound tax policy. Our economic and policy analysis is guided by fundamental tax principles that should serve as touchstones for sound tax policy everywhere.

## IN THIS ISSUE



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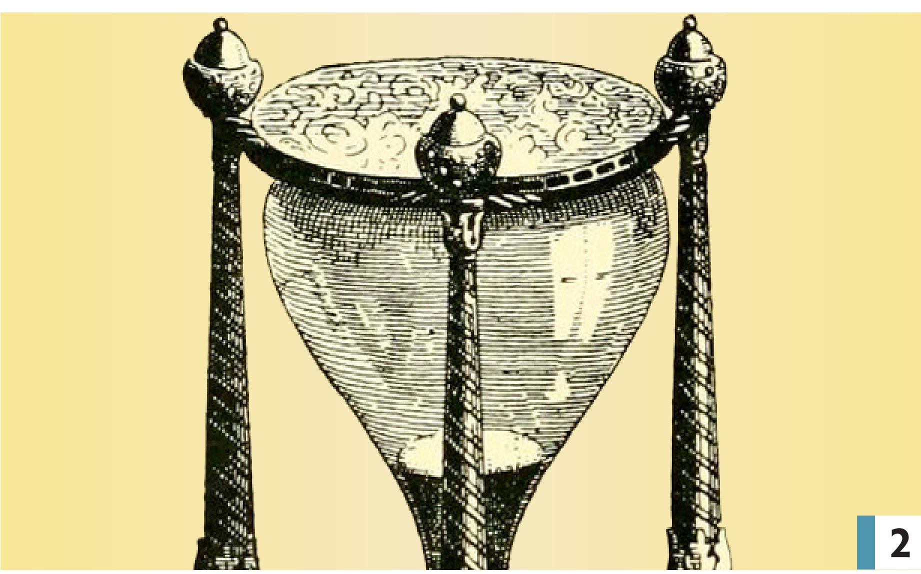

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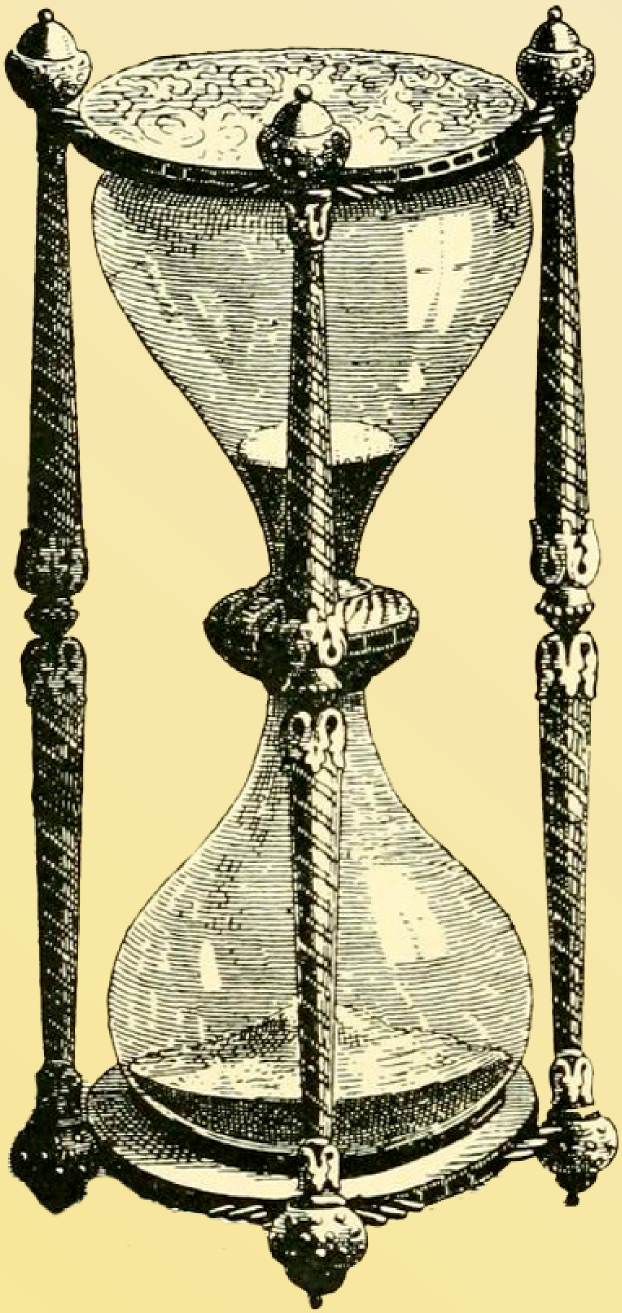
# History of the Tax Foundation



**The Tax Foundation was officially born on December 5, 1937, when it was formally organized at a meeting in New York City. However, the seeds for starting this unique institution were actually planted at an informal lunch at New York's University Club in 1935, where a small group of national business leaders met, pondered, and agreed that a new presence was needed in America to monitor the tax and spending policies at all levels of government—state, local, and federal.**

In that group of Founding Fathers were Alfred P. Sloan, Jr., Chairman of the General Motors Corporation; Donaldson Brown, GM Financial Vice President; William S. Farish, President of Standard Oil Company of New Jersey; and Lewis H. Brown, President of Johns-Manville Corporation, who later became the first Chairman of the Board of the Foundation.

Our first goal was to assemble a team of experts who would gather factual data on government finances, publish this information in readable form, and then encourage grassroots groups of citizens to organize their own state and local groups to mount sustained tax and government efficiency drives in their communities. By 1943, there were approximately 1,200 local taxpayer groups and 35 statewide groups in operation. As a result of this early activism, we can be credited for helping to create the modern taxpayer movement.

The outbreak of World War II caused us to step up our research on federal government spending patterns, with a particular focus on financing for wartime expenditures. While we acknowledged that higher taxes were a necessary evil for funding a victory, we stressed the importance of reining in unnecessary spending, particularly superfluous spending undertaken under the guise of war necessity. Not all Tax Foundation activity in the 1940s was wartime doom and gloom, as we opened our first offices in New York City at 30 Rockefeller Plaza. From here, we would conduct our important work until the move to Washington, DC in 1978.

The 1940s also saw the debut of a publication that remains one of our most sought-after to this day: *Facts & Figures*. Originally a source of information on government spending and finance, this publication is now the go-to source for data on state tax rates, collections, burdens, and more.

One interesting aspect of our early history is our employment of women as analysts and economists. One of our first female researchers, Phoebe C. Main, came on board in the early 1940s and was a prolific writer of Tax Foundation newsletters and reports. Ms. Main was joined by several other female professionals at that time: Jo McBay, senior researcher; Mary Fernholz, statistician; and Vera H. Knox, librarian. These pioneering women bucked many of the accepted gender norms of the 1940s and were the first in a long line of female researchers, analysts, and economists at the Tax Foundation, a history of which we are exceedingly proud.

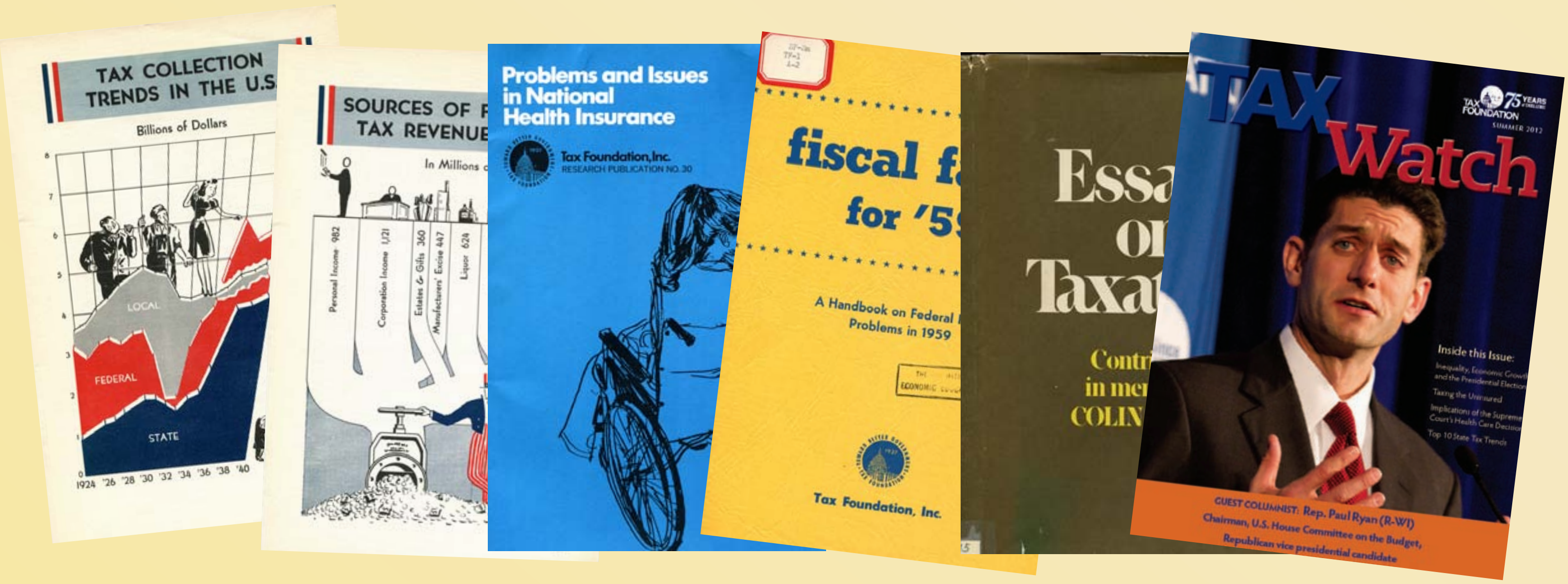
**One interesting aspect of the Tax Foundation's history is its early employment of women as analysts and economists.**

As the 1950s unfolded, we began the unenviable task of attacking the massive government spending and taxing that remained from wartime. Despite hopes to the contrary, the government continued to grow at an enormous rate and our focus settled firmly on federal tax and spending issues. In an attempt to make clear to the American public how powerful the impact of tax policies at the time was, we began calculating the "Tax Bite in an 8-hour Day," a simple way of illustrating how long people have to work every day to fulfill their tax liability. Another Tax Foundation fact-based illustration entitled *A Hundred Taxes on a Loaf of Bread* captured the attention of President Dwight Eisenhower, who quoted it extensively during speeches at the time. According to one observer, that simple illustration aroused "more consciousness about tax burdens than a thousand tables of statistics."

Not only did we spend the 1950s educating the general American public, but we also spent the time aggressively interacting with lawmakers on Capitol Hill in an attempt to push through tax and spending reforms. During this decade, we were almost constantly before Congressional committees testifying about sound tax policy. Our data was cited regularly by Congress and one particular three-volume study, *Can Federal Expenditures Be Cut?*, was cited by Senator Harry F. Byrd, Sr. of Virginia on one of the nation's first non-entertainment telecasts on an issue of national importance.

The 1960s and 1970s saw a continuation of our aggressive behind-the-scenes policy advocacy with legislators and policymakers. The Kennedy tax proposal in 1962 prompted us to establish a Committee on Federal Tax Policy that was charged with undertaking independent study of the basic changes needed for federal tax revision. This decade also saw us issue several lengthy reports criticizing the Social Security system and its funding structure. Our reports warned that Social Security would find itself in financial distress if better funding and benefit strategies were not implemented. As the current national discussion about Social Security reform indicates, these reports were incredibly (and unfortunately) prescient.

By the end of the 1960s, our membership had risen sharply, along with our scholarly output. As we moved into the 1970s, we truly developed our reputation as a nationally recognized source of non-partisan, common sense fiscal information for the media, schools, policymakers, and general public.




An exploding federal deficit accompanied by record-breaking spending and rapid inflation spurred greater and greater interest in our work. By the end of the 1970s, our membership and scholarly output were larger than ever; almost 400,000 copies of publications were distributed and we were cited over 1,000 times in publications reaching over 240 million readers worldwide.

In 1970, we issued reports warning against the adoption of what became the Alternative Minimum Tax (AMT). Proposed to prevent a small group of high-income taxpayers from using so many deductions and exemptions that they owed no income tax, the AMT "solved" this problem not by paring back the deductions but by layering a parallel tax system on top of the existing tax system. Our warnings stated that this was unnecessarily duplicative and would fail to address the real problem of a tax code packed with special interest provisions.

Tax Freedom Day, perhaps the most well-known Tax Foundation publication, was deeded to us in 1971 by its creator, Florida businessman Dallas Hostetler. This report shows how long into the year it takes Americans to pay their combined federal, state, and local tax burden.

While a boost in economic growth followed the 1964 Kennedy/Johnson tax cut, subsequent Vietnam War-era tax increases and 1970s stagflation pushed tax burdens even higher. As tax and fiscal policy became increasingly centered in Washington, D.C., the Tax Foundation moved there from New York City in 1978. The aim was to bring our staff into closer contact with federal policymakers and research resources. The move was well-timed, as tax policy soon took center stage for a nation suffering gasoline shortages, escalating oil prices, burgeoning inflation, and tight credit.

The Reagan tax cut signed into law in 1981 ushered in an economic boom; federal revenues grew but the economy grew even faster. Despite pressure on state and local taxes following taxpayer revolts like Proposition 13 in California, strong economic growth led to increased tax collections. The 1986 tax reform overhauled a system plagued with special interest provisions, eliminating them for lower tax rates across the board. Throughout the 1980s, we worked hard for policies that would spur capital formation, avoid overspending, and reduce tax burdens.

Unfortunately, 1989 saw the Tax Foundation experience a struggle of its own. As a result of executive financial mismanagement, the Tax Foundation found itself in financial distress and in need of restructuring. A loan from Citizens for a Sound Economy allowed the Foundation to undertake the necessary restructuring and establish a solid financial footing. By 1991, under new management, we had paid off the loan and reestablished ourself as the go-to source for reliable, common sense, non-partisan tax policy research.

The 1990s saw us broaden the scope of our research to issues which were not simply tax-code specific but were areas impacted generally by tax and economic policies. These issues included international trade, telecommunications, legal issues, and a number of works on the underlying philosophies of tax and economic policies. By finding new niches to explore, we broadened our appeal to a number of constituencies which previously had not approached us for information. The 1990s also saw our work begin to include state and local tax policies, marking a return to the subject upon which we were originally created.

As the Tax Foundation entered the new millennium, we found ourself once again at the top of the intellectual heap in Washington, sought after for reliable, non-partisan tax and economics scholarship. The 2000s were an exciting time of growth. New economists and analysts were employed to create what would become our current three centers: the Center for Federal Tax Policy, the Center for State Tax Policy, and the Center for Legal Reform. To provide the best analysis to the most taxpayers and policymakers, we began producing work in the three primary areas in which tax reform must be undertaken: the federal tax code, the state and municipal tax codes, and the courts.

The 2000s have seen the meteoric rise of the Tax Foundation's state-focused research and it is in this area that we conduct some of our hardest hitting and most powerful scholarship. Through publications such as *Facts & Figures: How Does Your State Compare?*, the *State Business Tax Climate Index*, and the annual *State-Local Tax Burdens* report, we have literally set the dialogue in many states on tax reform. We also undertake individualized analyses of states in an effort to work with the policymakers in those states to implement simple, neutral, transparent tax reform.

Our Center for Legal Reform has become a powerhouse in its own right, submitting briefs in cases at all levels of the legal system, from state courts to the United States Supreme Court. The Foundation submitted a friend of the court brief in the U.S. Supreme Court Obamacare case and was one of the only organizations to discuss the very issue that ended up deciding the case: whether the individual mandate was a tax or a penalty.

One of the most fortunate developments in recent history was the coming of Scott Hodge as our president in 2000. With 13 years at the helm, Scott is one of our longest-serving presidents and has been, by far, our most dynamic. Under his leadership, our work has flourished, with the number of publications and media citations tripling. Scott was instrumental in the creation of our three Centers, as well as the original creator of some of our most fundamentally important works: *Putting a Face on America's Tax Returns*, the *State Business Tax Climate Index*, and our popular *CompeteUSA* corporate tax reform video series.


Over the last 75 years, the work of the Tax Foundation has led us to be one of America's most established and relied-upon think tanks, working for simple, sensible tax policy at the federal, state, and local levels. We do this by informing Americans about the size of tax burdens and providing economically principled analysis of tax policy issues.

It has been our pleasure to serve the taxpayers of the United States for these 75 years and we look forward to continuing this service into the distant future.TW

# History of Federal Tax Work at the Tax Foundation

The history of the Tax Foundation is a record of the history of the national tax and fiscal debate in this country. When we were founded in 1937, our work focused almost exclusively on state and local tax and spending issues. It was not until the outbreak of World War II that we began shifting our focus to federal taxing and spending issues. We began laying the intellectual groundwork for post-war economic reform. Our efforts focused on areas where wasteful spending could be curtailed in order to ensure the most resources for the war effort. As part of this effort, we debuted our *Tax Facts & Figures on War Finance* in 1942, which kept the American people, and policymakers, informed about the levels of wartime spending.

Unfortunately, after the war ended, spending and taxing did not. The nation had become accustomed to large-scale government spending and deficits and our work became almost exclusively focused on federal issues in an attempt to drive national tax and spending policies back into the realm of the sensible and sustainable. We began to raise the alarm about American competitiveness in the global market in the 1950s as corporate tax rates grew ever higher, a warning we continue to issue to this day. By the time we entered the 1960s, we had become a leading voice on Capitol Hill for sound tax policy. Tax Foundation staff could be found in congressional hearings testifying for tax reform and in the media informing the public about the impact of poor tax and spending policies on the average American family.

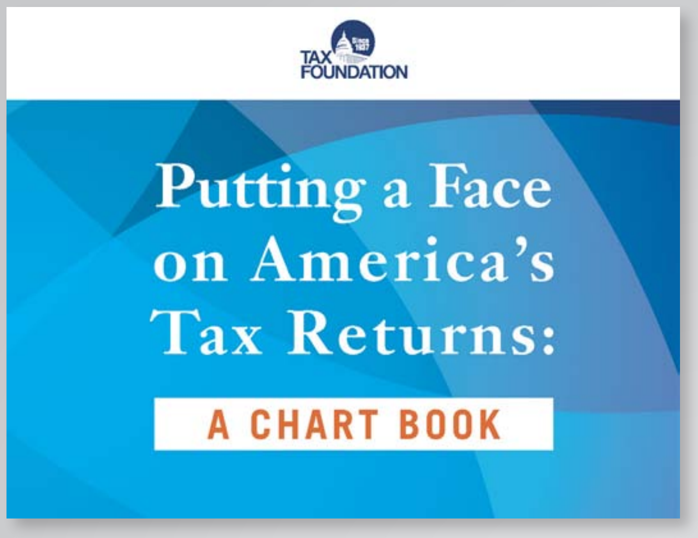
Our work at the federal level was acknowledged by not one but three presidents of the United States in 1962, on the occasion of our 25th anniversary. Presidents Hoover, Eisenhower, and Kennedy sent us letters thanking us for our work on behalf of the American people and encouraging our continued efforts. President Kennedy said, “The [Tax] Foundation’s distinguished record of accomplishment should be a source of pride to its members, who deserve the thanks of all our citizens for their dedication to a task which contributes so much to the effective functioning of the American democratic system.”

In 1970, we warned against the adoption of what is now known as the Alternative Minimum Tax. 1971 saw the debut of perhaps our most famous publication, Tax Freedom Day, showing how long into the year it takes Americans to pay their combined federal, state, and local tax burden. Work like this continued to propel us into position as an organization which could be trusted for reliable, non-partisan data presented in a common sense way. Our move to Washington, DC in 1978 allowed us to be closer to the action and strenghtened our ability to influence the debate on Capitol Hill over the nation’s fiscal policies.

The Reagan tax cut signed into law in 1981 ushered in an economic boom, while the 1986 tax reform eliminated special interest provisions in the tax code and lowered tax rates across the board. These developments energized our work and we pushed even harder for policies that would spur capital formation, avoid overspending, and reduce tax burdens.

More recent history has seen the debut of our groundbreaking research on who bears the cost of government. Our fiscal incidence research, published in 2007, compared how much households at different income levels received in total government spending (federal, state, and local) to the total amount of taxes they paid at all levels. We continue to conduct research that shows an increasingly smaller group of taxpayers bearing an ever-greater share of the cost of government.

Today, our Center for Federal Tax Policy produces and promotes timely and high-quality data, research, and analysis on federal tax issues that influences the debate toward economically principled policies. Our experts are routinely relied upon for presentations, legislative testimony, and media appearances on individual and corporate tax issues. The center’s webpage is a comprehensive resource for taxpayers, journalists, lawmakers and their staff.




# We Put a Face on America's Tax Returns

by Scott Hodge

Inequality has been at the forefront of the nation's political discourse over the last couple years thanks to a number of published reports purporting to show the rich getting richer while the rest of America is stuck in neutral. Indeed, one report suggested that Americans have not been this unequal since the Great Depression in 1929.

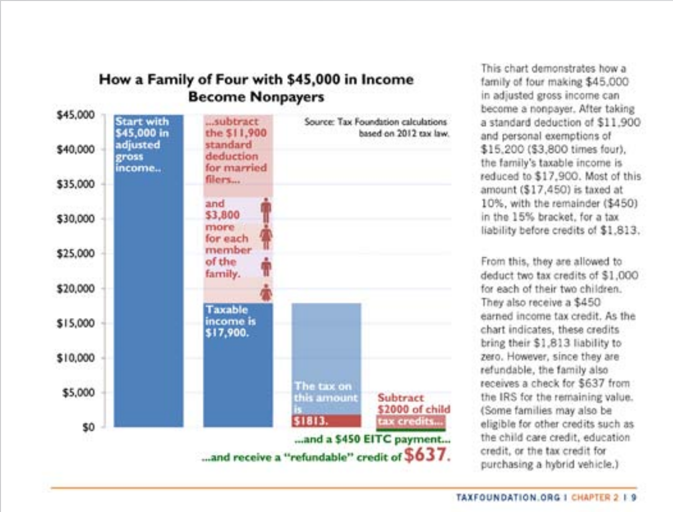
Spurred by this news, support has been growing in both Washington and among the public to raise tax rates on the "rich" to reduce inequality in America. Indeed, many believe that the tax policies enacted in 2001 and 2003—which lowered marginal tax rates for all taxpayers—are a root cause of today's inequality. Therefore, critics conclude, raising tax rates on high-income Americans will halt the growth of inequality.

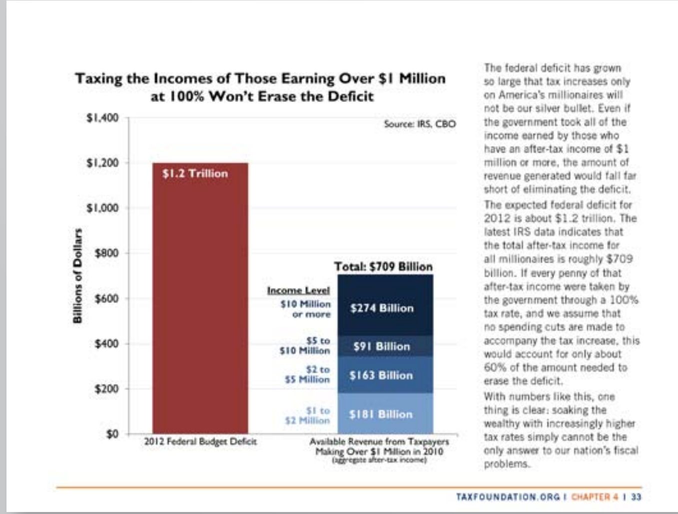
We created this book to show that much of the perceived rise in inequality is really the result of the business cycle combined with social and demographic changes far beyond the role of tax policy. Indeed, there is no evidence of a long-term trend in inequality over the last twenty years, only wide swings up and down.

Thanks to misdirected tax policy, America is becoming divided between a shrinking group of taxpayers who are bearing the lion's share of the cost of government today and a growing group of taxpayers who are disconnected from the basic cost of government.

With this book, we seek to put a face on the ever-changing demographics of American taxpayers. The failure to understand these changes has produced poor tax policy and threatens to undermine efforts to overhaul the tax code.

Since it was published in October of 2012, approximately 4,000 copies of *Putting a Face on America's Tax Returns: A Chart Book* have been distributed. Over 500 were sent to people who purchased additional copies after being impressed with the book, including leaders of citizen economic study groups and accountants who decided to include the book in the financial packets for all of their clients at the end of the year.TW



# Raising Revenue: The Least Worst Options

By Scott Hodge

The nation barely survived the fiscal cliff, but the problems surrounding the budget, the debt, and the tax system remain unresolved. As the nation confronts the need to address these issues, the specter of revenue will likely rear its head again. Lawmakers must keep in mind that not all revenue raisers are equal. Some will have far more harmful economic consequences than others.

Based on OECD research that established which taxes are most and least harmful for long-term economic growth, we put together a non-comprehensive, ranked list of strategies to raise revenue while doing the least damage to economic growth.

These strategies, from least harmful to most harmful, are:

## #1 Least Harmful—Economic growth

This may seem obvious, but whether or not we have enough new economic growth to generate more revenues for the Treasury is directly dependent upon some of the policy choices listed below.

## #2 Asset Sales

The U.S. federal government owns hundreds of billions worth of assets that it can, and should, sell off in order to pay down the national debt. The biggest benefit of asset sales is turning tax-subsidized enterprises into tax-generating ones.

As a second-best option to asset sales, require Government Sponsored Enterprises (GSEs) and federally-owned businesses to pay federal income taxes.

## #3 User fees and leases

Lawmakers could raise billions with no harm to the economy by raising user fees for many of the goods and services the government provides (such as flood insurance, inland waterways, National Parks, and loan originations) and opening up more public lands for oil and mineral leasing.

## #4 Tax certain non-taxed business activities

There are a number of non-taxed businesses or industries that compete directly with private businesses but have the advantage of not paying federal income taxes. These include: credit unions; rural electric coops; nonprofit hospitals; and certain types of insurance firms. These businesses should be taxed as any for-profit enterprise.

## #5 Premium and co-pay increases

Increasing Medicare premiums and co-payments are not likely to be politically popular, but asking seniors to contribute more toward their federal health insurance would be far less harmful to the economy than a broad-based income tax. Even if these policies were means-tested, they might actually add a measure of market forces into a system that has few.

## #6 Federal Employee Contributions

As most private employers are now doing, the federal government should ask federal employees to contribute more to their own health care and retirement costs. Currently, federal employees pay 25 percent of the costs of a basic health plan (some pay more for more expensive plans). This share should be increased to at least 30 to 35 percent.

## #7 Sales/Excise Taxes

Increasing current excises or creating a new one would not be costless, but less so compared to higher income taxes. For example, according to CBO, increasing the federal gas tax by 25 cents could raise about $30 billion per year.

## #8 Base-broadening

This is a tricky one because while everyone talks about broadening the tax base and eliminating “spending” in the tax code, the truth is that not all tax preferences are created equal (see discussion about untouchables, below). From an economic perspective, eliminating tax preferences produces less harm than increasing marginal tax rates, but caution is also in order.

- Eliminate industry subsidies, targeted tax preferences, and refundable credits first
- Tax employer-provided health care benefits
- Restore PEP and Pease
- Cap deductions
- Untouchables: For individuals, do not eliminate or scale back broad-based savings vehicles such as 401ks, Roth IRAs, or investment incentives such as the reduced rates on dividends and capital gains. For businesses, do not lengthen depreciation schedules, eliminate business expensing or depletion, or eliminate deferral. These provisions offset double taxation and move the tax system toward a consumption base.

## #9 Raising the Payroll Tax Rate and / or Raising the Wage Base to Which it Applies

Because it applies to wages only, and the Social Security portion applies only to the first $110,000 in wages, the payroll tax has little impact on saving, investing, entrepreneurship, and high-productivity labor.

## #10 Raising the Alternative Minimum Tax and/or a "Buffet Rule"-type minimum tax

Minimum taxes merely complicate the code, introduce uncertainty for taxpayers, and invite special interests to lobby for exemptions. In the end, they raise little revenue.

## #11 Allowing "temporary" expensing to expire

Full expensing on a permanent basis would permanently shift investment forward, leading to permanently increased production and income. Making full expensing permanent could boost GDP by more than 2.7 percent over the long run, while 50 percent expensing could boost GDP by 1.36 percent.

## #12 Raising top individual income tax rates

Increasing the marginal tax rates in the top two tax brackets from 33 percent to 36 percent and from 35 percent to 39.6 percent would lower long-term economic growth by 0.44 percent. Our model also shows that for every $1 such a policy would raise for the treasury, GDP would fall by 2.77 percent. That's a poor tradeoff.

## #13 Raising the Tax Rate on Estates

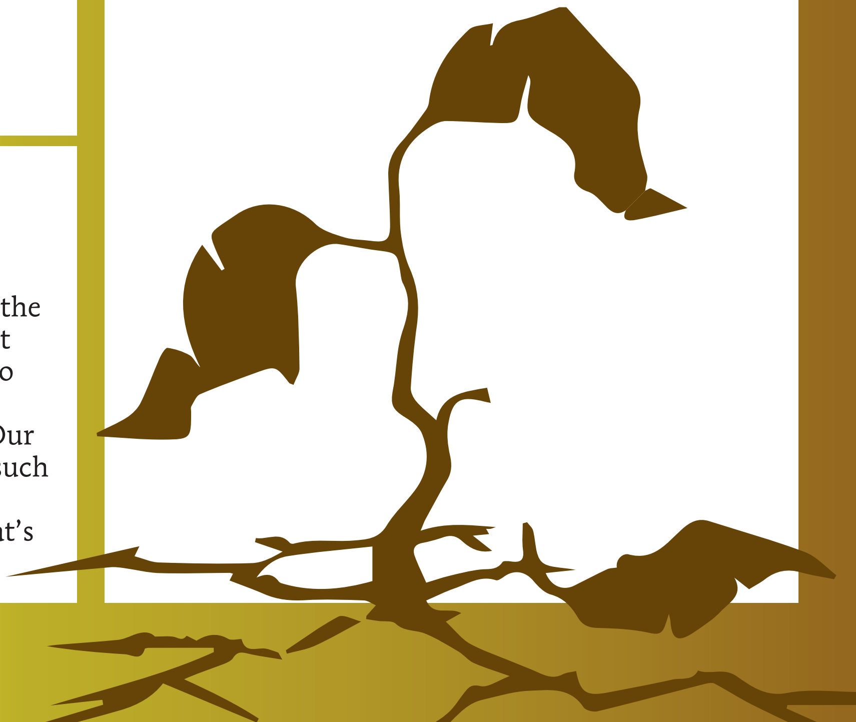
This ranks worse than raising top individual rates because it is a revenue loser not a revenue gainer. President Obama's budget proposed increasing the federal estate tax from the current 35 percent top rate with a $5 million exempt amount to the 2009 levels of a 45 percent top rate and a $3.5 million exempt amount. This policy would lower GDP by 0.23 percent. While this may seem like a small effect, the loss in GDP is nearly five times the amount of new tax revenue gained from this policy.

## #14 Raising tax rates on capital gains and dividends

Increasing the capital gains top rate to 20 percent and letting the tax rate on dividends revert to 39.6 percent for people in the top two brackets would lower GDP by 2.15 percent and would not raise any new tax revenues because of its depressive effects.

## #15 Most Harmful

Raising corporate income tax rates.



# Taxpayers Feel the Bite after Deal on Fiscal Cliff

On January 3, 2013, President Obama signed into law legislation designed to avert the fiscal cliff. Among many things, the deal

- Made permanent the 10 percent, 15 percent, 25 percent, and 28 percent income tax brackets from the Bush tax cuts, while retaining the 33 percent and 35 percent brackets for taxable income under $400,000 (single) and $450,000 (joint filers). The deal imposed a 39.6 percent tax rate on income above this level
- Phased out personal exemptions (PEP) and limited itemized deductions (Pease) for for adjusted gross income over $250,000 (single) and $300,000 (joint filers)
- Set the capital gains tax and dividend tax at 20 percent for taxpayers with income over $400,000 (single) and $450,000 (joint filers)
- Permanently patched the AMT
- Raised estate and gift taxes to 40 percent, but above the current exemption level (~$5.12 million) and adjusted for inflation in future years
- Ended the 2 percent payroll tax cut

While the fiscal cliff deal debate focused on how much higher taxes on wealthy Americans would be, and contained many provisions affecting various parts of the tax code, it is the expiration of the payroll tax holiday that will be felt most acutely by most Americans.

The payroll tax holiday was enacted in 2011, reducing the employee share of the Social Security payroll tax from 6.2 percent to 4.2 percent (appearing on many paystubs as FICA, OASDI, or Social Security). Because this tax holiday was not renewed in the fiscal cliff deal, most Americans are now seeing a 2 percent cut in their pay.

The payroll tax holiday reduced revenues dedicated to Social Security by $10 billion per month, so while popular it was also costly. U.S. payroll taxes also fund some of our largest entitlement programs, so reducing them potentially aggravated the long-term solvency of Social Security. Proponents of the holiday argued that it boosted spending, but experts debate whether such short-term "stimulus" is effective. The holiday also meant larger federal government borrowing at a time of record deficits.TW

# Tax Foundation Again Named Organization of the Year

**by Richard Morrison**

Industry journal *State Tax Notes* has again named the Tax Foundation as Organization of the Year for the second year in a row. The award recognizes the Tax Foundation's reputation as the group most widely relied upon by practitioners, researchers, and the news media as a source of information on state tax issues.

"We are honored and humbled by being named Organization of the Year for a second year in a row," said Tax Foundation Vice President for Legal & State Projects Joseph Henchman. "This award is a testament to all of the work done not only by our state team, but to everyone at the organization. We're especially excited to be receiving this recognition during our 75th anniversary year."

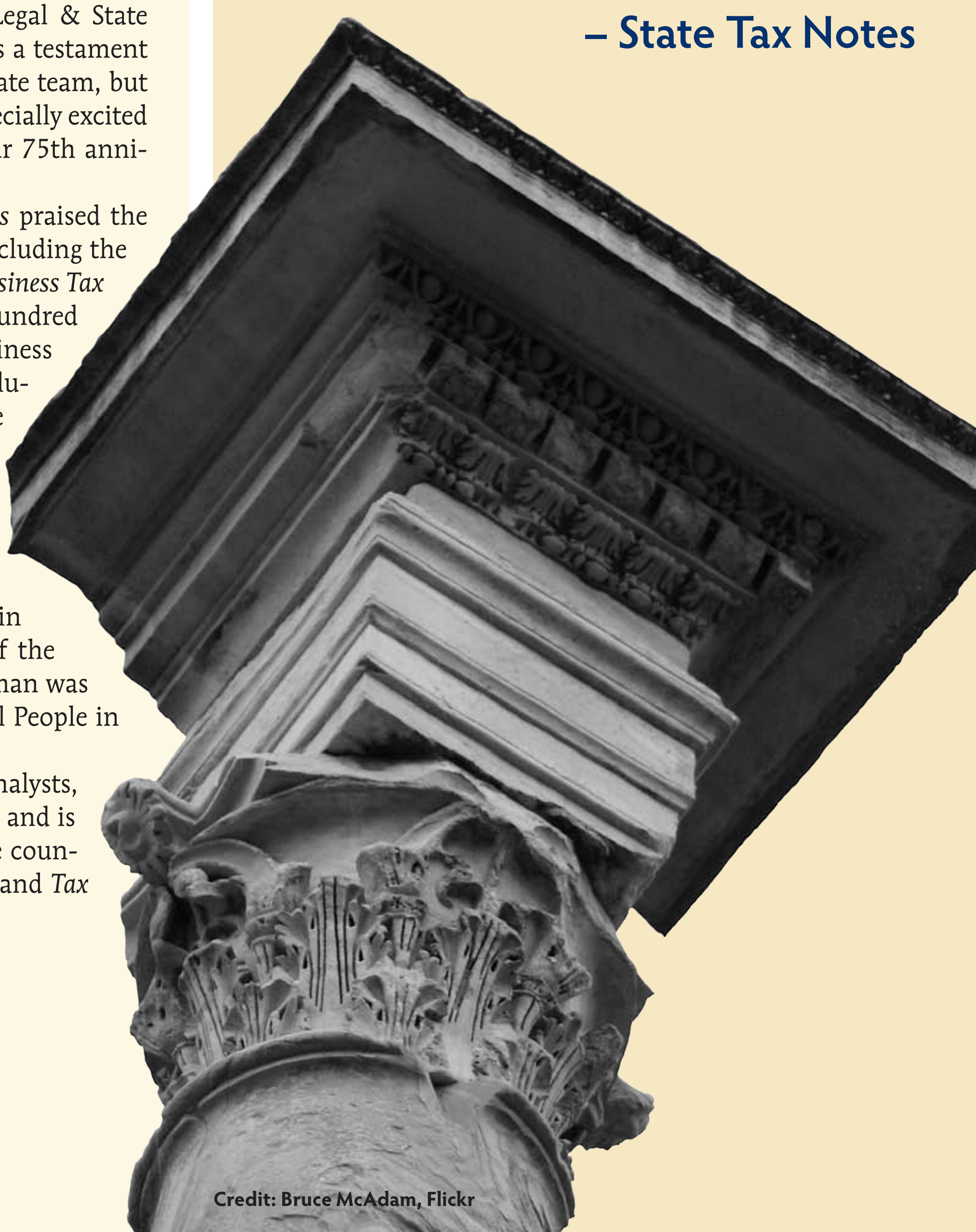
In their award citation, *State Tax Notes* praised the Tax Foundation's flagship publications, including the guidebook *Facts & Figures* and the *State Business Tax Climate Index*, which synthesizes over a hundred metrics to measure the business-friendliness each state's tax system. Citing the influence of the *Index*, they note that "there is no question" that the Tax Foundation is "influential in shaping the state tax reform debate."

Award recipients are selected based on interviews, polling, and analysis by the editorial staff of *State Tax Notes*. In 2011, in addition to being named Organization of the Year, the Tax Foundation's Joseph Henchman was named one of the Top 10 Most Influential People in State Tax Policy.

*State Tax Notes*, a publication of Tax Analysts, is a leading source for multistate tax news and is widely read by tax practitioners across the country. Tax Analysts also publishes *Tax Notes* and *Tax Notes International*, among other titles.TW

## "The foundation is once again State Tax Notes' Organization of the Year because it is a constant and reliable source of data, studies, and other fiscal information."

– State Tax Notes



Credit: Bruce McAdam, Flickr

# History of State Tax Work at the Tax Foundation

We were founded in 1937 as a grassroots organization focused almost exclusively on state and local tax issues. Even though federal tax collections exceeded local collections for the first time in 1937 and the federal government had begun to grow larger than ever before, it was tax policy at the state and local level that most concerned activists.

This was particularly evident soon after our founding when the Westchester County, New York Board of Supervisors proposed an increase in taxes. The newly-established Tax Foundation sent staff up to New York to educate the taxpayers' association on sound policy and advocacy. As a result of our work, the tax increase was defeated. Soon after, we helped taxpayer associations throughout New York organize action in Albany against a state budget increase; again, our mission was successful and the state budget was cut $25 million below the previous year.

After starting as a grassroots organization, the founding staff realized our better value was to serve as a national resource for research and data for state and local organizations. We barnstormed the country setting up state and local taxpayers' associations and public expenditure councils, using our national organization as a clearinghouse to provide them data, analysis, and direction. In this, we were incredibly successful. As our executive director in 1940, Fred Eldean, put it: "it is self-evident that action by citizen groups... should always be based on an intelligent command of the facts.... Research must be combined with constant vigilance." We continue to work closely with many of these national taxpayers' conference (NTC) organizations today.

Through our efforts to educate and provide scholarly resources and reliable data to the state associations, we were able to set the dialogue at the state and local level with regard to tax and spending reform. By 1941, our efforts at the state and local level had produced savings (through combating poor tax policy and wasteful government spending) of over $95 million in 12 states and 48 cities and counties. This was no small amount of money in 1941 and no small accomplishment for the very young Tax Foundation.

The war years, however, saw us begin shifting our focus to federal taxing and spending issues. Federal issues remained the focus of the Tax Foundation's work, exclusively for most of the time, until the early 1990s. At this time, interest in state and local tax issues began to rise again within the Tax Foundation.

In 2004, to rekindle this element of our work, we set up our Center for State Tax Policy. Our scholars and analysts prepare annual studies calculating state tax burdens and ranking the business-friendliness of state tax structures. These *State-Local Tax Burdens* and *State Business Tax Climate Index* ranking reports have considerable impact on state policymakers, tapping into their competitive instincts. These rankings, bundled in our reformulated *Facts & Figures* booklet, reach every state legislator and continue to spur positive developments in state tax policy.

As we approach the tenth anniversary of the Tax Foundation's reconstituted state policy program, there are a number of astonishing successes to tally. Our efforts have directly contributed to enacted positive tax changes, some major, in Indiana, Iowa, Kansas, Maine, Michigan, Rhode Island, Virginia, and Washington. We helped blunt or weaken damaging proposals in California, Illinois, Maryland, Nevada, and New York. Our rankings have been cited in governors' state of the state addresses in fourteen states in the past three years and perhaps most importantly, legislators on both sides of the aisle use us as their resource for reliable tax data, research, and analysis. As *State Tax Notes* found in our 2011 award citation, "even the most ardently liberal legislator acknowledged, often grudgingly, that the foundation was generally right in its approach to tax policy."

In a recent survey we conducted, 70 percent of state-based think tanks and taxpayers' associations say they "frequently" use our research in their state, and when asked to describe our work, the vast majority of these organizations used words such as *timely*, *reliable*, *helpful*, and *high-quality*. Respondents particularly praised our *Location Matters* book and our recent work on sugar and snack taxes, estate taxes, and film tax credits.

As the only organization providing a national perspective on 50 unique tax systems, our state team economists and analysts will continue to barmstorm the country to present our findings and meet with officials to make the case for simple, sensible tax policy. TW

# State-Local Tax Burdens Average 9.9 Percent

**by Elizabeth Malm**

For nearly two decades, we have calculated state and local tax burdens to draw the attention of taxpayers and policymakers to the amount of income that goes to state and local governments each year.

New York residents paid the most at 12.8 percent of income. Next on the list are New Jersey (12.4 percent), Connecticut (12.3 percent), California (11.2 percent), and Wisconsin (11.1 percent). Alaskans had the lowest tax burden at 7.0 percent. The next lowest states were South Dakota (7.6 percent), Tennessee (7.7 percent), Louisiana (7.8 percent), and Wyoming (7.8 percent).

Our methodology, unlike other measures, adjusts for the cross-border reach that some taxes have. For example, Alaska exports much of its tax burden by placing hefty taxes on oil extraction, a tax that is paid by taxpayers in other states when they fill up at the pump. Despite collecting large amounts of revenue, Alaska residents actually have the country's lowest tax burden.

With this report, we encourage taxpayers to examine states around the country with lower burdens and ask the question "Am I getting something more for the additional tax burden?"

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*Read this year's Burdens report at http://taxfoundation.org/article/annual-state-local-tax-burden-ranking-2010-new-york-citizens-pay-most-alaska-least*

# Lawmakers Look To *State Business Tax Climate Index* for Reform Guidance

**by Scott Drenkard & Joseph Henchman**

Our annual *State Business Tax Climate Index* was released in October to a flurry of media attention and recognition. The report, which uses over 100 variables to evaluate whether state tax structures are pro-growth, serves as a guiding document for states aiming to make positive corporate tax reform.

One of the biggest stories this year was Michigan's positive reform in their corporate code. The state eliminated its distortionary Michigan Business Tax that was littered with special credits and replaced it with a flat, simple, 6 percent corporate income tax. This monumental tax change, which subjects business in the state to a more level, neutral tax code, improved Michigan's corporate score from 49th in the country last year all the way to 7th.

Policymakers rely on this hefty 56-page report. Seven governors issued statements about it shortly after its release. Governor LePage of Maine took the occasion of the *Index* release to call for cuts in the Maine's corporate code. An aide to Governor Andrew Cuomo of New York even sparred publically about our results (New York ranks dead last), saying the report shouldn't be trusted. Media outlets, including the New York Times and New York Post, jumped to our defense, praising the report and noting that Cuomo had cited the Index results in his State of the State address the year before.

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*Read the 2013 Index at http://taxfoundation.org/article/2013-state-business-tax-climate-index*

# Defending Taxpayers and Pro-Growth Tax Law in the Courts

While we at the Tax Foundation have spent decades analyzing federal tax policy and pressuring for better state tax policy, our Center for Legal Reform is a young creation. It arose after a 2004 federal court decision on a targeted incentive package that ruled that it was unconstitutional for states to compete on tax policy.

We're good federalists at the Tax Foundation, firm believers in Justice Louis Brandeis's description of the states as the "laboratories of democracy." Targeted tax incentive packages may be bad policy, and we say so frequently, but they don't violate the U.S. Constitution. Our staff attorney filed two briefs with the U.S. Supreme Court, successfully asking them to take the case and then successfully getting them to reverse the federal court decision unanimously.

Lawyers in other cases fighting bad tax policy liked our work and sought our help, and we quickly began filing briefs in other cases. We realized that judges play an important role in developing tax policy, by interpreting tax codes, applying sections in individual cases, and dealing with circumstances unforeseen when legislation was drafted. By explaining complex tax legal reform issues, we can encourage judicial and policy decisions that protect taxpayers and promote sensible tax policy.

Probably the biggest area of our legal program is working to define the scope of state tax power. States are eager to export their tax burdens to out-of-state companies, business travelers, and tourists. The courts are reluctant to infringe on states' sovereign tax power, but they will do so if a state's purpose is to discriminate against non-residents.

We've helped a number of taxpayers prevail against an overreaching state revenue department, including a taxpayer who got a $180,000 tax bill after visiting a state for one day and an athlete's mother who faced a dozen states wanting to divvy up taxes on a small sports prize. Our experts routinely testify to Congress and speak to the media on these important issues, and our research reports are widely cited.

Right now, we're active in explaining proposed bills that would stop states from demanding income tax from business travelers unless they are in the state for at least 30 days (many states demand withholding from day one), that would limit taxation of out-of-state businesses with no physical presence, and that would limit discriminatory taxation of consumer services.

Other victories include striking down an impact "fee" in Hamilton, Ohio that was really a tax, striking down a "tax payment processing fee" in San Diego as really a tax on a tax, striking down an illegal sales tax district in northern Virginia, winning the right to challenge property tax assessment methods in Georgia, preventing a judicial takeover of education financing in Indiana, and requiring Los Angeles to allow taxpayers to file refund claims to get back an illegally collected telephone tax.

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*Learn more about the Tax Foundation's Center for Legal Reform at http://taxfoundation.org/tax-topics/center-legal-reform.*

# Current Case: Protecting Taxpayers' Rights to Receive Full Refunds of an Illegally Collected Tax

On December 17, we filed a brief with the California Supreme Court involving the Long Beach, California telephone tax, which was allegedly unconstitutionally collected for the period 1979 to 2006. California law establishes a procedure for taxpayers to file a group refund claim, known as a class claim, an efficient process that reduces costs. Long Beach, however, claims it is not bound by the state law, and instead requires taxpayers to file separate refund claims. The trial court in this case ruled in favor of Long Beach, and the California Supreme Court has agreed to hear the appeal.

If Long Beach wins, the practical effect will be that the City will keep most of its illegally collected revenue because it is unlikely all past taxpayers will individually pursue refund claims.

We support this option of filing class refund claims because it fosters government accountability and subjects state and local revenue agencies to a fair and transparent refund processes. California chose to give consumers one process, providing a fair and open standard. Large suits make courts accessible for groups of consumers with small individual claims. By challenging Long Beach's attempt to avoid recognizing this claim, we hope to send a message that governments should not refuse to provide full refunds of illegally collected taxes.

The case, *McWilliams v. City of Long Beach*, No. S202037, is pending before the California Supreme Court. Our brief is a joint submission by the Tax Foundation, Consumer Action, and the National Association of Shareholder and Consumer Attorneys (NASCAT).

# Current Case: Challenging Drainage Taxes Disguised as "Fees"

In January 2013, we filed a brief in a lawsuit involving the city of Ocean Shores, Washington, and their assessment of a "stormwater charge" on all real estate lots in the city. The "fee" is based on property square footage, even though stormwater management is a general public service and the charge is not based on the use of drainage facilities or other measures of benefit and burden. The jury was instructed as to the definition of taxes and fees properly except to deny that a fee involves a particularized benefit, and consequently concluded that the charge is a valid fee. Banks has appealed. Our brief recited the proper definition of fee and warned against permitting cities to impose taxes disguised as fees. Attorneys for the city urged the court not to consider our argument but their objection was overruled.

Credit: Steve A. Johnson, Flickr

# From the Archives: A Pension Problem Prediction

by Donald Johnson

In 1976, the Tax Foundation issued Research Publication No. 33, *Employee Pension Systems in State and Local Government*. This publication was one of the first to critically analyze public pension systems in the United States, as well as the financial practices surrounding those systems. Using both general research and specific state and local case studies, we concluded that current funding practices in many public pension systems were cause for serious concern. Increasingly generous benefit provisions that far outpaced input increase formulas were setting both state and local pension systems on the road to ruin. We concluded about local pension systems:

**"Certain of the nation's major cities will be faced with serious future troubles in meeting payments unless there are basic changes in levels of funding, benefit levels, or both."**

As of 2012, over thirty cities and counties have declared Chapter 9 bankruptcy, in no small part due to massive pension obligations that could not be met. States like Illinois and Rhode Island have pension systems which are less than fifty percent funded, while only sixteen states have pension systems which are over eighty percent funded.

When the Tax Foundation issued Research Publication No. 33 in 1976, it stood like Cassandra upon the walls of Troy, heard but disbelieved or disregarded. We know now that this publication was prescient and could have saved many state and local governments a great deal of financial trouble. To help further the dialogue on public pension reform, Tax Foundation Research Publication No. 33, *Employee Pension Systems in State and Local Government*, will be digitized and reissued in early 2013. TW

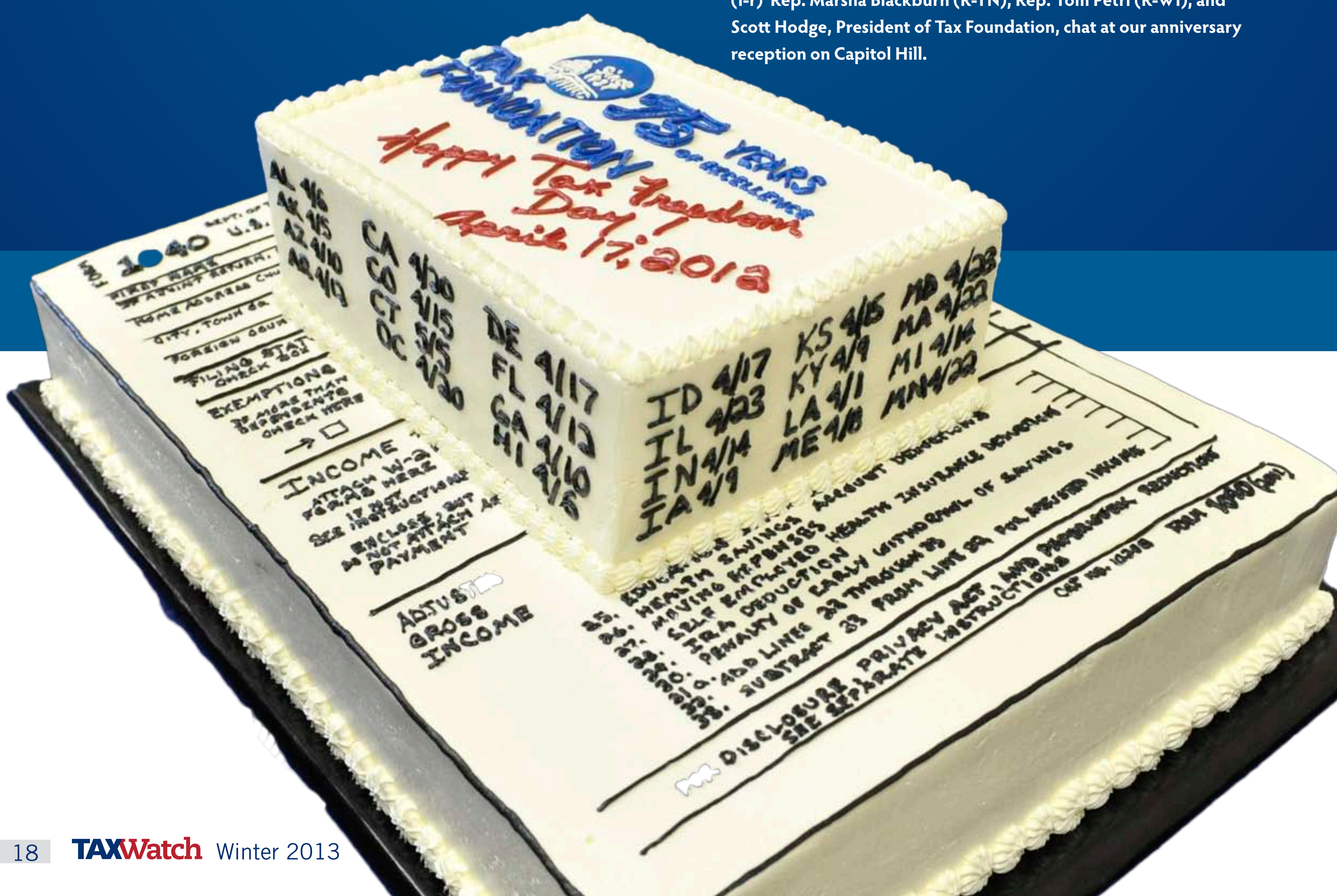
# Happy Birthday Tax Foundation!

2012 marked a special year for the Tax Foundation. It was our 75th birthday, our diamond anniversary. To celebrate this auspicious milestone we hosted a reception in April on Capitol Hill and an open house in our office on our official December 5th birthday.

The reception was held in the Russell Senate Building and it coincided not only with the deadline for filing federal income taxes but also with 2012's Tax Freedom Day. We invited legislators, congressional staffers, and supporters in the area to drop by and help us commemorate the special day with a birthday cake.

It's not often a nonprofit group achieves this longevity and this much success!

**(l-r) Rep. Marsha Blackburn (R-TN), Rep. Tom Petri (R-WI), and Scott Hodge, President of Tax Foundation, chat at our anniversary reception on Capitol Hill.**



Highlights

## The Highlight of the Tax Foundation's Annual Dinner

## Distinguished Service Award Recipients through the Years

(l-r) Rep. David Camp, Chairman of the Committee on Ways and Means accepts the award from the Honorable Bill Archer, a Tax Foundation Board of Directors member. Bill was honored as a Distinguished Service Award Recipient twice by the Tax Foundation during his tenure as a representative from Texas.

(l-r) Douglas Holtz-Eakin, President of American Action Forum, sixth Director of the CBO and Tax Foundation Board of Directors member, presents the award to Dan Henninger, Deputy Editor of the Wall Street Journal.

Since 1941 we've honored those titans in the field, from both the public and private sectors, who have worked steadily to advance principled tax policy. We present to these individuals the Distinguished Service Award at our Annual Dinner, affectionately nicknamed "Tax Prom." It is a widely attended event drawing a significant number of key congressional members and staffers, government officials, corporate executives, and tax professionals.

For many years, when we were headquartered in New York City, the ceremonies were held at the Waldorf Astoria on Park Avenue. When we relocated to our nation's capital, the gala shifted to the elegant grand dame, the Mayflower Renaissance, also known as Washington's second best address.

Those that have received the award are an impressive and elite group representing a Who's Who in government, academia, and industry. Importantly, political parties were never an issue in the decision process and recipients have included Republicans and Democrats alike.

At the first awards ceremony in 1941 there were three recipients: Senator Harry Byrd of Virginia; Harry Wriston, president of Brown University; and George Benson, president of Harding College. Both Wriston and Byrd went on to receive the award multiple times throughout their careers as have a small number of other recipients. Especially noteworthy is the fact that Senator Bryd's eldest son, Senator Harry Byrd, Jr., won the award himself in 1973, thirty two years after his father. Harry Byrd, Jr. attended the Dinner for 49 years in a row and is still a supporter of the Tax Foundation.

Past award winners include Speaker of the House John A. Boehner, Senate Finance Committee Chairman Max Baucus (D-MT), Eli Lilly Chairman and CEO Sidney Taurel, House Ways and Means Committee Chairman Bill Thomas (R-CA), former Treasury Secretary James A. Baker III, Federal Reserve Chairman Paul Volcker, National Taxpayer Advocate Nina Olsen, former Secretary of Defense Casper Weinberger, former Chairman of the Federal Reserve Alan Greenspan, Senator Patrick Moynihan, Rep. Dick Armey, Rep. Paul Ryan, President George W. Bush, President Dwight D. Eisenhower, and President Herbert Hoover.

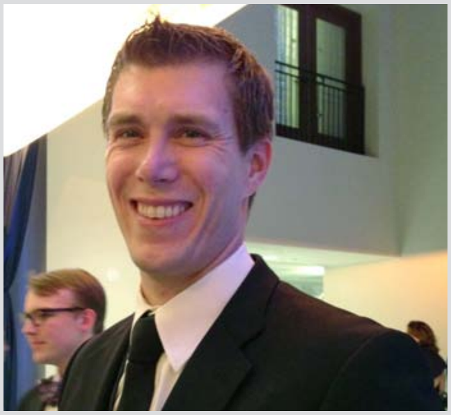
In 2012 we honored Rep. David Camp, Chairman, House Committee on Ways and Means and, for the first time, a representative of journalism excellence, The Wall Street Journal Editorial Page. The Wall Street Journal's award was accepted by Dan Henninger, deputy editor.

# Meet Our New Staff Members

## Elizabeth Malm

Elizabeth has joined us an Economist for the Center for State Tax Policy at the Tax Foundation. She holds a B.S in Economics and B.A. in History from the University of Wyoming, and holds an M.A. in Economics from Duke University. During her tenure at Duke, her research interests included applied microeconomics, mechanism design, and competitive pricing in health insurance markets. Liz also interned for the Wyoming Taxpayers Association where she contributed to the *Wyoming Tax Roundup* quarterly publication on topics such as state mineral trust funds, education and retirement financing, and the effect of healthcare reform on state finance.

Liz is the co-author of the *Annual State-Local Tax Burden Ranking* report. Her work has appeared in five states and over twenty news publications. Outlets such as Yahoo! News, MSNBC News, *the Hill*, *the Advocate*, the *Dayton Daily News*, *Democrat* and *Chronicle*, and the *International Business Times* have sought out her work on *State-Local Tax Burden Ranking*, gambling taxes, and film tax credits.



## Chris Saddock

Chris Saddock is a Tax Advisor and Tax policy analyst who serves as the Tax Foundation's Law Clerk. Chris holds a B.A. in Communication from the University of Texas at Austin and a Business minor. He also holds a J.D. from Southern Methodist University and is currently working towards his LL.M. in Taxation at the Georgetown University Law Center. Chris has served as a Tax Advisor for high net worth individuals for the past four years, providing tax assistance and advice on matters related to state and local taxation, federal gift and estate taxation and federal income taxation for individuals and business entities.

Chris is interested in drafting tax policy opinions and amicus briefs related to federal and state policy issues. In particular he has worked on the appropriate nexus standards for state sales tax, the implications of the new international FATCA tax regime, and explaining changes arising from the American Taxpayer Relief Act of 2013. Chris has also been actively involved in legal work to find and seize the proceeds of human trafficking. He hopes to utilize his studies at Georgetown to develop an innovative information reporting and asset seizure mechanism to help combat this crime.

## Fall 2012 Interns

### Julia Morriss

Julia was a policy intern for the fall of 2012 and was a participant in the Charles G. Koch Internship Program. She is currently pursuing a bachelor's degree in Law and Society at American University. In the summer of 2012 she worked as a government affairs intern at the Cato Institute where she also researched international tax and budget policy. Her analysis of tax and fiscal policy has been featured in the Daily Caller.

### Ben Stutts

Ben was a policy intern for the fall of 2012. He is currently pursuing a master's degree in Applied Economics at Georgetown University. He holds a bachelor's degree in Economics and Politics from Washington and Lee University and a master's degree in Public Policy from Johns Hopkins University. Ben help conduct research for our new book on North Carolina tax reform options.

# Stephen Entin and Michael Schuyler Join Tax Foundation

In October 2012 the Tax Foundation was delighted to add economists Stephen Entin and Michael Schuyler to its federal policy team. Entin and Schuyler were both previously with the Institute for Research on the Economics of Taxation (IRET), a pro-free market economic policy organization based in Washington, D.C.

"We're thrilled to have two such distinguished economists joining us," said Tax Foundation President Scott Hodge. "Steve and Mike bring extremely impressive accomplishments to the tax policy debate, including experience in academia, government service, and the think tank world."

Stephen J. Entin is a Senior Fellow at the Tax Foundation. Previously, he was President and Executive Director at the Institute for Research on the Economics of Taxation. He is a former Deputy Assistant Secretary for Economic Policy at the Department of the Treasury and advisor to the National Commission on Economic Growth and Tax Reform (the Kemp Commission). Prior to joining Treasury, Mr. Entin was a staff economist with the Joint Economic Committee of the Congress, where he developed legislation for tax rate reduction and incentives to encourage saving. Mr. Entin is a graduate of Dartmouth College and received his graduate training in economics at the University of Chicago.

Dr. Michael A. Schuyler is a Fellow at the Tax Foundation. Previously, he was a Senior Economist at the Institute for Research on the Economics of Taxation. He is the author of numerous economic analyses in which he has addressed a wide range of tax and regulatory issues, particularly concentrating on how government policies alter incentives and how incentives affect economic choices. Among his publications are studies on the impact of government mandates on the health insurance market, income-based phase-out provisions in the tax code, and the national debt. Dr. Schuyler received his Ph.D. in economics from the University of Maryland, where he has taught courses on macroeconomics and money and banking. TW

## Entin & Schuyler Help Change the Terms of the Tax Debate

If pro-growth tax reform is to be a reality, the reform movement must have the capability to drive the debate with our own credible, nonpartisan research and modeling techniques. These techniques must be based on real-world models of the economy and individual responses to tax policy.

In 2013, the Tax Foundation will launch a multi-year project to build and deploy the economic models needed to support the empirical case for tax reforms that promote long-term economic growth.

The project is already starting out with a solid foundation. Now that we've been joined by Stephen Entin and Michael Schuyler, we are the only organization in Washington using a tax simulation model in conjunction with a Neoclassical Growth Model to measure the long-term impact of tax changes on economic growth. These dynamic models were developed over the past five years by former Treasury economist Gary Robbins and Stephen Entin.

The overarching goal of this project is to change the terms of the tax reform debate away from redistribution to economic growth.

**TOTAL CITATIONS**

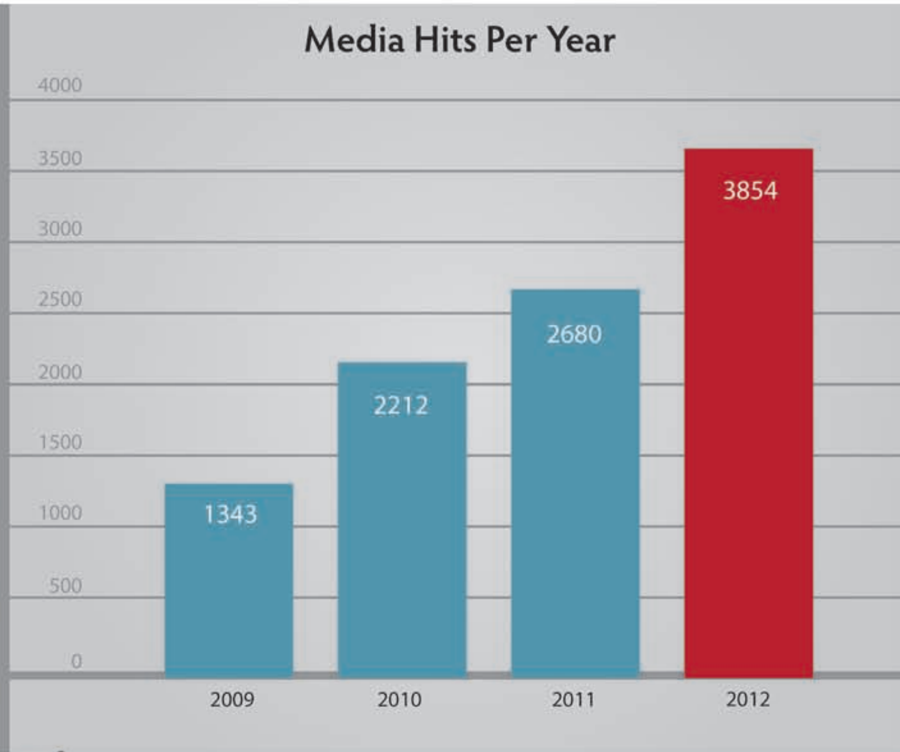
**3584** in 2012

40.23% Increase from 2011

**Unique Sources in 2012: 1526**

**Average Citations Per:**

| DAY | WEEK | MONTH |
|---|---|---|
| 11 | 75 | 322 |




**Breakdown of Sources:** 88 104 1344 2075

**Top Topics:**

State Business Tax Climate Index
State-Local Tax Burdens
Tax Freedom Day
Nonpayers
Location Matters
Fiscal Cliff
Sales Taxes
Corporate Taxes

**Top 10 States for Print, TV, and Radio:**

New York
California
Florida
New Jersey
Pennsylvania
Alabama
Louisiana
Michigan
Illinois
Ohio

## Cited by many of the most influential media outlets

# A History of the Tax Foundation's Communications Program

by Richard Borean

To understand the evolution of the Tax Foundation's communications program is to appreciate the impact of technology on the communications world as a whole. Having existed for three-quarters of a century, we have adapted to many technological and societal changes. Whereas newspapers, daily radio broadcasts, and evening news programs in the 30s, 40s, and 50s updated Americans on the latest issues, today, 24 hour news networks and constant internet access allow people to gather information on stories before the dust even settles.

During our formative years after our inception in 1937, print media was the predominant means of information distribution. Between 1944 and 1945, the amount of literature distributed by the Tax Foundation doubled to nearly 1.3 million pieces. Our material began to appear in paid advertising; at least one bank used our cartoons in a paid ad, and the Cleveland press used extensive visual material in what the advertising department described as "a series of ads to stimulate interest of the general public in the tax question and to move him to do something about it through his elected representatives." In 1958, our material was used in General Electric's economics course for its employees, entitled *Corporate Problems in the National Economy*. Our focuses on business employee education, as well our dedication to national coverage, provided us with a diverse and robust audience.

However, as impressive as our own distribution was, our main outlet for the education of taxpayers on sound tax policy remained the reprinting and quoting of our material by various news publications. In 1955, the combined reach of Tax Foundation-inspired articles and publications was approximately 127 million readers, and by 1957, that number increased to over 400 million worldwide.

Beginning in the late 1940s, we began to capitalize on the growing popularity of televised productions and continued to build its presence on radio stations across the country. In 1950, we created a motion picture entitled *Our Money's Worth*. The film was used by companies such as General Electric, Hiram Walker, and Westinghouse. State associations showed the film at more than 500 meetings, with audiences between 100 and 4,500 viewers. On the radio front, we created a series of three fifteen-minute segments narrated by Robert Montgomery, Raymond Moley, and Roswell Magill which were made available to state organizations for use on local radio programs.

> **Having existed for three-quarters of a century, we have adapted to the many technological and societal changes which have taken place.**

Fast-forward half a century and our communications team takes on a much different appearance. Although we still cater to businesses, news companies, legislators, and individuals, our methods of distribution and our educational materials have evolved to take advantage of the modern technologies now available to us. In earlier years, when print media and phone calls were the main forms of communication, we measured successes by noting how many times newspapers and magazines contacted us with questions. Today, however, we maintain a growing interactive website which is home to thousands of Tax Foundation documents; reporters, legislators, business owners, and curious individuals are able to access our information in just a few clicks. Media citations are now tracked and logged by advanced software. Our presence on the radio is no longer restricted to a limited number of pre-composed segments; rather, we regularly appear on stations across the country to discuss topics that specifically affect a particular region, while also commenting on stories of national interest. Although we no longer create lengthy motion pictures, we appear on the largest national news networks and a variety of local news channels, and we offer animated and educational videos for public consumption on our YouTube channel. Social media provides an additional outlet, allowing our most popular pieces to "go viral." Tax Foundation reports and data can now be found on Facebook, Twitter, LinkedIn, and Pinterest. TW




# The 2013 Tax Reform Agenda

**by Rep. David Camp (R-MI), Chairman, House Committee on Ways and Means**

Each of my predecessors, Republican and Democrat, has taught me a great deal—just as the Tax Foundation has. This organization consistently provides the resources, research, and data that Congress needs to understand the impact of tax policies. Please join me in applauding the Tax Foundation's work and congratulating them on this very special milestone—the 75th Anniversary of the Tax Foundation.

Lately, as I have thought about comprehensive tax reform—both the work that we have already done and the work that is ahead—the 1986 effort keeps creeping into my mind. Some things are different, and yet, some things haven't changed at all.

Undoubtedly, there are some striking similarities between 1986 and today. Then, we had a divided government with President Ronald Reagan in the White House and Speaker Tip O'Neill in the U.S. House. Then, we had an economy in peril—unemployment was at seven percent in October of 1986 when the Tax Reform Act was signed into law.

And of course, Charlie Rangel was on the Ways and Means Committee. Like I said, some things never change.

But there are substantive differences too. Since 1986, there has been an exponential growth in pass-through entities such as LLCs and S corporations, whose incentives to invest and create jobs are a function of the individual tax rates rather than the corporate rate.

Our deficit has skyrocketed from a few hundred billion dollars to more than one trillion dollars. International competition has exploded. Places like China, India, and Brazil are real competitors, and several EU countries have already implemented aggressive tax reforms.

The Tax Reform Act of 1986 actually started several years earlier, and the roots of that reform were found in both the Democratic and Republican parties. Some labored away in Congress while others labored away in the basement of the U.S. Treasury. Wherever they worked, the goal was obvious—keep the momentum moving forward.

Tax reform wasn't something to be finished in a matter of days and weeks, as some might suggest we do today. Instead, it came about in the same manner as so many other things that have true meaning and lasting value—methodically, meticulously and as the result of work on both sides of the aisle.

**Tax reform wasn't something to be finished in a matter of days and weeks, as some might suggest we do today. Instead, it came about in the same manner as so many other things that have true meaning and lasting value—methodically, meticulously and as the result of work on both sides of the aisle.**

Similar to 1986, Washington began serious work on tax reform several years ago. Senator Ron Wyden has introduced a tax reform bill in every Congress since 2005, more recently with bipartisan cosponsors. Then-Chairman Charlie Rangel put out a bill in 2007, Bowles-Simpson laid out an aggressive framework in 2010, and my very first hearing of the 112th Congress was on tax reform. Since then, the Ways and Means Committee has held more than 20 different events on tax reform to examine what is working, what is not, and what can be done differently.

We produced draft legislation last year that would bring America's international tax system into the 21st century, and we moved to lower the top rate for families and job creators of all sizes.

The House of Representatives has passed budgets for the last two years that include a combination of pro-growth tax reform and spending restraints that economists predict will create up to a million jobs in the first year alone.

Key members of the Senate have also started to plant seeds for comprehensive tax reform.

Our colleagues in the other body have called the code antiquated, overly complex and an anchor on job creation. They have also consistently stated that tax reform is necessary to strengthen our economy.

I couldn't agree more.

Admittedly, in the absence of one big bill, many in America might not have known that so many were doing so much to advance tax reform. But then a funny thing happened—the presidential elections began to take shape and tax reform became part of the mainstream conversation.

Now, it would be easy to hang your head and say that the problems are too big, and that the work is just too hard. But as Chairman Rostenkowski said in 1985, "Don't let yourself get misled... the tax reform train is moving. It is picking up speed, and there's a real danger that doubters will be left behind at the station."

Those same words and that same sentiment holds true today. Tax reform is more necessary now than it was in 1986, and that is why the Ways and Means Committee will write, act on, and pass comprehensive tax reform legislation in 2013.

Let me repeat that: we intend to move a comprehensive tax reform bill in 2013—no matter what.

I've said it time and time again—but that won't stop me from saying it again here tonight—comprehensive tax reform is THE path forward. Tax reform can get more revenues for the President and the Democrats. And, tax reform can get more economic growth and job creation for the American people.

When the 1986 Tax Act was finally complete, the headline in the Washington Post said it best by calling tax reform the "Impossible that became the inevitable."

I'd like to see that headline again, and I hope that you would too. There is still so much more to do, and I am depending on all of you to help get tax reform across the finish line. TW

TAX FOUNDATION

Since 1937

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