TAX FOUNDATION 65 YEARS

TAX FEATURES

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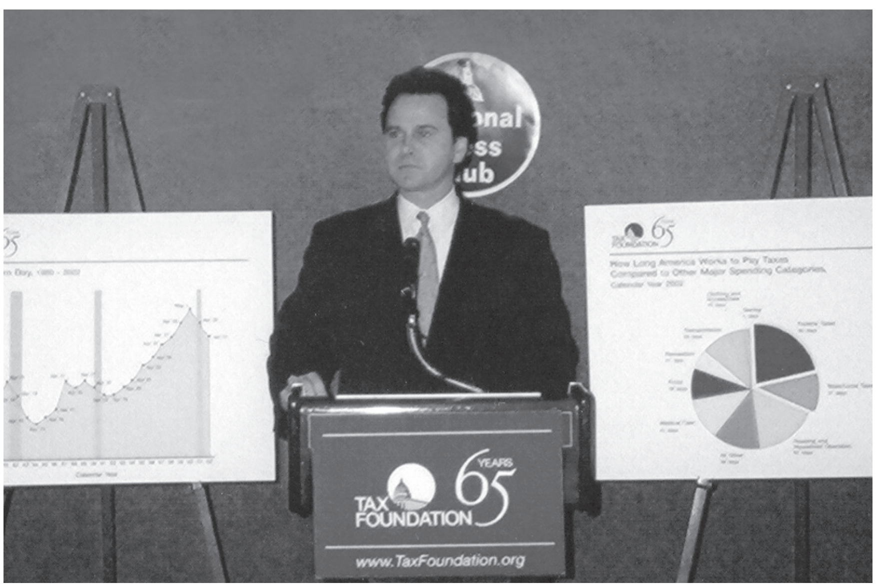
America Celebrates Tax Freedom Day® on April 27, 2002

Date Means U.S. Works 117 Days to Pay for Government, Two Days Less Than in 2001, and Four Days Less Than in 2000

Americans celebrated Tax Freedom Day® on April 27, 2002. That is two days earlier than in 2001 and four days earlier than in 2000 (see Figure 1 on page 2).

Foundation economists have spread the word in dozens of interviews for newspapers and radio stations. CNN covered Tax Freedom Day on television and the web, often as a lead-in to other tax stories which were often based on recent Tax Foundation reports on tax complexity and state tax burdens (see sidebar on page 3).



Tax Foundation Executive Director Scott Hodge presents the Foundation's recent calculation of Tax Freedom Day to the press.

In the new report, *Tax Foundation Special Report No. 112*, "America Celebrates Tax Freedom Day," economists Scott Moody and David Hoffman explain why the overall tax burden has been trending down the last two years, pushing Tax Freedom Day back into April, after a long string of later and later Tax Freedom Days.

"Two factors are combining to make the average American tax burden lighter in 2002," said Moody, "federal tax reductions and a slower economy."

Federal tax cuts in 2001 and 2002 lowered this year's average federal tax burden, and the recession in 2001 followed by slow growth in subsequent months arrested the growth of tax collections at all levels.

Starting in 1992, when Tax Freedom Day fell on April 19, until 2000 when Tax Freedom Day hit May 1, the total tax burden grew markedly, requiring 12 extra days of work from American taxpayers. With state-local tax burdens virtually unchanged in the last decade, the increase was entirely due to the rapid growth of federal tax collections.

See Tax Freedom on page 2

In this issue:

FRONT & CENTER

Fighting to Keep Our Tax Code Competitive in the Global Economy

Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives

6-7

Tax Freedom

from page 1

Working for Each Type of Tax

Americans face such a plethora of different taxes in their day-to-day lives that it is difficult to total them up. Figure 2 presents a breakdown of the nation's tax bill for 2002 by type of tax.

Individual income taxes represent the largest component of Americans' tax bills. In 2002, Americans will have to work an average of 51 days to pay federal, state and local income taxes. Another 29 days will be spent working for payroll taxes, which fund social insurance programs such as Social Security and Medicare.

Some taxes are less apparent to the taxpayer than income and payroll taxes. Foremost among these "hidden taxes" are sales and excise taxes. Americans will work 18 days to pay these add-on taxes that raise the prices of nearly all goods and services.

Another 11 days will be spent working to pay property taxes, mostly levied by local governments.

Americans will then have to work an additional 8 days to pay their share of corporate income taxes, which are collected from companies but ultimately paid by consumers, employees, and shareholders.

Taxes and Other Expenses

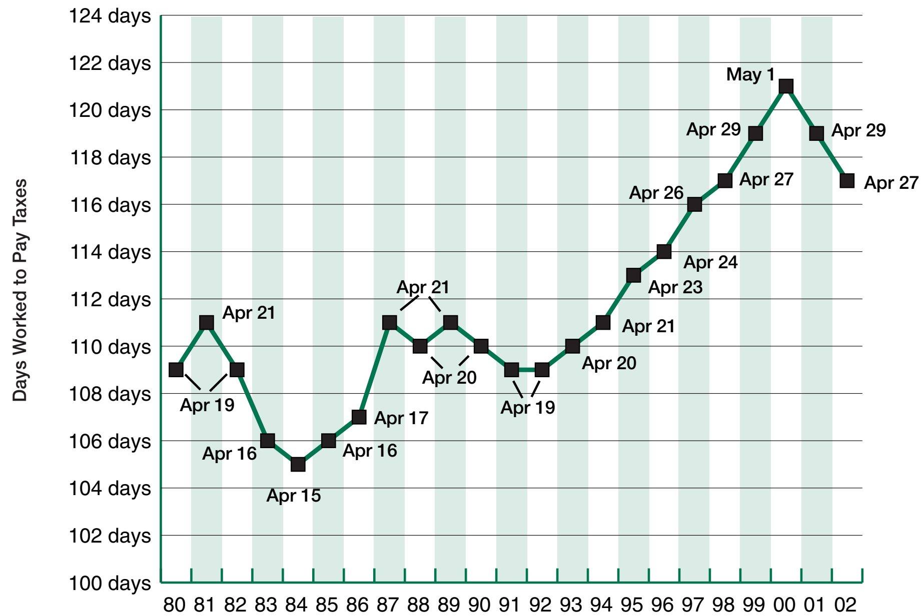
Figure 3 uses the number of days worked as a yardstick to measure the price of government against the price of other important categories of consumer spending. The graph reveals that Americans will work longer to pay for government (117 days) than they will for food, clothing, and shelter combined (106 days).

Only in the last decade have taxes exceeded spending on these basic necessities, and federal taxes alone cost Americans more (80 days) than any of the other major budget item.

Tax Complexity

No regulatory cost is included in the calculation of Tax Freedom Day, but the report does comment on the increasing complexity of the federal income tax code, and concludes that Americans' time and effort spent complying with just the 2002 federal in-

Figure 1: Tax Freedom Day, 1980–2002



Note: Leap day is omitted to make Tax Freedom Day comparable in all years.
Source: Tax Foundation.

Figure 2: Number of Days Worked to Pay Taxes by Type of Tax and Level of Government, 2002

* Less than half a day.
Note: Due to rounding, components may not always add up to totals.
Source: Estimates based on National Income and Product Account definitions.

come tax code is worth $194 billion. America needs to work six days to earn that sum.

The Origin and Popularity of Tax Freedom Day

The concept of Tax Freedom Day was invented in 1948 by Florida businessman Dallas Hostetler. He copyrighted the name and calculated Tax Freedom Day himself for many years. Upon retirement in 1972, he assigned the intellectual property rights to the Tax Foundation which has promoted the concept ever since.

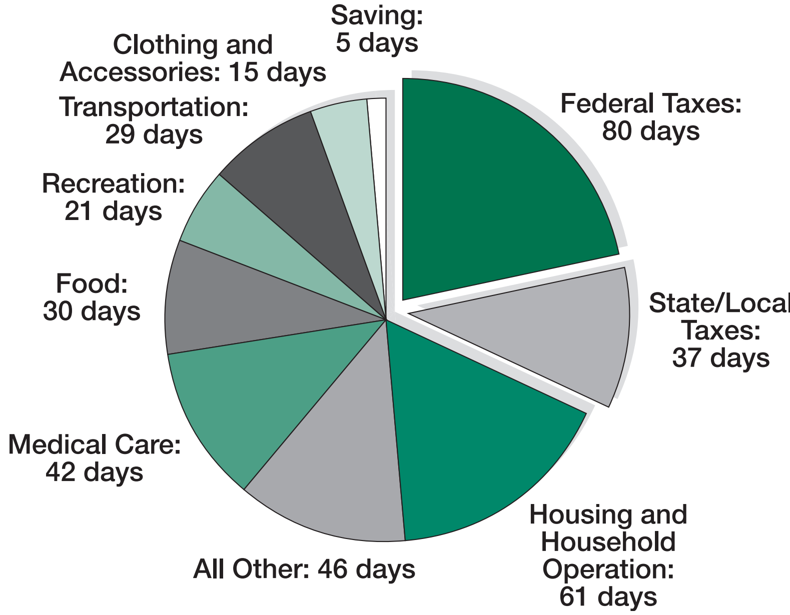
The idea has spread around the world, with independent research groups in India, Great Britain, Canada, and several other nations calculating their national Tax Freedom Day. Every nation counts income and taxes differently, however, so valid international comparisons are difficult.

How the Date is Computed

Tax Freedom Day, announced by the Tax Foundation each year for 30 years, is used to illustrate the portion of the American budget that goes to pay for taxes. Once Tax Foundation economists project the nation's effective tax rate, 32.1 percent this year, it is applied to a calendar year to provide a graphic illustration of how long Americans work for government.

The income figure used is Net National Product (NNP), a component of the National Income Product Accounts (NIPA). Computed annually by the Commerce Department's Bureau of Economic Analysis (BEA), NIPA data is the best measure of income available, and the entire historical series is frequently revised. Therefore, the new report on Tax Freedom Day is the only valid source for historical or current data used to calculate Tax Freedom Day, either at the national or state level.

Figure 3: How Long Americans Work to Pay Taxes Compared to Other Major Spending Categories, 2002



Source: Tax Foundation calculations using Department of Commerce consumption data.

Tax Foundation Research Fills the Airwaves

On April 25th, CNN used Tax Foundation data for a television story about which states tax the least, and throughout this "Tax Freedom" season, radio news and talk shows are carrying on the celebration of Tax Freedom Day.

Tax Foundation economists were on the air to millions of people during the tax season, doing radio interviews on major syndicated shows like The Mike Gallagher Show in New York, National Public Radio, and Judicial Watch Radio. Many stations around the country carried interviews about income tax burdens, the effect of recent tax legislation, and of course Tax Freedom Day. They included KXEL in Iowa; KXLY in Spokane; KRLD in Dallas; KYW in Philadelphia; KTSA in San Antonio; WLAC and WTN in Nashville; KCRS in Midland; WCBK in Battle Creek; KKSU in Manhattan, KS; WPZZ in Indianapolis; KKR in Omaha; KTAR in Phoenix; KPAM in Portland, OR; KMOX in St. Louis; WOKV in Jacksonville; KTJJ in Farmington, MO; KQV in Pittsburgh; KOA and KRDO in Denver; WIZM in Lacrosse, WI; WKRC in Cincinnati; WAEB in Allentown, PA; WSAU in Milwaukee and dozens more.

Publication Summary

General: Special Report No. 112; ISSN 1068-0306; 20pp.; $10 or $50/yr. for at least 6 Special Reports on varied fiscal issues

Title: America Celebrates Tax Freedom Day®

Authors: J. Scott Moody and David Hoffman

Date: April 2002

Subject: Calculation of the total effective tax rate for the United States, and for each of the 50 states plus the District of Columbia

Tables: Tax Freedom Day & Total Effective Tax Rate by Level of Government, 1900–2002; Tax Freedom Day by State and Rank, 1990–2002; Tax Freedom Day by State and Rank, 2002; Days Spent Working to Pay All Taxes in Each State, Total Taxes as a Percentage of Income, Per Capita and Rank, 2002; Days Spent Working to Pay Federal Taxes in Each State, Federal Taxes as a Percentage of Income, Per Capita and Rank, 2002; Days Spent Working to Pay State/Local Taxes in Each State, Per Capita and Rank, 2002; Number of Days Americans Have to Work to Earn an Amount Equal to Federal Income Tax Compliance Costs, 2002; State and Local Tax Incidence Results by State, 2002; Effective State/Local Tax Burdens by State and Rank, 1992–2002

State Tax Freedom Days Differ Widely, Reflecting Local Economies and Tax Systems

Alaska to Celebrate First on April 8; Connecticut's May 14 is Last

The tax burden borne by different states varies considerably, not only because residents of different states face different state and local taxes, but also because they pay dissimilar federal taxes. Table 1 gives each state's Tax Freedom Day, which includes all federal, state and local taxes.

Connecticut's total tax burden is the heaviest among the 50 states, so taxpayers there can't celebrate Tax Freedom Day until May 14. Outside Connecticut and Washington, DC, where Tax Freedom Day is May 17, residents of the State of Washington work the longest for taxes—until May 9. New York (May 6), New Jersey (May 5), and Wyoming (May 4) round out the top five states.

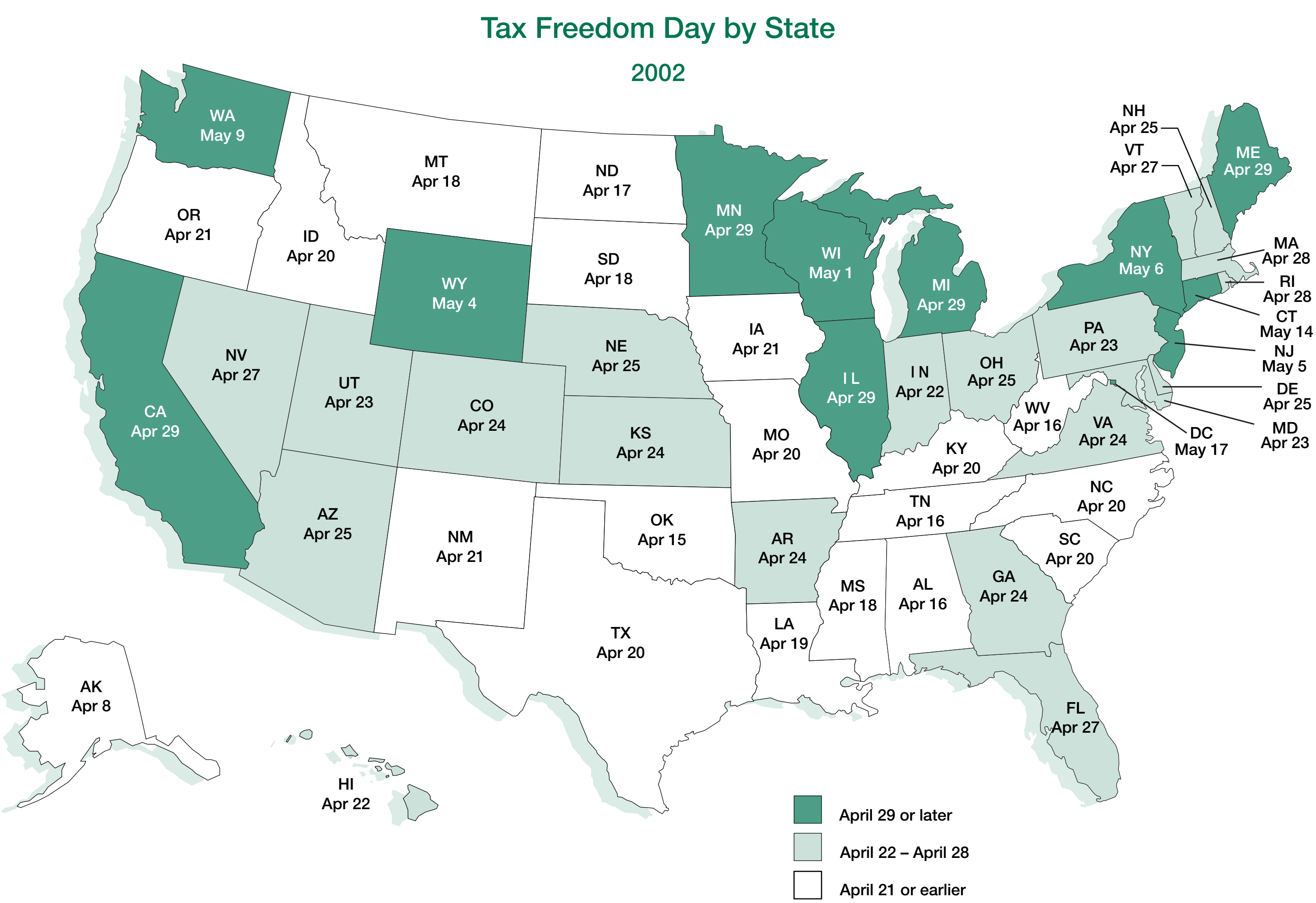
At the other end of the tax burden spectrum are states with comparatively early Tax Freedom Days. Alaska's is the earliest, April 8, and Oklahoma is next with a Tax Freedom Day on the tax filing deadline, April 15. Three states will celebrate Tax Freedom Day on the 16th of April: West Virginia, Tennessee and Alabama.

Comparing State/Local Tax Burdens

To facilitate comparisons of state/local tax burdens, the new Tax Freedom Day report presents each state's tax burden with federal taxes excluded for the last decade. The nation's average state/local tax burden is 10.2 percent of residents' income, with the highest being Maine's 12.8 percent and the lowest being Alaska's 6.3 percent.

Nearly every state saw its federal tax burden fall. The three contributing factors were the tax relief passed in 2001, the economic stimulus passed in 2002, and the economic slow-down in 2001. (See article on page 1.)

Meanwhile, the state and local tax burden has held steady for over a de-



cade, hovering around 10.2 percent. There are two principal reasons for this stability.

State and local taxes are generally less progressive than the Federal tax system. With a progressive tax system, a growing economy produces faster tax growth than income growth because taxpayers are pushed into higher brackets. Similarly, a shrinking economy pushes people into lower brackets, so tax collections shrink faster than income. States and localities avoid this volatility by collecting only 27 percent of revenue from income taxes compared to 61 percent at the federal level.

Secondly, states have been far more responsive to constituent demands and legal mandates to return their budget surpluses to the taxpayers. In FY 2001, 31 states reduced taxes equaling almost $10 billion.

Table 1: Tax Freedom Day by State and Rank

Calendar Years 2001 and 2002

	2001 Tax Freedom Day	2002 Tax Freedom Day	Rank in 2002
U.S.	April 29	April 27	–
Connecticut	May 17	May 14	1
Washington	May 12	May 09	2
New York	May 09	May 06	3
New Jersey	May 08	May 05	4
Wyoming	May 06	May 04	5
Wisconsin	May 03	May 01	6
Minnesota	May 01	April 29	7
Michigan	May 02	April 29	8
Illinois	May 02	April 29	9
California	May 02	April 29	10
Maine	April 30	April 29	11
Massachusetts	May 02	April 28	12
Rhode Island	April 30	April 28	13
Nevada	May 01	April 27	14
Florida	April 30	April 27	15
Vermont	April 30	April 27	16
Delaware	April 28	April 25	17
Arizona	April 28	April 25	18
Nebraska	April 28	April 25	19
Ohio	April 27	April 25	20
New Hampshire	April 29	April 25	21
Georgia	April 27	April 24	22
Kansas	April 27	April 24	23
Colorado	April 27	April 24	24
Virginia	April 26	April 24	25
Arkansas	April 25	April 24	26
Utah	April 26	April 23	27
Pennsylvania	April 26	April 23	28
Maryland	April 26	April 23	29
Hawaii	April 25	April 22	30
Indiana	April 25	April 22	31
Iowa	April 24	April 21	32
Oregon	April 24	April 21	33
New Mexico	April 23	April 21	34
North Carolina	April 22	April 20	35
Texas	April 24	April 20	36
Idaho	April 23	April 20	37
Missouri	April 22	April 20	38
Kentucky	April 22	April 20	39
South Carolina	April 22	April 20	40
Louisiana	April 21	April 19	41
Montana	April 20	April 18	42
Mississippi	April 20	April 18	43
South Dakota	April 21	April 18	44
North Dakota	April 19	April 17	45
Tennessee	April 19	April 16	46
Alabama	April 18	April 16	47
West Virginia	April 17	April 16	48
Oklahoma	April 17	April 15	49
Alaska	April 11	April 08	50
District of Columbia	May 17	May 17	–

Table 2: Days Spent Working for State/Local Taxes, State/Local Taxes as Percentage of Income, Per Capita and Rank

Calendar Year 2002

	Tax Burden Rank	Days Spent Working to Pay Taxes	State/Local Tax Burden as a Percentage of Income	State/Local Tax Burden Per Capita	Income Per Capita
United States	–	37	10.2%	$ 3,274	$ 32,010
Alabama	46	33	9.1%	$ 2,291	$ 25,313
Alaska	50	23	6.3	1,979	31,327
Arizona	28	36	10.1	2,768	27,317
Arkansas	7	41	11.3	2,683	23,782
California	24	37	10.3	3,585	34,924
Colorado	45	33	9.1%	$ 3,196	$ 35,309
Connecticut	11	39	10.9	4,906	44,990
Delaware	27	37	10.2	3,427	33,713
Florida	42	34	9.3	2,833	30,390
Georgia	25	37	10.2	3,086	30,219
Hawaii	4	42	11.6%	$ 3,323	$ 28,631
Idaho	17	38	10.5	2,639	25,044
Illinois	31	36	10.0	3,451	34,610
Indiana	34	36	9.9	2,850	28,801
Iowa	22	37	10.4	2,983	28,758
Kansas	21	37	10.4%	$ 3,085	$ 29,666
Kentucky	18	38	10.5	2,763	26,228
Louisiana	16	38	10.5	2,631	24,953
Maine	1	46	12.8	3,582	27,900
Maryland	37	35	9.7	3,566	36,792
Massachusetts	39	34	9.5%	$ 3,924	$ 41,438
Michigan	14	39	10.7	3,356	31,304
Minnesota	5	41	11.3	3,936	34,879
Mississippi	15	39	10.7	2,413	22,522
Missouri	38	35	9.7	2,833	29,347
Montana	32	36	10.0%	$ 2,400	$ 24,083
Nebraska	13	39	10.8	3,216	29,656
Nevada	43	33	9.2	2,956	32,100
New Hampshire	48	31	8.6	3,086	35,951
New Jersey	23	37	10.3	4,146	40,258
New Mexico	12	39	10.9%	$ 2,570	$ 23,667
New York	2	44	12.3	4,648	37,902
North Carolina	29	36	10.1	2,950	29,324
North Dakota	26	37	10.2	2,733	26,852
Ohio	9	40	11.2	3,368	30,128
Oklahoma	33	36	9.9%	$ 2,556	$ 25,760
Oregon	41	34	9.4	2,768	29,443
Pennsylvania	35	35	9.9	3,174	32,181
Rhode Island	6	41	11.3	3,589	31,816
South Carolina	30	36	10.0	2,599	25,977
South Dakota	44	33	9.1%	$ 2,508	$ 27,589
Tennessee	49	30	8.4	2,353	28,039
Texas	47	32	9.0	2,726	30,304
Utah	8	40	11.2	2,860	25,468
Vermont	10	39	11.0	3,227	29,455
Virginia	40	34	9.4%	$ 3,228	$ 34,276
Washington	20	38	10.5	3,498	33,436
West Virginia	19	38	10.5	2,480	23,573
Wisconsin	3	43	12.0	3,656	30,554
Wyoming	36	35	9.8	2,873	29,228
District of Columbia	–	50	13.9%	$ 5,894	$ 42,366

Fighting to Keep Our Tax Code Competitive in the Global Economy

by Representative Bill Thomas (R-CA)

"Struggle and contrive as you will, lay your taxes as you please, the traders will shift it off from their own gain."
— John Locke, 1691

Tax Freedom Day — the day when workers stop working to pay taxes and start working to earn money for themselves — has fallen back from May into April thanks mostly to smart GOP tax legislation.

First, the $1.35 trillion tax cut that Congress passed last May and signed into law last June, the largest tax cut ever, improved Tax Freedom Day starting in 2001. It created a new 10 percent tax bracket for a portion of taxable income that was previously taxed at 15 percent and will generally lower marginal rates by 3 percentage points for the other tax brackets as it phases in over the next few years.

Second, the recently signed Job Creation and Worker's Assistance Act of 2002 further reduced Tax Freedom Day by providing the accelerated depreciation that will encourage businesses to ramp up investment and create new jobs.

The rate reductions will allow working families to keep more of their paycheck for the goods and services they value most. More importantly, they will allow families to save more money for the future — to buy a first home, pay for a child's education or provide more income during retirement. In addition, more savings will lead to more investment, and that means a larger economy and a higher standard of living. Accelerated depreciation provides further insurance that the economy will experience robust growth and job creation this year and in years to come.

Another reason the date of Tax Freedom Day has improved is, unfortunately, the downturn in our economy last year. While the slowdown began in the second half of 2000, it was the horrendous events of September 11 that pushed our economy into a temporary freefall and pushed our economy into recession.

Although many economists are now predicting that this will be the mildest and perhaps shortest recession on record, there have still been 1.4 million jobs destroyed and hardship felt in many homes around the country. In Kern County, part of my Congressional district in California, the unemployment rate is almost 13 percent as many businesses there have reduced their payrolls substantially during the recession.

Fortunately, it appears that the economy is recovering rapidly. Manufacturing activity is increasing, investment appears to be recovering and personal spending remains strong. Economists estimate that GDP growth in the first quarter of 2002 could easily be 4 to 5 percent at an annualized rate.

There are two ways to change the date of Tax Freedom Day: reduce taxes collected or increase economic growth. We should do both.

Although Tax Freedom Day is a challenge to calculate each year, the basic point is that Americans work to pay taxes until early spring every year. And although we are proud of the $1.35 trillion tax cut passed last year and are working hard to make these cuts permanent, we must realize that Tax Freedom Day will continue to coincide with the cherry blossoms in Washington for the foreseeable future unless more fundamental changes occur.

We need to move to a tax system that promotes economic growth, job creation and capital formation. This is the only way to raise wages and the standard of living in America. Remember, there are two ways to change the date of Tax Freedom Day: reduce taxes collected or increase economic growth. We should do both.

To understand how best to do this, it is useful to broaden our perspective from Tax Freedom Day in the U.S. to an examination of tax burdens around the world. Over the last 10 years Tax Freedom Day has digressed from April 19 to May 1 before this year's modest improvement. During this same time period most other industrialized countries have reduced their tax rates, in particular corporate tax rates. What do falling tax rates around the world mean for the U.S. economy? And how has the emergence of the global economy changed the importance of differing tax rates?

Recent research confirms that lower tax rates lead to high growth rates. The more that the government takes from your paycheck or your savings account, the less willing you are to work and save. Quite simply it is these two activities, working and saving, that lead to economic growth and a rising standard of living.

Around the world, governments have embraced this fact and slashed their tax rates considerably. Germany has cut its corporate tax rate from 52 percent in 1999 to just 25 percent in 2001. France has recently cut its corporate tax rate by 10 percent. Ireland is famous for its dramatic cut in taxes to just 10 percent that has spurred huge amounts of foreign investment and growth; and Italy just passed a first draft of a bill that would lower its corporate tax rate from 37 percent to 33 percent.

Of course, the statutory corporate rate is just one measure of the burden of taxation on businesses and the economy. Economists have calculated the effective tax rate by also considering depreciation schedules for assets, tax treatment of

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debt verse equity and other tax particulars. When considering these factors we also observe falling tax rates around the world.

According to calculations by the consulting firm KPMG, average corporate rates in the EU have fallen nearly 5 points or 13 percent during that last five years. Average corporate tax rates in Latin America and Asia are 30 and 31 percent respectively, both lower than the U.S. rate.

As European tax rates and rates around the world fall, a starkly different situation is apparent in the U.S. Although the Tax Reform Act of 1986 lowered the U.S. corporate tax rate dramatically to a level significantly lower than almost all European rates, this advantage has eroded during the last 15 years the U.S. corporate tax rate has remained unchanged.

Recently, a few U.S. firms have moved their corporate headquarters offshore for tax advantage purposes. Although these "corporate inversions" are neither new nor hardly an epidemic, they do suggest that there are more attractive countries from a tax perspective to incorporate a business — another clear sign that there is a competitive problem with our tax code.

How concerned should we be about these corporate changes? Who is the loser from these "inversions"? Only the U.S. Treasury.

Firms that invert will make the same business development decisions as a U.S. chartered corporation (both their senior executives and product line generally remain unchanged), but they will do so while paying less tax to the U.S. government. This means these firms will keep more of their profits to share with employees, stockholders or invest back into the company. We must view this phenomenon of inversions as a symptom of a larger problem, a serious weakness in our tax structure, and work towards fundamental steps to reverse this trend. It demonstrates that in a free world and global economy we can not create just any tax laws we choose and expect to successfully raise revenues.

In a free world and global economy, we can not create just any tax laws we choose and expect to successfully raise revenues.

What is the force behind falling tax rates around the world? As the global economy becomes more transparent and trade and foreign investment increase, taxes become an increasingly important factor in business decisions. We have witnessed many examples of this tax competition within the U.S. as states offer tax incentives to tempting businesses to locate and create jobs in their state. Internationally the situation is the same. Countries are competing for capital and those countries that are winning are growing the fastest.

Currently, there is an impetus for change facing Congress. Three months ago, the World Trade Organization (WTO) ruled that the U.S. had lost its final appeal in a challenge brought by the European Union (EU) against a portion of our tax code. That provision, known as Extraterritorial Income Exclusion (ETI) was an attempt to create a more competitive playing field for U.S. exports by reducing the tax burden on these goods and services. The WTO has ruled (and ruled again and again) that our tax system provides an unfair subsidy to our exports.

The U.S. has acknowledged the WTO decision and must move forward in a thoughtful and deliberate way to comply with this ruling in a timely manner. The House Ways and Means Committee and the Select Revenue Subcommittee are actively engaged. The need to change our laws related to the taxation of international business activity creates an opportunity to examine our code more broadly and make more fundamental changes.

We can improve the competitiveness of our multinational businesses worldwide and make the United States a more attractive place to own businesses, employ workers and build factories and facilities. We must realize that the tax burden placed on a corporation in the United States is high by international standards, and that high corporate tax rates are harmful to both the 84 million households that own stocks and the 142 million employees in our economy. There is a need and an opportunity for broad changes that will support job creation and move our economy towards a higher standard of living by encouraging firms to locate in the U.S.

Everyone wins if the government can collect its needed revenue earlier in the year. We have moved that date from May to April. Could the Ides of March be next?

The Tax Foundation invites national leaders from all perspectives to contribute columns in Tax Features, *generally alternating between the major parties.*

Recent Tax Cuts Have Worsened Tax Complexity; Annual Cost of Compliance Nears $200 Billion

Most Americans think of their income tax burden simply as the amount on the bottom line of their 1040 forms. Economists may express the tax burden as a percentage of GDP or even as a date on the calendar, such as Tax Freedom Day. But such measures fail to register another cost to taxpayers — the cost of complying with the tax system.

A new *Tax Foundation Special Report* by Senior Economist J. Scott Moody estimates how much it costs individuals (see table below) and businesses to read the rules, fill out the forms, and do all the other things necessary to comply with the nation's tax laws. (See Publication Summary.)

In fact, Moody's estimate of how much all this bookkeeping and paperwork will cost in 2002 is $194 billion. That will amount to approximately 20 cents for every dollar collected. The cost of lobbying and litigating is excluded, so even this startlingly high amount is a cautious estimate of the system's real burden.

Moody finds that while recent tax legislation has lowered tax liabilities for everyone who pays income taxes, the tax cuts in 1997 and 2001 have ironically imposed a greater tax compliance burden on the public, adding hundreds of pages to the tax code, requiring new forms, and complicating old ones.

Even though many complex tax forms are not filled out by low- and middle-income people, the cost of compliance is nevertheless a regressive burden that falls more heavily on people with moderate incomes who do their taxes without professional help.

Publication Summary

General: Special Report No. 113; ISSN 1527-0408; 16pp.; $10 or $560/yr. for 6 issues on varied fiscal topics

Title: The Cost of Complying with the U.S. Federal Income Tax

Author: J. Scott Moody

Date: May 2002

Subject: Measures the growth of the IRC and the resulting cost to individuals and businesses of filing tax returns.

Tables: Estimated Number of Words in the Code, Selected Years, 1955–2000; Comparison of 1954 Code with 2000 Code; Compliance Cost to Individuals, Businesses, and Nonprofits of the Federal Income Tax System, 2002; IRS Costs, Collections and Employees, FY 1970–2000: Annual Growth in the Time Estimates of Various Tax Forms, 1995–2001; The Income Distribution of Federal Income Tax Compliance Costs, 2002; Federal tax Compliance Costs by State, Per Capita and Per $1,000 of Personal Income, 2002; Federal tax Compliance Costs by Type of Filer, by State, 2002

Estimated Cost to Individuals of the Federal Income Tax System

Hours Per Return in Calendar Year 2002

	Number of Returns	Record-keeping	Education Stage	Form Preparation	Packaging/ Sending	Total for One Taxpayer	Total Hours
Forms							
1040 (a)	83,392,058	2.8	3.5	6.6	0.6	13.5	1,121,623,178
1040A (b)	13,892,400	2.3	3.6	7.0	2.3	15.2	211,396,020
1040EZ (c)	14,609,700	0.1	1.7	2.1	0.3	4.2	61,117,245
1040ES (Estimated Tax)	41,478,600	1.3	0.3	0.8	0.2	2.6	107,153,050
1040X (Amended 1040)	3,529,200	1.3	0.5	1.2	0.6	3.5	12,352,200
1041 (Estates and Trusts)	3,745,200	46.6	18.5	35.0	4.3	104.4	390,874,040
1041ES (Estimated Tax)	991,600	0.3	0.3	1.6	1.0	3.1	3,090,487
4868 (Extension of Time) (d)	8,320,700	0.4	0.2	0.3	0.2	1.1	9,291,448
2688 (Extension of Time) (e)	2,394,900	0.0	0.2	0.3	0.3	0.8	1,836,090
Other Forms	18,414,662	13.0	7.6	13.7	4.5	38.8	89,264,122
Tax Credits							
2441 (Child Care Expenses Credit)	6,927,706	0.7	0.4	0.8	0.5	2.4	16,511,033
1116 (Foreign Tax)	2,157,248	2.7	1.0	2.8	0.6	7.1	15,352,411
8863 (Education Credit)	4,760,771	0.2	0.2	0.6	0.6	1.5	7,220,503
8839 (Adoption Credit)	35,972	0.8	0.3	1.8	0.6	3.4	122,904
3800 (General Business Credit)	356,066	17.9	1.0	1.3	0.0	20.3	7,210,331
8396 (Mortgage Interest Credit)	142,529	0.8	0.1	0.5	0.2	1.5	216,170
8801 (Prior Year Minimum Tax Credit)	287,845	2.1	1.9	1.7	0.3	5.9	1,688,688
Other Credits	1,320,808	34.0	4.3	4.2	4.0	46.4	8,900,381
1040 Schedules							
Sch A (Itemized Deductions)	53,722,551	3.1	0.7	1.6	0.3	5.6	301,741,660
Sch B (Interest & Dividends)	40,524,631	0.6	0.1	0.4	0.3	1.4	58,085,304
Sch D (Capital Gain/Loss)	38,071,117	1.5	3.0	2.6	0.6	7.6	289,340,486
Sch E (Supplemental Income)	22,515,376	3.0	1.0	1.4	0.6	6.0	134,341,745
Sch EIC (Earned Income Credit)	23,741,871	0.0	0.0	0.2	0.3	0.6	13,453,727
Sch H (Household Taxes)	406,352	1.6	0.5	0.9	0.6	3.6	1,456,094
Sch R (Elderly or Disabled Credit)	443,059	0.3	0.3	0.5	0.6	1.6	723,663
Estate and Gift	493,100	13.1	8.8	16.5	11.7	50.0	8,474,043
Individual Totals (Forms + Schedules)	386,676,020	NA	NA	NA	NA	NA	2,872,837,024

(a) Includes 1040PC and electronically filed 1040 forms.
(b) Schedules 1-3 and EIC are included in the average time.
(c) Includes Telefiled 1040EZ forms.
(d) Application for automatic extension of time in which to file the individual income tax return.
(e) Application for additional extension of time in which to file the individual income tax return.

Typical American Family in for Huge Tax Hike When 2001 Tax Cut Expires at Decade's End

Taxpayers May Find That Not Every Sunset is Beautiful

A forthcoming *Tax Foundation Special Report* by Foundation chief economist John S. Barry maps out the next decade of income and taxes for a typical family of four, and concludes that the 2010 "sunset" of the 2001 tax cut will be an ugly sight for all who witness it. (See Publication Summary.)

Because of the "Byrd Rule," a technical budgetary rule named after West Virginia Senator Robert Byrd, last spring's tax cut is actually scheduled to expire, or "sunset," at the end of 2010, returning all the income tax rates and deductions to what they were before it passed.

The House of Representatives, recently passed H.R. 586, the Tax Relief Guarantee Act of 2002, that would make permanent all the provisions of the 2001 tax cut, but passage is unlikely because, as the April 22 issue of *Tax Notes* reports, Senate Majority Leader Tom Daschle has stated, "We will … never bring up the permanent tax cut the president has advocated. It is bad policy, it is wrong, and it compounds the budget disaster that our country currently faces."

The major provisions of the bill, formally called the Economic Growth and Tax Reform Reconciliation Act (EGTRRA), all set to sunset after December 31, 2010 include:

♦ The new 10 percent individual income tax bracket;

♦ A phased-in reduction of the other individual income tax rates over the next five years;

♦ A phased-in increase in the Child Tax Credit from $500 per child to $1,000 per child in 2010; and

♦ Marriage penalty relief phased in primarily between 2004 and 2010.

All of these provisions affect average American families. In fact, if Congress and the President do not act to make the provisions of EGTRRA permanent, a typical family of four earning the median family income can expect its federal income tax bill to increase by $2,681 between 2010 and 2011, a 48.8 percent increase (see table). Families with more than two children will experience an even greater increase in their taxes between 2010 and 2011.

The effective federal income tax rate for a typical family of four with an income of $64,033 in 2001 (the median income for families of four) was 8.6 percent. (The effective rate is simply total federal income taxes paid divided by income.) Because many of the major provisions of EGTRRA phase in over the next 10 years, the effective federal income tax rate for this typical family will continue to fall, reaching a low of 6.9 percent in 2010. But when EGTRRA expires at the end of that year, the family's effective rate will jump to 10 percent in 2011, even higher than it was in 2001.

State-by-State Figures

Because median family income varies from state to state, the sunset hits some states harder. Measured as a percentage of federal income taxes due, the tax bill of a typical family of four in Arkansas will jump 102 percent between 2010 and 2011. Five other relatively poor states will be especially hard hit, as families of four in Louisiana, Mississippi, Montana, New Mexico, and West Virginia all see their federal income taxes rise more than 80 percent between 2010 and 2011.

How a Typical Family of Four's Taxes Will Change When the 2001 Tax Cut Sunsets After 2010

				2001–2010		2010–2011	
	2001	2010	2011	Absolute Change	Percentage Change	Absolute Change	Percentage Change
Adjusted gross income	$64,033	$79,422	$81,407	+ $15,389	+ 24.0%	+ $1,986	+ 2.5%
Standard deduction	$7,600	$10,811	$9,210	+ $3,211	+ 42.3%	– $1,602	– 14.8%
total personal exemptions	$11,600	$13,800	$14,000	+ $2,200	+ 19.0%	+ $200	+ 1.4%
Taxable Income	$44,833	$54,810	$58,198	+ $9,978	+ 22.3%	$3,387	+ 6.2%
Tax before credits	$6,725	$7,493	$9,174	+ $768	+ 11.4%	$1,681	+ 22.4%
Total child tax credits	$1,200	$2,000	$1,000	+ $800	+ 66.7%	– $1,000	– 50.0%
Total income taxes due	$5,525	$5,493	$8,174	– $32	– 0.6%	+ $2,681	+ 48.8%
Effective tax rate (total fed. inc. taxes paid divided by inc.)	8.6%	6.9%	10.0%	-1.7%	– 19.8%	3.1%	+ 45.2%

Assumptions: Standard deduction, no childcare credits

Publication Summary

General: Special Report No. 114; ISSN 1527-0408; 4 pp.; $10 or $50/yr. for 6 issues on varied fiscal topics

Title: The Effect of EGTRRA's Sunset on a Typical Family of Four

Author: John S. Barry

Date: May 2002

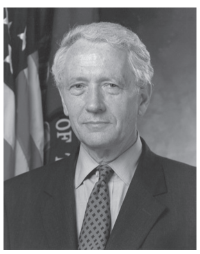
Subject: Shows the effect on a family of four of the planned expiration of the 2001 tax cut on December 31, 2110.

Tables: Income and Taxes of a Typical Family of Four, Selected Years 2001–2011; Income and Taxes of a Typical Family of Four by State, Selected Years 2001–2011

Congressional Leaders Join Deputy Treasury Secretary Dam in Examining Nation's Finances

Baker & Hostetler, PricewaterhouseCoopers, Clark & Bardes, and Tax Foundation Co-Host Tax Policy Conference

On April 17, 2002, Deputy Secretary of the Treasury Kenneth Dam spoke to the Tax Foundation and announced the forthcoming publication of a series of tax simplification proposals from the Treasury Department.



Kenneth Dam Deputy Secretary of the Treasury

He made this announcement at the 13th annual Tax, Budget and Legislative Policy Seminar co-hosted by the Tax Foundation with Baker & Hostetler LLP, PricewaterhouseCoopers LLP, and Clark & Bardes Consulting.

A sophisticated analysis of the nation's regulatory, budgetary, and legislative forces, the seminar annually brings together a line-up of the U.S. Senators and Representatives and Administration officials who will shape federal tax and budget policy in the coming years.

Sober analysis and party slogans were mixed together as the makers of the nation's tax law assessed the legislative agenda and sharpened their rhetoric for the upcoming congressional elections.

Rep. Jennifer Dunn (R-WA) House Ways and Means Committee

Naturally, potshots and appreciations were offered on the subject of last spring's tax relief, as Democrats portrayed federal programs as underfunded due to the tax cut and Republicans attributed the mildness of the recession to prompt action on tax relief.

The Tax Foundation's executive director Scott Hodge spoke early in the program and explained the Foundation's recent calculation of Tax Freedom Day, which illustrates the lower tax burden that Americans now face after the tax cut in 2001, the recession, and 2002's economic stimulus package.

Although Deputy Secretary of the Treasury Kenneth Dam spoke briefly about tax relief and tax law enforcement, he concentrated mostly on the Administration's tax simplification initiatives, which include the ambitious goal of assuring that the average taxpayer does not need professional help to do his return correctly.

Senator Kent Conrad (D-ND) Chairman, Senate Budget Committee

Secretary Dam announced the forthcoming release of a series of simplification proposals intended to achieve a wide range of tax simplification. The first would address the tax treatment of families and children, specifically the uniform definition of a qualifying child, determining taxpayers' filing status, the earned income tax credit, and taxation of dependents.

Speaking from the Democratic side of the Senate Finance Committee, Senators Kent Conrad (D-SD), who is also chairman of the Senate Budget Committee, led the attack on the Administration's Budget in which "the numbers just don't add up."

Senator Don Nickles (R-OK) spoke for the Republican side of the Senate Finance Committee, praising the GOP's initiatives for tax relief and asserting that the President's Budget strikes the right balance between higher spending on defense and homeland security, and holding the line in other areas.

Benjamin Cardin (D-MD), member of the House Ways and Means Committee, spoke at length about pension reform. Cardin was disappointed that the bill he and Rep. Rob Portman (R-OH) had introduced was recently replaced by a bill that "failed to give employees the control they should have over their retirement savings."

Senator Don Nickles (R-OK) Assistant Republican Leader, United States Senate

Later in the afternoon, the bill's co-sponsor Rob Portman (R-OH) pointed out that the final bill did respond to Enron Corp.'s spectacular bankruptcy by prohibiting companies from forcing their employees to invest retirement funds in company stock. It also requires companies to give employees a month's notice before any "blackout" period during which employees are unable to trade among investment options in their retirement plan.

Rep Phil Crane (R-IL) Chairman, Subcommittee on Trade, Ways and Means Committee

Four other Members from the House Ways and Means Committee spoke: Rep. Phil Crane (R-IL), chairman of the Subcommittee on Trade; Rep. Jennifer Dunn (R-WA); Rep. Richard Neal (D-MA); and Rep. Jim McCrery (R-LA), chairman of the Subcommittee on Select Revenue Measures.

Other notable speakers were: Sen. Byron Dorgan (D-ND), chairman of the Senate Democratic Policy Committee; and Rep. Roy Blunt (R-MO), House Chief Deputy Whip.

FOUNDATION MESSAGE

States That Use Tax Hikes to Close Budget Gaps Could Open Employment Gaps

Scott A. Hodge
Executive Director
Tax Foundation

Thanks in large measure to the Bush tax cuts passed last spring and the economic stimulus bill passed just a couple months ago, Americans are enjoying the largest drop in their tax burden in two decades. This year, Tax Freedom Day arrived on April 27, two days earlier than last year and a full four days earlier than 2000, when Tax Freedom Day arrived on May 1 — the latest day ever.

But for millions of taxpayers in more than three dozen states, the gift Washington has given taxpayers may soon be taken away by their own state legislatures. Because of the weakened economy, these state lawmakers are considering a wide array of tax hikes — rather than spending cuts — in order to close budget gaps.

While lawmakers are naturally concerned about the impact of spending cuts on "essential" services, they should be even more concerned about the effects of tax hikes — not only on the performance of their own state's economy, but on the overall economy. Numerous economic studies have demonstrated that states can damage their own economies with high taxes. But we should also not ignore the potential negative impact on the national economy resulting from the cumulative effect of dozens of state tax hikes all in the same year.

The basic lesson of tax policy is as old as Adam Smith: in most every instance, the more a good or service is taxed, the less of it is supplied and demanded. So if lawmakers try to raise more revenue through higher payroll taxes, chances are there will be lower employment. Likewise, an increase in the sales tax will lead to fewer sales, and an increase in taxes on businesses will lead to fewer businesses to employ workers.

But few state lawmakers appear to have learned this simple lesson. Maryland lawmakers, for example, recently increased the state's tobacco tax by 50 percent, to $1.00 per-pack from 66 cents per-pack. Based on what we know from the large number of economic studies of tobacco taxes, the results of Maryland's effort is predictable. First, the burden of these new taxes will fall directly on lower-income individuals because over one-third of tobacco tax revenue is collected from people who earn less than $20,000.

Second, the state will see a rise in the illicit smuggling of cigarettes by criminals and a rise in the number of everyday consumers who will cross into neighboring states with lower tobacco taxes to purchase their cigarettes (Virginia's tax is 2.5 cents per-pack). The result: Maryland will collect far less revenue than their politicians are now predicting even though the same amount of cigarettes will be consumed in the state.

Other states are considering similar hikes in taxes on beer and spirits. Economic studies consistently show that the result of such tax increases are the same as tax hikes on tobacco — increased smuggling, cross-border purchases, a greater tax burden on the poor, and, ultimately, fewer tax collections than predicted.

Given how easily capital and certain firms — such as software designers — can move these days, lawmakers should be very cautious about harming their business climate. Lawmakers in Indiana, for example, are considering an increase in the state's corporate income tax from 7.9 percent to 8.5 percent. Were this to pass the legislature, it would make the state's corporate income tax the highest in the Great Lakes region and place Indiana at a competitive disadvantage in both new business starts and existing business re-location decisions.

Income tax hikes are also looming for taxpayers in many states. Some Indiana lawmakers, for example, have proposed a 0.2 percentage point increase in the individual income tax, while lawmakers in many other states are trying to legislate postponements or repeal of recently passed tax cuts. While some of these increases may appear small, economic studies show that any increase in personal income taxes will mean slower growth in personal income, employment, and small business creation.

Several states are considering keeping their estate and gift taxes even as the federal "death tax" is phased out. Needless to say, these states risk losing their wealthy residents to states without a death tax.

Many states are also considering "decoupling" their state tax rules from the changes passed recently in the federal tax code. For example, lawmakers in Illinois are on the verge of decoupling the state from the new accelerated business depreciation component of the 2002 stimulus package. The federal provision is designed to boost the economy by encouraging businesses to invest in new plant and equipment. It allows them to write off 30 percent of the cost of new equipment purchases within the first year. Given the potential benefit to a state's economy, it is hard to imagine a more self-destructive measure than to disallow this federal expensing provision at the state level.

While many states will succeed in closing their budget deficits through a variety of tax increases, the victory will be Pyrrhic. The economic evidence is very clear that these tax increases will hurt their economies, lower incomes, and slow business creation as economic activity moves to low-tax locations. This seems like a high price to pay to avoid making tough choices on state spending.

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To commemorate our 65th Anniversary, we are using this page during 2002 to remind our readers of Tax Foundation highlights from years past. The chronology below was assembled for our 25th anniversary in 1962.

1937 Tax Foundation established in December by small group of business leaders called together by Alfred P. Sloan, Jr.

1939 Citizens Public Expenditure Survey of New York established, the first of 16 new state taxpayer groups organized by the Tax Foundation.

1940 Public Finance Fellowships established at New York University. First edition of *Facts and Figures on Government Finance*.

1943 First in series of 24 studies on state-local spending, taxes, and debt issued.

1944 Nine-year joint program with Governmental Research Association begun.

1945 Published "A Tax Program for a Solvent America," from the Committee on Post-war Tax Policy, chaired by Roswell Magill.

1947 House Ways and Means Committee appoints Special Tax Study Committee, chaired by Roswell Magill and including John Hanes, newly elected TF President.

1948 National Conference of State Taxpayer Executives organized.

1949 Herbert J. Miller, new Executive Director, loaned to Hoover Commission as Research Director. TF organizes Citizens Committee for the Hoover Report and 34 state committees.

1954 Magill Committee on Federal Tax Policy issues new study "Federal Finances," coinciding with first major revision of Internal Revenue Code in 50 years.

1957 Roswell Magill succeeds John Hanes as Chairman of the Tax Foundation.

1962 110th research study, "Growth of Federal Domestic Spending Programs, 1947–1963, published.

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