TAX FOUNDATION

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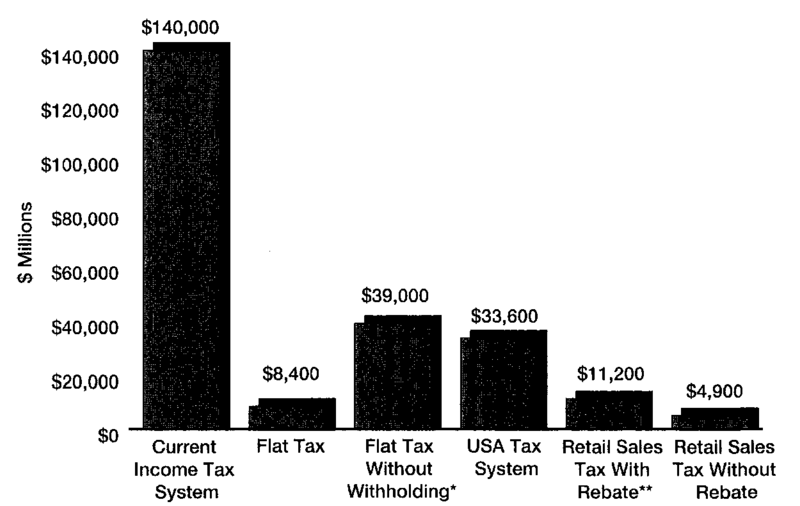
Alternative Tax Plans Would Cut Compliance Costs

Ways & Means Testimony Puts Dollar Figure on Savings

In testimony before the House Ways & Means Committee June 6, Tax Foundation Senior Economist Arthur P. Hall estimated that any of the three predominant alternative tax plans being discussed on Capitol Hill could dramatically reduce America's tax-related compliance burden, without necessarily sacrificing a dime of federal tax revenue.

Chart 1: Estimated Total Cost of Compliance for Current and Alternative Tax Systems



* Rep. Dick Armey has proposed eliminating withholding with passage of his flat tax.
** Proponents of a national sales tax have proposed rebates to offset effects of regressivity.
Source: Tax Foundation.

Dr. Hall's analysis shows that complying with the entire federal tax system—which he likens to a surcharge on all taxpayers— costs Americans $200 billion annually, $140 billion of which is attributed to the rules and regulations for the federal income tax alone (see Chart 1). In his testimony, Dr. Hall noted one way to comprehend the magnitude and economic waste of those costs: "Imagine putting every vehicle sold by General Motors in 1994 onto ships and dumping them into the ocean."

In comparison, he calculates that Rep. Richard Armey's (R-Texas) flat tax proposal could reduce the costs by 94 percent to $8.4 billion, assuming that the current convention of annual tax filing is retained. However, if Rep. Armey achieves his stated goal of eliminating individual income tax withholding and moving to monthly tax payments, the flat tax would reduce the cost by 72 percent to $38 billion.

A second alternative plan, Senator Sam Nunn (D-Ga.) and Senator Pete Domenici's (R-N.M.) Unlimited Savings Allowance (USA) Tax System, could reduce the surcharge by 76 percent to $33.6 billion, according to Dr. Hall. And a third alternative, in the form of a national retail sales tax, could reduce costs by 92 percent to $11.2 billion, assuming the sales tax plan included a per-person rebate scheme to instill progressivity. If no rebate scheme were

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State Tax Receipts Continue Rise

State tax and fee collections grew by 8.3 percent between 1993 and 1994, according to a new *Special Report* by Senior Economist Arthur Hall, titled "State Tax Rates and 1994 Collections." The growth in inflation-adjusted tax collections continues a trend that began more than a decade ago. In the report, Dr. Hall notes that the three fastest growing categories of state collections were license fees (33.1 percent), property taxes (10.6 percent), and corporate income taxes (9.9 percent).

The growth rate of state tax collections relative to personal income growth varies substantially from state to state, observed Dr. Hall. From 1993 to 1994, the five states that had the highest tax growth relative to personal income growth were New Hampshire, South Dakota, Delaware, Utah, and Mississippi. The five states that had the highest personal income growth relative to tax growth were Alaska, Rhode Island, Louisiana, Pennsylvania, and Vermont.

Alaska had the highest state taxes per capita ($2,647), followed by Hawaii, Delaware and Connecticut (see accompanying table). Alaska also had the highest state taxes per $1,000 of personal income ($111.23), followed by New Mexico, Hawaii, and Delaware.

Many states enacted legislation for 1995 that alters individual income tax laws via changes in deductions, exemptions, and tax credits. However, five states changed (reduced) their income tax rates: Arizona, Michigan, New Jersey, New Mexico, and New York. Five states also changed (reduced) their corporate income tax rate: Arizona, Michigan, New Jersey, New York, and Pennsylvania.

In the report, Dr. Hall lists the current personal and corporate business tax rates, sales tax rates, gasoline tax rates, cigarette tax rates, and tax rates on liquor, wine, and beer by state. •

State by State Tax Collections, Per Capita and Per $1,000

State	Per Capita	Per Capita Rank	Per $1,000 Personal Income	Per $1,000 Personal Income Rank
AL	$1,153	47	$64	35
AK	2,647	2	111	2
AZ	1,491	21	78	13
AR	1,266	39	75	19
CA	1,660	13	74	23
CO	1,111	48	50	51
CT	2,190	5	74	21
DE	2,312	4	101	5
DC	4,420	1	142	1
FL	1,278	37	59	42
GA	1,243	40	61	39
HI	2,464	3	102	4
ID	1,526	18	84	6
IL	1,344	33	57	45
IN	1,376	29	68	30
IA	1,538	17	76	18
KS	1,395	28	67	32
KY	1,420	26	80	11
LA	970	51	55	48
ME	1,453	22	74	22
MD	1,588	16	64	37
MA	1,835	8	72	26
MI	1,610	15	72	25
MN	1,872	6	83	7
MS	1,314	36	83	8
MO	1,199	44	58	43
MT	1,356	32	76	17
NE	1,317	34	64	34
NV	1,680	12	70	27
NH	1,225	43	52	50
NJ	1,743	10	62	38
NM	1,849	7	108	3
NY	1,803	9	69	29
NC	1,516	19	77	15
ND	1,443	23	78	14
OH	1,277	38	61	40
OK	1,365	30	77	16
OR	1,314	35	64	33
PA	1,429	24	64	36
RI	1,236	41	56	46
SC	1,234	42	70	28
SD	1,162	46	59	41
TN	1,105	49	57	44
TX	1,103	50	56	47
UT	1,406	27	82	10
VT	1,362	31	67	31
VA	1,189	45	53	49
WA	1,694	11	75	20
WV	1,426	25	83	9
WI	1,658	14	79	12
WY	1,495	20	73	24
US	$1,469		$67	

Source: Tax Foundation

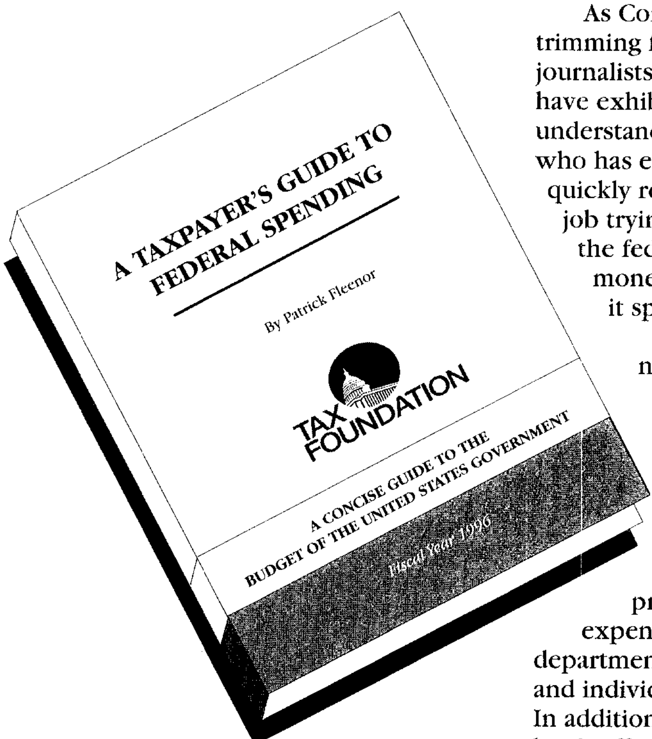
Who Claims Mortgage Interest Deductions?

A contentious issue in the tax reform debate will be whether to keep the mortgage interest deduction. Senior Economist Arthur Hall developed the table below, which offers an estimated breakdown by income group of who will claim the deduction in 1995 and the average size of that deduction. For example, over 7.6 million taxpayers with incomes between $50,000 and $75,000 will claim the deduction this year. That figure represents about 69 percent of the total number of taxpayers for that particular income group. The deduction will reduce this group's taxable income by an estimated $64.4 billion, or an average of $8,389 per taxpayer/homeowner within the group.

Income (AGI) Group	Est. No. of Taxpayers Claiming Deduction	Est. Share of Taxpayers Claiming Deduction	Est. Total Amount of Deduction ($Thousands)	Est. Avg. Deduction per Claim
Under $10,000	460,464	1.38%	$3,108,747	$6,751
$10,000 under $20,000	1,728,934	6.56	10,883,926	6,295
$20,000 under $30,000	3,297,731	18.52	20,149,155	6,110
$30,000 under $40,000	4,419,847	35.10	29,340,151	6,638
$40,000 under $50,000	4,652,321	51.70	33,570,993	7,216
$50,000 under $75,000	7,673,964	69.40	64,376,528	8,389
$75,000 under $100,000	2,684,288	79.14	29,772,648	11,091
$100,000 under $200,000	1,888,855	78.62	30,118,974	15,946
$200,000 under $500,000	506,269	76.44	12,259,783	24,216
$500,000 or More	124,433	67.98	4,543,593	36,514
Total	27,437,105	23.50	238,124,499	$8,679

Source: Tax Foundation.

New Book Simplifies Presentation of Federal Budget



As Congress begins the process of trimming federal spending this year, journalists and many policy makers have exhibited a growing interest in understanding the budget. As anyone who has examined the federal budget quickly realizes, it's a tedious, vexing job trying to determine exactly where the federal government spends money and exactly how much it spends.

The Tax Foundation has now made the job easier with the publication of a new book, *A Taxpayer's Guide to Federal Spending*. Economist Patrick Fleenor has distilled the federal budget into a working document, with FY 1996's projected $1.61 trillion in expenditures organized by department, agency, program area, and individual expenditure account. In addition, pie charts throughout the book offer a concise picture of how each department divides its budget among component agencies and major program areas.

Mr. Fleenor's presentation makes reading and understanding the budget a lot easier for those who find the Office of Management and Budget's traditional presentation hard to comprehend. For example, if readers are interested in finding out where the Department of Defense ranks in terms of overall federal spending, they could simply flip to the opening chapter of the book and examine the initial pie chart. To determine where the Treasury Department spends its money, a reader can turn to the opening page of that department's chapter, where he would find that outlays on interest payments on the national debt comprise 90.3 percent of Treasury's total spending.

Similarly, if readers want to quickly ascertain the impact of eliminating the Department of Commerce, a quick look at the pie charts would tell them that the department spends less than one percent of total net outlays — and that 70.9 percent of this spending funds science and technology projects.

The book, 8-1/2" X 11", softbound, with 326 pages, is available to the public for $45. •

Compliance Costs

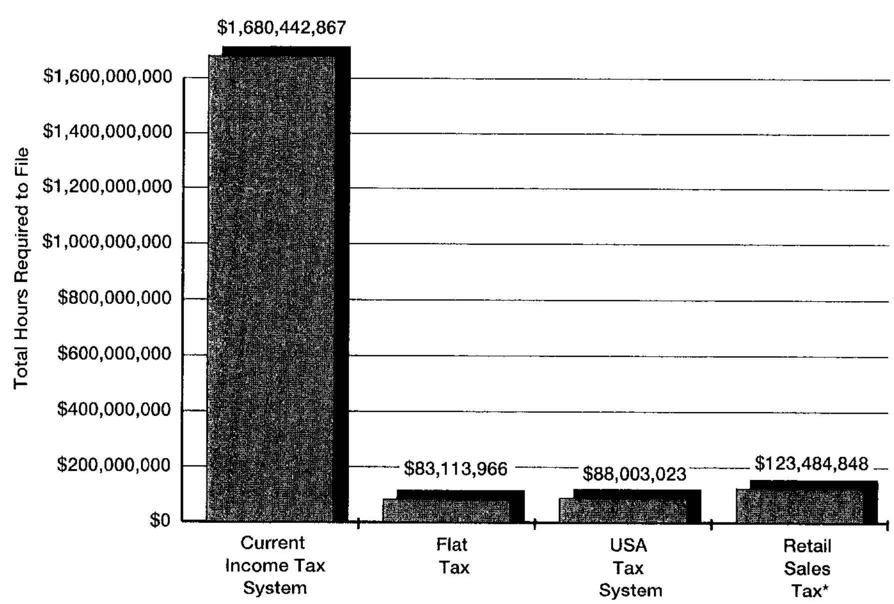
Continued from page 1

part of the retail sales tax, Dr. Hall says the plan could reduce the surcharge by an estimated 96.5 percent to $4.9 billion—but the entire burden of compliance would fall on retail businesses.

The inherent complexity of an income tax base bears most predominantly on the income taxation of commercial activity, observed Dr. Hall. In fact, compliance costs for American businesses in recent years have amounted to three-fourths of their income taxes. That means in 1991, while businesses paid approximately $110 billion in income taxes, they had to spend some $81 billion just to comply with the tax laws.

As Chart 2 clearly shows, businesses could see a significant lowering of the number of hours spent complying with the federal tax code if any of the alternative tax systems are adopted. •

Chart 2: Estimated Total Business Hours Spent Complying with Alternative Tax Systems



*Includes a per-person rebate scheme.
Source: Tax Foundation, using Internal Revenue Service data and estimation methods.

Balancing the Budget: Revolution or Common Sense?

Rep. John R. Kasich
(R-Ohio)

In 1969 man walked on the moon for the first time and Congress balanced the budget for the last time. For 26 years our revolutionary space program has prospered while common sense budgeting has been forsaken.

Today we're trying to balance the federal budget and modern day revolutionaries we've become. Inside the Washington Beltway, that is. Our allies say we're revolutionaries because of the boldness and scope of our undertaking. Our foes accuse us of fomenting a revolution of apocalyptic proportion.

For those millions of families who gather around kitchen tables to figure out how to make ends meet each month, the word revolution doesn't enter the discussion; a better word is reality.

To families around the country, though, balancing the budget isn't revolution, it's common sense and the moral thing to do. Their message to Congress is simple: If we can live within our means, so can you. Just do the right thing and preserve the future for our children and grandchildren.

Since when is it revolutionary to take power, money, and influence from the federal government and return it to the states and the people?

Since when is it revolutionary to slow the rate of growth of government spending, such that we'll spend $11.9 trillion over the next seven years rather than $13.3 trillion and still balance the budget?

Since when is it revolutionary to save Medicare from going bankrupt in seven years?

Since when is it revolutionary to cut needless bureaucracy, reestablish spending priorities, reform ineffective welfare programs, attack corporate subsidies, and cut foreign aid?

And since when is it revolutionary to preserve the American dream of leaving our children a world better than we found it?

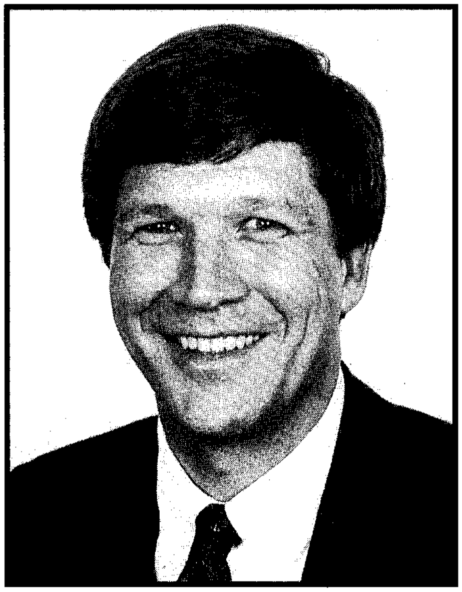
Only in Washington. Where common sense takes a back seat to protecting the status quo.

For those millions of families who gather around kitchen tables to figure out how to make ends meet each month, the word revolution doesn't enter the discussion; a better word is reality. For them deficit spending month after month is not an option. For them the expression "tough choices" has real meaning, as in pick one: braces for the kids' teeth or a family vacation.

It's no wonder people are in awe when they visit Washington for the first time. The conventional wisdom is that it's the beautiful and historic memorials, monuments, and museums alone that catch their eye and spark their interest. Not exactly. It's also the frightening realization that amidst the beauty lies the bureaucracy. That within the huge and numerous buildings work the bureaucrats and politicians who spend their tax dollars, regulate their lives and businesses, and purport to make their lives better, safer, and happier.

I'm reminded of the "Wizard of Oz." Until the curtain is torn away revealing only an insecure little man, the wizard was believed to be an omnipotent and indomitable being. I'm further reminded of a group of my constituents from a Columbus, Ohio, suburb whose recent visit to Washington sums up where we have come and how far we have to go.

My constituents came to tell



me of their opposition to the welfare reform proposal then before Congress. The room we were in had a panoramic view of Washington's federal office buildings. Do you know who works in those buildings, I asked. No, the said. It's the federal bureaucrats who run the programs you are concerned about. Have you ever met any of them? Again, the answer was no. Do you think any of those workers would know where your hometown is? Probably not. Would they even know what time zone Ohio is in? Unlikely.

So, I said, what makes you think these people in Washington, who you've never met, who don't know anything about your home town, and probably don't know what time zone you live in, can do a better job of solving our problems than we can back home?

My constituents discussed it among themselves and soon departed, saying they would reevaluate their position. What other response could they have had? The curtain had been torn away revealing well-intentioned but ineffective bureaucrats. There really is no place like home when it comes to accepting responsibility and solving problems.

Congress is currently putting the finishing touches on the fiscal year 1996 budget, a seven-year plan that balances the budget by 2002. The House-passed budget is an honest plan that shows in candid detail the types of changes and sacrifices we would all have to make in order to slow the rate of growth of government spending and bring it in line with growing revenues.

But the determined pursuit of a balanced budget is much more than a numbers game. It's a catalyst for reevaluating the government down to its core. Getting government back to living within its means will require fundamental, systemic reform, including the following steps:

Provide Tax Relief—Our plan provides for a $500 per child tax credit, 74 percent of which goes to families earning less than $75,000 per year. We also would reduce the capital gains tax rate, which will promote economic growth and create jobs.

Attack Corporate Subsidies—Our plan terminates billions in federal grants to many of the nation's largest corporations.

Save Medicare—The Medicare Part A Trust Fund is projected to be completely broke in seven years. The Part B Trust Fund already draws tens of billions from the general revenue each year just to stay afloat. To save Medicare it must be transformed and its rate of growth must be slowed from the current 10 percent to around seven percent. Our plan provides three illustrative paths for saving Medicare.

Eliminate Needless Bureaucracy—Our plan calls for the elimination of three cabinet-level departments (Commerce, Education, and Energy), and the elimination or privatization of 13 agencies, 69 commissions, and 284 programs.

Cut Foreign Aid—Many foreign aid programs are wasteful and counterproductive. Reforming them will save taxpayers billions of dollars.

Reform Welfare—The current welfare system hurts the people it is supposed to help. It shackles them to a life of dependency rather than pushing them toward self-sufficiency. Our plan incorporates the Personal Responsibility Act of 1995, which the House passed as part of the Contract with America. This plan maintains a safety net that will not entangle its beneficiaries. It renews the basic values of American civilization, emphasizing work, family, and opportunity.

Strengthen National Defense—The defense strategy reflected in ourbudget is responsible, sustainable, and matched by the requisite number of dollars—in contrast to the mismatch between spending and strategy reflected in the Clinton budget.

Protect Social Security—As we promised, this budget makes no changes in Social Security benefits, and it repeals the increased taxes on Social Security benefits imposed as part of the 1993 Clinton tax plan.

It's time to balance the federal budget. It's no longer a question of if, but how. We've laid an honest, fair plan that requires everyone in this country to step up to the plate and be a part of the solution. Our plan pushes back the pendulum, which has swung too far in favor of big government at the expense of the everyday person and the American family. To ensure the future of this country and the prosperity of the next generation, we must act now. The window of opportunity before us won't last forever.

Hardly a revolution. Just common sense. •

The views expressed in Front & Center are not necessarily those of the Tax Foundation.

Foundation Analysis Examines Middle-Class Family

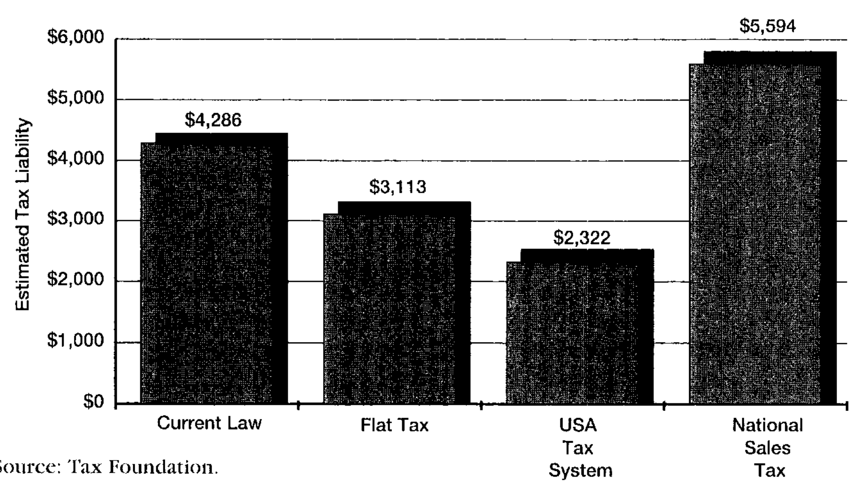
How Would Tax Reform Affect the Jones Family?

With the push for tax reform gaining momentum on Capitol Hill, what's the bottom line for American taxpayers? To illustrate the different tax rules and effects for individuals under the alternative plans, Tax Foundation Senior Economist Arthur Hall assisted the Cable News Network (CNN) in calculating a specially selected Tennessee family's tax burden under three major reform plans, comparing these burdens with the burdens under the current income tax system. The Tax Foundation has now published its findings in a *Special Report*, "How Will Alternative Tax Reform Plans Affect the Jones Family?" (The Tax Foundation changed their last name in the report to ensure privacy.) The report also provides the fundamental rules of each of the tax reform plans.

The three alternative tax reform plans examined are the flat tax introduced by Rep. Dick Armey (R-Texas) and Sen. Richard Shelby (R-Ala.); the Unlimited Savings Allowance (USA) Tax System sponsored by Senators Pete Domenici (R-N.M.) and Sam Nunn (D-Ga.); and a national retail sales tax advocated by presidential candidate Sen. Richard Lugar (R-Ind.).

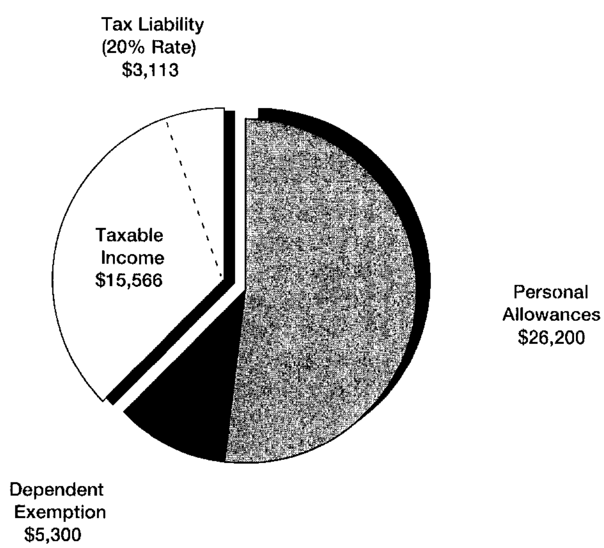
Chart 1 reports the "bottom line" for the Joneses under each tax system. Dr. Hall's analysis showed that, while the Joneses owe $4,286 under the current federal income tax system, the family would have a tax liability of $3,113 under the Armey-Shelby flat tax proposal, at the initial 20 percent tax rate. Under the USA Tax, the Joneses would owe $2,322 at the higher initial tax rates. The national sales tax, set at a 17 percent rate, would result in a tax liability of $5,594. •

Chart 1: Estimated Tax Liabilities for the Joneses Under Current System and Alternative Tax Plans



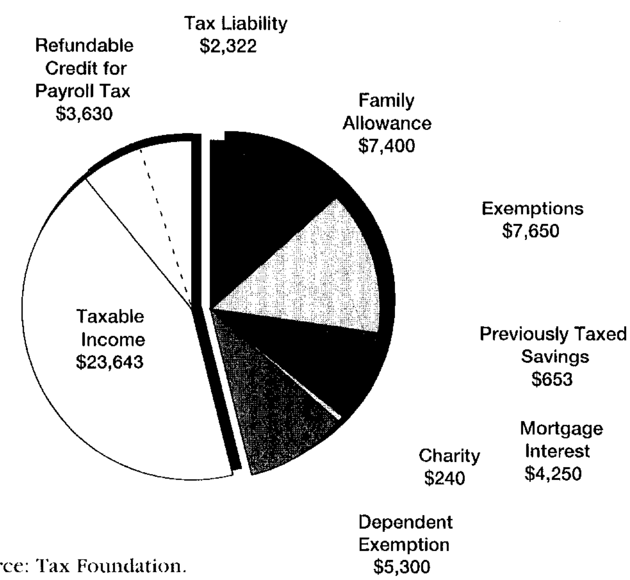
Source: Tax Foundation.

Chart 2: Tax Consequences of Jones Family's $47,066 Income under the Flat Tax



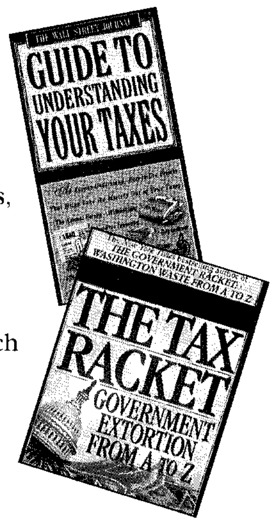
Source: Tax Foundation.

Chart 3: Tax Consequences of Jones Family's $47,066 Income under the USA Tax



Source: Tax Foundation.

Tax Foundation Cited in Newly Published Books



Two tax-related books that hit the book stores in recent months have, to make their points, highlighted Tax Foundation research. Both are primers that undertake to teach Americans about the tax system, though the similarities stop there.

A *Guide to Understanding Your Taxes* is a Wall Street Journal effort published by Lightbulb Press and Dow Jones & Co. Co-authored by Journal reporter Scott R. Schmedel and communication specialists Kenneth M. Morris and Alan M. Siegel, the *Guide* offers an interesting and educational overview of the U.S. tax system—including a historical perspective on taxation, a lesson on filing your taxes, and a discussion about tax planning.

The Tax Foundation's research is highlighted in several sections, including a chart comparing tax burdens in various industrialized nations and another citing Tax Freedom Day data.

Journalist Martin L. Gross's *The Tax Racket: Government Extortion from A to Z* offers a more critical examination of the federal, state, and local tax system in this country. Published by Ballantine Books, Mr. Gross's publication starts with "Airline and Airport Taxes" and cleverly works through the alphabet of taxation. In the process, the author cites Tax Foundation research in such areas as total tax burden and estate taxes, while making a case for reforming the U.S. tax system. Mr. Gross supports replacing the income tax with a national sales tax. •

FOUNDATION MESSAGE

The President Enters the Budget Debate — Finally

In the movie "Top Gun", Tom Cruise plays an F-14 fighter pilot with the call sign "Maverick". At the end of the movie, Maverick has a big problem—he can't "engage." That is, he can't bring himself to enter into a dogfight of Soviet fighters playing live-fire cat and mouse with another American F-14. Finally, Maverick finds the nerve to nose his plane back into the fight.

In a way, that's exactly what President Clinton has done by submitting his own plan to balance the budget. He has gone from recent spectator to participant in the battle for a balanced budget. In choosing to engage, the President must have known he would be sneered at by the congressional budget cutters, who are well into the third quarter of the annual budget cycle, having already done most of the heavy lifting; by submitting a new budget the President has basically completed his pregame warm-ups.

J.D. Foster
Executive Director and Chief Economist

He also knew he would be roundly attacked by members of his own party because he was agreeing to cut the spending programs they fought so hard to create and protect. And, after leading congressional Democrats in saying the Republicans were wrong to try to eliminate the budget deficit, he left them to find their own way when he took the off ramp of the deficit spending highway.

Even a day late and a dollar short, the President showed political courage by submitting a second budget for this year. But the credit is tempered by the fact that he had no choice.

The President submitted a budget at the start of the year showing large and growing deficits. He and his staff spent the following months saying the Republicans couldn't reach a balanced budget and, when they reported out two such budgets, he said they shouldn't have tried. Essentially, the President had backed himself into the untenable position of actively supporting permanent deficit spending. He had to get out of this trap and the only way to do this was to submit a budget showing a balance at some future date. Had he stood pat with his February budget, he would truly have been a spectator to the debate, with only his veto pen to assure a modest dose of relevance.

But the price of relevance was steep. By submitting his new budget, the President has affirmed that the deficit hawks of both parties have been right all along. Whatever the short-term political considerations, fiscally the President did the right thing. There is now all the more reason to hope that chronic deficit spending will soon be an extinct species of fiscal policy.

There remains, however, the little matter of tax cuts. By submitting his new budget, the President has also gained a say about the direction of tax policy, and here he is on much surer footing because tax cuts must be fully paid for. There in lies true leverage that he can now apply having bought a seat at the table.

When it comes to cutting taxes, the basic fight is and has been two-dimensional. First, should tax cuts be targeted to economic, rather than social, policy? Second, what is the distribution of the tax relief? In both, the political lines are wavy, which gives the President maneuvering room. As we get into autumn, the issue will be the tax cuts, not whether the budget should be balanced in seven or 10 years. And the President will be a party to the tax debate.

In "Top Gun," Maverick is able to dispatch the offending Soviet Migs, save his plane, and return to his carrier a hero. It's unlikely the President will come out of this fight a hero, but he has at least given himself a chance to fight another day.

U.S. Tax Collections Soar to $2.183 Trillion

Governments Will Collect $21,760 for Every Household

TAX FEATURES

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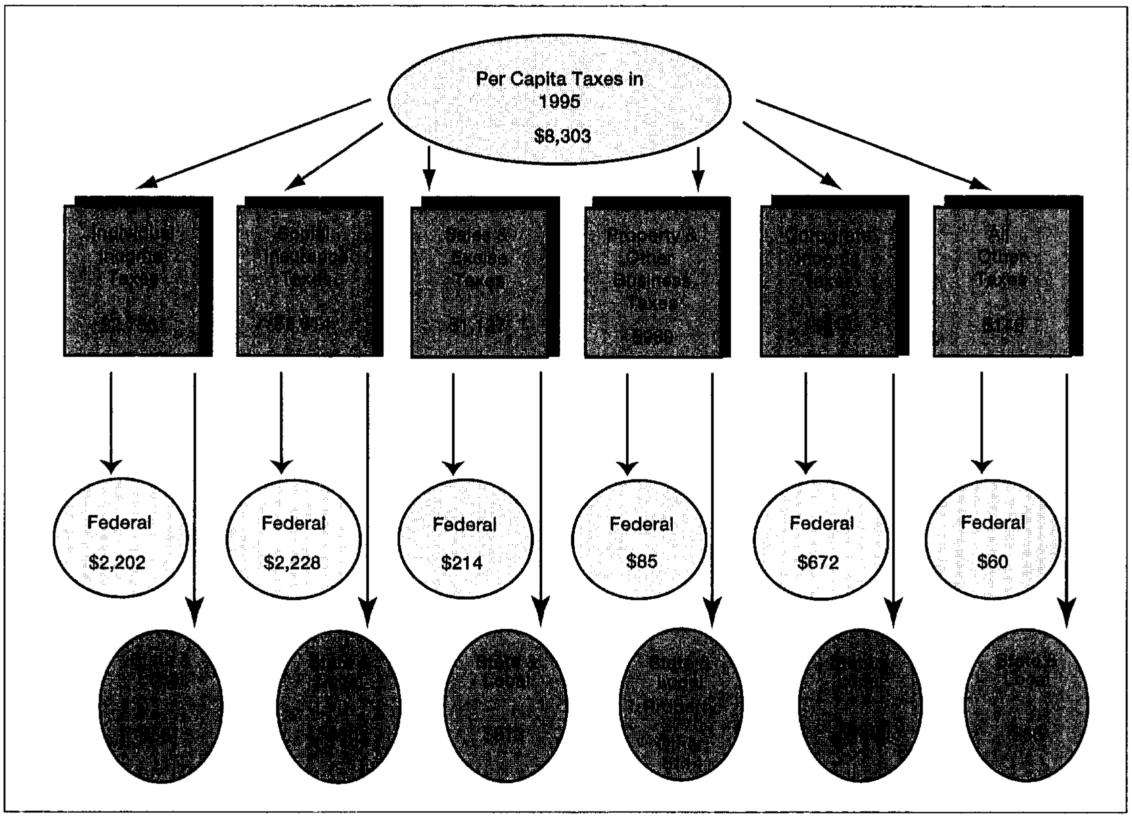
Total tax collections in the U.S. are expected to equal $2.183 trillion in 1995, according to an analysis by the Tax Foundation. That represents a 5.7 percent increase over 1994 total tax collections and a 31 percent rise over the 1990 level.

To put this figure into perspective, federal, state, and local governments will collect an average of $8,303 for every American, or $21,760 in taxes for every household.

The analysis by Foundation Economist Patrick Fleenor showed that the federal government is expected to collect 66 percent of this total, or $1,436 billion. State and local governments will collect another $747 billion.

The accompanying chart illustrates that these funds stem from a variety of sources. The two levies extracted from Americans' paychecks, individual income taxes and social insurance taxes, are the two largest sources of revenue. Individual income taxes will represent a third of all tax receipts, or $719 billion. •



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