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In OECD Comparison of Wage Taxes, U.S. Ranking Would Slip Badly if 2001 Tax Cuts Expired

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I. Introduction

When U.S. lawmakers enacted personal income tax cuts across the board in 2001, they were part of a larger, worldwide tax-cutting trend that continues to the present. Last year, Iceland instituted an individual flat tax of 23.75 percent of income, which will fall to 22.75 percent this year.[1] In August of this year, lawmakers in the Czech Republic will vote on a plan that will swap the current income tax system, with rates ranging from 12 to 32 percent, in favor of a system that taxes income at a single rate of 15 percent.[2]

Tax rate information is most current and available for the 30 nations that form the Organization for Economic Cooperation and Development (OECD), which includes most of the United States' major economic competitors. The tax-cutting trend in these nations has mostly kept pace with the Bush tax-cutting pace here. Thus, while the U.S. has improved its competitive position on wage taxes between 2000 and 2006, other countries are improving their rankings as well.

If the Congress now imposes a surtax on wages above a certain amount—$100,000 in some plans—as part of an AMT fix, and then in four years, the 2001 rate cuts are allowed to expire, the U.S. will jump considerably in the rankings among OECD nations, erasing all positive movement in those rankings since 2000 and leaving us worse off than we were before the 2001 tax cuts. This will certainly harm the competitiveness of American businesses in the international marketplace.

II. A Comparison of Top Marginal Combined Individual Income Tax Rates in the OECD

Table 1 shows the top marginal combined individual income tax rates for all 30 countries in the OECD in 2006 and 2000. The rates in 2006 ranged from a high of 59.74 percent in Denmark to a low of 19 percent in the Slovak Republic. The average top rate in 2006 was 42.95 percent, with seventeen countries levying rates lower than average and thirteen countries levying rates higher than average.

Table 1
Top Marginal Combined Individual Income Tax Rates in the OECD
2000 and 2006

Country	Top Combined Marginal Individual Income Tax Rate in 2000[a]	Rank	Top Combined Marginal Individual Income Tax Rate in 2006[a]	Rank	Percentage Reduction in Marginal Rate (2000-2006)
Denmark	59.70%	3	59.74%	1	0.06%
Sweden	55.38%	4	56.60%	2	2.20%
France	53.25%	6	55.85%	3	4.88%
Belgium	63.90%	1	53.50%	4	-16.27%
Netherlands	60.00%	2	52.00%	5	-13.33%
Finland	48.67%	8	50.90%	6	4.58%
Austria	45.00%	17	50.00%	7	11.11%
Japan	50.00%	7	50.00%	7	0.00%
Australia	48.50%	9	48.50%	9	0.00%
Canada	46.41%	13	46.41%	10	0.00%
Germany	53.81%	5	45.37%	11	-15.67%
Spain	48.00%	10	45.00%	12	-6.25%
Italy	46.40%	14	44.10%	13	-4.96%
Switzerland	43.23%	21	42.06%	14	-2.71%
Portugal	35.00%	28	42.00%	15	20.00%
Ireland	44.00%	20	42.00%	16	-4.55%
Poland	40.00%	23	40.00%	17	0.00%
Greece	45.00%	18	40.00%	18	-11.11%
United Kingdom	40.00%	24	40.00%	19	0.00%
Norway	47.50%	11	40.00%	20	-15.79%
United States[b]	46.09%	15	39.76%	21	-13.74%
New Zealand	39.00%	26	39.00%	22	0.00%
Luxembourg	47.15%	12	38.95%	23	-17.39%
Korea	44.00%	19	38.50%	24	-12.50%
Iceland	45.37%	16	36.72%	25	-19.07%
Hungary	40.00%	25	36.00%	26	-10.00%
Turkey	35.60%	27	35.60%	27	0.00%
Czech Republic	32.00%	30	32.00%	28	0.00%
Mexico	40.00%	22	29.00%	29	-27.50%
Slovak Republic	35.00%	29	19.00%	30	-45.71%
Average	**45.93%**		**42.95%**		**-6.46%**

a) From OECD, Table I.4, "Top marginal personal income tax rates for employees"
b) Since a combined federal and state rate is presented, the U.S. rate is adjusted to account for the deductibility of state and local taxes. The U.S. is the only OECD country that allows the state

and local tax deduction. In 2000, we assume that 80 percent of the state and local tax deduction was clawed back by Pease. In 2006, we assume that less than 20 percent of the state and local tax deduction was clawed back by Pease.
Source: Tax Foundation calculations based on statistics from the OECD

Since 2000, more than half the countries in the OECD have lowered their top marginal rates, reducing the OECD average rate from 45.93 to 42.95 percent. The biggest movers in either direction between 2000 and 2006 were Portugal, which jumped thirteen places after increasing its top rate by 20 percent, and Luxembourg, which dropped eleven places after cutting its top rate by over 17 percent.

The U.S. reduced its top rate by over 13 percent between 2000 and 2006, dropping it from 15th to 21st in the rankings. If no other country had reduced its tax rates, the U.S. would stand at 26th highest, but the strong tax-cutting trend in other OECD countries blunted the impact of the 2001 rate cuts.

III. Future Movement in the U.S.'s Ranking and the Economic Consequences
With lawmakers in the House and Senate approving budget resolutions that assume the expiration of the 2001 tax increases in 2011,[3] and others talking about surtaxes for wealthy taxpayers as part of AMT reform,[4] it is useful for lawmakers to consider the international ramifications. The rest of the world is still cutting rates while we anticipate tax hikes.

Full repeal of the 2001 rate cuts after a surcharge to fix AMT would move the U.S. from 21st to 9th highest in the rankings (see Table 2), and that assumes the tax cutting abroad comes to a halt. A repeal of the 2001 tax cuts with no AMT surcharge would move the U.S. to 11th highest, while an AMT surcharge alone would move the U.S. to 14th highest. In all three cases, the U.S. would rank higher than it did in 2000 (15th), before the passage of the 2001 tax cuts.

Table 2
Repeal of 2001 Tax Cuts and AMT Fix Could Give U.S. 9th Highest Individual Income Tax Rate in OECD

Policy Change	Top Marginal Combined Rate[a]	OECD Ranking	Change in Ranking
None (keep current system)	39.16%	21	n/a
Repeal of 2001 Tax Cuts[b]	45.49%	11	+10
4% Surcharge on Top Rate to Fix AMT[c]	43.76%	14	+7
Repeal of 2001 Tax Cuts and 4% Surcharge on Top Rate to Fix AMT[d]	49.49%	9	+12

a) Federal rate plus state rate, adjusted for deductibility of state taxes from federal taxes
b) The 2001 tax cuts are repealed on January 1, 2011, restoring the tax rates to pre-2001 level;

furthermore, top-rate taxpayers will only be able to take 20 percent of the state and local tax deduction from 2011 onward. The rate presented takes these factors into account.
c) The 4% surcharge will be levied on adjusted gross income (AGI), which means that it will not be offset by state and local taxes.
d) See notes b and c.
Source: Tax Foundation calculations based on data from the OECD.

The economic consequences of this jump in the rankings will almost certainly be negative, especially when coupled with the fact that the U.S. currently has the second-highest combined corporate income tax rate in the OECD.[5] A high individual income tax rate will stunt our economic growth by increasing the cost of employing labor in the U.S., impeding entrepreneurship and innovation,[6] and harming the international competitiveness of many small and medium-sized U.S. businesses. These firms are organized not as large publicly held corporations but as S-Corps, Limited Liability Corporations and other forms that pay tax through the individual income tax system. These higher business taxes will ultimately reduce their return on investment, lower the wages of their U.S. workers and increase the prices of their products.

IV. Conclusion
The 2001 tax cuts that lowered U.S. individual income tax rates were part of the broader tax-cutting trends in the OECD from 2000 to 2006, and they succeeded in dropping the U.S. from 15th to 21st in the OECD rankings on marginal income tax rates. If lawmakers in Congress impose a surcharge as part of AMT reform and allow the 2001 tax cuts to expire, the U.S. will jump to 9th in the rankings. This will not only reverse the positive economic benefits from the 2001 tax rate reductions but will also harm the international competitiveness of our individual income tax system.

Notes

1. *See* Iceland Ministry of Finance, "Principal tax rates 2006," located at http://eng.fjarmalaraduneyti.is/media/Taxes/Principal_tax_rates_2006.pdf.

2. *See* "Report: Czech Gov't to Propose Flat Tax," *International Business Times* (March 26, 2007), located at http://www.ibtimes.com/articles/20070326/czech-tax-reform.htm; "Thousands of Czech Labor Union Members Protest Proposed Tax Reform, Cuts in Welfare Spending," *International Herald Tribune-Europe* (June 23, 2007), located at http://www.iht.com/articles/ap/2007/06/23/europe/EU-GEN-Czech-Labor-Union-Protest.php.

3. *See* Brian Riedl, *Budget Resolution Calls for Massive Tax Hikes and Spending Increases*, Heritage Foundation WebMemo #1460 (May 17, 2007), located at http://www.heritage.org/Research/Budget/wm1460.cfm.

4. *See* Len Burman and Greg Leiserson, *A Simple, Progressive Replacement for the AMT*, Tax Policy Center, located at http://www.taxpolicycenter.org/newsevents/simpletax.cfm.

5. *See* Chris Atkins and Scott Hodge, "U.S. Lagging Behind OECD Corporate Tax Trends," *Tax Foundation Fiscal Fact*, No. 55 (May 2006), located at http://www.taxfoundation.org/publications/show/1466.html.

6. *See* William Gentry and Glenn Hubbard, *'Success Taxes,' Entrepreneurial Entry, and Innovation*, NBER Working Paper No. 10551 (June 2004) (finding that the level of the marginal tax rate has a negative effect in entrepreneurial activity).

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