TaxWatch

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TAX FOUNDATION Since 1937

What Do Corporate Income Taxes Cost American Families?

Ask a typical family about the taxes they pay, and they'll likely focus on America's biggest and most visible taxes: property taxes at home, sales taxes at the store, and income and payroll taxes deducted from their paychecks at work.

One tax they're likely to ignore is the corporate income tax. And the reason is simple: most who pay corporate income taxes aren't even aware that they exist. But although corporate taxes are invisible to the average taxpayer, they quietly tap family pocketbooks for nearly $320 billion per year in the form of higher prices, lower wages and poorer returns on investments.

"Most people think corporate income taxes are paid by wealthy, anonymous companies," said Scott Hodge, President of the Tax Foundation. "But as economists have been teaching for centuries, people bear the burden of corporate taxes, not companies."

Family Burden Tops $2,700

How much do corporate income taxes take from the average family? According to a recent Tax Foundation study, the federal corporate income tax alone collected $320 billion in 2005. That's an average household burden of $2,757 per year—more than the average household spends on restaurant food, gasoline or home electricity in a year.

Your Corporate Tax Bill

American households pay $2,757 on average in corporate income taxes per year. How does that compare to other family expenses?

- Down payment on a 2007 Ford Ranger: $3,070
- **Average household corporate tax burden: $2,757**
- Five-night Royal Carribean cruise for six: $2,394
- One-year supply of gasoline: $2,013
- Four Apple iPhones: $1,596
- 42-inch Panasonic flat screen television: $1,560
- Three Nintendo Wii game systems: $1,500

"Typically, the argument for cutting the U.S. corporate tax rate centers on improving the ability of American companies to compete globally," said Tax Foundation economist Gerald Prante. "While true, those arguments overlook the fact that individual households bear the corporate tax burden, and their pocketbooks will benefit most from reform."

New research from the U.S. Congressional Budget Office shows that in a global economy where capital is highly mobile but workers can't easily

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TaxWatch

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TAX FOUNDATION Since 1937

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Message from the President:

A New Year's Helping of Political Reality

Like most people, I begin the new year full of naïve hope and optimism. I hope that I'll use my new health club membership to shed the extra pounds I gained over the holidays. I'm optimistic that I'll meet even more Tax Foundation supporters this year than last year.

And, most of all, I naïvely hope there will be less "class warfare" rhetoric during the 2008 election season than before.

In my two decades in Washington, I can't remember a time when anti-"rich," anti-business sentiment has been as shrill as today. To listen to presidential candidates, higher taxes on the "rich" will cure everything from global warming to teenage smoking.

Politicians love to demagogue the "rich," as long as they can avoid putting a dollar figure on it. The reason is simple. The minute they define what they mean by "rich," they risk alienating most ordinary American families.

The Washington Post reported on November 26th that frontrunners Sen. Hillary Clinton (D-NY) and Sen. Barack Obama (D-IL) have been sparring over whether to lift the cap on income taxed by federal payroll taxes, which was capped at $97,500 in 2007. According to Sen. Obama, "only 6 percent of Americans make more than $97,000 a year. So 6 percent is not the middle class. It is the upper class."

Unfortunately for Sen. Obama, the *Post* revealed that a New York City firefighter can make more than $86,000 with overtime, and a fire captain can make more than $140,000. Most New York school superintendents make more than $100,000. Oops.

In response, Sen. Clinton disagreed with Sen. Obama, saying "I represent firefighters. I represent school supervisors." She said only households making over $250,000 should be considered "rich."

So who are these "rich" in America today? It turns out the vast majority are hard-working business owners. Tax Foundation research shows about 75 percent of households paying the highest income tax rate have some form of business income. A new study by Peter Merrill, head of the National Economic Consulting Group at PricewaterhouseCoopers, reports that because of the explosion in "pass-through" businesses over the past 20 years, more business income is now being taxed by the individual tax code than under the corporate tax code.

What do these numbers tell us? First, "class warfare" rhetoric is as obsolete as vacuum tubes in televisions. The "rich," as defined by the leading presidential candidates, aren't really rich at all. They're mostly dual-income suburban households comprised of firefighters, principals, bank managers and computer programmers.

Second, as America becomes a nation of entrepreneurs, the current push in Congress to repeal Bush's 2001 and 2003 tax cuts because they "benefit the rich" would result in one of the biggest tax hikes on business ever.

Well, there went my optimism for the year. Forget that gym membership—I think I need a large helping of reality.

Sincerely,

Scott A. Hodge

Some States Win, Lose from Federal Taxing and Spending

A useful way of thinking about federal taxes and spending is as a national give-and-take. Taxpayers pay federal taxes to Washington and receive federal government spending in return.

However, taxpayers in some states receive a lousy return on their tax dollars, while others profit handsomely. The result: widespread redistribution between states through federal fiscal policy.

"All taxpayers know that the federal government uses tax and spending policy to redistribute income from citizens with high incomes to those who make little," said Tax Foundation President Scott A. Hodge. "Americans are less aware of geographically based income redistribution."

According to a new Tax Foundation analysis of the latest tax and spending data from 2005, taxpayers in New Mexico benefited most from the give-and-take with Uncle Sam. They received $2.03 in federal money for every $1.00 they paid in taxes. That's a staggering 103 percent return on investment for each tax dollar paid.

"This first-place finish is nothing new in New Mexico," said the Tax Foundation's William Ahern. "The 'Land of Enchantment' has been perched atop our list of biggest federal beneficiaries for many years."

Other big winners in 2005 were Mississippi ($2.02), Alaska ($1.84), Louisiana ($1.78), and West Virginia ($1.76).

2005's biggest loser was New Jersey, which received 61 cents in outlays per tax dollar. Other low-ranking states included Nevada (65 cents), Connecticut (69 cents), New Hampshire (71 cents), and Minnesota (72 cents).

According to the study, the pattern of winners and losers isn't caused by the political power of Members of Congress. It's caused by the progressive federal income tax.

"The pattern of winners and losers isn't caused by political power. It's caused by the progressive federal income tax."

"Because of the heavy tax burden the income tax places on high-income states, it's almost impossible for them to ever receive as much federal spending as they pay in taxes," said Ahern. "The federal tax code is unlikely to change much, and federal spending is largely on auto-pilot, so high-income 'donor' states are almost certain to keep sending more to Washington than they get in return."

Although taxes are the main culprit, there are clear spending-related causes in some states. For example, the large number of retirees collecting Social Security in Florida increases the flow of federal funds. An even bigger difference is created by the disproportionately large federal grants funneled to Alaska and the District of Columbia. Similarly, Virginia and Maryland benefit from their proximity to the nation's capital in salaried federal employment. Alaska, Hawaii and New Mexico also receive disproportionately large sums in this category.

Fifty Years of Redistribution

The annual study is one of the most famous reports from the Tax Foundation, which has been calculating the figures since the 1950s.

A 1957 report looking only at federal grants-in-aid found similar patterns to today's studies. Low-income states of Mississippi, Arkansas and Oklahoma were the biggest winners then, receiving $3.49, $3.25 and $2.88 per dollar of federal taxes, respectively. The high-income states of Delaware, New Jersey and Connecticut received between $0.41 and $0.45 in spending per dollar of taxes.

"Our studies over the years show that regardless of political party, Congress has always redistributed income between states," said Hodge. "And all signs suggest they will continue to do so."

Read the Tax Foundation's original 1957 study online at www.taxfoundation.org/publications/show/1640.html, or read the new analysis at www.taxfoundation.org/press/show/22659.html.

Celebrating Seventy Years of the Tax Foundation

"Seventy years later, the Tax Foundation stands as a beacon for sound tax policy."

When the Tax Foundation opened its doors in 1937, America faced a bleak future. The nation was mired in the Great Depression, taxes were rising under President Franklin D. Roosevelt, and World War II was brewing on the horizon.

Since then, America's fortunes have changed dramatically. But eleven presidents and 70 years later, the mission of the Tax Foundation remains the same: to educate Americans about sound tax policy and the size of the tax burden at all levels of government.

On November 15th, 2007 nearly 350 supporters and friends of the Tax Foundation gathered for an evening gala in Washington to celebrate the organization's 70th birthday.

As is customary at the Tax Foundation's annual dinner, awards were presented for "distinguished service" to those working for sound tax policy in the public and private sectors.

The 2007 private sector award was shared by Mark L. McConaghy and Bernard (Bob) M. Shapiro of PricewaterhouseCoopers LLP. The public sector award went to Nina Olsen, National Taxpayer Advocate at the IRS.

Below is an excerpt from the public sector award introduction from Scott A. Hodge, President of the Tax Foundation:

"I've often thought that the least represented group in Washington is the American taxpayer. After all, where else in America would you find the Geothermal Tax Group, the American Fly Fishing Trade Association, and the American Sheep Industry Association?

"While there may not be enough watch dogs to monitor how our tax dollars are being spent, there is at least one tenacious individual who is monitoring how we are being taxed and working within the system to make it work better for all taxpayers—especially the little guy.

"Nina Olsen is a self-described 'street lawyer' from Richmond, Virginia. When you talk to people who have worked with or know her, you hear the same accolades over and over: 'She was born to fight for the underdog…'; 'She is never afraid to speak out for the little guy…'; 'Representing disadvantaged taxpayers is her life's calling.'

"Since taking the reigns of the Taxpayer Advocate's Office in January 2001, Nina has transformed the office and molded it to what it is today—a truly independent voice inside the IRS.

"By all accounts, Nina has created a culture within the Advocate's Office in which her staff is trained not to take 'no' for an answer when it comes to protecting taxpayer rights. She gives out bulldog awards to the folks on her staff that show the most tenacity in solving problems.

"But her job is not just to protect the little guy. It is also to identify the systemic problems facing taxpayers and the IRS itself, and make recommendations to Congress on how to fix those problems.

"This may not make her the most popular person within the IRS. But, as the military author Richard Marcinko once said, 'Popularity is not leadership.'

"Tenacity, honesty, passion, and leadership are all the traits that make Nina Olsen such a worthy recipient of this year's Tax Foundation Public Sector Distinguished Service Award."

View photos and more from the 70th anniversary celebration online at www.taxfoundation.org/events/show/55.html.

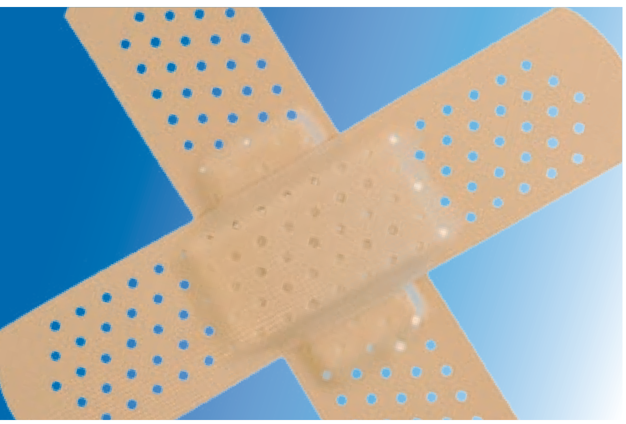
Above: John Samuels (right) congratulates private sector service award winners Bob Shapiro (left) and Mark McConaghy (center).

Left: Tax Foundation President Scott A. Hodge presents the public sector service award to Nina Olsen.

Congress Delays AMT Fix, Offers Temporary Patch

Taxpayers hoping for an end to the unpopular Alternative Minimum Tax (AMT) didn't get their wish last December. However, they'll enjoy a temporary break thanks to a last-minute move by Congress.

With just 12 days left until the new tax year, the U.S. House of Representatives passed a short-term fix for the growing AMT in late December. The legislation, which President Bush indicated he will sign and which has already been approved by the Senate, will prevent any new taxpayers from facing a tax liability under AMT in 2008.



As news of the bill's passage hit the airwaves, Tax Foundation economists were quick to highlight the fact that the AMT crisis shines yet another bright light on the need for fundamental tax reform.

Relief Only Temporary

"Save the newspaper stories written today about AMT, because you'll be able to recycle them next year," said Scott Hodge, President of the Tax Foundation. "Crises like these happen because the tax code is such an unwieldy, uncontrollable mess. Sound tax policy requires these one-year fixes, gimmicks, and patches to end. It's time for a permanent solution—one that takes the best features of AMT and the current tax code and merges them into one simpler and fairer system."

"Good tax reforms always cut rates and broaden bases. AMT reform should do the same."

The AMT bill passed in December was an important step for both taxpayers and the IRS. For taxpayers, it protected millions of new families from being thrust into the AMT and facing markedly higher tax burdens. For the IRS, it will prevent a mad scramble to handle a flood of new AMT tax returns.

Much of the debate over the AMT bill centered on the House Democrats' so-called "pay as you go" or "paygo" rules. Those rules require that every tax cut in Congress be matched by an equivalent cut in government spending, or an increase in a different tax somewhere else. However, the President said that he wouldn't sign any AMT patch bill that included tax increases on American families.

"Budget rules that keep government spending in check are a good idea, but the current 'paygo' rule simply isn't working," said Hodge. "It has bitten Congress and the taxpaying public, forcing a long delay in passage of an AMT patch that will spare taxpayers and the IRS the trouble of dealing with 21 million new AMT forms."

The Tax Foundation has published a range of studies and articles on the AMT in recent years. In 2007, the Tax Foundation released two studies on the AMT, one answering common questions about the AMT and another offering a revenue-neutral solution.

In December, Tax Foundation economist Gerald Prante appeared on C-SPAN's "Washington Journal" to discuss the Tax Foundation's AMT reform plan.

"Most plans to permanently fix AMT focus on raising taxes on high-earners to pay for reform," said Prante. "But instead of raising rates on income we're already taxing, we should start broadening the tax base to include income that's currently tax-free."

"The theme of every sound tax reform is 'broader tax bases, and lower rates,'" said Prante. "AMT reform should do the same."

Read more about the Tax Foundation's research on AMT reform at www.taxfoundation.org/publications/topic/118.html.

Tax Fact:

Annual corporate tax burden per household: $2,757

Annual household spending on gasoline: $2,013

Corporate Tax Burdens (continued from page 1)

> *"Most Americans aren't aware of the hidden burden they pay for business taxes."*

move abroad—a good description of today's economy—workers end up bearing the brunt of corporate taxes. In a 2007 working paper, economist William Randolph found that 70 percent of corporate tax burdens fall on domestic workers, while the remaining 30 percent fall on company shareholders.

"Based on Randolph's findings we measured the burden of corporate income taxes on American households, first according to their incomes and then according to where they live," said Hodge. "The results help put a human face on the debate about whether the U.S. should lower its corporate income tax rate."

Only Payroll Taxes Hit Poor Harder

One of the most surprising findings from the Tax Foundation study is that the lowest-income households bear a large share of the corporate tax burden.

In total, the poorest 20 percent of households pay more in corporate income taxes each year than they pay in individual income taxes to the IRS each April. Households earning under $23,700 in 2004 paid $271 in corporate income taxes, compared to just $171 in individual income taxes.

As a share of their total tax burden, corporate taxes were 6.3 percent of low-income households' tax bills compared to just 4 percent for individual income taxes. The only tax that hits low-income families harder than corporate taxes is the federal payroll tax, which is designed to pay for Social Security and Medicare.

"What this means is that cutting corporate tax rates is not about handing money to U.S. companies," said Hodge. "It is about providing tax relief to American families, much of which will provide enormous benefits to the nation's lowest-income wage earners."

Read the full study, "Personalizing the Corporate Income Tax," online at www.taxfoundation.org/publications/show/22694.html.

Media Impact Report

This winter the Tax Foundation continued shaping the debate over taxes in Washington, D.C. and across the country. Our studies, and the talented team of economists who write them, have been featured in news reports nationwide.

Television: Tax Foundation economist Gerald Prante appeared on C-SPAN's "Washington Journal" to discuss the Tax Foundation's plan to fix growing problems with the Alternative Minimum Tax (AMT). That same week, Prante also appeared on CNBC's "Power Lunch" to discuss AMT legislation in Congress.

Newspapers: Tax Foundation staff authored an average of two op-eds per month in 2007, with placements in top publications such as the *New York Post*, *Providence Journal*, *Boston Herald*, *The Hill*, *State Tax Notes* and many others. In the past quarter, Tax Foundation work has been cited in the nation's five biggest papers, for a circulation reach of over 70 million coast-to-coast.

Website: The Tax Foundation study "Who Pays America's Tax Burden, and Who Gets the Most Government Spending?"—along with the academic study it's based on—was downloaded 90,000 times last year. Our popular booklet Facts & Figures was downloaded 32,000 times. In eight of the twelve months last year, our "Tax Policy Blog" was read by 50,000 visitors.

Learn more about the Tax Foundation's media impact at www.taxfoundation.org/press/.

Tax Fact:

Tax returns affected by the Alternative Minimum Tax in 1970: 19,000

In 2005: 4,045,000

Victory for Taxpayers in Supreme Court Case

Agreeing with a Tax Foundation amicus brief, the U.S. Supreme Court handed an important victory to American taxpayers in December.

In a unanimous 9-0 decision in CSX Transportation, Inc. v. Georgia State Board of Equalization, the court ruled in favor of a railroad seeking to challenge Georgia's property tax assessment methods. Georgia's method led to a 47 percent tax hike on the company's property tax bill in a single year. The Tax Foundation filed a friend-of-the-court brief in July supporting CSX's challenge.

"The ability of taxpayers to challenge flawed property tax assessment methods is important for ensuring transparency and stability in the tax system," said Tax Foundation tax counsel Joseph Henchman. "Discriminatory tax assessment methods cannot be shielded from legal challenge."

Chief Justice John Roberts wrote the court's opinion, which echoed many of the Tax Foundation's arguments.

"The total lack of textual support for Georgia's position is not surprising," the Court's opinion said. "… [D]iscriminatory taxation by States was the very evil the [1976 4-R] Act aimed to ban."

"This decision is a major victory for taxpayers in the courts," said Tax Foundation President Scott Hodge. "We're glad to see the Supreme Court has sided with the arguments we presented in our brief."

Read the press release announcing the Supreme Court's decision online at www.taxfoundation.org/press/show/22793.html.

State Policy Report: Turning Ideas into Good Policy

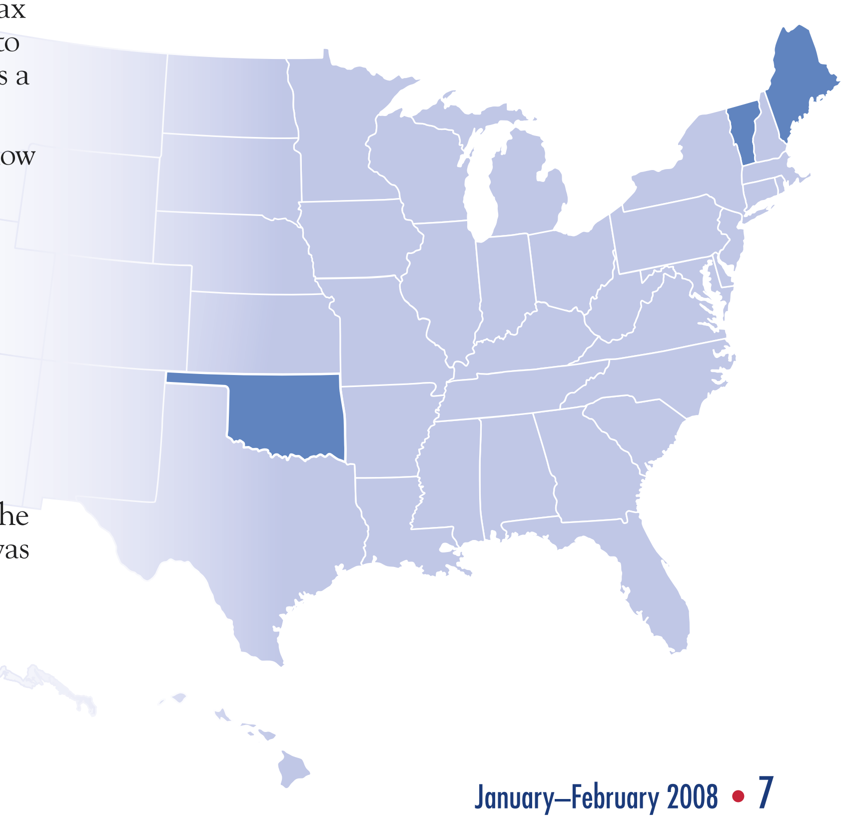
In addition to our publications and media outreach, Tax Foundation economists also work at the ground level to put the theory of sound tax policy into practice. Here's a summary of our recent state-level work:

Maine: The Tax Foundation hosted a panel titled, "How to Impact the Tax Debate in Your State" at the State Policy Network's annual meeting in Portland, Maine. The panel discussed the upcoming legislative season, and presented ideas for making an impact on policy.

Oklahoma: Former Tax Foundation attorney Chris Atkins testified before the Oklahoma House of Representatives Revenue and Taxation Committee on ways to improve the state's tax system.

Vermont: Tax Foundation economist Gerald Prante testified before the Ways and Means Committee in the Vermont State Legislature in December. The topic was property tax reform and alternative ways of funding public schools.

Learn more about the Tax Foundation's state policy work online at www.taxfoundation.org/research/topic/9.html.



Special Free Offer: Why Taxes Matter

As a Tax Foundation supporter you know that taxes matter—for business, personal freedom and the pocketbooks of ordinary families. But explaining *why* taxes matter to friends and colleagues without overwhelming them with information can be difficult.

Why Taxes Matter is a new publication from the Tax Foundation that makes it easy to explain what's wrong with America's tax code—and how to fix it.

This beautifully designed 32-page booklet condenses a decade of Tax Foundation research into a simple story about how taxes affect families, jobs and the future of American prosperity.

And it's **free**. Just visit us online at **www.taxfoundation.org/whytaxesmatter** to download a free copy. Understanding why taxes matter has never been easier!

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