Tax Watch

Spring 2005

TAX FOUNDATION
Since 1937

America Celebrates Tax Freedom Day®

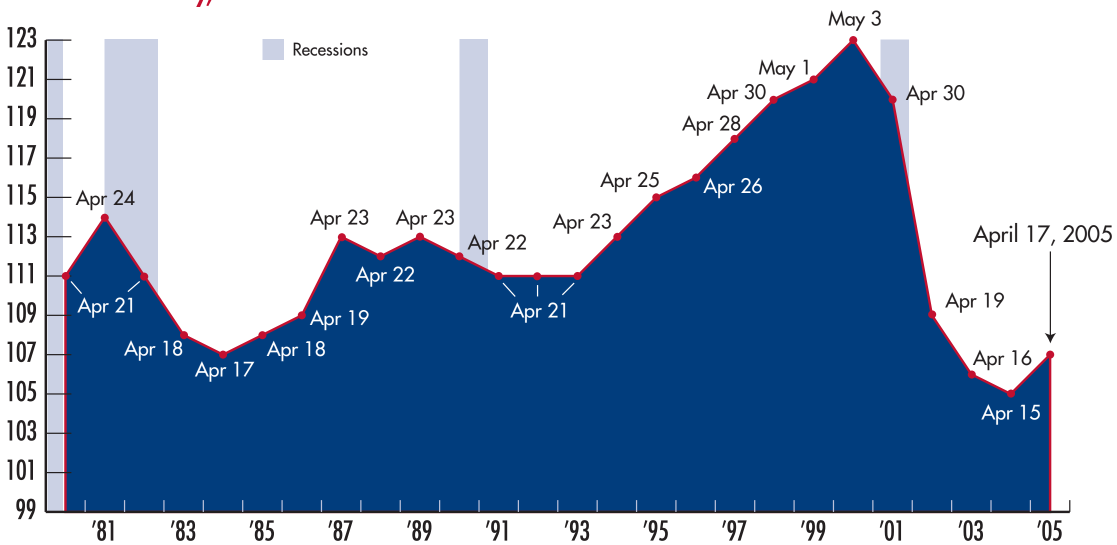
After four years of decline, America's tax burden is on the rise once again.

Tax Freedom Day®—the day when Americans earn enough to pay taxes and start working for themselves each year—fell on Sunday, April 17 in 2005 according to Tax Foundation calculations.

The report shows Americans will still spend more this year on taxes than food, clothing and medical care combined.

In 2005 Americans will work a total of 107 days to pay taxes—70 days for federal taxes and 37 days for state and local taxes. By comparison, they'll work 65 days for housing, 52 days for health care, 31 days for food, 31 days for transportation, 22 days for recreation and 13 days for clothing.

Tax Freedom Day, 1980-2005



That's two days later than last year, but much earlier than 2000 when Tax Freedom Day reached its all-time peak of May 3.

"With four consecutive years of tax cuts and the dot-com recession behind us, the tax burden has resumed its more typical upward course as economic growth pushes people into higher tax brackets," said Tax Foundation President Scott A. Hodge.

Some States Work Longer to Pay Taxes

Of the five states with the heaviest tax burdens, four are in the Northeast. Connecticut worked longest to pay its taxes (May 3), followed by New York (April 29), New Jersey (April 25),

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Tax Watch

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TAX FOUNDATION Since 1937

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Visit us on the web at www.taxfoundation.org or call (202) 464-6200.

Message from the President:

Is Stock Market Investing "Too Risky" for Social Security?

The debate over allowing younger workers to invest part of their Social Security taxes in personal retirement accounts has become increasingly politicized, with some charging that the plan amounts to "gambling" away American's retirement security for political gain.

In reality, American workers—including government and union employees—routinely depend on stocks and bonds for their retirement in the form of pension funds.

Some of the largest pension funds in America are public employee and union pension funds. Most of these funds are managed by private investment houses like Goldman Sachs, Morgan Stanley, and Solomon Smith Barney. Few are managed in-house.

According to the Federal Reserve Board, government employee pension plans alone have nearly $2 trillion in assets. On average, these funds have 60 percent of their assets invested in the stock market. Union pension funds invest roughly 57 percent of their funds in the stock market.

Stocks and Bonds: Good Enough for Government and Union Employees but "Too Risky" for Social Security?

	Percent of Fund Invested In:		
	Stocks	Bonds	Cash & Other
Government Employee Pension Funds	60%	28%	11%
Union Employee Pension Funds	57%	32%	10%

Source: **Pensions and Investments *magazine***

These public employee pension funds are all defined benefit plans. The largest defined contribution plan in the nation is the federal employee Thrift Savings Plan (TSP)—government workers' version of a 401(k). TSP has 3.3 million participants and more than $140 billion in assets. Federal employees can choose among five funds, three of which are stock funds managed by Barclays Global Investors.

It's no surprise private retirement funds have diversified investment portfolios that include stocks. Federal law requires it. The Employee Retirement Income Security Act (ERISA), mandates that funds hold diversified portfolios. Why? In order to minimize the risk of large losses. Does that sound "too risky" for Social Security?

Americans are slowly becoming aware that the Social Security "Trust Fund" is not a diversified portfolio. It is invested solely in government IOUs rather than real assets that grow in value to pay future benefits.

Millions of government employees and union members owe their retirement security to the prudent investment of pension funds in stock market investments. Let's hope the success of these funds puts to rest the claim that stock markets are too volatile for sound retirement planning.

Cordially,

Scott A. Hodge

Putting A Face On America's Tax Returns

New Poll: Americans Favor Tax Reform

The following remarks were delivered by Tax Foundation President Scott A. Hodge at the National Press Club in Washington, D.C. on April 14, 2005. The event was a press conference announcing the Tax Foundation's "Annual Survey of Attitudes on Tax and Wealth" conducted by Harris Interactive polling.

Good morning. My name is Scott Hodge, President of the Tax Foundation. I'm pleased to be here today to announce the results of a new Tax Foundation/Harris Interactive poll of more than 2,000 American adults. The purpose of the poll was to gauge Americans' attitudes on taxes, the fairness of the tax code, and perceptions of wealth.

Overall the survey results show that Americans are ready for fundamental tax reform. A majority of U.S. adults believe federal taxes are too high, the tax code is too complex, the tax system is unfair, and they support simplification—even if that means giving up some deductions and exemptions. Some key results:

- 81 percent of respondents said the federal income tax is somewhat or very complex, and 70 percent said they either "hated" or "disliked" doing their income taxes.
- 77 percent of U.S. adults said that the federal tax system should be completely overhauled or needs major changes, and 54 percent said they are willing to give up some deductions to make the tax code simpler.
- When asked, "Who pays more federal income taxes as a percentage of income—you or Donald Trump?" a remarkable 59 percent believe they pay a higher income tax rate than Trump.
- 55 percent said federal income taxes are too high, while just 2 percent believe they are too low.
- When asked for the maximum percentage of anyone's income that should go to taxes, the average response was 16 percent—far below the 29.1 percent of national income that taxes will consume this year.
- 66 percent said the value received from the taxes paid to the federal government is fair or poor.
- When asked to choose between a national sales tax, a flat-rate income tax with no deductions or the current income tax system, 37 percent chose a flat tax, while 19 percent favored a national sales tax and 19 percent favored the status quo.
- An overwhelming 68 percent favored complete elimination of the estate tax.
- 34 percent said taxes and government services should be reduced, while only 13 percent favored increases.
- 28 percent said they had bought something over the Internet rather than from a local store, 25 percent said they gave more to charity, and 14 percent said they crossed a border to shop in a neighboring area with lower taxes because it meant that they would pay less tax.

Overall, the survey results send a clear message to the President's tax reform panel. Americans overwhelmingly favor tax reform and simplification, and are willing to give up some deductions to get it. They want a tax code with fewer loopholes. They are troubled by the fact that millions have been knocked off the tax rolls and they think that everyone—including low income people—should contribute something to the cost of government. And they want better value for the taxes they pay to the federal government.

View the complete poll results online at www.taxfoundation.org/taxsurvey.html.

"A remarkable 59 percent of U.S. adults believe they pay a higher income tax rate than Donald Trump."

From Our Archives: 1960

"Presented to the honorable Dwight David Eisenhower, 34th President of the United States, in recognition of his illustrious leadership of the American people, his deep devotion to fiscal responsibility and sound government, his resolute stance against centralization of government power, and his profound faith in individual liberty and enterprise."

The Tax Foundation
New York
December 6, 1960

Our Economists in the News

News Stories

ABC News "Celebrating Tax Freedom"
Los Angeles Times "The Price of Living in a Fragile Paradise Keeps Getting Steeper"
CNN Money "Tax freedom comes late to Northeast"
AOL News "Tax Freedom Day to Arrive April 17"
Christian Science Monitor "Trumped"
CNN International "Powerball players on record streak"
Boston Herald "Freedom tax day falling later than predicted"
Providence Journal "Throwing tax code overboard"
MSN Money "Could you be hit by the 'jock tax'?"
Scripps Howard News Service "A tax aimed at the rich now hits the masses"
New York Sun "Social Security Hypocrites"
Indianapolis Star "Stadium proposal gets few cheers"

Visit our new "Press Room" at www.taxfoundation.org/pressroom.html.

Free Trade and Taxes: Will the WTO Slam U.S. Exporters?

The age-old rivalry between the U.S. and Europe has taken an unusual twist—a legal battle over taxes on export income.

During the past three decades Europe has repeatedly challenged U.S. tax law under international trade rules. The reason? U.S. tax laws treat export income differently, and European leaders argue that makes them unfair and illegal trade subsidies.

"In the last three decades U.S. policy on taxing exports has taken more twists and turns than a movie by M. Night Shyamalan," said Chris Atkins, staff attorney at the Tax Foundation. "Each time Congress has passed legislation to comply with trade rulings, and each time the new legislation has also been challenged."

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The Latest Dispute

The current dispute erupted in 1999 when a WTO panel ruled U.S. Extraterritorial Income (ETI) tax provisions constituted an illegal export subsidy. The 2004 Jobs Act aimed to repeal the FSC/ETI provisions slowly and provide transition relief to U.S. companies. The EU challenged that transition relief as well, arguing for immediate FSC/ETI repeal. A WTO panel ruling is expected by year end.

"The 2004 American Jobs Creation Act was supposed to square U.S. export tax law with WTO rules," said Atkins, author of a new report on the export-tax controversy. "But the EU won't let the export tax issue die."

The new report, "FSC/ETI Transition Relief in the New JOBS Act: Does the U.S. Have to Quit Cold Turkey?" argues that the EU is likely to prevail in the upcoming WTO ruling, resulting in a retroactive tax change for U.S. companies or allowing the EU to impose punitive trade sanctions on the U.S.

"A ruling against transition relief would constitute a retroactive tax change that would be highly unfair to U.S. companies who've formed contracts based on today's tax law," said Atkins. "The U.S. prohibits retroactive tax changes by the Internal Revenue Service at home, and it owes it to U.S. taxpayers to fight against unfair retroactivity in WTO law as well."

Although an EU victory at the WTO would be unfortunate, the report shows Congress can act today to help mitigate the potential harm to U.S. companies.

One way is by accelerating and enhancing the tax cuts in the JOBS Act. In particular, Congress could accelerate the phase-in of the deductions for qualified production activities income (not scheduled to be fully implemented until 2009), and consider making the tax relief available to all U.S. corporations, not just those engaged in manufacturing.

The report highlights a key lesson from the ongoing dispute with the EU—piecemeal tax reform can have disastrous results.

"The United States' tinkering with the tax system to give exporters a benefit gave the EU the chance to cry foul to begin with," said Atkins. "Fundamental reform of the tax code toward economic neutrality across industries would help avoid these conflicts in the future."

The full report, "FSC/ETI Transition Relief in the New JOBS Act: Does the U.S. Have to Quit Cold Turkey?" by Chris Atkins, is available on our website at www.taxfoundation.org/sr133.pdf.

Tax Freedom Day® (continued from page 1)

Massachusetts (April 24) and Wyoming (April 24).

Why is the Northeast's tax burden higher? The main reason is its higher cost of living. In places with high living costs, salaries also tend to be higher. That means taxpayers are hit harder by the progressive federal income tax, which means they work longer to celebrate Tax Freedom Day.

The five states with the lowest tax burdens—and who celebrate Tax Freedom Day earliest—are Alaska (April 2), Alabama (April 4), Tennessee (April 6), South Dakota (April 7) and Mississippi (April 7).

"Assuming no tax changes, Tax Foundation economists predict Tax Freedom Day in 2006 will likely fall later in April."

The Future of Tax Freedom Day

Where is Tax Freedom Day headed next year? The answer depends partly on tax changes now being debated. Will Social Security reform lead to higher or lower taxes? Will the President's tax reform commission recommend fundamental tax reform? Will President Bush's recent tax cuts expire in 2008 and 2010 as currently scheduled, or will they be made permanent?

Assuming no tax changes, Tax Foundation economists predict the nation's tax burden will grow as the economy grows over the next year, and Tax Freedom Day in 2006 will likely fall later in April.

Tax Freedom Day Around the World

The concept of Tax Freedom Day was trademarked in the U.S. in 1948 by Florida businessman Dallas Hostetler and later transferred to the Tax Foundation. Many other organizations around the world now produce their own "Tax Freedom Day" report:

- Great Britain's Tax Freedom Day is May 31 in 2005 (Adam Smith Institute: www.taxfreedomday.co.uk).
- Canada's Tax Freedom Day was June 28 in 2004 (Fraser Institute: www.fraserinstitute.ca).
- South Africa's Tax Freedom Day was April 22 in 2002 (Free Market Foundation: www.freemarketfoundation.com).
- Slovakia's Tax Freedom Day fell on June 18 in 2002 (Association of Slovak Taxpayers: http://www.zdps.sk).
- The Czech Republic's Tax Freedom Day fell on June 7 in 2001 (Liberalni Institut: www.libinst.cz/english/index.php).
- Lithuania's Tax Freedom Day fell on May 8 in 2004 (Lithuanian Free Market Institute: www.freema.org).
- India's Tax Freedom Day fell on March 14 in 2000 (Centre for Civil Society: www.ccsindia.org/index.asp).
- Australia's Tax Freedom Day fell on April 21 in 2001 (Center for Independent Studies: www.cis.org.au).

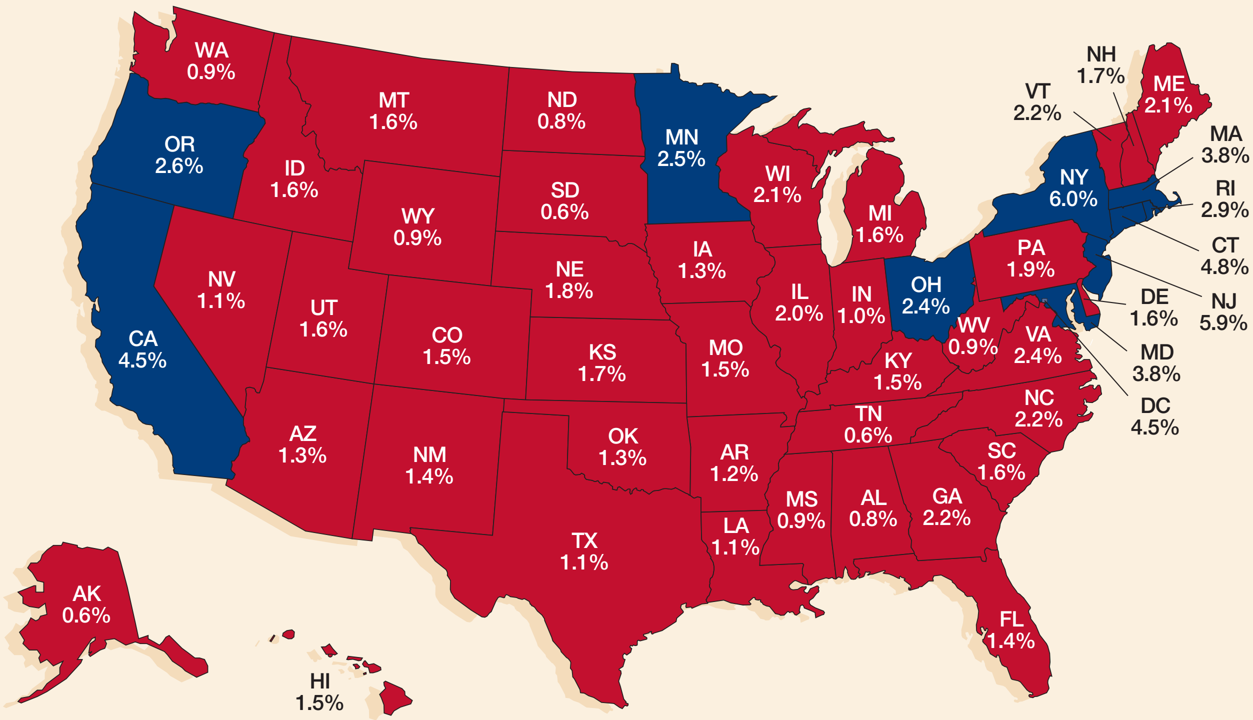
How We Calculate Tax Freedom Day

Ever wonder how Tax Freedom Day is calculated? Our goal is to answer the question, "What price is the nation paying for government?" To do that, we use two numbers from the Bureau of Economic Analysis—total tax collections and national income. Dividing tax collections by income gives the percentage of income paid in taxes. This year we are paying 29.1 percent of income for government. Converting that percentage into days of the year, that amounts to working from January 1 until April 17 to pay taxes.

This year's report is titled "America Celebrates Tax Freedom Day®," by Scott A. Hodge, Curtis Dubay and Sumeet Sagoo. Read more at www.taxfoundation.org/taxfreedomday.html.

Who Pays the Alternative Minimum Tax?

The Alternative Minimum Tax (AMT) is a second income tax that's parallel to the regular income tax. It was originally designed to make sure very wealthy taxpayers didn't get away with paying no income tax, but thanks to inflation it's hitting more less-than-wealthy Americans every year. According to the U.S. Treasury, 3.8 million taxpayers will be hit with the AMT this year. Here's a map showing which states have the most AMT filers (top 10 states colored blue):



Making Taxes Simple: What's the Real Cost of the Income Tax?

Most Americans think of their income tax burden as the amount on the bottom line of their 1040 form. But the cost of income taxes isn't just the amount we pay. It's also the lost time we spend filling out forms.

Economists call these "tax compliance" costs. The IRS estimates Americans will spend 6.6 billion hours filling out tax forms this year, including 1.6 billion hours on the ubiquitous 1040 alone. Incredibly, IRS tax forms now account for roughly 80 percent of the entire paperwork burden of the federal government.

Of course, these estimates understate true compliance costs since they don't include the time spent on tax planning, which can easily consume more time than filling out forms on Tax Day.

In 2002 the Tax Foundation published an extensive study of the cost of complying with the federal income tax code. Its conclusion? Americans spent $194 billion filling out tax forms that year—which amounts to 20 cents of compliance cost for every dollar collected by the tax system.

Given this, it's no surprise a recent Tax Foundation survey (see page 3) found 70 percent of U.S. adults say they "hate" or "dislike" doing their income taxes.

Read our full study, "The Cost of Complying with the Federal Income Tax" by J. Scott Moody, on our website at www.taxfoundation.org

Leave a Legacy to the Tax Foundation

In 1937, at the height of the New Deal when federal spending had grown 170 percent in the previous decade, the Tax Foundation was founded to monitor the growth of government.

From our founding day, we have been grounded in the belief that dissemination of basic information about government finance is the foundation of good policy in a free society.

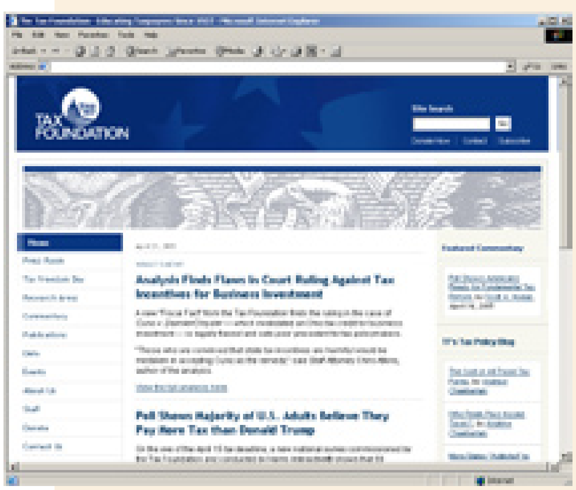
The mission of the Tax Foundation is to educate taxpayers about sound tax policy and the cost of government. By making a gift to the Tax Foundation, you can help ensure the future of sound tax policy for coming generations of American taxpayers, as well as our own.

When planning your estate, we understand the importance of providing support for those you love and who uphold the values you have dedicated your life to. As you provide for your estate please consider making a gift to support the Tax Foundation's work.

Our staff is available to discuss planned giving options such as bequests, stock gifts or endowed gifts. Please join us in leaving a legacy of improved tax policy in America.

For more information on our planned giving program, please contact Julie Burden, Director of Development, at (202) 464-5102 or burden@taxfoundation.org

Watch for Our New Website



Keep an eye out for the Tax Foundation's new and improved website—coming in May 2005. New features include:

- Faster searches—browse studies by author, date or topic.
- New "tax policy weblog" with daily updates.
- More tax data in downloadable Excel and PDF formats.
- More downloadable studies from our archives.
- RSS broadcast feeds for new op-eds, press releases and publications.
- A fresh new look and feel.

Please visit us on the web this May at www.taxfoundation.org and tell us what you think!