TaxWatch

Spring 2011

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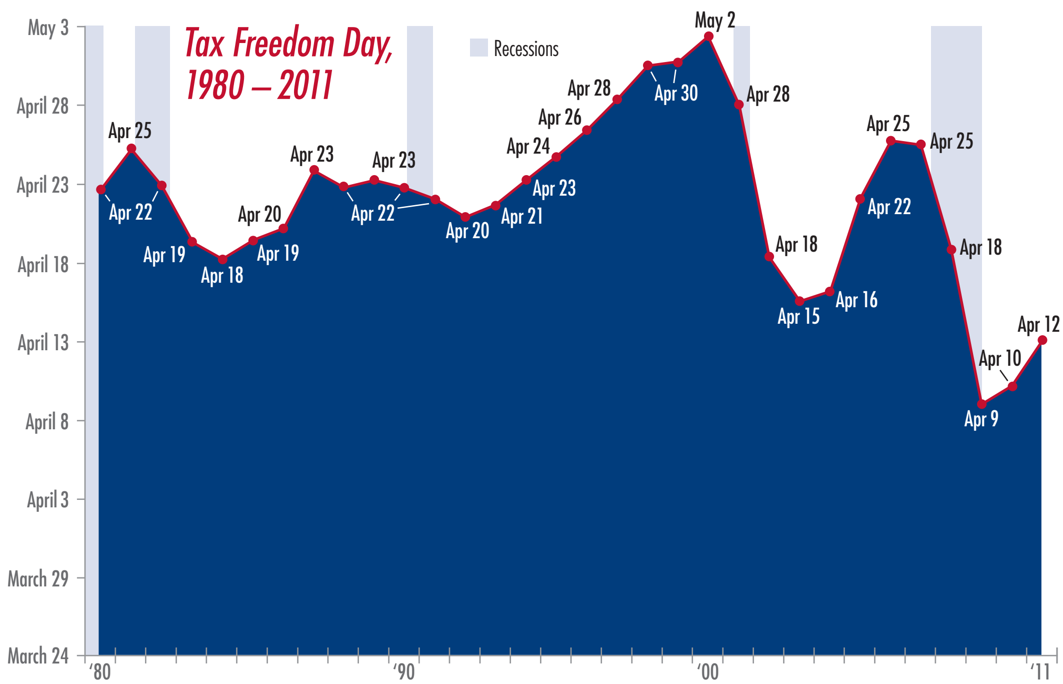
America's Burden: Taxes Are Down, But Rising Fast

The recession may be over, but Americans are bracing for a new economic challenge: a rising national tax bill. That's according to the latest study of total tax burdens from the Tax Foundation.

But while taxes are rising, they're still well below the all-time high of 2000, when taxes consumed one-third of income and America worked until May 2nd for government.



According to the study, Tax Freedom Day—the day each year when Americans have earned enough to pay for government and start working for themselves—will arrive April 12th this year. That amounts to working almost 30 percent of the year to pay for government at all levels, the highest since 2008.

More Income, More Taxes

"As the economic recovery continues, rising incomes push families into higher tax brackets," said Scott A. Hodge, President of the Tax Foundation. "This year's higher taxes were also caused by a return of the death tax, and phase-ins of tax hikes from the health care bill."

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TaxWatch

Tax Watch (ISSN 1552-924X) is published four times per year by the Tax Foundation in Washington, D.C., a nonprofit, non-partisan research organization that has monitored tax policy at the federal, state and local levels since 1937.

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The Tax Foundation is a 501(c)(3) nonprofit organization that relies on tax-deductible contributions for support. Please send correspondence to:

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Message from the President:
Time to End "Welfare" in the Tax Code

The following excerpt is from testimony of Tax Foundation President Scott A. Hodge before the U.S. Senate Budget Committee on March 9, 2011.

The ideal tax system should do only one thing—raise enough revenue to pay for government with the least harm to the economy. By all accounts, the U.S. tax system is far from that ideal.

Over the past two decades, lawmakers have increasingly asked the tax code to direct all manner of social and economic objectives, such as encouraging people to buy hybrid vehicles, turn corn into gasoline, save more for retirement, purchase health insurance, buy a home, replace the home's windows, adopt children, put them in daycare, take care of Grandma, buy bonds, spend more on research, purchase school supplies, go to college, invest in historic buildings, and the list goes on.

In many respects, the IRS has become a substitute for every other cabinet agency, from Energy and Education to HHS and HUD.

Thanks to the generosity of credits and deductions in the code a record 52 million, or 36 percent of all filers, pay no income taxes and are off the tax rolls. They have no "skin in the game." Many Americans today look to the IRS as a source of income thanks to the $100 billion in refundable tax credits paid out each year.

Sadly, many companies and industries are now looking to the IRS as a source of income too. In a recent case, one-third of the profits of a major appliance company were attributable to energy tax credits. I doubt members of Congress intended that program to be for appliance companies what the EITC is for poor Americans—an income subsidy.

Today, the biggest crises facing working families and the economy are health care, housing, and state and local government finances. Ironically, these are the areas in which government and the tax code is already the most involved.

The tax preference for employer-provided health insurance has undermined in health care the market forces that deliver quality goods at low prices for everything from bread to computers. The recent health care reform legislation will make this problem worse, not better. Housing suffers a similar problem because of the plethora of tax and spending subsidies intended to promote home ownership.

Washington can actually do more for the American people by doing less. The solution lies in fundamental tax reform—which means lowering tax rates while eliminating many of the preferences in the code.

Fundamental tax reform can restore the nation's competitiveness and put us on a growth path for the future. Not only will this improve living standards in America, but it will improve the nation's fiscal health. That is a win-win for everyone.

Sincerely,

Scott A. Hodge
President

U.S. Corporate Tax Soon to Be Highest in World

America will soon top the list of highest corporate income taxes in the world, according to a new Tax Foundation study.

"Once lawmakers in Japan enact tax reforms in April, the United States will be left with the highest statutory corporate tax rate in the developed world," said Scott Hodge, President of the Tax Foundation. "This is a red flag to lawmakers that the U.S. corporate tax rate is far out of line with the lower tax rates of other nations."

President Scott A. Hodge (right) testifies before the U.S. Senate Budget Committee on "tax expenditures".

This year marks the 20th year that America's corporate tax rate has been above the average of OECD countries. As other nations have enacted rate cuts, our higher corporate tax rate risks becoming a hindrance to economic growth and competitiveness.

Currently, the combined U.S. federal and state corporate tax rate is 39.2 percent, taking nearly two-fifths of every dollar earned by businesses. Until this year, only Japan had a higher rate. But Japanese lawmakers have planned to enact tax cuts this April, leaving the United States with the top rate of all economies in the OECD.

"While many OECD nations have cut corporate tax rates in recent years to stay competitive, they are not the only countries doing so," said Hodge. "Since 2006, some 75 countries have cut their rates, with many cutting rates multiple times."

> *"Dozens of countries have realized that high corporate tax rates are an economic dead end."*

Falling Behind

Many countries have improved their business climates by lowering corporate tax rates in recent years, while tax rates in the U.S. have remained unchanged. Between 2000 and 2010, nine countries cut corporate tax rates by double-digit figures. Those include major trading partners such as Germany, Canada, Greece, Turkey and Ireland.

According to the study, Congress would have to cut the federal rate from 35 percent to roughly 20 percent to move to the middle of the OECD pack.

"Many lawmakers are unwilling to give up the revenue that would come from such a sharp reduction in rates," said Hodge. "However, a short-term focus on lost revenue could do serious long-term harm to the economy if corporate rates remain out of line with countries competing for investment dollars."

There is a growing consensus that the U.S. corporate tax rate needs to be lowered, but there is little agreement on the details. Several proposals have been put forward in recent years that would cut rates while scaling back deductions available to businesses.

One plan from former Ways and Means Chairman Charlie Rangel was proposed in 2007. It would have cut the federal rate from 35 percent to 30.5 percent in exchange for eliminating the Domestic Manufacturing Deduction and changing tax rules affecting multinational companies.

However, a major flaw of the Rangel plan was that it ignored that 44 U.S. states impose their own corporate income tax. According to the study, what matters for global comparisons is the combined federal and state-level rate.

"Dozens of countries around the world have realized that high corporate tax rates are an economic dead end," said Hodge. "It's time for the U.S. Congress to act."

Read the full study, "Countdown to #1: 2011 Marks 20th Year That U.S. Corporate Tax Rate Is Higher than OECD Average," at www.taxfoundation.org.

Tax Fact:

Highest state corporate income tax rate: 12 percent; Iowa.

Lowest: 0 percent; Nevada, South Dakota, Washington, and Wyoming.

New Online Tools Give Taxpayers the Facts

Taxpayers now have more ways than ever to get the facts on taxes, thanks to an innovative collection of free online tools recently launched by the Tax Foundation.

"With more Americans getting news and information online, interactive tools like these help reach new audiences with the facts about how tax burdens affect family budgets and the economy," said Scott A. Hodge, President of the Tax Foundation.

The free online tools include a calculator showing how much a "taxpayer bill of rights" (TABOR) would have cut government spending in each state, and a tool showing how much a value-added tax (VAT) in America would cost families.

Analyst Nick Kasprak (right) discusses his state spending limitations calculator at a Mercatus Center event at George Mason University.

The new TABOR calculator shows taxpayers exactly how much they could have saved over the years if lawmakers in their state had been restrained by a tax and spending limitation.

"The most common type of spending limit is a TABOR," said analyst Nick Kasprak, developer of the online tools. "It requires that taxes or spending cannot exceed some specified limit, with the amount annually adjusted for inflation and population growth."

> *"The potential impact of a value-added tax on American taxpayers would be enormous."*

The calculator uses data on state spending, population and inflation to determine how the tax or spending limit would have grown over time. It then shows users a graph comparing their state's actual spending to the TABOR limit.

As an example, spending in California began growing rapidly after 1998. If a TABOR had been enacted in that year, the calculator shows California spending over the next decade would have been cut dramatically, from $1.32 trillion to roughly $973.6 billion.

"As debates about tax and spending limitations heat up, this tool lets taxpayers quickly get the facts on how a TABOR could curb the growth of spending in their state," said Hodge.

Paying for VATs

A second online tool shows taxpayers the cost to them if lawmakers were to enact a European-style value-added tax in the United States. The calculator lets users pick a VAT rate, a revenue target, and decide which consumer items are exempt from the tax.

"Europe's experience with value-added taxes has proven they are a massive revenue raiser for governments," said Hodge.

Advocates of the VATs describe them as broad-based, low-rate taxes that cause less economic harm than income taxes. However, most existing VATs are riddled with exemptions, special rates and other complexities that produce a result worse than would be expected from a simple, broad-based tax.

According to the calculator, a single earner making $50,000 a year would owe an additional $3,490 per year with a VAT. A family of four with one earner making $85,000 would owe an extra $6,100 per year. A married couple, together making $120,000, would pay an extra $8,600 per year.

Many lawmakers such as Indiana governor Mitch Daniels have recently denounced the VAT, citing fears that it would expand the federal government. Most developed countries today use a VAT, with rates ranging from 5 percent to 25 percent.

"The potential impact of a VAT on U.S. taxpayers would be enormous," said Hodge. "Now taxpayers can get a sense of that in just a few minutes with our online VAT calculator."

View the free tax calculators online at http://interactive.taxfoundation.org.

Cell Phone Taxes Soaring in the States

Taxes on cell phones are high and rising, according to a new Tax Foundation study. The average wireless customer today pays 16.26 percent in taxes and fees, more than 11 percent of which are state and local add-ons.

"Taxes on mobile phones are significantly higher than most other typical consumer goods," said Joseph Henchman, Tax Counsel and Director of State Projects at the Tax Foundation. "Often they are hidden or obscured by state and local governments."

Economist Mark Robyn discusses state-local tax burdens on Fox News.

According to the study, 23 states have average state-local wireless taxes and fees of over 10 percent. When combined with federal taxes, some cell phone subscribers pay over 20 percent in taxes.

States favor cell phone taxes because they can raise revenue in a relatively hidden way. For example, Texas went so far as to sue cellular provider Sprint because the company listed a state tax as a line-item on its bill to consumers, rather than hiding it as required.

> *"Cell phones are taxed more highly than cigarettes and alcohol in some areas."*

Dialing for Tax Dollars

Some areas today tax cell phone service at higher levels than even alcohol or cigarettes. For example, in Nebraska the combined federal-state-local average rate is 23.69 percent. In four other states (Florida, Illinois, New York, and Washington), taxes exceed 20 percent.

"Cell phone users are overtaxed relative to consumers of other goods, and are also at risk of double taxation," said Henchman.

According to the study, cell phone usage has boomed in recent years, from 55 million in 1997 to 292 million users today. At the same time, traditional landlines have been on the decline. Lawmakers have noticed the trend, and today target wireless services for higher taxes to make up for declining landline tax revenue.

"Each state and many localities can impose their own cell phone taxes, and researchers have found it difficult even to create a database of cell phone taxes," said Henchman. "Cell phone companies themselves have encountered problems calculating their taxes owed."

For example, Baltimore imposes a $4 per month tax on wireless users, on top of federal and state charges. Nearby Montgomery County, Maryland imposes a $3.50 per month tax. These charges are per line, and are especially burdensome on low-priced "family share" cell phone plans.

Utah uses a cell phone fee to pay for its poison control centers—a service that benefits everyone, not just cell phone users. Six states (Kentucky, Indiana, North Dakota, Pennsylvania, Rhode Island, and South Dakota) impose both sales taxes on wireless customers and gross receipts taxes on wireless companies, both of which are ultimately paid for by customers.

The study notes that experts from across the political spectrum have criticized cell phone taxes as burdensome, regressive and harmful to consumer choice. Legislation entitled the "Cell Phone Tax Moratorium Act" has been introduced in Congress, which would curb excessive state-local wireless taxes.

"Making cell phone calls may be getting easier, but paying cell phone taxes is not," said Henchman. "State and local governments should not single out one product for stealth tax increases, as they are doing with wireless services."

Read the full study, "States Target Cell Phones for Stealth, Burdensome Taxes," at www.taxfoundation.org.

Tax Fact:

Highest state personal income tax rate: 11 percent; Hawaii.

Lowest: 0 percent; Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

(continued from page 1)

"If today's deficit were counted as a tax, America's tax burden would be the highest since World War II."

According to the study, the cost of government continues to dominate the American taxpayer's budget. Households will spend more on taxes in 2011 than on food, clothing and housing combined.

In 2011, Americans will work 64 days to earn enough to pay federal taxes, and 37 more days for state-local taxes. Meanwhile, buying groceries requires about 35 days of work, clothing 13 days, and housing 60 days. Other major expenses are medical care (50 days), transportation (29 days), and recreation (21 days).

While taxes are up, they've taken a sharp dip in recent years. According to the report, three factors explain the drop in taxes since 2007:

- The Great Recession cut tax collections even faster than it reduced income;
- Congress extended the Bush-era tax cuts for two extra years; and
- As part of the extension agreement, the "Making Work Pay" tax credit was replaced with a two-percent cut in federal payroll taxes.

The Tax Freedom Day measure only counts taxes, so it ignores budget deficits. During times of massive government over-spending, it can give the impression that government is smaller than it really is.

"If we instead counted today's budget deficit as a tax, federal taxes would have been $1.45 trillion higher this year," said economist Kail Padgitt, author of the study. "By this deficit-inclusive measure, Tax Freedom Day would not arrive until May 23rd, the latest since World War II."

Which States Pay Most?

While taxes are rising everywhere, some states pay a higher bill. The lowest tax burden this year was in Mississippi. Taxpayers in that state celebrated Tax Freedom Day on March 26th—more than two weeks before the national average. Tennessee had the second lowest burden, followed by South Carolina, Louisiana and South Dakota.

"Tax Freedom Day tends to fall earlier in lower-income states, since the federal income tax hits their income at lower rates of 10 percent and 15 percent," said Padgitt.

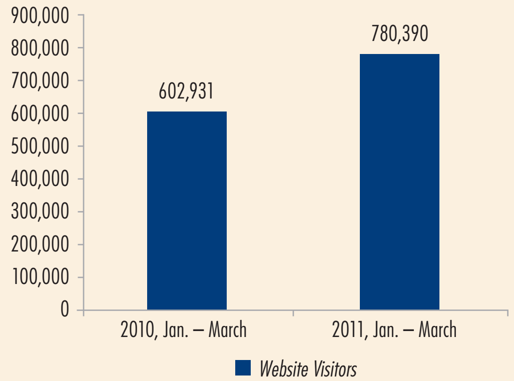
Not surprisingly, the nation's heaviest tax bills are paid in America's higher-income states. The nation's latest Tax Freedom Days fell in Connecticut this year (May 2nd), followed by New Jersey, New York, Maryland and Washington State.

"The big risk for taxpayers is that Congress will turn today's huge federal deficits into tomorrow's tax hikes," said Hodge. "In the long run, high government spending is what pushes Tax Freedom Day later in the year."

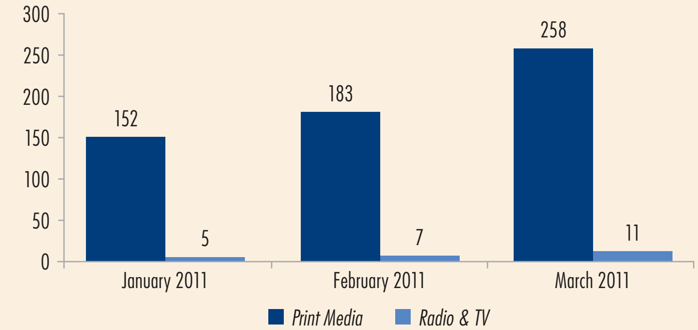
Read the full report, "America Celebrates Tax Freedom Day," online at www.taxfoundation.org/taxfreedomday/.

By the Numbers...

Website Visitors



TV & Radio Citations



Media Impact Report

Economist Kail Padgitt discusses tax hikes in Illinois on Fox News.

This year began with controversy at the state level, as state lawmakers in deficit-ridden Illinois adopted tax increases on individual and corporate income. Tax Foundation analysis was cited throughout local and national media, including the *Chicago Tribune*, *Bloomberg News*, *Reuters*, the *New York Times* and the *Huffington Post*.

The 2011 edition of the *State Business Tax Climate Index* by economist Kail Padgitt, Ph.D., has been widely cited since its premier last year. National and regional media outlets cited the report more than 130 times so far in 2011 alone. In addition, several governors mentioned their state's rank in their annual "State of the State Address"—events that generate significant media coverage of their own.

Our latest study of state-local tax burdens proved popular again this year, as the *Washington Post*, *Business Week*, the *Wall Street Journal* and other media outlets reported on the new study co-authored by economist Mark Robyn. Robyn appeared on Fox News Channel as well as radio stations in Albany, Richmond and Chicago to discuss the study.

Tax Foundation research was also featured on television stations in Philadelphia, Providence, and New York City as well as on C-SPAN and NBC's *Today* show, which is broadcast in every major media market in the country.

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

Bringing Sound Tax Policy to the States

Tax Foundation experts have been busy throughout the states this spring:

Arizona: Tax Foundation Director of State Projects Joseph Henchman published an analysis of the state's proposed flat income tax in March.

California: Joseph Henchman testified on state tax reform and reducing the volatility of the state's tax system in February.

Connecticut: Economist Mark Robyn and policy intern Kailee Tkacz published an analysis of Gov. Dannel Malloy's proposed budget plan, which raises taxes by about $425 per person.

Illinois: Economist Kail Padgitt and Joseph Henchman published an analysis of the state's recent tax hike that raises the corporate income tax from 7.3 percent to 9.5 percent.

Indiana: Tax Foundation President Scott Hodge testified before the Tax Committee on corporate income tax reform in February.

Michigan: Kail Padgitt and policy intern Alex Wood-Doughty published an analysis of taxes and spending in Gov. Snyder's recent budget proposal.

Minnesota: Tax Foundation President Scott Hodge testified on income taxes before the Minnesota House Tax Committee in February.

North Carolina: Joeseph Henchman spoke at a panel on state tax structure in Raleigh in April.

Ohio: Our Center for Legal Reform filed a brief with the Ohio Supreme Court challenging a "fee" as an unconstitutional tax.

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

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You don't have to be wealthy to make a significant gift to the Tax Foundation. As you plan your estate, it is possible to leave money both to your heirs and to pro-liberty organizations that help defend your deeply held beliefs.

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Creating a planned gift helps ensure the future of sound tax policy for coming generations of American taxpayers. Also, it is a lasting way of honoring the memory of those you love. Please consider making a planned gift to support our mission of sound tax policy.

To learn more, please contact Carter DeWitt at (202) 464-5110 or cdewitt@taxfoundation.org.

"The true meaning of life is to plant trees under whose shade you do not expect to sit."
—Nelson Henderson

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