

Tax Watch

Spring 2010



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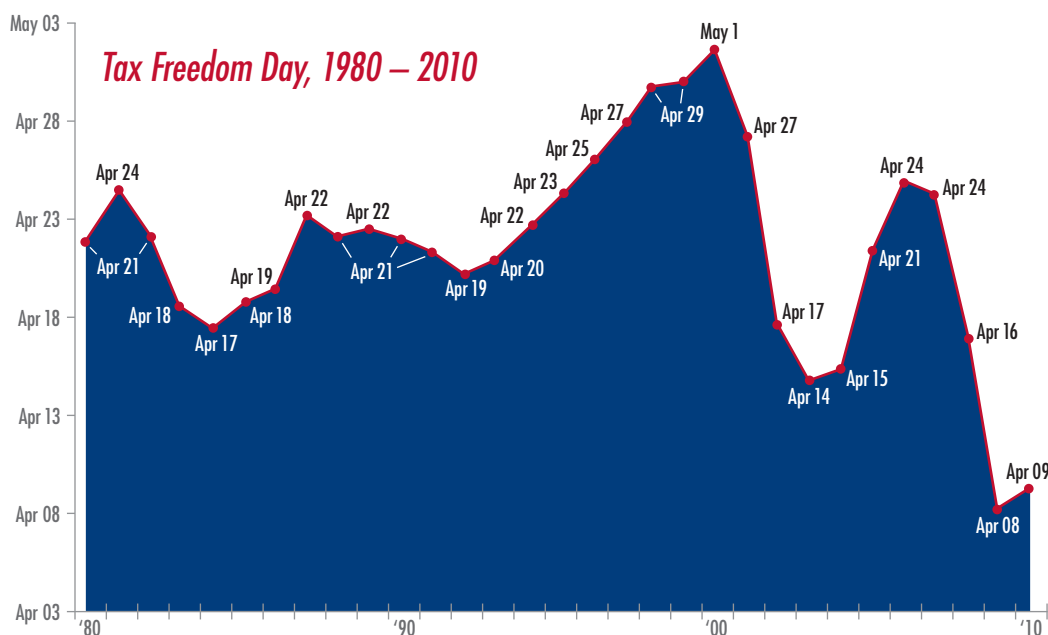
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America Celebrates "Tax Freedom Day"

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

That's the latest finding from the Tax Foundation's annual survey of tax burdens. This year, Tax Freedom Day®—the day each year when Americans earn

the recent recession has pushed down income and payroll tax collections. But more importantly, Congress is increasingly spending money through deficits rather than higher taxes, hiding the cost of federal spending from taxpayers."



enough to pay for government and start working for themselves—arrives Friday, April 9th, 2010. That's one day later than in 2009, but still more than three weeks earlier than the all-time high of May 1st set in 2000.

"Two factors are behind the recent dip in tax burdens," said Scott A. Hodge, President of the Tax Foundation. "First,

Tax collections are at historic lows, but exploding deficit spending may push tax burdens to unprecedented levels in the coming decade.

"Government spending has boomed over the past two years," said Kail Padgitt, Tax Foundation economist and author of the new study. "Rather than raising taxes, lawmakers have chosen deficit spending.

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TaxWatch

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Message from the President: A Nation of Takers



Are you a giver or a taker? No, that is not a bad pickup line from an internet dating site. It's a question every American should be asking themselves these days. "Do I take more than I give?"

I'm sure most of us want to be considered givers, not takers. After all, we grew up with the old adage that "it is better to give than receive." But we all know people who are takers more than givers. We've all seen someone bring a small salad to a potluck but pile casserole high on his plate.

Or the person in a lunch group who orders the most expensive meal because she knows everyone is splitting the check.

The same thing happens with government. There is a growing number of Americans who are contributing little but taking a lot, and a shrinking number who are giving a lot but taking little. Recent IRS data for 2008 show a record 52 million Americans—36 percent of all filers—filed a tax return but had no income tax liability because of the credits and deductions that have been enacted over the past 15 years.

The tax code has always had exemptions to protect the poor, but the new credits—the child tax credit, Making Work Pay credit, and First Time Homebuyer Credit—are now exempting even middle-class families. Remarkably, a family of four earning up to \$52,000 can expect to pay no income taxes because of these various tax credits. That is also a new record.

Many of these taxpayers are now getting checks back from the IRS even though they pay no tax. The IRS paid out \$70 billion in "refundable" checks to nonpayers in 2008. In essence, lawmakers have turned the IRS into an ATM machine for welfare benefits—and "ATM" now stands for "Another Taxpayer's Money."

Millions of people now see April 15th as payday, not tax day. Sadly, President Obama's policies from health care to taxes will increase the number of takers in America while reducing the number of givers. Our analysis of Obama's 2011 budget shows it would increase redistribution from the top 10 percent of families by nearly \$100 billion per year, to a total of \$854 billion.

Economists have identified a phenomenon they call "fiscal illusion." When people perceive the cost of government is less than it really is, they demand ever more government. The danger today is not that we have so many nonpayers, but that the \$1.5 trillion deficit is making the cost of government look cheap.

Every marketing guru will tell you if something is free, people will take as much as they can whether they need it or not. But for a nation, this is a recipe for fiscal disaster.

There was once a time when there was a stigma about taking handouts from government in America. It is time we renew that sentiment and reject the notion that we are entitled to endless handouts from Washington, D.C.

Sincerely,

Scott A. Hodge

Hollywood Tax Credits A Loser for Taxpayers

Lawmakers have been rolling out the red carpet for Hollywood filmmakers recently, offering generous tax bonuses. But according to a new Tax Foundation study, film production tax incentives are an economic loser for taxpayers.

According to the report, movie production incentives—including film tax credits, cash rebates, grants and various tax exemptions—fail to spur economic growth or raise tax revenue, contrary to the claims of advocates.

“Motion picture incentives are often touted as ‘job-creating’ programs, but in reality they create mostly temporary positions with limited upward mobility,” said Tax Foundation adjunct scholar William Luther, author of the study. “The only thing film incentives create is the need for more incentives, as productions move on to whatever other states have sweetened their incentives.”

Red Carpet Treatment

Eight years ago, just five states had movie production incentives. That number has skyrocketed recently, with 44 states, the District of Columbia and Puerto Rico today offering generous incentives. Of the 28 states and Puerto Rico that offer tax credits, 15 offer “refundable” credits that deliver money directly to film companies. In addition, 18 states offer direct cash rebates to filmmakers. Three governments—Texas, Tennessee and the District of Columbia—offer additional cash grants.

On top of these generous credits and grants, many states also grant preferential tax treatment to film production companies: 30 states offer sales tax exemptions, while six states offer free locations and the use of police officers to block roads and direct traffic—all at taxpayer expense.

“Based on fanciful estimates of economic activity and tax revenue, states are investing in movie production

projects with small returns and taking unnecessary risks with taxpayer dollars,” said Luther. “In return, they attract mostly temporary jobs that are often transplanted from other states.”

According to the study, some states are suspending their film incentives due to recent budget pressures and revelations of fraud and abuse. For example, Kansas has suspended its film tax credit program, and an Iowa panel appointed by Gov. Chet Culver recommended eliminating the state’s film credit after reports of abuse.

Some states justify film tax incentives with studies claiming they create local jobs. For example, a Pennsylvania study endorsed the state’s tax credit program, claiming benefits of \$4.5 million. However, the flawed study simply assumed that all film activity—some \$500 million worth—would immediately disappear if the credit were repealed.

“The flawed Pennsylvania study is another outlandish example of how states are willing to stretch economic assumptions to justify massive giveaways to film companies,” said Joseph Henchman, Tax Counsel and Director of State Projects at the Tax Foundation.

Rather than encouraging growth by reducing tax burdens across the board or removing cumbersome regulations, the study explains that politicians tend to focus on what is easy: industry-specific incentives.

“A better solution would be to repeal incentive programs and focus instead on broad-based tax competition,” said Luther.

Read the full study, “Movie Production Incentives: Blockbuster Support for Lackluster Policy” at www.taxfoundation.org/publications/show/25706.html.

Tax Fact:

Percentage of tax filers that paid zero federal income tax in 2008: 36.3 percent.



Analyst Mark Robyn discusses tax credits for Hollywood film producers on Fox Business Channel.

“Politicians focus on what is easy: film tax incentives rather than broad-based tax relief.”

Tax Day Becoming "Pay Day" for Many Americans

Taxes are on the rise for most Americans, but a new analysis from the Tax Foundation shows a record number of households pay zero federal income taxes—and some even profit—thanks to generous tax credits, deductions and exemptions enacted by Congress.

"Two records were set in 2008—the most 'nonpayers' and the highest-earning nonpayers," said Scott A. Hodge, President of the Tax Foundation. "More than a third of all tax returns now pay nothing, and many get back quite a bit more—turning Tax Day into a payday."

According to the study, a "nonpaying" tax return is one filed by a person or couple who owe nothing thanks to legal credits and deductions. That means these filers get back every dollar that was withheld from their paychecks and sometimes more. In 2008, 51.6 million tax returns or 36 percent of the total were filed by "nonpayers."

"Nonpaying status used to be a sign of poverty," said Hodge. "But thanks

to increased use of the tax code to deliver social benefits, encourage certain behaviors and funnel money to targeted groups, even middle-class families have been pulled into the growing pool of nonpayers."

According to the report, the income level at which a typical family of four will owe zero income tax has risen rapidly in recent years, now topping \$51,000.

Democracy in Danger?

According to the study, the shrinking number of taxpayers bearing the nation's tax burden is a troubling development for any democratic society.

"America is becoming divided between a growing class of people who pay no income tax, and a shrinking class who

bear the majority of the burden," said Hodge. "We're now in a situation where a record number of tax filers are completely disconnected from the cost of government."

Since its creation in 1913, the federal income tax has always exempted low-income workers from paying taxes. The standard deduction, personal exemption, dependent exemption and the earned income tax credit (EITC) all cut tax liabilities for poor families.

However, in the early 1990s lawmakers increasingly began using taxes to funnel benefits to constituents. Tax credits now subsidize childbirth, college attendance, hybrid cars and more. While most tax credits only cut liabilities to zero, "refundable" credits that actually pay out cash—similar to traditional welfare spending—are becoming more popular with lawmakers.

The study finds the number of Americans paying zero income tax has increased by 59 percent in the past decade, growing from 32.6 million in 2000 to 51.6 million in 2008. During that time period, the total number of tax filers grew by only 10 percent.

"The major tax change that created a record number of nonpayers in 2008 was the Economic Stimulus Act, which included a tax rebate of \$300 per person and \$600 per couple," said Hodge.

The number of nonpayers may grow even larger soon thanks to a flood of new credits in President Obama's latest budget.

"These measures have not only added complexity to our already Byzantine tax code, they have eliminated the connection between taxes and the cost of government for millions of Americans," said Hodge.

Read the full study, "Record Numbers of People Paying No Income Tax," at www.taxfoundation.org/publications/show/25962.html.



President Scott A. Hodge discusses state tax increases on CNN Tonight.

"America is becoming divided between a growing class of 'nonpayers' and a shrinking class who pay the tax burden."

States Target Online Shoppers with "Amazon Taxes"

Booming online shopping in recent years has created a new target for tax-hungry state lawmakers: online retailers. But according to a new Tax Foundation study, these so-called "Amazon taxes" are harming both state budgets and local economies.

"Amazon taxes are just the latest effort to eliminate the long-standing physical presence standard for state taxes," said Joseph Henchman, Tax Counsel and Director of State Projects at the Tax Foundation and author of the new study. "Their goal is to replace it with a nebulous, arbitrary 'economic presence' standard, where companies could be taxed in every state where they have customers."

Under such a system, even small online retailers would be required to navigate some 8,000 different sales tax systems throughout the nation—a staggering burden.

Amazon taxes or "affiliate nexus taxes" require retailers that use "affiliates"

in other states to collect sales and use taxes in every area where affiliates happen to be. Affiliates are independent agents throughout the country who post links to companies on their website and get a share of revenue in return.

"Enactment of Amazon taxes by states is really an aggressive and unconstitutional assertion of state power to tax out-of-state companies," said Henchman.

E-Commerce at Risk

According to the study, New York, Rhode Island, North Carolina and Colorado currently have Amazon taxes. California and Hawaii also passed Amazon tax laws, but governors vetoed them in 2009. Amazon taxes have been proposed in Iowa, New Mexico, Vermont and Virginia, and several states have considered but failed to enact them, including Connecticut, Illinois, Maryland, Minnesota, Mississippi, Tennessee and Wisconsin.

Contrary to many advocates, Amazon taxes do not provide easy revenue for states. In fact, the nation's first few Amazon taxes produced no revenue at all, and there is even some evidence of lost revenue. For example, Rhode Island's Amazon tax generated no sales tax revenue simply because Amazon.com reacted by fleeing the state and discontinuing its affiliate program there.

"Amazon taxes are unlikely to produce revenue in the near term," said Henchman. "New York continues to face a lengthy legal constitutional challenge, and Rhode Island has even seen a drop in income tax collections due to the law."

Some lawmakers argue Amazon taxes help "level the playing field" between brick-and-mortar and online business. But the new study shows they actually mandate extra burdens on online retailers. Enacting Amazon taxes also signals a state's hostility to companies engaged in interstate trade—risking retaliation from other states and hurting efforts to make sales taxes more uniform around the country.

"The real concern with Amazon taxes is the extent of state powers," said Henchman. "Should states be able to reach beyond their geographic borders and impose taxes on everything, everywhere? Do we really need to force taxes to be the same in all states, preventing people from shopping by tax rates as they do with price, quality or convenience?"

Read the full study, "[Amazon Tax' Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems](http://www.taxfoundation.org/publications/show/25949.html)" at www.taxfoundation.org/publications/show/25949.html.

Tax Fact:

Number of "state of the state" addresses citing Tax Foundation research this year: 7.



Tax Counsel and Director of State Projects Joseph Henchman discusses 'Amazon taxes' on C-SPAN's Washington Journal.

"Amazon taxes are an aggressive and unconstitutional assertion of state power."

(continued from
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*"Taxpayers
around the
world celebrate
Tax Freedom
Day as a simple
reminder of
how hard
they work for
government."*

If we counted this year's budget deficit as a tax, Tax Freedom Day would not arrive until May 17th—the second-latest date ever for this deficit-inclusive measure."

Despite today's lower tax burden, Americans still work more than three months to pay for taxes—more than food, shelter and clothing combined. According to the study, Americans will pay a total of \$3.47 billion in local, state and federal taxes this year, about 27 percent of the nation's income.

Where Are Taxes Lowest?

The annual "Tax Freedom Day" study is one of the most celebrated reports from the Tax Foundation. Released each year around April 15th, the study summarizes every tax paid by Americans at the federal, state and local levels. It also shows which states pay the highest and lowest tax burdens.

"This year the three most heavily taxed states in the nation are Connecticut,

New Jersey and New York," said Padgitt. "They are followed closely by other relatively high-tax states of Maryland, Washington, Massachusetts, California, Virginia and Vermont."

In contrast, the three lowest-tax states this year are Alaska, Louisiana and Mississippi. They are followed by South Dakota, West Virginia, New Mexico, Tennessee, Alabama, Nevada and Arkansas.

"In general, Tax Freedom Day arrives latest in states with the highest incomes thanks to the progressive rates of the federal income tax," said Padgitt. In high-income states, more income is taxed at the highest rates of 33 percent and 35 percent. By contrast, most income in lower-income states is taxed at the bottom rates of 10 percent and 15 percent.

Tax Freedom Day Around the World

The concept of "Tax Freedom Day" was first developed and trademarked by Florida businessman Dallas Hostetler in 1948. In 1971 he transferred the trademark to the Tax Foundation, which has calculated Tax Freedom Day ever since.

The success of Tax Freedom Day in America has sparked worldwide interest in the idea. In recent years, dozens of think tanks around the world have developed their own version of "Tax Freedom Day":

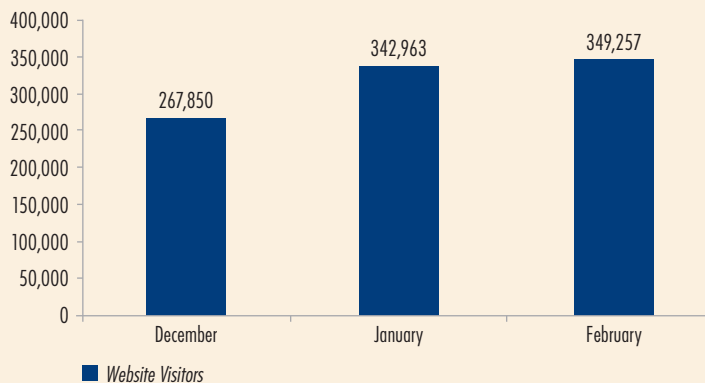
- United Kingdom's "Tax Freedom Day" arrives May 14th, according to the Adam Smith Institute;
- Canada's "Tax Freedom Day" arrives June 6th, according to the Frasier Institute;
- Australia's "Tax Freedom Day" arrives April 22nd, according to the Centre for Independent Studies;

"Taxpayers around the world celebrate Tax Freedom Day as a simple reminder of how hard they work for government," said Hodge. "This year, we hope Americans will take a moment on April 9th to reflect on how their tax dollars are being spent—from local city councils to their elected representatives in Washington D.C."

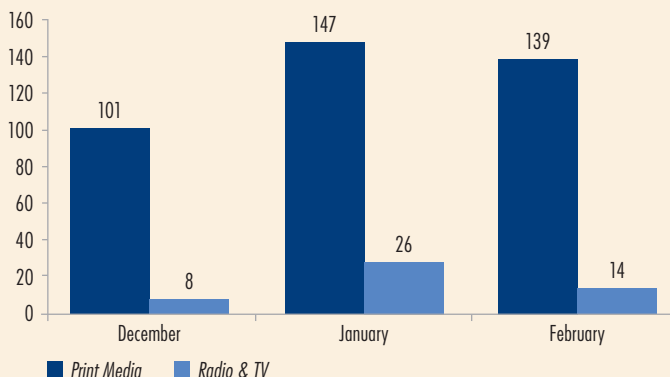
Read the full study, "America Celebrates Tax Freedom Day," at www.taxfoundation.org/taxfreedomday/.

By the Numbers...

Website Visitors



TV & Radio Citations



Media Impact Report



Senior Fellow Robert Carroll discusses America's corporate tax rate on CNBC.

With new reports on “Amazon taxes,” film tax credits and more, Tax Foundation experts were cited throughout the media this winter.

Television and Radio

Scott A. Hodge appeared on several Fox News Channel programs, including “Your World with Neil

Cavuto,” “Glenn Beck” and “Special Report with Bret Baier.” He also appeared on “CNN Tonight” to discuss state taxes, and on several radio programs discussing issues from Ohio’s tax climate to the growing number of “nonpayers.”

Robert Carroll, Ph.D., appeared on CNBC’s “Street Signs,” and Kail Padgitt, Ph.D., appeared on “CNN Tonight” to discuss health care reform. Padgitt was also interviewed by radio stations in Oregon and Philadelphia. Mark Robyn

appeared on “FoxBusiness.com Weekend” to discuss film tax credits, and gave several radio interviews in Philadelphia, Boston, Columbus and Richmond.

Joseph Henchman appeared as a guest on C-SPAN’s “Washington Journal,” where he discussed state tax issues. Henchman was also interviewed by radio stations in Philadelphia, San Francisco and Minneapolis. Patrick Fleenor discussed Georgia cigarette taxes in two radio interviews, and Gerald Prante was interviewed by radio programs in Baton Rouge and Olympia, Washington.

Newspapers

Scott Hodge published op-eds in several newspapers, including the *Statesman-Journal* and the *Detroit News*. William Ahern authored an op-ed for the *Detroit News*. And Justin Higginbottom published an op-ed in the *Pittsburgh Business Times*.

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 winter:

California: Joseph Henchman spoke to lawmakers and media on the state’s proposed “Amazon tax” and invalidated city landlord taxes.

Georgia: Lawmakers requested follow-up analysis after reports by Patrick Fleenor and Justin Higginbottom looked at the state’s cigarette and other taxes.

Idaho: The 2010 *State Business Tax Climate Index* was cited by Gov. Butch Otter in a letter to businesses in Oregon and Washington, urging them to consider moving to Idaho. Additionally, Scott Hodge met with legislators on tax reform.

Iowa: Mark Robyn’s work on film tax credits helped lead to a freeze in Iowa’s program and a review of its effectiveness.

Kansas: Gov. Mark Parkinson praised the Tax Foundation’s state-local tax burdens report in his state-of-the-state address, calling it an “objective way of finding out where we stand.”

Maryland: Kail Padgitt testified on bills to implement a spending cap, adjust tax brackets for inflation, and eliminate the state estate tax.

Minnesota: Gov. Tim Pawlenty noted Minnesota’s rank in the 2010 *State Business Tax Climate Index* in his state-of-the-state address, stating, “we need to be lower.”

Nebraska: Gov. Dave Heineman cited the 2010 *State Business Tax Climate Index* in his state-of-the-state address in January.

Ohio: A Tax Foundation report on Ohio caught the eye of the Associated Press and Ohio policymakers.

Pennsylvania: State officials and the media extensively discussed Tax Foundation reports on the state budget, job migration, and a proposed Philadelphia soda tax.

Nationally: Joseph Henchman submitted testimony to the U.S. House Subcommittee on Commercial & Administrative Law on the extent of state taxing power.

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



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*From the Tax Foundation's 2009 annual dinner:
Distinguished Service Award winners
John M. Samuels and Eric Solomon.*

Join Us! The Tax Foundation's 73rd Annual Dinner

Mark your calendar: the Tax Foundation's 73rd annual dinner and awards ceremony will be held on Wednesday, November 17th, 2010 at the Mayflower Renaissance hotel in Washington, D.C.

This event is Washington's premier gathering of friends and supporters of the Tax Foundation's mission. In addition to a cocktail reception and elegant dinner, President Scott A. Hodge will present this year's "distinguished service awards" for leadership in sound tax policy.

Previous award winners have included the nation's leading advocates of pro-market tax policy, including Dick Armey, Bill Archer, Martin Feldstein, Alan Greenspan, Bill Thomas and more.

To reserve your seat today, please contact the Tax Foundation at (202) 464-6200 or visit www.taxfoundation.org/events. We look forward to seeing you in November!

***Tax Foundation—The gold standard for nonpartisan research
and analysis on sound tax policy...since 1937.***