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THE TRUTH ABOUT TAX INCREASES

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Employment data released last month continue to show lackluster job growth in the private sector and a continued decline in the total number of jobs. In September, we lost another 95,000 jobs in total and created a mere 64,000 private sector jobs. On average, we have created an abysmal 68,000 jobs per month in the first 8 months of 2010, an insufficient number to lower unemployment from 9.6%.

Once again, America must swallow its disappointment as we watch an economy mired in the doldrums, failing to put people back to work. Americans are tired of this lackluster performance and Congress' unwillingness to address it.

It's simple. According to a September CNN poll, a majority of economists think that extending current tax rates for all taxpayers is the most important thing that Congress can do to help the economy. It would spur job creation, consumer spending, and investment and get us on the road to recovery. As the studies referenced below indicate, a failure to extend tax rates for all taxpayers, including high income earners who already pay their fair share, is just too much for our economy to bear.



Dr. Martin Regalia
Senior Vice President
and Chief Economist,
Economic Policy
U.S. Chamber of
Commerce

GDP and Job Growth. A September study finds that even in normal economic times (not the extraordinary ones we now face), raising taxes on higher income households would reduce real GDP by 0.4 of a percentage point in 2011 and 0.2 of a percentage point in 2012. Also, the study notes that allowing taxes to increase on higher income households (even in better economic times) would reduce payroll employment by 770,000 and cause the unemployment rate to increase by almost 0.4 of a percentage point by mid-2012, the peak of the impact.

These numbers should come as little surprise if one examines the impact of marginal income tax rate hikes on small businesses. According to Tax Foundation research, roughly one-third of ALL business taxes are paid by owners of flow-through businesses—sole proprietorships, partnerships, and S corporations that are often small in size and entrepreneurial—who file individual tax returns. Increasing the top two marginal rates hurts small businesses, which create between 60% and 80% of net new jobs and employ more than half the labor force.

And while only 2% to 3% of taxpayers with business income will be affected by higher income tax increases, it's actually the amount of business income and activity, not the number of taxpayers impacted, that really matters. According to the Joint Committee on Taxation, 50% of additional revenue created by an increase in the top two rates can be attributed directly to the income reported from pass-through businesses by their owners. The Tax Foundation estimates that about 39% of revenues generated from tax hikes on high income earners proposed in President Obama's FY2011 budget, or \$246 billion over 10 years, would come from business income.

In other words, small businesses, the backbone of the economy and America's jobs creators, will bear a substantial portion of the higher tax rates. Just as it seems things can't get worse, Congress is considering taxing the success that brings about economic growth and job creation.

Consumer Spending. Adding to America's disappointment is the projected impact of tax increases on higher income earners on already anemic demand. Higher income households account for almost 25% of all consumer spending, according to a September study, and it would not take much more of a pullback by higher income households to derail the recovery.

A September analysis by the Thomson Reuters University of Michigan Survey of Consumers echoes this sentiment, suggesting that higher income households are already scaling back their spending plans in

anticipation of higher taxes.

Even President Obama's former Office of Management and Budget (OMB) chief, Peter Orszag, has called for an extension of current tax rates, albeit temporarily, saying that higher taxes now would crimp consumer spending and further depress already inadequate demand.

Investment. The effects of increasing investment tax rates, even just on high income earners, cannot be easily isolated; those effects resound through markets and ultimately affect all investors regardless of income level. A recent study finds that hiking capital gains tax rates would reduce growth in real GDP, raise the unemployment rate, and significantly reduce productivity, which hurts all taxpayers.

Further, a September 2010 J.P. Morgan study concludes that raising taxes on dividend income could cause companies to reduce increases on dividend payouts or lower dividends outright. This would discourage investment in dividend-paying companies, thereby reducing stock value for all shareholders. Who bears the brunt of increased investment taxes? Seniors who have spent a lifetime saving and investing for retirement.

Fairness. Despite this superfecta of damage attributable to increasing taxes on high income earners, some still oppose extending current rates for all taxpayers because it's only fair that those with higher incomes pay their fair share.

Unfortunately for those who oppose extending current rates, the truth is going to get in their way. The tax burden is already heavily skewed toward higher income earners and became more so after the 2001 and 2003 rate reductions.

A 2009 Congressional Budget Office (CBO) report shows that in 2006 the top 1% of households paid almost 30% of ALL federal taxes, and the top 20% (highest quintile) paid almost 70% of all taxes. These are greater percentages than what they paid in 2000. Conversely, the middle and lowest quintiles paid only 9% and 0.8%, respectively, of federal taxes in 2006, a decrease from 2000 shares and the lowest shares in the CBO's entire reporting period from 1979 to 2006. In fact, the data indicate that the top 5% have borne the brunt of tax increases during that time frame.

The imbalance in tax distribution becomes more pronounced when only INCOME taxes are considered. According to IRS Statistics of Income data for 2007, the top 1% of taxpayers paid 40% of the total income taxes collected by the federal government. According to the nonpartisan Tax Foundation, this is the highest percentage in modern history and a significant increase from the 25% of the income tax burden this group bore 20 years earlier. In addition, the top 5% of taxpayers paid about 60% of income taxes in 2007, while the other 95% paid just short of 40%.

As the Tax Foundation points out, this means that the top 1%, made up of just 1.4 million taxpayers, pays a larger share of the income tax burden than the bottom 134 million taxpayers combined. Further, the top 50% of taxpayers account for more than 97% of income taxes paid, while the bottom half pays less than 3% of all income taxes.

Fair share? Seems that our tax system is already progressive enough—a finding reiterated by a 2008 Organization for Economic Cooperation and Development (OECD) study concluding that the United States has the most progressive income tax system among all OECD nations, relying more on the top 10% of taxpayers than any other nation, and that those with lower incomes have the lowest tax burden of those in any nation.

Congress, America is disappointed that you've done nothing to improve the economy and are threatening to make it worse by increasing taxes on the very taxpayers who carry the greatest tax burden and drive economic growth. Listen up: Extend all the current tax rates and help America get back on its feet and on the road to recovery.

Caroline L. Harris, chief tax counsel at the U.S. Chamber, authored this article.

