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Thank the Taxpayer

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Did you ever think about what would happen if the top 1 percent of the taxpayers suddenly decided to go "on strike" and refuse to produce all that income?

The IRS just released the numbers for 2005, and they show the top 1 percent of taxpayers paid almost 40 percent of the nation's total income tax bill, and that the top 5 percent paid 60 percent of the taxes, as can be seen in the accompanying table.

WHO PAYS THE FEDERAL INCOME TAX?		
(2005 IRS Report)		
Percentiles Ranked by Adjusted Gross Income (AGI)	Group's Share of Total AGI (%)	Group's Share of Income Taxes (%)
Top 1%	21	39
Top 5%	36	60
Top 50%	87	97
Bottom 50%	12	3

The country would be in deep trouble if all the top taxpayers suddenly decided to stop working and just put all of their assets into nontaxable municipal bonds, nonearning assets such as palatial homes and yachts, or move out of the country to some lower tax jurisdiction and then renounce their U.S. citizenship. In such a situation, either the federal government would have to be cut by 40 percent or everyone else's taxes would have to be raised 40 percent.

The table clearly shows the top 1 percent of the taxpayers pay almost double their fair share in relation to income, while the bottom 50 percent only pay about one-quarter of their fair share ("fair" being defined as everyone paying the same portion of income in tax). Many people think the "rich" should pay a disproportionate share of the income tax,

but then the question becomes, how much more? One great advantage of being "rich" is that you are far more able than the average person to determine how much you are paid, where you are paid and how to structure your income. Rich people are often clever or, at least, smart enough to hire clever tax lawyers and tax accountants, and so in every country from the beginnings of income taxes the rich find perfectly legal ways to minimize their taxable income (and some, of course, find illegal ways).

One of the main ways the rich have of silently protesting what they perceive as excessive taxation is to merely withdraw all or part of their labor or productive investment. This, of course, hurts everyone else, because the productive investment of the rich creates many new jobs and provides the venture capital needed for productivity improvements and creating new goods and services.

In 1981, before the Reagan tax cuts, the top 1 percent only paid about 18 percent of the income tax. But after the Reagan tax cuts, the rich paid almost 28 percent of the income taxes by 1988. Total income tax receipts rose from \$282 billion in 1981 to \$413 billion by 1988, and that paid by the top 1 percent more than doubled from \$50 billion in 1981 to \$114 billion in 1988.

Some argue that the rich pay more because their share of income has increased. However, much of this apparent increase is due to how the Internal Revenue Service calculates "adjusted gross income" (AGI). That is merely an IRS construct which tends to understate real income for low-income people and overstate it for upper-income people, because many of the deductions and credits lower- and middle-income people receive are now phased out for upper-income people by recent changes in the tax law.

Also lower-income people receive many in-kind benefits from government, such as food stamps, rent subsidies, etc., that are not counted as part of their income. In addition, the reduction in income tax rates encourages the top 1 percent to report more taxable income, as they have shifted income from nontaxable to taxable activities. (If you are interested in the details, I recommend an excellent new book by the economist Alan Reynolds, "Income and Wealth.")

Some of those very rich who complain of being undertaxed (Warren Buffet and Sen. John Kerry come to mind) have spent considerable money on lawyers to find ways to legally reduce their tax bills, while, in fact, nothing prevents them from paying more to the IRS if they so wish. Last month, Ways and Means Chairman Charles Rangel released his new tax proposal that greatly increases tax rates on "high-income individuals" (who are always conveniently defined as people who make a little bit more than members of Congress). Unfortunately for him, those charged with estimating the revenue for Congress told him his proposals would bring in much more tax dollars from the rich. Only in the fantasy world of Capitol Hill do people believe this, as contrasted with good, independent tax economists who really understand the numbers and human behavior and know the rich are likely to pay less under the higher rates rather than more.

Fortunately there is a better way — to thank those who pay most of the taxes rather than demonize them. The new nonpartisan civil discourse advocacy group ThankTheTaxpayer.org seeks to do exactly that. They seek to "tip our hats to the heavy lifters, those 5 percent of our fellow citizens who shoulder 60 percent of the federal income tax burden." *Amen.*

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