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TAX FOUNDATION FIGURES DO NOT REPRESENT MIDDLE-INCOME TAX BURDENS

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The Tax Foundation today released its report on "Tax Freedom Day," which it describes as the day when "Americans will finally have earned enough money to pay off their total tax bill for the year." Over the years, pundits and policymakers have commonly misinterpreted the Tax Foundation's reports as reflecting the level of the tax burdens that the broad swath of middle income families must shoulder; the Tax Foundation's presentations invite this misinterpretation. In fact, however, middle-income taxpayers pay far lower taxes than the Tax Foundation's report implies.

The Tax Foundation routinely shows tax burdens that are substantially higher than authoritative nonpartisan sources find middle income taxpayers bear. For example:

- The new Tax Foundation report claims that federal taxes will equal 21.8 percent of income in 2002.

- By contrast, the Joint Committee on Taxation finds that the federal tax burden in 2002 on families in the middle of the income spectrum equals 14.8 percent of income. An update of a Congressional Budget Office analysis finds such families will pay no more than 16.2 percent of income in federal taxes in 2002.

- The Tax Foundation implies that typical or average middle-income taxpayers pay at least 35 percent more in federal taxes than is actually the case.

The Tax Foundation's conclusions conflict with Treasury, CBO, and Joint Tax Committee findings because the Tax Foundation uses a seriously flawed methodology that distorts — and inflates — tax burdens. In fact, in a recent Congressional hearing, Federal Reserve Chairman Alan Greenspan essentially stated in response to a question that this type of methodology is invalid.

The Problems with the Methodology

In computing what it says are average tax burdens, the Tax Foundation uses a measure of tax receipts as a percentage of the economy. The Tax Foundation divides total tax receipts by an

estimate of the total amount of income in the nation. This method produces significant distortions.

Share of Income for Federal Taxes

	1995	1997	2000	2001	2002
CBO (middle quintile)*	17.6%	17.5%	17.2%	16.3%	16.2%
JCT ($30,000-$40,000)			16.3%	15.1%	14.8%
Tax Foundation (average)	20.8%	21.8%	23.3%	22.7%	21.8%

** The CBO figures for 2000 to 2002 reflect updates by the authors.*

Under our progressive tax system, high-income taxpayers pay significantly greater percentages of income in federal income taxes than middle-income families do. Under the Tax Foundation methodology, the higher tax payments that high-income taxpayers make are used to make the taxes that "average Americans" are said to pay look considerably larger than they actually are.

Suppose four families with incomes of $25,000 each pay $1,250 in income tax — five percent of their income — while one wealthy family with $400,000 in income pays $100,000 in income tax, or 25 percent of its income. If one averages these figures, one finds that 21 percent of the total income of these five families goes to pay federal income taxes. Dividing these families' total tax payments of $105,000 by their total income of $500,000 shows that 21 percent of their total income is paid in taxes.

Under the Tax Foundation methodology, this 21 percent figure would then be used to say that the average family in this group pays 21 percent of income in income taxes and must work until 21 percent of the year has passed to pay its income tax. Yet the 21 percent figure is a misleading indication of the typical tax burden of families in this group. The four moderate-income families pay five percent of their income in income tax, less than one-quarter of the average 21 percent rate. Using averages in this fashion when talking about tax burdens, as the Tax Foundation does, produces skewed results; it essentially ascribes to the average taxpayer the tax rates that only people at considerably higher income levels pay.

Exacerbating this problem, the Tax Foundation methodology fails even to provide an accurate representation of the average tax rate for the nation as a whole. At a recent Congressional hearing, Federal Reserve Chairman Alan Greenspan warned that the type of approach the Tax Foundation uses — dividing total tax receipts by total income, as measured by the Gross Domestic Product, to determine an overall average tax rate — is not valid. Greenspan flatly stated: "you can't use tax receipts over nominal GDP as a tax rate." He explained one reason such an approach is improper: although capital gains taxes are counted as part of federal

tax receipts, the capital gains *income* on which such taxes are paid is *not* counted in GDP. (The Tax Foundation uses another, similar Commerce Department measure of income that also omits capital gains.) Counting capital gains taxes as part of tax receipts while failing to count capital gains income as part of income distorts — and inflates — average tax rates. Despite Chairman Greenspan's warning that "you can't use" this measure, an admonition other tax experts have made in the past, the Tax Foundation repeats this mistake every year.

Given these and other problems with the Tax Foundation measure, it is not surprising that the Tax Foundation's claims are inconsistent with the findings of the leading authoritative, nonpartisan institutions that study tax burdens. Data from the Treasury Department, the Congressional Budget Office, and the Joint Committee on Taxation all show that tax burdens on typical middle-income families are considerably lower than the Tax Foundation reports suggest.