WebMemo
Published by The Heritage Foundation

No. 2790
February 3, 2010

Obama's 2011 Budget Tax Hikes Contradict Focus on Job Creation

Curtis S. Dubay

President Obama has said his number one goal for 2010 is to create jobs, but the abundance of tax increases in his recently released 2011 budget contradict this objective.

Higher taxes on businesses, upper-income taxpayers, and fossil fuels; an increased death tax; and new taxes to pay for health care would destroy jobs and slow economic recovery. Congress should reject these higher taxes and the rest of its business-killing agenda to speed economic growth and encourage job creation.

Steep Increase. President Obama's 2011 budget calls for $2 trillion in higher taxes over 10 years—after accounting for the $154 billion in tax cuts called for in the budget. This would be a $17,000 tax increase for every American household during that span. This figure does not include possible revenue from the cap-and-trade legislation currently before Congress.

The budget claims additional tax cuts, such as the Making Work Pay credit for 2011 and 2012, the research and experimentation credit, and bonus depreciation for certain assets. Each of these provisions is an extension of current policy and should not count as an additional tax cut.[1]

Tax Hikes for Everybody. The tax increases proposed in the budget break down into six broad categories:

1. Higher Taxes on Businesses. The higher taxes on businesses include the recently proposed "bank tax" that is supposed to recapture the money lent to big banks as part of the TARP program—even though most of the banks hit by the tax have already paid back the funds they received.[2] The Obama budget would also repeal the "last in, first out" method of inventory accounting that allows businesses to deduct their more costly inventory from income first. This would increase taxes for many businesses.

The most damaging tax increase on businesses, however, would be the higher levies on businesses operating internationally. The budget would restrict their ability to deduct interest expenses associated with foreign income until the business recognizes it in the U.S. The budget would also make it more difficult for businesses operating internationally to claim a credit for taxes paid in foreign countries, increasing the likelihood of double taxation.

The U.S. is the only country in the world that taxes the overseas income of its businesses. All other countries tax only income earned within their borders. To help level the playing field, the tax code allows businesses with foreign income to pay tax only when businesses bring the income back to the U.S. This tax credit prevents them from paying tax on income already taxed by other countries.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Taxes/wm2790.cfm

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

The Heritage Foundation
LEADERSHIP FOR AMERICA

Changing these provisions will substantially increase taxes on U.S. businesses that operate overseas and, in doing so, hurt job creation at home. Higher taxes will further encourage these businesses to keep their income earned abroad in those foreign countries and invest it there. They will move jobs they would have created in the U.S. to other countries. Not only will this reduce employment in the U.S., it will depress wages for existing workers.

Going after businesses that operate internationally is a backward method of job creation that is akin to trade protectionism.[3] The U.S. already has the second highest corporate income tax in the world, trailing only Japan.[4] Implementing these provisions would only further reduce America's international competitiveness and discourage businesses from opening new ventures in the U.S.

2. *Higher Taxes on Upper-Income Earners.* President Obama's 2011 budget would allow the 2001 and 2003 tax cuts to expire for families making over $250,000 a year and raise their top two marginal tax rates from 33 and 35 percent to 36 and 39.6 percent, respectively. The budget would also limit the amount these families could deduct from their income and reduce their personal exemptions. President Obama also proposes raising the tax rates on dividends and capital gains from 15 percent to 20 percent for taxpayers with incomes over $250,000 a year.

Each of these provisions would hurt economic growth and lead to slower job and wage growth. Higher income taxes on high-earners would decrease investment, which would lead to fewer new businesses opening and dissuade existing businesses from expanding operations. Higher taxes on dividends and capital gains would drive the cost of capital higher, which would compound the problem.

President Obama would also hammer taxpayers that move income offshore with higher taxes. To the extent these taxpayers are engaging in illegal activity, they should be prosecuted. But most of the taxpayers that move their income offshore do so legally because of high capital taxes in the U.S. The answer to this problem is not to make the U.S. even less inviting for capital investment but to reduce capital taxes to keep that money here so it can support domestic job creation.

3. *Death Tax Increase.* The dreaded estate tax, better known as the "death tax," expired on January 1. This was the result of a decade-long policy that reduced the tax and finally repealed it for 2010. But due to budgeting quirks, the tax comes back to life in 2011. The Obama budget stealthily increases it by assuming in its baseline that Congress will vote to continue the death tax at 2009 levels (45 percent rate and $3.5 million exemption) starting in 2011 and beyond. If Congress continues the tax, it would be a tax increase, and the budget should explicitly count it as such.

The budget would also *increas taxes on family farms and businesses.* When the death tax was active, family farms and business could discount asset values to account for the fact that it is difficult to sell them in order to pay the death tax. The Obama Administration would disallow this discount and force families to pay the death tax on the full value of the assets, even though there would be no new cash generated to pay the tax. The budget would also make it more difficult for family-owned businesses to protect their business from the death tax as it grows.[5]

Repealing the death tax permanently would create 170,000 to 250,000 jobs each year.[6]

1. See Curtis S. Dubay, "Tax Hikes Unnecessary for Extension of Current Policy," Heritage Foundation *WebMemo* No. 2722, December 8, 2009, at *http://www.heritage.org/Research/Taxes/wm2722.cfm*.
2. See David C. John, "Obama's 'Financial Crisis Responsibility Fee': Not Responsible, Not a Fee," Heritage Foundation *WebMemo* No. 2770, January 21, 2010, at *http://www.heritage.org/Research/Economy/wm2770.cfm*.
3. J. D. Foster and Curtis S. Dubay, "Obama International Tax Plan Would Weaken Global Competitiveness," Heritage Foundation *WebMemo* No. 2426, May 5, 2009, at *http://www.heritage.org/Research/Taxes/wm2426.cfm*.
4. Tax Foundation, "National and State Corporate Income Tax Rates, U.S. States and OECD Countries, 2009," at *http://www.taxfoundation.org/taxdata/show/23034.html* (February 1, 2010).

4. Higher Energy Taxes. The budget increases taxes on oil, gas, and coal companies by repealing several tax credits available to these businesses.

These energy companies would undoubtedly pass these tax increases on to customers in the form of higher prices, which will increase costs across the entire economy. And higher taxes on energy would act as yet another deterrent to job creation, since they increase the cost of doing business, which includes hiring new workers and retaining existing ones.

5. Health Care Taxes. The budget creates an allowance for revenue raised due to health care reform. Since a final bill is not complete, it is not possible to know what specific taxes would pay for health care reform if it passes Congress.

The taxes included in the separate House and Senate bills—and a variety of other taxes proposed but not included in either bill—are the best guide available to which taxes could do the job.[7] Each of these taxes would have their own punitive effect on the economy and each would hinder job creation in its own way.

6. Other Taxes. The budget includes several other tax increases, including taxing carried interest as regular income, closing the tax gap through stricter enforcement, more taxes on businesses, and making the unemployment insurance surtax permanent.

This long list of tax increases shows that the Administration is desperate for revenue and looking under every rock to squeeze more and more money out of individual taxpayers and businesses.

Remove Uncertainty. President Obama has said repeatedly that job creation is his number one priority in 2010. But if Congress passes the tax hikes included in the budget into law, countless jobs will be destroyed.

Congress should pass on these tax hikes and drop the anti-business legislation it is currently considering. Legislation such as health care reform, cap and trade, card check, and other regulations are plaguing businesses with uncertainty that is preventing them from expanding, taking on new risk, and adding new workers. Unfortunately, all the new taxes proposed in President Obama's budget will only add to their worries.

—Curtis S. Dubay is a Senior Analyst in Tax Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

5. American Family Business Institute, "U.S. Treasury Department Proposes Estate Tax Changes That Will Hamper Family Business Survival and Cost Jobs," June 24, 2009, at *http://www.nodeathtax.org/files/U.S.%20Treasury%20Department%20Proposes%20Estate%20Tax%20Changes%20-%206-25-2009.pdf* (February 2, 2010).

6. William W. Beach, "Seven Reasons Why Congress Should Repeal, Not Fix, the Death Tax," Heritage Foundation *WebMemo* No. 2688, November 9, 2009, at *http://www.heritage.org/Research/Taxes/wm2688.cfm.*

7. Curtis S. Dubay, "Taxes Proposed to Pay for Health Care Reform," Heritage Foundation *WebMemo* No. 2706, November 20, 2009, at *http://www.heritage.org/Research/HealthCare/wm2706.cfm.*