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Tax Day 2011: Deficit Spending Hides Future Tax Hikes

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Tax Day is the one time of the year when taxpayers get the best sense of what they are paying to fund Washington. Many taxpayers will be dismayed to see how high their total tax tabs are, but deficit spending is badly obscuring this crucial calculation by hiding the deficit surcharge—i.e., the future cost of today's overspending.

If Americans knew the level of income taxes they would have to pay in the not-too-distant future to cover current and future federal overspending, Tax Day would be even more alarming. The simple fact is that Washington cannot tax its way out of its spending problem. Big, bold spending cuts are necessary.

Income Tax Collections Would Need to Soar to Cover Deficits. The federal government levies a broad array of taxes to fund its activities, but the income tax is the one that most Americans associate with their personal share of the federal government's burden. Indeed, the income tax is the largest revenue-raiser and the tax that funds the government services that are tangible to most Americans, such as national defense, homeland security, the judicial system, and national parks.

In 2010, the federal government collected about $2.2 trillion in total tax revenue. Income taxes accounted for $900 billion of collections, or about 40 percent of all tax receipts. The federal government spent around $3.5 trillion, with the resulting deficit of $1.3 trillion made possible by borrowing.

If Congress, rather than borrowing or cutting spending, raised income taxes by the $1.3 trillion necessary to pay for 2010 deficit spending, it would need to more than double income tax collections. In fact, income tax revenue would need to increase by 144 percent to cover the overspending.

Tax Rates Would More Than Double. To collect the additional revenue necessary to close the 2010 deficit, income tax rates would have to have been considerably higher than their current levels. Without altering other aspects of the tax code, if Congress collected the extra revenue by simply hiking each income bracket based on its portion of current tax collections, every tax rate would need to more than double.

For a family of four earning $50,000 that takes the standard deduction, its current tax bill of $766 would increase by almost $4,000. A similar family of four that earned $75,000 a year would see its tax liability of $4,500 increase by over $9,000 a year. If the same family earned $100,000, it would pay more than $15,600 above the $8,800 it actually paid in 2010.

The top rate in this scenario would be 85 percent. A top rate at that level would grind economic activity to a halt. Businesses would stop investing and creating new jobs because the tax-diminished

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http://report.heritage.org/wm3224

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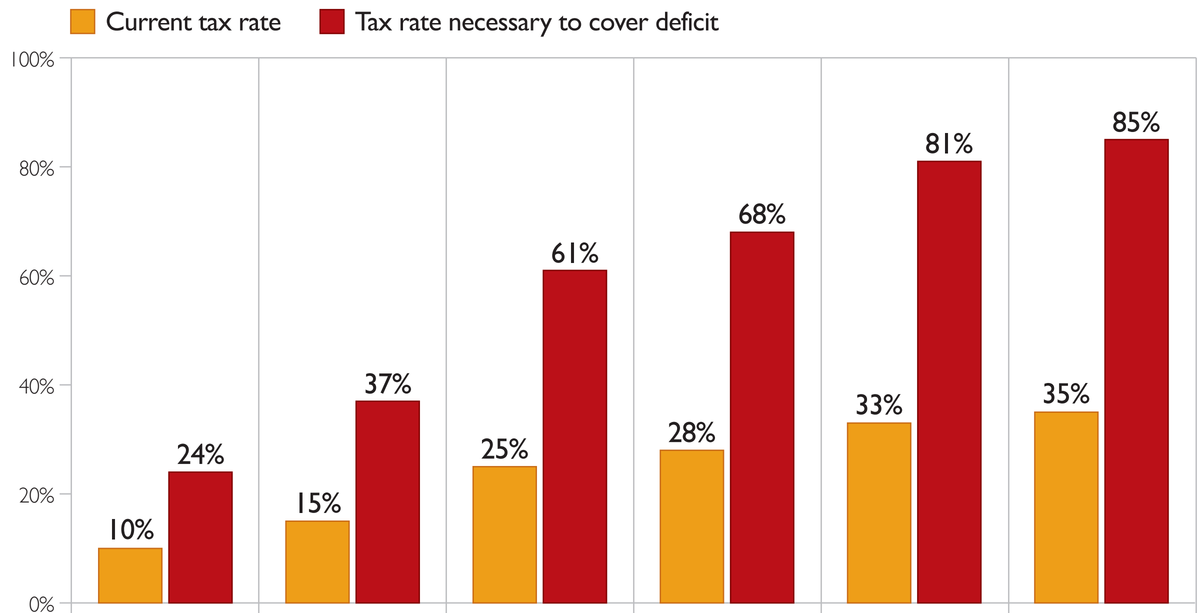
Income Tax Rates Need to More Than Double to Cover the 2010 Deficit



Bracket	1	2	3	4	5	6
Income for Single Filers	*$0– $8,375*	*$8,375– $34,000*	*$34,000– $82,400*	*$82,400– $171,850*	*$171,850– $373,650*	*$373,650+*
Income for Joint Filers	*$0– $16,750*	*$16,750– $68,000*	*$68,000– $137,300*	*$137,300– $209,250*	*$209,250– $373,650*	*$373,650+*

Source: Heritage Foundation calculations based on data from the Internal Revenue Service and the White House Office of Management and Budget.

Chart 1 • WM 3224 heritage.org

returns would not be worth the risk. Many workers would cut back the hours they spend on the job. The end result would be a poorer nation with a bleaker future.

Top Rates Rise to Impossible Levels Under Obama Tax Plan. President Obama has long said that he would not raise income taxes on any family earning less than $250,000 a year. That roughly corresponds to the top two income tax brackets.

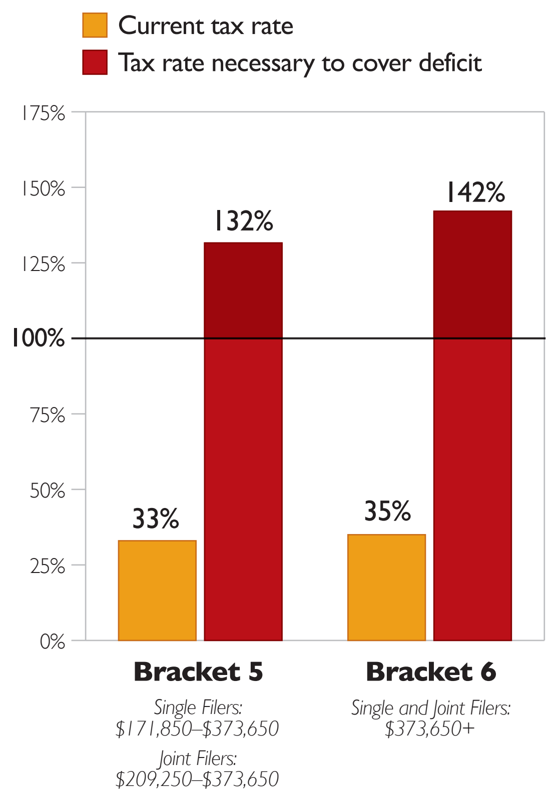
If, instead of raising taxes at all income levels, Congress collected it from just those making $250,000 or more per year, their rates would have to rise to levels that are not even possible. The top two rates would need to rise to 132 percent and 142 percent.

Of course, it is impossible to tax at a rate over 100 percent. Doing so would require confiscating savings, investment, or even other assets. Moreover, as a practical matter, it is impossible to get even close to 100 percent and still raise revenue because businesses, workers, and investors would simply stop producing, working, and investing as the government came close to confiscating almost every additional dollar they earned. Much of their economic activity would be driven underground.

Future Rates Would Remain Higher Under Obama Budget. In his recently released budget, President Obama proposes to keep deficits at unsustainable levels throughout the 10-year window. Income tax rates would have to remain nearly

Obama's Tax Hike Plan Would Require Rates That Are Impossible

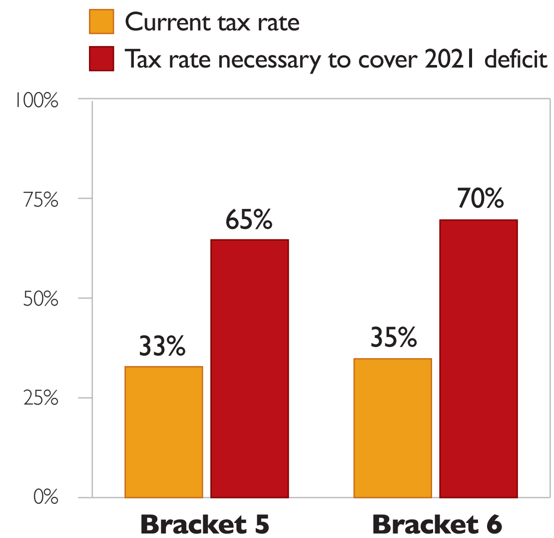
President Obama has repeatedly pledged to raise taxes only on the "rich." But if he raised taxes on only the top two income brackets, their rates would need to rise well beyond 100 percent—a fiscal impossibility—just to close the 2010 budget deficit.



Source: Heritage Foundation calculations based on data from the Internal Revenue Service and the White House Office of Management and Budget.

Chart 2 • WM 3224 heritage.org

Raising Taxes on the Largest Incomes to Close the 2021 Deficit



Source: Heritage Foundation calculations based on data from the Internal Revenue Service and the White House Office of Management and Budget.

Chart 3 • WM 3224 heritage.org

50 percent higher than current levels through 2021 to close the gap without cutting spending.

Higher Taxes Are Not the Answer. Would the President and Congress really be willing to raise rates to these levels and suffer the economic and political damage that such hikes would cause? It is doubtful. The real danger is that, through continued trillion-dollar deficits, they would hide the true cost of government from the taxpayers.

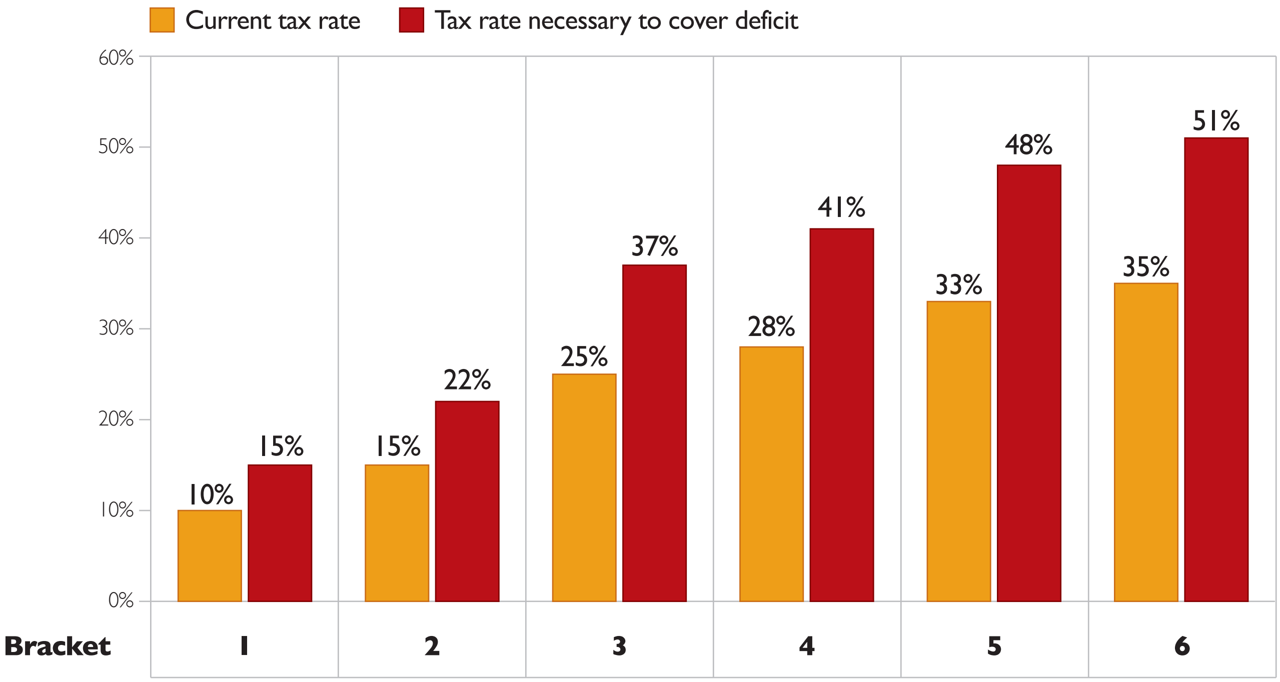
According to the Congressional Budget Office, if Congress enacts President Obama's 2012 budget, interest payments on accumulated deficits will total $931 billion in 2021 alone. That would account for 20 percent of all tax receipts. Combined with spending on other mandatory programs like Social Security, Medicare, and Medicaid, 95 percent of all tax revenues would be spoken for before Congress can allocate funds to national defense or any other essential function of government.

Raising taxes in the face of such a specter will not solve the problem as entitlement and interest spending continues to balloon out of control. Tax rates would have to be raised perpetually to keep pace.

Balance the Budget. Despite this bleak outlook, higher tax rates and the slower-growing economy that would come with them are not inevitable. Congress and the President must cut spending, and they must do so soon—before interest expenses and entitlement spending take off.

Closing the 2021 Deficit by Raising Taxes Would Require Huge Hikes

Figures are based on all taxpayers equally sharing the 2021 deficit.



Source: Heritage Foundation calculations based on data from the Internal Revenue Service and the White House Office of Management and Budget.

Chart 4 • WM 3224 heritage.org

It is time for Congress and the President to stop the current trajectory of massive spending and borrowing and be honest with the American people about the hidden deficit taxes that they are asking them to pay in the future. As millions of American taxpayers are finding out on Tax Day, taxes are already too high. Rather than pass on these hidden deficit taxes, it is time for Washington to get to work and cut spending.

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