TAX FOUNDATION Since 1937

TAXWatch

SUMMER 2011

Brighter future for tax reform?

Tax Foundation President Scott Hodge and Congressman Paul Ryan (R-WI) Speak at a Policy Briefing on Capitol Hill

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Please send correspondence to: Alicia Hansen, Editor at Tax Watch, National Press Building, 529 14th Street, N.W., Suite 420, Washington, D.C. 20045.

Visit us on the web at www.taxfoundation.org or call (202) 464-6200.

Message from the President

Some Things Get Better with Age

It's hard to believe, but next year the Tax Foundation turns 75. In a day and age where every product must be "new and improved," I'm proud to say that we are old and just keep getting better.

As we count down to our diamond anniversary, we are renewing the commitment that our founders made in 1937—to be the nation's #1 authority on economically sound tax policy at all levels of government. Over the past seven decades, the Tax Foundation has become to tax policy what J.D. Power and Associates is to the auto industry, what Good Housekeeping is to housewares, and what Underwriters Laboratories is to electronics. When lawmakers in Washington and state capitals want to know if their tax plans are economically sound, they come to us because our research is factual, impartial, and reliable.

"The Tax Foundation has become to tax policy what J.D. Power and Associates is to the auto industry, what Good Housekeeping is to housewares, and what Underwriters Laboratories is to electronics."

We constantly look for better ways to disseminate our research to lawmakers, taxpayers and journalists. I'm sure you noticed the new look of this newsletter. Thanks to feedback from readers, we've given it a fresh look, doubled the length, and doubled the circulation. You'll notice too that we've included more news on the work of our Center for Federal Fiscal Policy, Center for State Fiscal Policy, and Center for Legal Reform.

We're also remodeling our website to meet the increased demand for our research. Last year, it received more than 4 million visitors and we expect that number to top 5 million this year. Our website gets more traffic than any other tax group in the country. Indeed, if you Google "tax," chances are a Tax Foundation publication will appear on page one of that search. The new website will be able to handle the increased traffic while letting us contribute even more content to the worldwide web.

As always, your support and commitment to our mission is what keeps us going. Don't hesitate to call me with your ideas on how we can better make a difference here in Washington and in your state. To borrow a phrase from the poet Robert Browning, "Grow old with me! The best is yet to be."

Sincerely,

Scott A. Hodge
President

SUMMER 2011

TAXWatch

The Tax Foundation is an independent, nonpartisan and nonprofit research institution founded in 1937 to educate taxpayers, policymakers and the courts on sound tax policy. Our economic and policy analysis is guided by fundamental tax principles that should serve as touchstones for sound tax policy everywhere.

IN THIS ISSUE

Tax Foundation Testifies on Fairness in the Federal Code

> "There is wide consensus among policymakers that the U.S. corporate tax system is out of line with most industrialized nations—and that America's global competitiveness is suffering as a result."

Testifying before the Senate Finance Committee on whether the distribution of tax burdens and benefits is fair and equitable at the federal level, Scott Hodge, Tax Foundation president, went beyond the usual critiques to question the structure and goals of the U.S. tax system itself.

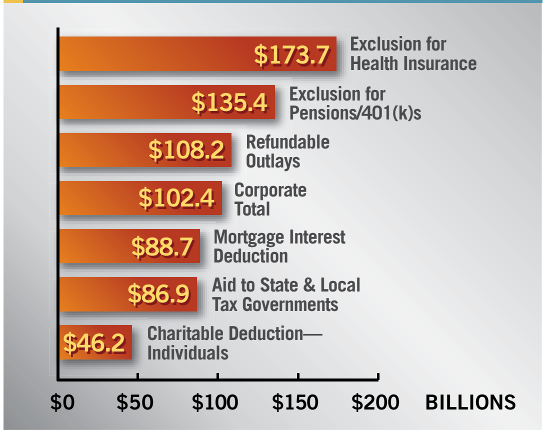
This testimony on May 3, 2011 questioned the motivation behind many of the changes in the U.S. tax code in the last 25 years, the era since the last major overhaul and simplification of the federal system. He asked members of the committee to consider what is fair not just for individual taxpayers at various income levels, but what constitutes an equitable economic system for the country at large.

Here is an excerpt from his testimony:

Over the past two decades, lawmakers have increasingly asked the tax code to direct all manner of social and economic objectives, such as encouraging people to buy hybrid vehicles, turn corn into gasoline, save more for retirement, purchase health insurance, buy a home, replace the home's windows, adopt children, put them in daycare, take care of Grandma, buy bonds, spend more on research, purchase school supplies, go to college, invest in historic buildings, and the list goes on.

Tax Foundation President Scott Hodge testifies before Congress on fairness in the tax code

Figure 1: Major Categories of Tax Expenditures FY 2011



The U.S. tax system is in desperate need of simplification and reform. The relentless growth of credits and deductions over the past 20 years has made the IRS a super-agency, engaged in policies as unrelated as delivering welfare benefits to subsidizing the manufacture of energy-efficient refrigerators. I would argue that were we starting from scratch, these would not be the functions we would want a tax collection agency to perform.

So the question before the committee today is: "Is the distribution of tax burdens and tax benefits equitable?"

My answer is no, it is not. But not in the way most of you may think.

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"Top Ten" Lists on Corporate Tax Reform

By Tax Foundation President Scott A. Hodge

There is near unanimous bipartisan agreement in Washington that the U.S. corporate tax rate is out of step with rates levied by most industrialized nations and that America's global competitiveness is suffering as a result. What seems to be lacking to fix the problem, however, is a sense of political urgency and a broader understanding of the substantial economic benefits that a lower corporate tax rate will generate.

At more than 39 percent, the overall U.S. corporate tax rate is the second-highest in the world, 15 percentage points higher than the OECD average of 25 percent and China's 25 percent tax rate.

> "There is wide consensus among policymakers that the U.S. corporate tax system is out of line with most industrialized nations—and that America's global competitiveness is suffering as a result."

Over the past four years, 75 countries have cut their corporate tax rates to be more attractive to business investment.

In addition to being subject to the second-highest corporate tax rate in the world, U.S. businesses must also operate under a worldwide tax system, in which business income is taxed no matter where it's earned—even if it is income from foreign operations that has already been taxed by a foreign government. The worldwide system saddles American companies with a greater financial burden and distorts their financial planning. A territorial system—like the ones in place in most other developed countries—would allow foreign profits to be taxed by foreign governments while only subjecting domestic profits to U.S. tax rates.

In May, we released two studies on the importance of making the U.S.'s corporate tax system more competitive. Here is the "top ten" list from one of those reports, which can be found at goo.gl/fq2El.

Ten Benefits of Cutting the U.S. Corporate Tax Rate

1. Cutting the corporate tax rate will promote higher long-term economic growth.
2. Cutting the corporate tax rate will improve U.S. competitiveness.
3. Cutting the corporate tax rate will lead to higher wages and living standards.
4. Cutting the corporate tax rate will boost entrepreneurship, investment, and productivity.
5. Cutting the corporate rate lowers the tax burden on low-income taxpayers and seniors.
6. Cutting the corporate rate will lower the overall dividend tax rate and taxes on capital.
7. Cutting the corporate tax rate can attract foreign direct investment (FDI).
8. Cutting the corporate rate would lead to lower corporate debt and reduce the incentives for income shifting.
9. Cutting the corporate tax rate can reduce compliance costs.
10. Cutting the federal corporate rate can help the states compete globally. tw

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Also, see "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings" at goo.gl/fq2El.

Did Bush-Era Tax Cuts Cause the Deficit?

By William McBride

Contrary to recent reports which assign the lion's share of the current federal budget deficit to Bush-era tax cuts, the growth in federal spending, both on-budget and via the tax code itself, is the real culprit. Using recent data from the Congressional Budget Office, we find that while economic policies of the previous administration contributed to the substantial federal budget deficits we see today, the effect was most pronounced on the spending side of the equation rather than the tax side.

In recent years tax revenues have largely tracked the economy and did not significantly drop below the historical average until the 2008 financial crisis -- seven years after the first Bush tax cut and five years after the second Bush tax cut. It is spending, more than revenues, which has changed dramatically and diverged from the historical averages, jumping from 20.7% of GDP to 25% between 2008 and 2009 alone.

Entitlement spending has roughly doubled in the last forty years as a percentage of GDP and is projected to remain there into the foreseeable future. The effects of the last decade's tax cuts are marginal compared to this massive budgetary liability. tw

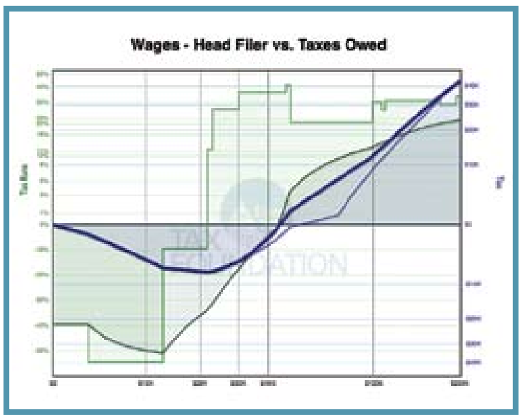
Tax Fact:

Congress enacted the AMT in 1969 following testimony by the Secretary of the Treasury that 155 people with adjusted gross income above $200,000 had paid zero federal income tax on their 1967 tax returns. **Now millions of Americans are forced to pay this tax that was intended for a few wealthy families.**

NEW ONLINE TOOL FOR TAXPAYERS:
Calculate How Your Tax Rates Change Along with Your Income

By Nick Kasprak

In April we added a new tax calculator to our collection of online tools that allows individuals to measure how changes in their income will affect their marginal tax rate and their total tax liability. The 2011 Marginal Tax Rates Calculator is programmed to estimate tax bills for the current year and provide a custom generated graph illustrating total taxes, average tax rates, effective marginal rates, and more.



Because of the progressive nature of the federal income tax, a person's tax rate climbs as they earn a higher income. The change in rates, as well as other year-to-year changes in exemptions and deductions claimed, can dramatically change a household's effective tax rate. The 2011 Marginal Tax Rates Calculator combines these variables for a unified view of how liabilities change under different financial scenarios. tw

You can find the calculator at goo.gl/2Ifj3. Or watch an instructional video at goo.gl/QpkX0.

Scott Hodge, president of the Tax Foundation, and George Pataki, former Governor of New York

Tax Foundation President Addresses Capitol Hill Audience in Panel Discussion on National Debt

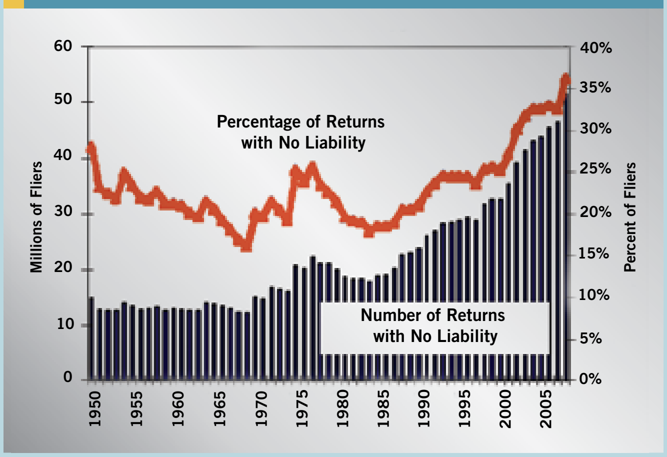
On June 16 Tax Foundation president, Scott Hodge, participated in a nonpartisan symposium on Capitol Hill to discuss the nation's growing debt. Joining Scott on the panel were Rep. Paul Ryan (R-WI), Former New York Governor George Pataki, and Karen Harbert, President and CEO of the U.S. Chamber of Commerce. Scott spoke about the benefits of a territorial corporate tax system. tw

Karen Harbert, president of the U.S. Chamber of Commerce's Institute for 21st Century Energy; Scott Hodge, president of the Tax Foundation; Rep. Paul Ryan (R-WI); and George Pataki, former Governor of New York

continued from page 1, TESTIMONY

First, while it's well understood that the major tax preferences largely benefit upper income taxpayers, the real issue is the harmful effects that these preferences are having on the economy and the people they are intended to benefit. The biggest crises facing working families and the economy are health care, housing, and state and local government finances, yet these are the areas in which government and the tax code are already the most involved. The cure for what ails these industries is to be weaned off the tax code, not given more subsidies through such things as the First Time Homebuyer's Credit, Premium Assistance credits, or more tax-free bonds.

Figure 2: Number and Percentage of "Nonpayers"; 1950 to 2008



Second, as a consequence of trying to use the tax code to help the "middle class," we have knocked millions of people off the tax rolls, turned the IRS into an extension of the welfare state, and created a growing class of people who are disconnected from the basic cost of government.

We need to have a national discussion over whether it is fair or equitable to have millions of people enjoy the benefits of civil society but contribute nothing to its costs. I believe that it is bad for democracy and bad for the fiscal health of the nation to have so many Americans with no skin in the game. tw

Read the full testimony at goo.gl/gSeFO.

2011's Tax Bite in the Eight-Hour Day

Nation Works until 11:13 AM to Pay All Taxes, Lunchtime to Pay off the Deficit

By Alicia Hansen

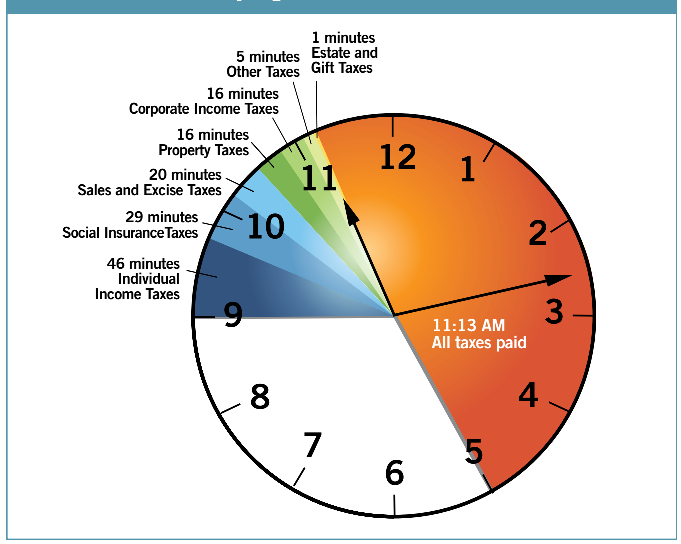
In 2011, Americans will devote 2 hours and 13 minutes of every eight-hour workday, or over a quarter of their working hours (27.7%), to paying taxes. In a nine-to-five workday, it takes until 11:13 a.m. to earn enough to pay that day's share of taxes at the federal, state and local level.

The Tax Bite in the Eight-Hour Day®, which measures the nation's tax burden in hours and minutes, is an offshoot of the Tax Foundation's annual Tax Freedom Day® calculation, which measures the tax burden in months, weeks, and days. These calendar- and clock-based illustrations are a useful way to explain how much the nation as a whole spends on government. Both Tax Freedom Day and the Tax Bite in the Eight-Hour Day illustrate what portion of their income Americans keep for themselves and what percentage they spend on government.

The chart below shows how long Americans work to pay each type of tax at the federal, state, and local levels. tw

To read the full study or to find out your state's Tax Bite in the Eight-Hour Day, see goo.gl/Zwuu2.

How Much of Each Eight-Hour Workday Goes to Paying the Nation's Tax Bills?



More States Abandon Film Tax Incentives

as Programs' Ineffectiveness Becomes More Apparent

By Joseph Henchman

Film tax credits fail to live up to their promises to encourage economic growth overall and to raise tax revenue. States claim these incentives create jobs, but the jobs created are mostly temporary positions, often transplanted from other states. Furthermore, the competition among states transfers a large portion of potential gains to the movie industry, not to local businesses or state coffers.

Year	States with Film Incentive Program	Incentive Amounts Offered
1999 and earlier	4	$2 million
2000	4	$3 million
2001	4	$1 million
2002	5	$1 million
2003	5	$2 million
2004	9	$68 million
2005	15	$129 million
2006	24	$369 million
2007	33	$489 million
2008	35	$807 million
2009	40	$1.247 billion
2010	40	$1.396 billion
2011	37	$1.299 billion

Source: Tax Foundation calculations.

In 2010, a record 40 states offered $1.4 billion in film and television tax incentives. All told, states have provided nearly $6 billion for such programs over the past decade. 2010 will likely stand as the peak year, since many governors and legislators are ending their programs, preferring to use the money for other priorities or leave it with taxpayers. tw

See the full report at goo.gl/R2TxQ.

Tax Foundation Economist to California Legislators:

Think Twice on Film Tax Credits

On March 21, Economist Mark Robyn testified to legislators on the state's film tax credit program. A latecomer, California adopted the incentives in 2009 in reaction to other states' incentive programs successfully draining away productions from Hollywood. Mark urged legislators to end the subsidies, or failing that, subject them to annual appropriation limits and improve transparency. tw

See the full testimony at goo.gl/CfSBV.

Tax Studies

Keep an eye out for upcoming Tax Foundation studies on unemployment insurance taxes, sales tax exemptions for groceries, sales tax holidays and soda/obesity taxes. Of significance, we will also be releasing **a new landmark study of the Tax Foundation**, a fifty-state cost analysis of corporate taxation that will be an apples-to-apples comparison of seven model firms. This new annual study is based on an innovative economic model built collaboratively with KPMG and will be released later this summer.

Tax Foundation's Work Pays Off as Indiana Adopts Tax Reforms

Months of discussions and research for Indiana state officials and experts helped bring about an ambitious tax reform bill approved by Gov. Mitch Daniels (R) in May.

The budget reduces the state's corporate income tax from a high 8.5% in steps to 6.5% by 2015, reduces the tax on smokeless tobacco to be in line with relative risk, and forestalls an unemployment insurance tax increase. The budget also authorizes a study of the effectiveness of targeted tax credits and sets up an automatic refund of future state surpluses.

Tax Foundation President Scott Hodge testified to Indiana legislators and met with officials in February and March, and our state policy and outreach team kept up a steady flow of research and policy suggestions. tw

FACTS & FIGURES

Now Available on Amazon.com

FACTS & FIGURES: ***How Does Your State Compare?*** **is a popular pocket-sized booklet comparing the 50 states on 32 different measures of taxation and spending, including individual and corporate income tax rates, business tax climates, excise taxes, tax burdens and state spending. Every year we send a copy of *Facts & Figures* to all state legislators, and many of them request extra copies of the booklet, telling us how useful it is and how often they refer to it.**

FACTS & FIGURES: ***How Does Your State Compare?*** **is available on Amazon.com. (goo.gl/eHGMy or search for "How Does Your State Compare?") and on our website as a PDF and Excel workbook at goo.gl/Mghqj.**

Tax Foundation Report on Nevada Helps Forestall New Business Taxes

By Joseph Henchman

Few states have been hit harder by the present recession than Nevada. A boom illustrated most prominently in the tourist and construction industry saw the state's population grow by a third since 2000, but that has now turned to bust.

This has created understandable concern about balancing the state's budget while maintaining necessary services and not undermining recovery and growth. While the state has a relatively good tax structure, its tax burdens and collections are about middle-of-the-pack among the states.

Some of these ideas for new or expanded taxes have focused on business, including a corporate income tax, a gross receipts tax similar to Washington's or Ohio's, or a "margin" tax similar to Texas's. Working with in-state experts, we prepared an analysis of all of these ideas, including how they would affect Nevada's performance in our 2011 State Business Tax Climate Index.

Our report explained the problems with gross receipts taxes, the unimpressive performance of Texas's margin tax, and the volatility problems of corporate income taxes. After its release, the report was widely read and cited by legislators, the media, and activists, and the final budget ultimately contained no business tax proposal. tw

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For the report, see goo.gl/1SyGW.

New York, New Jersey Lead Nation in Property Taxes

In May, Analyst Nick Kasprak updated our interactive property tax look-up tool at interactive.taxfoundation.org. The tool includes nearly all 3,139 counties in the United States, with five-year average data from 2005 to 2009.

Hunterdon County, New Jersey ranks first for median property taxes. For median property taxes as a percentage of median home value, Orleans County, New York takes the top spot, and all of the top ten counties for this statistic are in upstate New York. Finally, the No. 1 county for median property taxes as a percentage of median household income is Passaic County, New Jersey. tw

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See our summary report at goo.gl/Hav8Z. Check out your county's property tax at goo.gl/w51gX.

SALES TAX HOLIDAYS:

Politically Expedient but Poor Tax Policy

By Mark Robyn

Sales tax holidays are periods of time when selected goods are exempted from state (and sometimes local) sales taxes. Such holidays have become an annual event in many states, with exemptions for such targeted products as back-to-school supplies, clothing, computers, hurricane preparedness supplies, products bearing the U.S. government's Energy Star label, and even guns. High-tax New York State sparked the trend in 1997 as a way to discourage border shopping. In 2011, 16 states will conduct sales tax holidays, down from a peak of 19 states in 2010 (see table).

At first glance, sales tax holidays seem like great policy. They enjoy broad political support, with backers arguing that holidays are a highly visible form of tax cut and provide benefits to low-income consumers. Politicians and other supporters routinely claim that sales tax holidays improve sales for retailers, create jobs, and promote economic growth.

Despite their political popularity, sales tax holidays are based on poor tax policy and distract policymakers and taxpayers from real, permanent, and economically beneficial tax reform. Here are the reasons that sales tax holidays make poor tax policy:

- Sales tax holidays do not promote economic growth or significantly increase consumer purchases; the evidence shows that they simply shift the timing of purchases. Some retailers raise prices during the holiday, reducing consumer savings.
- Sales tax holidays create complexities for tax code compliance, efficient labor allocation, and inventory management. However, free advertising for what is effectively a paltry 4 to 7 percent sale leads many larger businesses to lobby for the holidays.
- Most sales tax holidays involve politicians picking products and industries to favor with exemptions, arbitrarily discriminating between products and across time, and distorting consumer decisions.
- While sales taxes are somewhat regressive, this is often exaggerated to sell the idea that sales tax holidays are an effective way of providing relief to the poor. To give a small amount of tax savings to low-income individuals, holidays give a large amount to others.
- Political gimmicks like sales tax holidays distract policymakers and taxpayers from genuine, permanent tax relief. If a state must offer a "holiday" from its tax system, it is a sign that the state's tax system is uncompetitive. If policymakers want to save money for consumers, then they should cut the sales tax rate year-round. tw

Sales Tax Holidays

State	Items	Days	Date	Years
Alabama	Clothing, computers, school supplies, books	3	Early August	2006-2011
Arkansas	clothing, school supplies	2	Early August	2011
Connecticut	Clothing, footwear	7	Mid August	2000-2011
	Energy Star appliances	3 months	June-September	2007
Florida	Clothing, footwear, books and school supplies (beginning in 2004)	7-9 (2004-2009), 2 (2010-2011)	Mid/early August (2010) End July (2004-2009)	1998-2001, 2004-2007, 2010-2011
	Emergency supplies	12	Late May/early June	2005-2007
	Energy Star appliances	7	Early October	2006
Georgia	Clothing, footwear, books, school supplies, and computers; Energy Star appliances in 2006	4	Late March (2002), early August	2002 (twice), 2003-2009
	Energy Star appliances	4	Early/mid October	2005, 2007-2009
Illinois	Clothing, footwear and school supplies	10	Early/mid August	2010
Iowa	Clothing, protective equipment, select sports equipment	2	Early August	2000-2011
Louisiana	Tangible personal property, first $2,500	2	Mid December, Early August in 2010	2005, 2007-2011
	Hurricane supplies	2	Late May	2008-2011
	Firearms	3	Early September	2009-2011
Maryland	Clothing, footwear	5-7	Mid/late August	2001, 2006, 2010-2011
	Energy Star appliances	3	Mid April	2011
Massachusetts	Tangible personal property under $2,500	1-2	Mid August	2004-2008, 2010
Mississippi	Clothing, footwear	2	Late July/early August	2009-2010
Missouri	Energy Star appliances	7	Late April	2009-2010
	School supplies, computer software and hardware, clothing and footwear (beginning in 2005)	3	Early/mid August	2004-2010
New Mexico	Clothing, footwear, computers, school supplies	3	Early August	2005-2011
North Carolina	Clothing, school supplies, computers, educational software, sports equipment	3	Early August	2002-2011
	Energy Star appliances	3	Early November	2009-2010
New York	Clothing, footwear	7	Mid January	1997-2000, 2004-2006
	Clothing, and footwear (beginning in 1998)	7	September, first week	1997-1999, 2003-2005
Oklahoma	Clothing, footwear	3	Early August	2007-2011
Pennsylvania	Personal computers	8	Mid August (2000, 2001), mid February (2001, 2002)	2000, 2001 (twice), 2002
South Carolina	Clothing, footwear, school supplies, computers, printers, software, various bath supplies and bed linens	3	Early August	2000-2011
	Most purchases	2	Late November	2006
	Firearms	2	Late November	2008-2011
Tennessee	Clothing, school supplies, computers	3	Early August	2006-2011
	Clothing, school supplies, computers	3	Late April	2006-2008
Texas	Clothing, footwear	3	Early/Mid August	1999-2011
	Energy Star appliances	3	Late May	2008-2011
Vermont	Computers	3	Mid August (2003, 2004), mid October (2004)	2003, 2004 (twice)
	Tangible personal property	1-2	Mid July (2008), late August (2009), Early March (2010)	2008-2010
	Energy Star appliances	7	Mid July	2009
Virginia	School supplies, clothing, footwear	3	Early August	2006-2011
	Energy Star appliances	4	Early October	2007-2011
	Emergency supplies	7	Late May	2008-2011
West Virginia	Clothing, footwear, school supplies, computers, educ. software	3	Early August	2002-2004
	Energy Star appliances	7; 3 months in 2009 and 2010	Early September; September 1 - November 30, 2009-2010	2008-2010
District of Columbia	School supplies, clothing, footwear	9-10	Early/mid August	2001-2002, 2004-2008
	Clothing and shoes	9-10	Late November	2001, 2004-2009

CONGRESSIONAL TESTIMONY:

Ensuring that State Taxation Does Not Harm the National Economy

Vice President, Legal & State Projects Joe Henchman was one of three witnesses to testify to the House Judiciary Committee's Subcommittee on Courts, Commercial, and Administrative Law on May 25. The topic was proposed federal laws to restrain states from taxing nonresident individual income, out-of-state business income, and out-of-state sales.

Responding to a claim by a state official that states can handle it themselves, Henchman argued that they have no incentive to do so and that Congress had pushed states to do so since 1959 without results. He noted that the Founders gave Congress the power to restrain states from harming the national economy through "beggar-thy-neighbor" tax discrimination. Read the full testimony at http://judiciary.house.gov/hearings/hear_04132011_2.html.

Excerpts from the testimony:

A few years ago, we got a call from a woman in Ohio. Her son was a semi-professional soccer goalie and he had earned $28,000. Spread across this woman's kitchen table were 10 state income tax returns, divvying up the tax on $28k. States are becoming more aggressive with nonresident income taxes, hunting schedules via Twitter, demanding travel vouchers, generally imposing a colossal compliance burden that is a net revenue wash, transferring tax dollars from low-tax, low-expense states to the states with the highest tax burdens.

Tax systems should aim to treat like transactions alike, whether the seller is remote or in-state. Income tax should be paid by those who work or live in a jurisdiction. However, the economy incurs enormous deadweight loss if income tax obligations kick in at minimal levels of activity. The proposed standard of restricting states' power to tax individuals who work in a state for less than 30 days is a good compromise.

The states are hurting, it is true. They aren't entirely innocent in that predicament. But state fiscal pain does not justify beggar-thy-neighbor policies that impose significant compliance and deadweight losses on the national economy. State power to tax should not extend to everything everywhere.

As a country we have gone from the artisan to Amazon.com. But the sophistication of technology only makes it more important that we be vigilant against state efforts to burden interstate commerce and impose uncertainty on the national economy. tw

Tax Foundation Clerkship Program

Laura Lieberman joins our Center for Legal Reform this summer as law clerk. Laura is a third-year student at George Mason University School of Law, where she studies taxation and law and economics. She is also the publications editor for the *Journal of Law, Economics, and Policy*. Before attending law school, she graduated from Berry College with degrees in history and government.

> "My favorite part of the clerkship so far is that in addition to learning about the nuances of the tax law, I've also been exposed to information concerning its economic consequences. In law school, it can be easy to get caught up in the particular details of the assigned cases, but the work I've done here has illustrated how tax law works in real life."
>
> —Laura Lieberman

Our clerkship is highly competitive but rewarding, as evidenced by recent news from two past clerks.

Arushi Sharma, who was our law clerk from the spring of 2010 through spring 2011, recently joined the American Gas Association as an attorney. During her Tax Foundation clerkship, Arushi had drafted several

continued, next page

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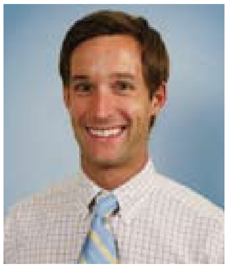
amicus briefs on taxpayer protections and the scope of state taxing authority, and co-authored papers on tax retroactivity and Justice Stevens's tax case history.

"The TF clerkship gives you everything you don't learn in law school: how to incorporate economic arguments into legal ones, distill heavily disputed case law into solid conclusions, use lay expertise in legal documents, foray into legal media, and master procedural niceties."

—Arushi Sharma

Travis Greaves, who was our clerk from the fall of 2008 through fall 2009, recently joined the firm of Reed Smith LLP and serves as an adjunct professor at Georgetown University Law Center. During his clerkship, Travis drafted amicus briefs on taxes vs. fees and co-authored research reports on then-Judge Sotomayor's tax case history, Justice Souter's tax case history, and the complex tax policy surrounding New York's new Yankee Stadium.



Learn more about our clerkship program at goo.gl/cPTIB.

Tax Foundation in the U.S. Supreme Court:

Ending the Nexus Guessing Game, Lamtec v. Washington

By Joseph Henchman

On June 16, we filed a brief with the U.S. Supreme Court asking them to take a case involving an out-of-state business forced to pay Washington State's Business & Occupation Tax. We argue that the state is unconstitutionally imposing its tax on economic activity occurring in other states and properly taxed by other states.

In 1992, the U.S. Supreme Court held that states can only impose sales tax obligations on businesses with property or employees in the state. Otherwise, the Court feared, retailers would be forced to comply with the several thousand sales tax systems in the United States, each with different rates, bases, and definitions.

Nevertheless, some states have asserted the power to tax non-present businesses. Our brief includes some examples:

- Merely having a phone number listed in a telephone book is treated as sufficient nexus-creating activity in nine states.
- Having a website hosted on another entity's server in the state creates nexus in thirteen states.
- Sending employees to attend a seminar but engage in no sales activity creates nexus in one state and the District of Columbia.
- While shipping products in non-returnable containers is protected by Public L. 86-272, shipping products into a state in returnable containers creates nexus in 26 states.

Our brief urges the Court to take the case as an opportunity to guide taxpayers' business arrangements by adopting a simple and sensible rule. Namely, a taxpayer with a continuous presence in a state is presumptively taxable on all commercial relations with that state, and has the burden of rebutting the presumption, while conversely a taxpayer that is present only intermittently is presumptively not taxable in the state, and the state has the burden of showing a causal relationship between the intermittent activities and the in-state customer relations.

See the full brief at goo.gl/Rnppa.

Congressman Jeff Flake (R-AZ)

The Debt Ceiling and Fiscal Responsibility

As vital as principled tax policy is, tax reform alone will not restore America's fiscal responsibility. Sensible tax policy must be paired with a balanced budget and curtailed spending. In this column, U.S. Rep. Jeff Flake explains the importance of cutting spending, creating enforceable spending caps, and balancing the federal budget.

Jeff Flake is presently serving his sixth term in Congress, representing the Sixth Congressional District of Arizona. Jeff serves on the House Committee on Appropriations. He is a fifth-generation Arizonian, raised on a ranch in Snowflake, Arizona. He graduated from Brigham Young University, where he received a B.A. in International Relations and an M.A. in Political Science.

"Unfortunately, some in Congress – and the White House – don't see the seriousness of our fiscal problem, and continue to pursue the status quo. Our fiscal future will take a nose dive if the status quo wins."

In May, the United States government was dealt a significant blow. Moody's credit-rating service announced that unless a plan to significantly reduce the federal budget and national debt is put into action over the next several weeks, our government could lose its sterling AAA credit rating. This comes after Standard and Poor's credit rating agency issued almost an identical warning in April.

That may not sound so much like an Armageddon scenario. Credit ratings, after all, can be improved over time through responsible spending habits.

But this isn't someone's personal credit rating we're talking about. This is the federal government's credit rating. If we can't get our spending habits under control and start eliminating some of our $1.4 trillion budget deficit and $14.3 trillion national debt — and if we continue to borrow more than we might be able to pay back — markets are going to realize the U.S. isn't a good credit risk. Absolute worst case scenario? We'll have to default — for the first time — on payments owed to our creditors. That's when our credit rating will take a nose dive. And, it will take many, many years to level out from a nose dive like that.

Our situation is serious. The U.S. Treasury Department recently issued a warning that if we don't raise our $14.3 trillion debt ceiling — which we've already hit — before August 2, we'll be on the fast track to that nose dive. We need to start eliminating some of our debt now.

The responsibility of piloting this mission to reduce our fiscal footprint falls primarily to Congress. Over the last several months, we have been embroiled in talks on how to solve our ever-deepening fiscal crisis. The most sensible and sustainable strategy to reduce our complicated money troubles that has emerged is simple in concept: cut, cap, and balance.

By cutting our existing spending, creating enforceable caps for future spending, and balancing the federal budget through a constitutional amendment, we'll avoid ruining the U.S. credit rating and at the same time, trim the excessive spending that put us on this unsustainable path in the first place.

A number of actions have been taken to put the cut, cap, and balance strategy into motion. The federal budget proposed by House Budget Committee Chairman Paul Ryan of Wisconsin is the first step in the right direction when it comes to righting our fiscal ship. It cuts spending by $6.2 trillion over 10 years compared to the President's budget and offers a plan to reform Medicare — the single biggest cost to the federal government — with the goal of keeping it around for future generations. It also offers a plan to balance the budget by 2040. The House passed the Ryan budget. However, the Senate rejected it.

In May, I joined Congressmen Jack Kingston and Tom Graves of Georgia and Congressman Jim Jordan of Ohio in introducing a bill that would help to prevent budget deficits, reduce the debt, and eventually balance the budget by putting in place enforceable spending caps that reduce

continued, next page

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spending levels to 18 percent of gross domestic product (GDP) over the next five years. Right now, no such cap exists.

The fiscally conscious proposals offered in the Ryan budget and the Kingston/Jordan/Flake/Graves bill offer a solid picture into what it will take for the House to pass any increase to the U.S. debt ceiling. An increase in the debt limit, a short-term problem-solver, will need to be accompanied by cuts, caps, and balance: short-term cuts to 2012 spending, near-term enforceable spending caps, and long-term budget reforms that ensure balance. So when the House voted on a straight increase to the debt ceiling without any of the cuts, caps, or balance so many in Congress have been clamoring for, it's no wonder the measure failed, and failed fairly miserably.

Congress now faces another vote to increase the debt ceiling. Unfortunately, some in Congress — and the White House — don't see the seriousness of our fiscal problem, and continue to pursue the status quo. Our fiscal future will take a nose dive if the status quo wins. tw

The Tax Foundation invites national leaders from all perspectives to contribute columns to Tax Watch. The opinions expressed are those of the authors and not necessarily those of the Tax Foundation.

Tax Fact:

When the Congressional Budget Office made a ten-year budget projection in 2000, their predictions underestimated the eventual gap between government revenue and spending by approximately $1 trillion. The policy changes most responsible:

- ↑ Discretionary spending increased by **$417 billion**
- ↑ Mandatory spending increased **$409 billion**
- ↓ Bush-era tax cuts reduced revenue by **$181 billion**

Source: goo.gl/ShFCP

Meet Our Summer 2011 Interns

While many D.C. organizations offer internships, ours is unique in that it is designed to introduce undergraduate and graduate students to tax policy principles, and how to find innovative ways to apply them in assessing and advancing public policy. We are rapidly gaining a reputation as one of the most substantive and competitive internships for aspiring fiscal policy experts.

Past interns, working with our staff, have produced research reports and published commentaries on policy in newspapers and journals. Interns also receive career mentoring, training in policy writing and speaking, and meet notable experts and officials in the D.C. area. This summer, interns are researching obesity tax proposals, sales tax holidays, local income taxes, tax amnesties, effective corporate tax rates, targeted tax incentives, film tax credits, and more.

We are able to provide our internship program thanks to the generous support of our donors. Please support our internship program by visiting www.TaxFoundation.org/support. tw

Back row, from left:

Philip S. Dittmer
M.P.P., Indiana School of Public and Environmental Affairs, 2012
B.A., History & Political Science, Purdue University, 2010

Toban N. Wiebe
B.A., Economics and Mathematics, University of Manitoba, 2013

Christopher M. Alcantara
B.A., Business Administration & Economics, Stetson University, winter 2011

Ryan J. Rosso
B.A., Political Science, University of California, Berkeley, 2012

Front row, from left:

Jason K. Sapia
M.P.P., Stony Brook University, 2011
B.A., Political Science & Economics, Hofstra University, 2009

Zachary W. Castle
B.A., Mathematical Economic Analysis, Rice University, 2012

Frederick W. Hubach
B.A., Economics & German, Wheaton College, 2012

Simeon J. Morris
B.A., Political Science & International Relations, University of California, San Diego, 2012

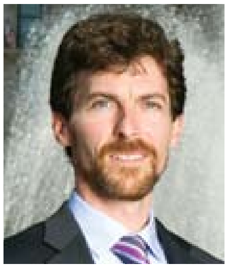
Tax Foundation Welcomes New Staff

We're excited to bring these four talented individuals onto the Tax Foundation team.

William McBride, PhD

Economist

William holds a PhD in economics from George Mason University, where his dissertation involved using agent-based modeling and simulation to analyze the effect of various banking regimes, including free banking, on asset prices. While at George Mason, William was a research assistant at the Interdisciplinary Center for Economic Science, which was established by Nobel laureate Vernon Smith as a center for research in experimental economics.

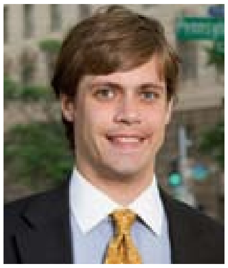


In addition to these areas, William's research interests are broad, including public choice, public finance, industrial organization, history of thought, and the economics of religion. He has taught microeconomics at George Mason's economics department and managerial economics at the School of Public Policy. He also has a bachelor's degree in physics and electrical engineering and worked as a software engineer for seven years.

David Logan

Economist

Before joining the Tax Foundation, David researched tax policy at the Brookings Institution under Bill Gale in the Urban-Brookings Tax Policy Center as the Brookings Institution's Peter G. Peterson Foundation Endowed Fiscal Intern. His research has spanned federal and state tax topics including financial transactions taxes, historical fiscal consolidations drivers, and the value-added tax.



David's other research interests include public finance, welfare economics, and applied game theory. He holds a bachelor's degree from Northwestern University, an MM from the University of Cincinnati and an MBA from Washington University in St. Louis, where he recently completed his first year in Olin Business School's PhD program in business economics.

David has sung operatic repertoire spanning the classical, romantic, and modern periods with such companies as Des Moines Metro Opera, Cincinnati Opera, Opera Iowa, Orlando Opera, and Opera Theater of St. Louis.

Scott Drenkard

Analyst

Scott is an analyst with the Tax Foundation in conjunction with the Koch Associate Program. Prior to joining the Tax Foundation, Scott was selected as a Charles G. Koch Summer Fellow by the Institute for Humane Studies and served as a Ronald Reagan Fellow in the Goldwater Institute's Center for Economic Prosperity. His work can be seen in their quarterly publication, *For the Record*. He holds a bachelor of science, Cum Laude, in economics from the University of Mary Washington, where he founded the Libertarian Readers Society and served as the Vice President of Omicron Delta Epsilon, the international economics honor society. He is a candidate for a master's degree in economics from George Mason University.

Michael Vogler

Government Relations and Corporate Development

Michael Vogler joined the Tax Foundation in February 2011 in the dual roles of Federal Government Relations and Corporate Development. He brings with him a long and diverse history of successful employment. His eight years of sales and business development expertise was strengthened through his time working with and for companies such as Minolta Business Systems, Hitachi Data Systems, Compaq, and Hewlett-Packard. Michael was also a public high school teacher in Loudoun County, Virginia where he taught American Government, World History and International Relations.

The pragmatic and necessary relationship that exists between individuals, businesses and government is what attracted Michael to the Tax Foundation. He is committed to working diligently to support the Tax Foundation's mission in order to advance transparency and neutrality in tax policy. TW

Tax Fact:

Number of states which have considered adopting "Amazon"-style sales tax laws in the past three years: **21**

States that have actually enacted Amazon laws for online retailers: **7**

Number of states with active proposals to repeal their state's Amazon law: **2**

http://www.taxfoundation.org/publications/show/27416.html

COMMENTARIES

"Temporary" Bush Tax Rates now in Law Longer than "Permanent" Clinton Tax Rates

The following is an excerpt from a June 9 Tax Policy Blog post by Tax Foundation President Scott A. Hodge:

Ironically, before the Bush-era rates expire (again) on December 31, 2012, they will have been in place for 10 years, which will tie the 1954 to 1963 period (with a top rate of 91 percent) for the second-longest period of stability for any set of tax rates. The longest any top rate was in effect was the 17 years between 1965 and 1981, when the top rate was 70 percent.

So although the Bush-era tax rates have now been the law of the land for longer than the Clinton-era rates they replaced, Washington's arcane budget rules still regard the Clinton-era rates as "permanent law" and require that the budget baseline be calculated as the amount of tax revenues the government could collect were those higher tax rates in effect.

To the Washington budget establishment, the projected tax revenues that could be raised from the Clinton-era tax rates are as good as collected. Thus, any difference between those higher estimates and the amount that can be collected under the Bush rates is money that must be "borrowed" to finance the government. This is kind of like the young couple who bought a home for $300,000 and now wants to sell it for $500,000, but think they will "lose" money if the home sells for $450,000.

So when does a temporary tax cut effectively become permanent law? Perhaps it is time to stop the pretense that the Bush-era tax rates are temporary and need to be "paid for." One thing is for certain, American taxpayers are being ill-served by the arcane and Beltway-centric jargon of the current tax debate. tw

Mitch Daniels Sets the Example

Excerpt from an op-ed published in the New York Times on May 17, 2011:
Indiana's governor, Mitch Daniels, deserves special praise for ensuring that long-term expenses match long-term revenues, and for building on his predecessors' work to ensure that government outcomes are measured and incentives for better performance are put in place. Arkansas, too, prioritizes expenditures as part of its legislative process, and if there's no money left, the lower priorities do not get funded. The state cannot run a budget deficit.

In too many states, however, the attitude has been to put temporary patches on the budget in hopes that the economy will recover enough to avoid the pain of cutting spending back down to earth. tw

The following are excerpts from a few of our recent media citations and interviews. For a more complete listing of the thousands of citations we receive annually, please see our website list at http://www.taxfoundation.org/press/

LAS VEGAS SUN

Las Vegas Sun, June 11

Though [Nevada Assemblywoman Marilyn Kirkpatrick's] original bill supported a 25 percent [film tax credit], she changed it to 15 percent, saying the state would have given away more money than it collected in taxes at the higher rate. Her enthusiasm for film incentives, she also said, was tempered by a report in June from the Tax Foundation showing some states cutting back on tax credits. The report concludes that "film tax credits fail to live up to their promises to encourage economic growth overall and to raise tax revenue."

THE WALL STREET JOURNAL.

Wall Street Journal, May 27

Property taxes in New York are among the highest in the nation and are growing fast. According to the Tax Foundation, the 15 counties in the U.S. with the highest property taxes, measured as a percentage of home value, are all in New York. Over the last decade property taxes have increased at an average annual rate of 5.4%, roughly double inflation. This is one reason that more than 100,000 New Yorkers have fled to Connecticut and Pennsylvania, according to a study by the Empire Center.

CBSNEWS.com

CBSNews.com, June 7

Mark Robyn, an economist with the nonpartisan Tax Foundation, said that tax rates during those periods [of rapid economic growth] were only "one piece of the puzzle."

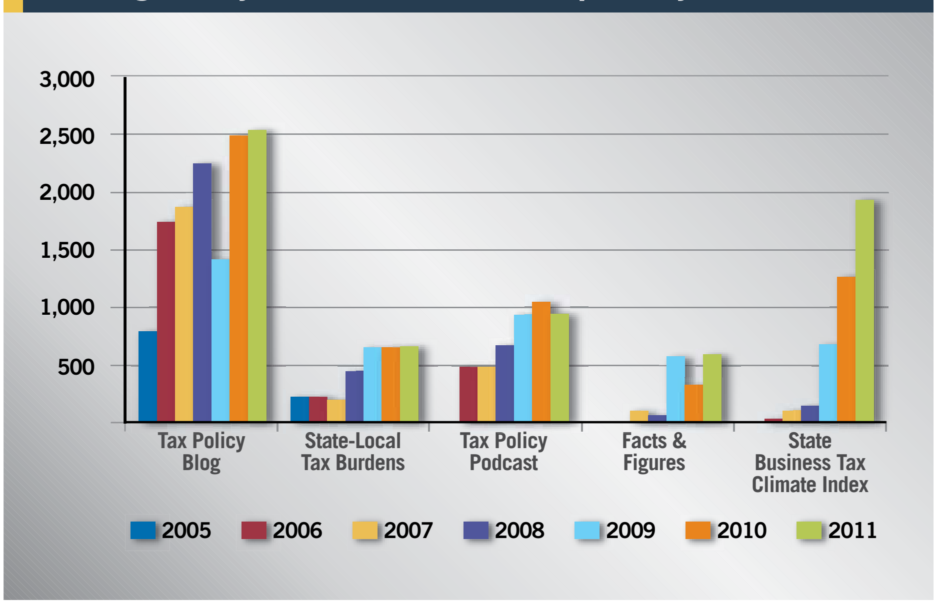
"There are a lot of variables that go into the macro economy," he told Hotsheet. "Economists on both sides try to reconcile their views with data that agrees with them. Ultimately, presidents probably get way too much credit for a good economy and get way too much blame for a bad economy."

CNN

CNN.com, May 19

Of the 10 counties with the highest property taxes in the United States, all are in New Jersey and New York. Connecticut and New Hampshire also had counties that finished high in the rankings. At the other end of the spectrum with the lowest property tax rates are Louisiana and Alaska, according to new calculations from the Tax Foundation, a Washington-based nonprofit that researches tax policy. It used Census data covering five years ended in 2009.

Average daily visits or downloads per day



Tax Foundation in the News

Los Angeles Times

Los Angeles Times, June 6

California property taxes are not among the lowest in the nation. Even with Proposition 13, we still rank higher than 36 other states when it comes to per-capita property taxes, according to the Tax Foundation. Without Proposition 13's protections, California taxpayers would fare far worse and property taxes would be at or near the top, just as we are when it comes to sales, car, gas and personal income taxes.

BusinessWeek

BusinessWeek, June 6

At least seven states instituted temporary so-called millionaire taxes during the recession. Those levies are becoming harder to justify now that state revenues are rebounding. Overall, state tax revenue grew 12 percent in April compared with a year earlier, which may trim $20 billion from estimated state budget shortfalls, according to a recent Goldman Sachs report. The soak-the-rich drive "just petered out," says Joseph Henchman, vice-president for legal and state projects at the Tax Foundation in Washington, a group focused on lowering taxes. "All of these states are backing away now."

The New York Times

The New York Times, May 24

New York has long had some of the highest property taxes in the nation, and those taxes increased by 5.5 percent, on average, each year from 1999 to 2009, according to statistics provided by the Cuomo administration. The Tax Foundation, a nonpartisan research group, said this month that three of the five highest-taxed counties in the nation were in New York: Nassau, Westchester and Rockland Counties. In Nassau and Westchester, the median annual property tax bill exceeds $8,000.

THE HILL

The Hill, June 1

Scott Hodge, the president of the Tax Foundation, said it was hard to put too much weight behind the Center for Tax Justice study because it relied on companies' financial reports to shareholders. "For very good reasons, none of us can have and should have access to their tax returns," said Hodge, whose nonpartisan group advocates for lower tax rates, among other things. "Financial and accounting records are not the same as a tax return, and they tell two different stories."

FOX NEWS Channel

Fox News, June 24

Fox News correspondent Doug McKelway: Economists agree loopholes are a huge source of revenue loss. Tax Foundation Economist Mark Robyn: There are many [corporate tax provisions] that don't need to be there, and if we can get rid of those we can cut the tax rate, raise the same amount of revenue, and be much better off.

By The Numbers

A comparative look at 2011 media citations

Total media citations and interviews from January through June 2010: **1246**

Total media citations and interviews from January through June 2011: **1803**

Increase from 2010 to 2011: **44.7%**

Television networks that have featured our policy staff in 2011: **CNN, NBC, Fox News, CNBC, C-SPAN, C-SPAN 2, MSNBC, Bloomberg TV, Al Jazeera English, Cox Television**

Media mentions of our state and local tax burdens report in 2011: **245**

Media mentions of the State Business Tax Climate Index in 2011: **268**

The New York Times

The New York Times, May 14

When Sears threatened last week to move its headquarters out of state, it should hardly have surprised Gov. Patrick J. Quinn <http://topics.nytimes.com/top/reference/timestopics/people/q/patrick_j_quinn/index.html?inline=nyt-per> , who in January dramatically raised income taxes. The tax increase made Illinois's total corporate tax burden heavier than all but 15 other states, according to the Tax Foundation <http://www.taxfoundation.org/> , a nonprofit research organization. That prompted other states to woo local companies.

The Washington Post

Washington Post, April 28

Federalism — which serves the ability of businesses to move to greener pastures — puts state and local politicians under pressure, but that is where they should be, lest they treat businesses as hostages that can be abused. According to the Tax Foundation <http://www.taxfoundation.org/> , Illinois has not only the fourth-highest combined national-local corporate income tax in the nation but also in the industrialized world. In Peoria, Doug Oberhelman, chief executive of Caterpillar, has told Illinois Gov. Pat Quinn that he is being "wined and dined" by other governors and their representatives encouraging Caterpillar to invest in their states.

The Street

TheStreet.com, April 7

"While tax cuts will always curry more favor with voters than new spending programs, Washington needs to call a truce to using the tax code for social or economic goals," [Scott] Hodge, president of The Tax Foundation said at [a U.S. Senate Budget Committee] hearing. "The consequence of trying to micromanage the economy as well as individual citizens' behavior through the tax code is a narrow tax base and unnecessarily high tax rates. These high rates are endangering America's global competitiveness and undermining the nation's long-term economic growth."

Tax Policy Podcast

Manager of Communications Richard Morrison recently spoke with Will Newton, Executive Director of the Texas chapter of the National Federation of Independent Business. Will gave an excellent recap of what had been accomplished in the Texas state legislature as lawmakers in Austin were bringing the 2011-12 biennial legislative session to an end, and had some colorful comments on the problems with the state's "margin" tax on businesses.

Will Newton on

- the state legislature: "When the legislature's in town, neither man nor beast is safe."
- the state margin tax: "The most disjointed, discombobulated system of taxation ever devised by man."
- his organization's legislative goals: "Keeping government off entrepreneurs' backs and definitely out of their back pocket."

Other recent episodes of the Tax Policy Podcast include interviews with...

Joseph Vranich, business consultant and "relocation coach" on tax trends in California and why the state is seeing a growing number of businesses moving facilities and operations out of state.

Fergus Hodgson, Capitol Bureau Reporter for the Pelican Institute, on recent developments in Louisiana, including the consideration of an online retailer "Amazon" tax, a proposed phase-out of the state income tax for individuals, and a veto fight between Gov. Bobby Jindal and the state legislature over cigarette taxes.

Karlyn Bowman, Senior Fellow at the American Enterprise Institute, on the history of opinion polls on national tax issues. Bowman recently authored the study "Public Opinions on Taxes: 1937 to Today," the most comprehensive collection of polls ever compiled on the topic.

Chris Atkins, General Counsel and of the Indiana Office of Management and Budget about the budget and tax reform bills recently signed by Gov. Mitch Daniels.

J.D. Foster, Senior Fellow at the Heritage Foundation, on Heritage's new blueprint for federal budget and tax reform, "Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending and Restore American Prosperity."

Kurt Wenner, Florida TaxWatch Vice President of Research, on the prospects for Gov. Rick Scott's tax reform proposals.

Ashley Denault, Director of Research at the Rhode Island Public Expenditure Council, about the tax provisions in the budget outline proposed by Gov. Lincoln Chafee.

William Schubart, Vermont Blue Ribbon Tax Structure Commission member, on the Commission's evaluation of Vermont's current tax structure and its suggestions for reform.

Matthew Mitchell, Mercatus Center Research Fellow, on the effects of state tax and expenditure limits. His recent study, "TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?" examines the various policies states have adopted to curb their budgets and how they've fared in practice.

Nina Olson, National Taxpayer Advocate, on complexity in the federal tax code. Her most recent report to Congress, "The Time for Tax Reform Is Now," identifies the most serious problems encountered by taxpayers and makes recommendations for improvement.

Listen to this and other episodes of the weekly Tax Policy Podcast at www.taxfoundation.org/podcast.

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About the Tax Foundation

What Do We Stand For?

As a nonpartisan educational organization, the Tax Foundation has earned a reputation for independence and credibility. However, it is not devoid of perspective. All Tax Foundation research is guided by the following principles of sound tax policy, which should serve as touchstones for good tax policy everywhere:

Simplicity: Administrative costs are a loss to society, and complicated taxation undermines voluntary compliance by creating incentives to shelter and disguise income.

Transparency: Tax legislation should be based on sound legislative procedures and careful analysis. A good tax system requires informed taxpayers who understand how tax assessment, collection, and compliance works. There should be open hearings and revenue estimates should be fully explained and replicable.

Neutrality: The fewer economic decisions that are made for tax reasons, the better. The primary purpose of taxes is to raise needed revenue, not to micromanage the economy. The tax system should not favor certain industries, activities, or products.

Stability: When tax laws are in constant flux, long-range financial planning is difficult. Lawmakers should avoid enacting temporary tax laws, including tax holidays and amnesties.

No Retroactivity: As a corollary to the principle of stability, taxpayers should rely with confidence on the law as it exists when contracts are signed and transactions made.

Broad Bases and Low Rates: As a corollary to the principle of neutrality, lawmakers should avoid enacting targeted deductions, credits and exclusions. If such tax preferences are few, substantial revenue can be raised with low tax rates. Broad-based taxes can also produce relatively stable tax revenues from year to year.

OUR MISSION

The mission of the Tax Foundation is to educate taxpayers about sound tax policy and the size of the tax burden borne by Americans at all levels of government. From its founding in 1937, the Tax Foundation has been grounded in the belief that the dissemination of basic information about government finance is the foundation of sound policy in a free society.

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