NATIONAL REVIEW ONLINE

Tax Day

How much, really, do different brackets of wage earners pay?

By Michael Tanner

April 16, 2014

Yesterday was, of course, tax day, the day on which most Americans file their federal and state income taxes. This, it should be noted, is different from the day on which Americans finally stop working just to pay taxes, which this year falls on April 18, three days later than last year. Until then, the government collects, on average, every cent that Americans earn, so you may still have a few more days to go until you can keep the fruits of your labor.

Altogether, Americans will pay roughly $3 trillion in federal taxes this year, the most ever in nominal dollars. For taxes as a share of GDP, it is topped only by the year 2000. So much for the idea that our budget problems are caused by a lack of revenue.

Tax day inevitably brings out a wide variety of pundits and politicians to repeat a number of persistent myths about American taxation, in particular the recycled claims about how the current tax system is rigged against the poor and middle class to benefit the wealthy.

There certainly is much to criticize about the American tax system. It is far too complex and riddled with special-interest favors. There is definitely something wrong when an estimated 1,000 American households earning more than $1 million were able to avoid paying any income taxes in 2013. Moreover, the time and effort put into tax avoidance is badly distorting to the economy in general. Those who believe in free markets should admit that not every tax break is justifiable.

However, on the larger point, wealthy Americans already pay a disproportionate share of federal income taxes. The top 1 percent earns 16 percent of all income in the United States, while paying 36.7 percent of all federal income taxes. The top 5 percent earns just over a third of U.S. income, but pays 59 percent of federal income taxes. On the other hand, the bottom half of tax filers earns 12 percent of U.S. income, but pays just 2.4 percent of federal income taxes. In fact, the 400 highest-earning Americans together pay nearly as much in federal income taxes as do the 50 percent of taxpayers at the low end of the scale. So, yes, the rich earn a lot more than the rest of us — that’s what makes them rich, after all — but they pay even more.

True, if you also take into account sales, payroll and corporate income taxes, things even out a bit. But even so, in 2010 the average federal tax rate was only 11.5 percent for the middle quintile, compared to 24 percent for the highest quintile. The much-maligned 1 percent faced an even higher average rate of 29.4 percent. All of this is before the increase in the top tax rates as part of the fiscal-cliff deal and the numerous tax increases embedded in Obamacare take effect; today, the tax system is even more progressive than it was four years ago.

And if you consider taxes as a transaction — what people receive from the government vs. what they pay — in 2010 those in the lowest quintile paid, on average, $300 in federal taxes but received $8,600 in transfers from programs like the earned-income tax credit, the Supplemental Nutrition Assistance Program, and the refundable portion of the child tax credit. But this phenomenon was hardly confined to the lowest-income Americans. Indeed, three-fifths of Americans received more in transfers than they paid in federal taxes, with those in the middle quintile receiving $8,400 more than they paid in.

As can be seen from the numbers above, the U.S. tax code is quite progressive. But American liberals might be shocked to discover that the United States actually has the most progressive tax system of all the major industrialized democracies. The OECD measured the ratio of percentage of taxes paid to percentage of market income for the top 10 percent of earners in 24 countries. Total market income is far larger than total taxes paid, so even if the ratio is above 1, this is not saying this population pays more in taxes than they earn; it is saying that the *share* of taxes they pay is greater than the share of income they earn. In this report the U.S. came out on top, with the share of taxes paid equaling 135 percent of the share of income earned, far ahead of such "progressive" countries as France (110 percent), Denmark (102 percent), and Sweden (100 percent).

We think of the European countries as having progressive tax systems because they have such high taxes on the rich. But we forget that they have high taxes on everyone else too. In addition, they rely heavily on value-added taxes, which are highly regressive. In 2011, nearly 18 percent of Europe's tax receipts, on average, came from value-added taxes — as much as 30 percent in Lithuania. Nor should we forget that the United States has a higher corporate tax rate than any of our European rivals.

A serious debate about tax reform is long overdue. But any such debate will require a few more facts — and a bit less class warfare.

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