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FROM SOUTH JERSEY TO YOU

Tiered, flat or sales tax?

By **MICHAEL L. DIAMOND** • Gannett New Jersey • November 7, 2010

Except for a brief period during the Civil War, the nation's progressive income tax system, in which wealthier citizens pay higher tax rates, began in 1913 with the passage of the 16th Amendment to the Constitution.

It wasn't universally embraced; some viewed it as an intrusion by the federal government. But it raised revenue and took some of the burden off lower-income workers.

"It was really a political calculation to say, 'Our goal here is to shift the burden up the income scale,'" said Joseph J. Thorndike, a tax historian with Tax Analysts, a nonpartisan research group based in Falls Church, Va.

Nearly 100 years later, President Barack Obama and Congress are butting heads over whether to extend tax cuts that were signed into law by former President George W. Bush. Obama wants to increase the top income tax rate. Conservative lawmakers want to see the rates for everyone remain the same.

The debate, about the fairest way to raise revenue to fund government services and promote economic growth, isn't confined to Washington. New Jersey Gov. Chris Christie, for example, has lowered the state's top income tax rate.

In many respects, the debate reflects taxpayers' own conflicted attitudes about taxes. They bemoan the loss of income and embrace their Social Security checks. They urge lawmakers to let them keep more money and complain about slow-moving trains. And the elected leader who votes to raise taxes or cut services does so perilously.

"It's tough," said Judy Rosner, 48, of Ocean Township. "I think everybody should have something -- that's the socialist in me. But you can't penalize people for doing well."

As it stands, the wealthy pay progressively more. The federal government's income tax rate for a married couple filing together ranges from 10 percent on the first \$16,750 of income to 35 percent on income of more than \$373,650.

New Jersey's income tax rates range from 1.4

percent on the first \$20,000 of income to 8.97 percent on \$500,000 of income or more.

In both instances, it has left the government with less money than it spends. New Jersey residents are uniquely positioned to observe two different strategies to narrow the budget gap.

Obama wants to raise the top rate to 39.5 percent for families with incomes above \$250,000 to help reduce the deficit and try to narrow what has been a growing income disparity between the rich and the poor.

Christie vetoed a Democratic proposal that would have extended a surcharge on millionaires to provide property tax relief, saying that the wealthy, tired of high taxes, are fleeing the state and taking their lavish spending with them.

"There are arguments on both sides," said Michael Livingston, a law professor at Rutgers University School of Law in Camden. "The weight of academic economists, who tend to be more liberal, would be more skeptical of the (benefits of a) tax cut for the rich, whereas, not surprisingly, the weight of businesses or people who teach in business schools would be more in favor of tax cuts.

"You can't really do an experiment" to see what works best, he said. "The reality is, it gets resolved more by belief systems."

The income tax system began with a top rate of 7 percent. But by 1918, with World War I raging, many of the same people who supported the modest



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income tax voted to revise it to include 56 tax brackets, including a rate of 77 percent for incomes over \$1 million, according to the Tax Foundation, a Washington, D.C., research group.

As recently as 1963, married couples paid 91 percent on income of more than \$400,000. But President Ronald Reagan ushered in an era of small government, and the Tax Reform Act of 1986 essentially created two rates, the highest of which was 28 percent.

Since then, elected leaders have raised taxes at their own peril. A Democratic Congress was swept out of office in 1994 after voting to raise the top rate from 31 percent to 39.6 percent. Yet the economy in the late 1990s surged. The federal government balanced the budget. And supporters of a progressive tax system pointed to it as proof that higher-income workers could bear a heavier tax burden without stifling economic growth.

They point to the economic theory of marginal utility. In a bid to build a fair society -- with schools, roads and public safety -- government turns to the wealthy, who, even in the face of higher taxes, can afford life's luxuries.

Raising their federal income taxes "would be a good thing," said Jay Soled, an accounting professor at the Rutgers University School of Business in Newark and New Brunswick. "Our economy would be more solid because we'd have a smaller deficit. We'd have to borrow less."

Others, however, said the progressive income tax has created a complicated system full of loopholes that are easily exploited by corporate interests.

Several New Jersey congressional candidates this fall said they favored repealing the 16th Amendment and replacing the income tax -- along with other taxes such as the estate tax, the Social Security tax, the capital gains tax and corporate taxes -- with a national sales tax.

A bill introduced in Congress in 2009 called for a sales tax of 23 percent -- with taxpayers getting a monthly rebate for "necessities." Its supporters say such a tax would be fairer, would promote savings and investment and would protect privacy.

Others favor a flat income tax. The proposal, pushed by figures such as Steve Forbes, would exempt low-income workers and tax everyone else

the same rate. Forbes proposed 17 percent.

Flat tax proponents say it would promote saving by preventing income gained from dividends and investments from being taxed twice. It would reward work, they argue, and be simple enough so that taxpayers could file their tax return on the back of a postcard.

In exchange, some popular exemptions would be eliminated. Among them, deductions from interest on mortgages and property taxes.

"It would be much better for the economy and it would reduce a lot of corruption in Washington," said Daniel Mitchell, senior fellow for the Cato Institute, a Washington, D.C., research group that advocates personal liberty. "Those are two big reasons.

"You would just have a much more friendly system that doesn't punish people for working, saving and investing as much. And also you'd get rid of a lot of crazy loopholes that encourage people to make investments for tax reasons instead of for economic reasons."

But when Congress convenes this fall and debates raising taxes on the wealthy, it likely will touch on class warfare, fairness, individual liberty and social responsibility.

In short, as the Tax Analysts shows in its online tax history museum, it will be part of a debate as old as the nation.

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The Supreme Court in 1895 found an income tax to be unconstitutional, forcing lawmakers to pass what would become the 16th Amendment.

The liberal New York World decried the court's decision, saying it was "another victory of greed over need." The conservative New York Tribune said, thanks to the court, "our government is not to be dragged into a communistic warfare against the rights of property and the rewards of industry."

It almost sounds like the same debate.

"In every way," Thorndike said.

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U.S. INCOME TAX HISTORY

Below are listed from left to right, by selected year, the top federal income tax rate for the highest earners and the number of different income-based tax rate brackets that existed that year:

1913 -- 7 percent -- 7

1918 -- 77 percent -- 56

1929 -- 25 percent -- 23

1932 -- 63 percent -- 55

1942 -- 88 percent -- 24

1952 -- 92 percent -- 24

1965 -- 70 percent -- 25

1982 -- 50 percent -- 13

1988 -- 28 percent -- 2

1994 -- 39.6 percent -- 5

2003 -- 35 percent -- 6

2010 -- 35 percent -- 6

Note: Information is for married couples filing jointly

Source: The Tax Foundation



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