Forbes

New CBO Report Shows Higher Taxes Amidst Nightmare Debt

Ryan Ellis

July 13, 2016

The Congressional Budget Office has just released their annual "Long Term Budget Outlook" which shows the path of taxes, spending, and debt over the next thirty years.

As usual, it's a very depressing document. There's already good write ups on it in the *Wall Street Journal*, as well as by Dan Mitchell of the Cato Institute and Veronique de Rugy at the Mercatus Center. Try not to read them too close to the nearest skyscraper window.

I wanted to drill down specifically on the tax section here. What's amazing is that even as the annual deficits and debt grow over the years, taxes are going up at the same time. Do the math, and that means that rate of spending growth is so fast that it *both* overwhelms steadily growing revenues *and* contributes to higher deficits and mounting debt. We have an over-spending problem, not an under-taxing problem.

Three ways taxes are going up on all of us over the next thirty years:

Higher Taxes for the Country

According to CBO, the 50-year average for taxes as a percentage of gross domestic product (GDP) is 17.4 percent.

In 2016, federal tax revenues will be 18.2 percent of GDP, quite a bit higher already than the historical average. It gets worse from there:

	Taxes/GDP
2016	18.2%
2031	18.5%
2039	19.0%

2046	19.4%

The numbers don’t stop getting higher. Eventually, taxes will hit and then exceed the record, 20 percent of GDP, which was reached in 2000 only.

Taxes are climbing inexorably toward record highs. Why is this? According to CBO, it’s due to a few significant factors besides technical issues:

Real bracket creep. This is the phenomenon whereby tax brackets are indexed to inflation, but personal income grows faster than inflation over time. As a result, people end up in higher tax brackets even after inflation is discounted.

The surtax on everybody. As part of Obamacare, a 3.8 percent tax was put on all “unearned” (basically, non-wage) income in households exceeding $250,000 ($200,000 in the case of singles). Similarly, a Medicare payroll tax bracket at this 3.8 percent level was also created for earned income above this amount. The dollar figures here are not indexed to inflation. As a result, more and more people will find themselves in this “high income” surtax over time, pushing up taxes for everyone before long.

Baby Boomer retirement. As Baby Boomers retire, they will begin to draw benefits from defined benefit pensions, and begin to make distributions from retirement accounts such as 401(k)s and IRAs. They will then pay taxes on these retirement sources of income.

Cadillac plan tax and bonus depreciation. These are the least certain of the upward drivers of taxation. Obamacare’s 40 percent excise tax on high cost health insurance plans was recently delayed until 2020 (most think it will never actually go into effect now).Similarly, businesses can currently deduct half the cost of new tangible personal property business investment (i.e, equipment and technology) before subjecting the rest to multi-year depreciation deductions. This “50 percent bonus depreciation” is set to glide downward and then expire in 2020. Congress routinely has reauthorized this partial expensing provision, however.

Higher Taxes on Both Labor and Capital

No one gets off free from these higher taxes. The CBO report says that the effective marginal tax rate on labor income will rise from 30 to 33 percent between 2016 and 2046. The effective marginal tax rate on capital will rise from over 14 percent to over 18 percent.

The “effective marginal tax rate” is a weighted average marginal tax rate across income distributions.

What that means is that there’s no escape from these higher taxes. Whether you work, or grow a business, or invest wisely, or save, you will face higher marginal tax rates on this activity.

The higher rates on capital are especially disturbing, since taxes on capital are a big input into the overall growth in the economy, personal income, and productivity.

Higher Taxes on Middle Class Families

What about the effect on typical families? CBO helpfully provides a snapshot of the average effective income-plus-payroll tax rate on three types of families: a median income family of four (half of families of four earn less and half earn more); a family of four earning half the median income; and, a family of four earning twice the median income.

Here's what happens to their income and payroll tax burdens as a percentage of their total income:

	2016	2046
Half Median ("Working Class")	2%	10%
Median ("Middle Class")	17%	19%
Twice Median ("Mass Affluent")	25%	28%

To put some meat on the bones for this, the median total income (as measured by CBO) for a family of four today is about $110,000. So, half median is $55,000 and twice median is $220,000. I would term these "middle class," "working class," and "mass affluent" (respectively) to describe these groups.

What we see is that all of them face higher taxes as a percentage of their income over time. What's scary (as noted by CBO) is that the working class cohort, those making $55,000 in total income today, will face the largest tax increase of all, from 2 to 10 percent of their total income being taken in taxes. Try to remember that the next time someone says that working class families with kids don't need any additional tax relief.

The "mass affluent," by contrast, face a significant but much more digestible tax increase. The goal should be to avoid tax increases on any of these cohorts, but the regressive nature of them is contrary to both basic humanity and Congressional intent.

Conclusion: We Need Tax Reform

The conclusion to this should be fairly obvious, at least on the tax side. Our tax code is rigged to produce higher taxes over time, even after inflation, and even after growth in the economy. We need tax reform (the House GOP blueprint is now the best one out there) in order to change this.

Absent fundamental tax reform, we should remove the automatic tax hikes from our tax code. That would involve:

Indexing tax brackets to nominal GDP growth (not just inflation), or repealing the 3.8 percentage point tax on virtually all income exceeding $200,000 per year

Repealing the Cadillac plan excise tax, or making 50 percent bonus depreciation permanent

Picking one option from each category would hold taxes to their current levels as a percentage of economic output indefinitely (static score, of course). Picking both options from each category would result in lowering taxes to their historical average. Absent fundamental reform, this should be the fallback option for a pro-taxpayer Congress.