The United States Tax Reforms

Introduction

In 1980, then Presidential candidate Ronald Reagan campaigned upon a platform that promised lower tax rates to stimulate economic growth. In 1981, his promise was fulfilled when the Economic Recovery Tax Act was enacted, reducing individual income tax rates approximately 23 percent across the board. The top rate for individuals was lowered from 70 percent to 50 percent. That Act was the centerpiece of the Reagan Administration's economic recovery program, the major domestic policy initiative of President Regan's first term.

Likewise, the most significant domestic policy achievement of President Reagan's second term in office was enactment of comprehensive reform of the individual and corporate Federal income taxes. Under this landmark tax reform legislation, marginal tax rates for both corporations and individuals were further reduced, leaving the top corporate rate 34 percent and the top individual rate 28 percent. Taking both the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986 together, the top individual income tax rate had been lowered a more modest, but still significant, 26 percent.

Following the United States' rate cutting model, most of the free world industrialized nations have just completed or

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are in the process of completing income tax reforms that finance lower tax rates with more comprehensive income tax bases.

The U.S. tax reforms represented the most sweeping changes in the Federal income tax laws of the United States since their enactment in 1913. Although the total level of taxes was left substantially unchanged, expansions in the tax base allowed the rates of tax on taxable income to be slashed. The top rates for both corporations and individuals were made lower than they had been at any time in roughly the last half century and lower than those in any of the countries considered our major economic competitors. Those low rates of tax, coupled with the broadened income tax base that made such drastic rate cuts possible on a revenue neutral basis, are expected to produce economic efficiencies that will kindle many long-term benefits. However, what is just as important is that these reforms have restored ordinary taxpayer's faith in the fairness of the U.S. income tax structure, enabling a voluntary system of taxation to continue to thrive.

Some results of tax reform worth highlighting are:

- Under the new law, 80 percent of all Americans pay a top rate of only 15 percent in Federal income tax and no individual ever pays more than 28 percent of total income in tax.

- A family of four with only a poverty level income (approximately $12,000 in 1988) will receive an earned income credit rebate of more than $600 instead of paying a (positive) Federal income tax under the old law of about $400, for a direct after-tax cash benefit of more than $1,000.

- About 4.3 million other families with low or moderate incomes have also been removed entirely from the Federal income tax rolls.

- Approximately 11 million fewer returns have itemized deductions, largely because of more generous levels of the standard (or lump-sum) deduction, but also, in part, because of cutbacks in expenses which can be deducted (e.g., interest incurred to purchase consumer goods other than housing and sales taxes paid to state and local governments).

- On average, Federal individual income taxes have been reduced about 6 percent in 1988, when most provisions are fully effective.

- The marginal tax rate for a two-worker, four-person family earning the median income has been cut 24 percent, from 19.8 percent before tax reform to 15 percent after tax reform.

- Over the 5-year 1987-1991 budget period, individual tax reductions will total about $149 billion, with corporate tax increases making up most of the loss (according to unpublished Treasury Department estimates that are consistent with the President's Budget for Fiscal Year 1989).

The Case for Tax Reform

The philosophical underpinnings for Federal tax reform had their roots in "Blueprints for Basic Tax Reform" (a study of fundamental tax reforms carried out by the U.S. Treasury at the request of then Secretary William Simon, January 1977), but were developed during the Reagan Administration. In the fall of 1982, the Treasury Assistant Secretary for Tax Policy told the Senate Finance Committee: "The Federal income tax is widely perceived to be complicated and unfair. Taxpayers want less complicated tax provisions along with more uniform tax treatment and low tax rates." In January 1984, President

Reagan called for "an historic reform for fairness, simplicity and incentives for growth", when he charged the Secretary of the Treasury to produce specific recommendations for tax reform by the end of that year.

The economic foundation of U.S. - style tax reform is extremely straightforward and uncomplicated.

- First is a belief that a lower and hence "flatter" tax rate structure will increase incentives for work effort and investment, and as a corolary, decrease incentives to seek unproductive tax shelter and to hide income from the tax authorities.

- Second is a belief that more uniform tax treatment of all income, no matter what its source or its eventual use, will remove tax considerations from everyday economic decisions made by consumers, investors, and businesses; and that, by restoring market-oriented decisions, productive resources (labor and capital) will be more efficiently allocated leading to greater growth and a higher living standard in the long run.

Improving economic efficiency for a better allocation of resources and the resulting improvements in long-term growth was one of the primary criteria upon which the Treasury tax reform recommendations, the President's proposals, and the ultimate bill were developed.

The other main design criterion was the standard of fairness, especially as understood by ordinary taxpayers who had become convinced that the tax laws favored big business and the wealthy because both groups could take advantage of gimmicks and loopholes to avoid paying their fair share of tax. While this is largely a problem of taxpayers' perceptions of fairness, it is nonetheless a serious concern for policymakers because widespread dissatisfaction with the tax laws - for whatever reason - threatens reliance upon the principle of voluntary compliance as the basis for tax administration.

Simplifying the tax system, especially for lower and middle income taxpayers, was also an important objective, perhaps more so for individuals than for businesses. The repeal of income averaging, getting 11 million taxpayers off the itemized deduction schedule, taking 4.3 million poor families off the tax rolls altogether, and, in general, removing the worry about tax consequences before any economic decision could be made, have all helped accomplish simplification for the typical individual.

In formulating the original Treasury proposals for tax reform, other design objectives that were consistent with the economic principles underlying tax reform were developed, considered, adopted, or dropped. For example, early in the process, Treasury abandoned as impractical the idea of taxing income in kind, accrued but unrealized income, and imputed income, such as the rent homeowners "pay" themselves.

Also, the very attractive notion of a single rate of tax, the so-called flat-rate tax, was taken off the drawing board simply because it produced too great a redistribution of tax burdens, from those with the greatest ability to pay to those with the least. Analysis did show, however, that the prior-law distribution of tax by income level could be achieved with only two or three rates applied to a broad tax base.

Finally, the alternative to substitute a consumption tax for part or all of the income tax was dismissed. It is estimated that a European-style flat-rate value added tax (VAT) applied to the U.S. economy could raise about $18 billion annually for each percentage point in the rate. This estimate is a net figure that makes allowance for approximately $4 billion of annual relief for low-income families and individuals. The prospect of a VAT as a powerful revenue-raising machine was cited by both its supporters and its detractors. Some feared that a VAT would have taken pressure off the Congress to find base-broadening reforms in order to pay for lower income tax rates. Also, there was a general acknowledgement that a VAT would give rise to a whole new federal bureaucracy required to administer it. Last, it was anticipated that State and local governments would strongly resist a VAT because it would be viewed as being in direct competition with the retail sales tax, traditionally the major source of revenue for State governments.

Perspectives

Throughout the period that the United States tax reform proposals were being developed, comparisons were made with other industrialized countries, especially our principal trading partners. And, it was concluded that by world standards the people of the United States are not over-taxed. In fact, even when social security contributions and state and local taxes are included in the total, in 1986 the United States ranked next to lowest (following Japan) in the ratio of tax revenues to gross domestic product (GDP) among six major free-world economic powers. (The other countries in this comparison are Canada, France, the Federal Republic of Germany, and the United Kingdom. See Table 1.)

Because there is a strong suspicion among some in the U.S. that the introduction of a European-style VAT would not substitute for some portion of the income tax, but instead would be an additional source of taxation, the second column of Table 1 recalculates the ratio of total tax revenues to GDP ignoring the VAT for those countries which have it. This column of figures shows that, were it not for the VAT, the overall burden of financing government varies very little from country to country. Although it is inconclusive whether European countries typically tax their citizens more because of the VAT or would maintain a higher level of taxation anyway, the relative stability of this ratio from country to country is remarkable considering some very different philosophies about the role of government in society among the countries included in this comparison.

The calculations in Table 2 were carried out to answer the question, "Is the U.S. reliance on income taxes greater than or less than that of our major competitors?" Here the results are even more clear. The ratio of income tax revenues to total tax revenues minus VAT receipts is surprisingly tightly grouped. Except for France, where an unusual Social Security tax burden helps account for the relatively low reliance upon income taxes, the range of income taxes to total taxes minus VAT extends from a low of 40.8 percent in Germany to a high of 45.7 percent in Japan, with the U.S. falling in between.

These findings helped establish the goal that tax reform should be revenue neutral and, in particular, should not lower or raise the overall level of income tax. Although the total level of income taxes is not significantly altered by the U.S. reforms, the mix of individual income tax and corporation income tax is changed, with nearly $130 billion of the tax burden of individuals being shifted to corporations over the course of the 5-year period, 1987-1991. 1/

This shift in emphasis from individual taxation to corporate taxation serves only to move the U.S. back into line with most of its competitors. According to the calculations in Table 3, in 1986, only the U.S. and Germany collected less than 18 percent of their respective income tax revenues from corporations. Except for the special case of Japan, the norm is to have corporation income taxes represent about 20 to 25 percent of total income tax revenues. 2/

The U.S. is within this range after tax reform. This is shown by the entry of 21 percent in the lower right-hand corner of Table 4. Because this shift in the tax burden from individuals to corporations has received considerable attention in the United States, it is useful to point out that the relative share of taxes paid by corporations remains low by domestic historical standards. Under tax reform, the corporation income tax will average just about 21 percent of total Federal income taxes paid by corporations and individuals combined for the period 1987-1991. While this is about 5 percentage points higher than the same calculation under prior law yields for the period 1980-1989, this is still low compared with ratios for prior years. For example, in the 1940s corporation income taxes averaged 43 percent of combined corporation and individual income taxes. In the 1950s this ratio had fallen to 39 percent. By the 1960s the corporate share had dropped to 33 percent and during the 1970s it continued to decline to 25 percent. Thus, the shift towards greater reliance upon corporate taxes still leaves the corporate share well below its level in the four previous decades.

Over the 5-year budget forecast period, 1987 through 1991, this shift results in a tax cut for individuals of about 6 percent and a tax increase for corporations of about 28 percent. 3/ These estimates are shown in Table 5.

Main Features of the U.S. Tax Reform

Tax Rates:

- A simplified 2-rate structure of 15 percent and 28 percent replaces the former 14-bracket structure with rates ranging from 11 percent to 50 percent.

- The top individual income tax rate is lowered to 28 percent from 50 percent, down from 70 percent in 1981. This is the lowest it has been since 1931, when it was 25 percent. Although marginal rates will increase above 28 percent within a narrow income range to recapture the benefit of the 15 percent rate and personal exemptions, in no case will anyone ever have to pay more than 28 percent of his or her total income in tax.

. The top corporation income tax rate is lowered from 46 percent to 34 percent. This is the lowest rate for corporations since 1941 when the top rate was 31 percent.

Standard Allowances for Individuals:

. The per capita personal exemption is raised from $1,080 in 1986 to $2,000 in 1989 ($1,950 in 1988 and $1,900 in 1987) and then indexed for inflation. It is phased out for high-income taxpayers.

. The lump-sum standard deduction is converted from an amount of income subject to a zero rate of tax and is raised from $3,850 to $5,000 for married couples and from $2,610 to $3,000 for single individuals.

Capital Gains:

. For individuals, the 60 percent exclusion of long-term capital gains is repealed, raising the maximun rate on long-term capital gains from 20 percent to 28 percent.

. For corporations, the 28 percent preferential rate is also repealed.

Other Base Expansion Items For Individuals:

. The $100 per capita dividends-received exclusion for individuals is repealed.

- The 10 percent deduction for two-earner married couples is repealed. (This change is justified largely because the provision is unnecessary with flatter rates.)

- Unemployment compensation is fully taxed.

- Losses from passive tax shelters are generally not deductible, except against other passive income.

- Individual Retirement Accounts are restructured so that upper income taxpayers lose deduction benefits unless they are not covered by an employer-sponsored pension plan.

Other Allowances for Individuals:

- The deduction for state and local sales taxes is repealed.

- Deductions of interest paid on loans for personal consumption expenditures are repealed.

- The floor under deductible medical expenses is raised from 5 to 7.5 percent of adjusted gross income.

- Only 80 percent of business meals and entertainment expenses are deductible.

- Miscellaneous expenses such as union dues and unreimbursed employee business expenses are deductible only by the amount that they exceed (in aggregate) 2 percent of adjusted gross income. Certain expenses of moving from one residence to another are also subject to this floor.

Miscellaneous Individual Provisions:

. Income averaging is repealed. (Like repeal of the current law deduction for second earners, this provision is needed less with flatter rates.)

. Unearned income of minor children is generally taxed at the parent's tax rate, preventing taxpayers from shifting income to other family members solely to take advantage of lower tax rates.

. The earned income credit is raised and indexed. The maximum credit is increased to $800 from $550. The credit rate is raised to 14 from 11 percent.

Other Business Tax Provisions:

. The investment tax credit is repealed, removing a significant bias in favor of investment in only certain kinds of assets.

. The dividends received deductions for corporations is lowered from 85 to 80 percent.

. The tax credit for research and development is scaled down from 25 percent of qualified expenditures to 20 percent.

. Rules allowing expensing for small businesses are tightened. The amount of investment that may be expensed is raised from $5,000 to $10,000, but the provision is targeted to small business by a phase-out for taxpayers whose new investments in personal property exceed $200,000.

. With some modifications requiring longer lives and less accelerated methods, prior-law capital cost recovery rules are maintained.

- Accounting rules changes generally require a better match-up of business income and expenses.

Minimum Taxes:

- For both individuals (at a 21 percent rate) and corporations (at a 20 percent rate), alternative minimum taxes are strengthened to ensure that no wealthy individual and no profitable business can avoid paying a fair share of tax.

The results of tax reform for individuals are summarized by the four columns of figures appearing in Table 6. The third column of figures shows how the dollar amount of total tax reduction is distributed by income class, and the last column shows how the percentage tax cut, averaging 6.1 percent for the year 1988, is skewed.

The figures in Table 7 better illustrate the fact that these overall cuts did not markedly alter the distribution of individual income tax. For example, those with incomes over $200,000 per annum continue to pay about 24 percent of the total tax bill and those with incomes over $40,000 continue to bear about 70 percent of the total burden. This constancy could not have been achieved with a single flat-rate tax.

Table 8 exposes the heart of the U.S. reform scheme for individuals. The first column of figures represents the effective rates of tax paid on a comprehensive definition of income before tax reform. Averaging 11.8 percent overall, the rates rose monotonically from 1.6 percent for those with incomes of $200,000 or more.

The second column illustrates how these effective tax rates would change as the result of only broadening the income base. While the overall rate is shown to rise to 14.4 percent, the rates at the upper end of the income scale soar. As changes in tax allowances are introduced (column 3) the effective tax rates for those with income below $40,000 dip well below prior law (column 1), but those in the middle and upper income ranges continue to face very large tax increases.

Minimum tax and tax credit changes are introduced in column 4. While they are important to individual taxpayers affected, they change the overall picture relatively little from column 3. It is not until the old tax rate schedule is replaced by the two-bracket 15-28 percent rate schedule (see the last column of figures) that effective rates of tax are brought back to almost their exact starting level, with only modest cuts up and down the income scale. Only for those in the lowest income groups are effective tax rates significantly reduced. This limited redistribution of tax was the intentional result of removing low income families from the burden of the Federal income tax.

This table demonstrates that progressivity of the tax system, when properly measured with a comprehensive income base, can be maintained even though a low and flatter schedule of marginal tax rates is substituted for a high and steeper set. As compared with prior law, progressivity is achieved with lower nominal tax rates because a more comprehensive taxable income base has replaced the prior-law taxable income base, which eroded markedly at higher levels of income.

Economic Impact Expectations

Unlike most of the tax bills in recent history, the 1986 Act was not designed with short-term economic goals of either fueling or cooling down the economy. Rather, the benefits from tax reform are expected to be long term and permanent. Treasury and Council of Economic Advisors (CEA) economists have together estimated the following specific attainments:

- Real growth up an estimated 0.2 to 0.3 percentage points per year over the next decade. This is equivalent to a long-run increase in economic performance of between 2 and 3 percent.

- Workers' real after-tax wages will increase by more than 5 percent, stimulating a 2 to 3 percent increase in long-run employment. This is equivalent to adding about 2.4 million new jobs to the economy (in addition to the 17 million new jobs created during the current record-breaking economic expansion).

- Lower tax rates and reduced incentives to borrow will cause interest rates to drop, stimulating greater investment.

- These direct economic effects will, in turn, have long-run positive impacts on the balance of trade and on the Federal deficit.

Ironically, these long-term macroeconomic benefits will occur despite the fact that one overall impact of tax reform is that the cost of capital is expected to rise, resulting in a somewhat smaller stock of capital than would otherwise exist. The reason economic welfare can improve under this scenario is that the remaining stock of capital will be more efficiently allocated so as to be more productive. 4/

In the short-run transition period, it was expected that there would be some unfavorable effects as labor and capital shift to more productive uses and as certain provisions of the law are phased in. In the fall of 1986, CEA Chairman Beryl Sprinkel had predicted, however, that any negative effects on economy during the next 6 to 9 months, such as those resulting from adjustments away from tax shelter financing (e.g., in real estate), "will not be of significant magnitude". His optimisim was well placed. During the period immediately following tax reform, economic performance remained phenomenal. Business fixed investment, which opponents of tax reform predicted would wither, grew 5 percent in 1987, following a decline in 1986, and surged 21 percent (at annual rates) during the first quarter of 1988. Real gross national product rose 4 percent during 1981 and grew at nearly that rate the first quarter of 1988, outperforming Administration, congressional, and most private forecasts.

Although the evidence that tax shelter investments are down is largely anecdotal at this time because information from post-tax reform partnership tax returns is not yet available for analysis, it is significant that heavily marketed tax shelters no longer dominate the advertisement pages of the financial press.

Impact on International Competitiveness

A better allocation of resources will make U.S. products cheaper to produce. Depreciation allowances for the purchase of new business equipment are more generous than those for all but one (Canada) of our five mejor trading partners. For Canada, France, Germany, The United Kingdom, and Japan, the top corporate tax rate ranges from a low of 35 percent (U.K.) to a high of 56 percent (Germany). The top U.S. rate is 34 percent (and still remains a second-lowest 39 percent when a typical State income tax rate is included in the comparison). See Table 9.

Thus, although the U.S. tax reforms were not designed to improve our trade balance position, they will. But it is important to keep in mind that taxes are not a major factor in determining international competitiveness. Taxes are relatively small compared to other corporate costs. Other factors, such as fluctuating energy prices, exchange rates, and interest rates, are all more significant determinants of international competitiveness.

Impact on State and Local Governments

There has been much discussion in the United States about the expected impact of the new law on state and local governments. The most important single issue being discussed in the windfall revenues that many states reap as the result of the Federal income tax base broadening. This windfall occurs because 30 states, including the District of Columbia, formally link their tax bases to the Federal definition on income. 5/ Consequently, unless state legislatures enact reductions in state tax rates, state tax revenues automatically rise.

Conclusion

Even though taxes may not have been too high in the United States, marginal tax rates were. Although statutory rates had been cut substantially in 1981-1984, they were still sufficiently high that incentives to work, save, and invest were being stifled and too much investment was going into unproductive tax shelters.

Economic efficiency suffered because not only were taxes raising general market prices of labor, capital, and material resources, but they were raising some prices much more than others. Tax-favored activities received too much investment while fully taxed activities received too little investment. High marginal tax rates amplified these market distortions, placing a greater penalty on fully-taxed activities and a greater value on tax preferences. Sharply graduated rates further introduced distortions by encouraging taxpayers to change the timing of transactions and to transfer income from higher to lower-taxed family members. Also, legal tax avoidance and illegal tax evasion were rewarded by high tax rates.

In addition, taxpayers generally felt that the income tax system was unfair. Well publicized examples of highly profitable corporations paying no income tax because of generous investment incentives and other tax deductions not generally available to individuals eroded confidence that our largely voluntary system of taxation was working properly. Other examples of individuals with equal incomes paying very different rates of tax because one of them sought out tax shelters, or received income from tax-preferred sources, or spent income on tax-preferred goods, further convinced the general population that our system of taxation was not fair.

It was these concerns that led to the U.S. income tax reforms.

The U.S. tax reforms are expected to have very positive impacts on long-run economic performance because resources are being allocated to more efficient uses as tax considerations are no longer extering into every economic decision made by consumers, investors, and businesses.

Although improvements in our trade balance and deficit position were not identified goals of tax reform, they are recognized by-products.

The point of tax reform is that the people win. In the long run, it is not a zero-sum game that requieres losers to exactly offset winners. In the long run everyone wins.

Table 1

Total Tax Revenues and Total Tax Revenues Minus VAT
As A Percentage of Gross Domestic Product

For Selected Industrialized Countries

1986

Country	Total Tax Revenues as a Percentage of Gross Domestic Product	Total Tax Revenues Minus VAT as a Percentage of Gross Domestic Product
	(............percent............)	
France	44.2	35.7
United Kingdom	39.0	32.9
Germany	37.5	31.8
Canada	33.2	33.2
United States	29.0	29.0
Japan	28.8	28.8

August 31, 1988

Source: Organisation for Economic Co-operation and Development, Paris, 1988.

Note: Includes State and local taxes where applicable.

Table 2

Income Tax Revenues As A Percentage Of
Total Tax Revenues And As A Percentage Of
Total Tax Revenues Minus VAT

For Selected Industrialized Countries

1986

Country	Income Tax Revenues as a Percentage of Total Tax Revenues	Income Tax Revenues as a Percentage of Total Tax Revenues Minus VAT
	(............percent............)	
France	18.1	22.4
United Kingdom	38.2	45.2
Germany	34.5	40.8
Canada	45.1	45.1
United States	42.3	42.3
Japan	45.7	45.7

August 31, 1988

Source: Organisation for Economic Co-operation and Development, Paris, 1988.

Note: Includes State and local taxes where applicable.

Table 3

Individual And Corporation Income Taxes
As A Share Of Total Income Taxes

For Selected Industrialized Countries

1986

Country	Individual Income Tax Share of Total Income Tax Revenues	Corporation Income Tax Share of Total Income Tax Revenues
	(............percent............)	
France 1/	71.8	28.2
United Kingdom	73.0	27.0
Germany	82.7	17.3
Canada 1/	82.0	18.0
United States	83.5	16.5
Japan	54.8	45.2

August 31, 1988

Source: Organisation for Economic Co-operation and Development, Paris, 1988.

1/ Certain taxes on income, profits, and capital gains that cannot be formally allocated between individuals and corporations have been divided prorata.

Note: Includes State and local taxes where applicable.

Table 4

Individual And Corporation Federal Income Taxes
In The United States

Historically Since 1940 And Projected Under Tax Reform

1940-1991, By Decade

Time Period	Individual Income Tax	Corporation Income Tax	Total Income Tax	Individual As Percent of Total Income Tax	Corporation As Percent of Total Income Tax
	(.........$ billions	....	)	(........percent	.........)
1940-1949......	119.0	89.8	208.7	57%	43%
1950-1959......	292.7	185.4	478.1	61%	39%
1960-1969......	545.6	262.9	808.5	67%	33%
1970-1979......	1,304.0	429.1	1,733.1	75%	25%
1980-1989 (prior law projected) 1/.	3,373.4	624.1	3,997.6	84%	16%
1987-1991 (current law proyected 2/.	2,137.7	577.1	2,714.8	79%	21%

August 31, 1988

1/ Based on unpublished Treasury Department estimates consistent with the President's Budget for Fiscal Year 1989 (1988).

2/ Based on the President's Budget for Fiscal Year 1989 (1988).

Table 5

Change In The Source of Federal Government Receipts
Resulting From Tax Reform, Fiscal Year Period 1987-1991

1987-1991 5-Year Period

Source of Receipt	Federal Government Receipts 1987-1991			
	Before Tax Reform	After Tax Reform 1/	Change 2/	Percentage Change
	$ billions			(percent)
Individual income taxes.....	2,286	2,138	-149	-6.5%
Corporation income taxes....	450	577	127	28.3%
All other receipts..........	2,183	2,182	-2	-.1%
Total revenues.............	4,920	4,896	-23	-.5

August 31, 1988

1/ Based on the President's Budget for Fiscal Year 1989 (1988).

2/ Based on unpublished Treasury Department estimates consistent with the President's Budget for Fiscal Year 1989 (1988).

Note: Current law receipts and prior law receipts are not strictly comparable since the two series were estimated on the basis of the same macroeconomic forecast of the economy. Consequently, changes in receipts resulting from induced long-term economic performance are excluded from the calculation of tax change due to reform.

Table 6

Tax, Change In Tax, And Percentage Change In Tax
Resulting From Tax Reform In The United States

(1988 Law And Levels Of Income)

Income Class	Tax Before Reform	Tax After Reform	Tax Change	Percentage Tax Change 1/
	(......... $ billions		.........)	(percent)
Less than $10,000...	2.7	.9	0	-65.1%
10,000 - 20,000...	26.8	20.8	-6.0	-22.3%
20,000 - 30,000...	49.1	44.3	-4.8	-9.8%
30,000 - 40,000...	50.3	46.4	-3.9	-7.7%
40,000 - 50,000...	45.5	41.4	-4.1	-9.1%
50,000 - 75,000...	67.5	66.3	-1.2	-1.8%
75,000 - 100,000...	28.0	27.7	-.3	-1.2%
100,000 - 200,000...	49.9	48.8	-1.1	-2.2%
$200,000 or more....	97.8	95.4	-2.4	-2.4%
Totals..........	417.5	392.0	-25.6	-6.1%

August 31, 1988

1/ Source: Joint Committee On Taxation (1987).

Table 7

Percentage Distribution Of Individual Income Taxes
In The United States, Before And After Tax Reform

(1988 Law And Levels Of Income)

Income Class	Before Tax Reform		After Tax Reform 1/	
	Simple Distri-bution	Cumulated From Highest	Simple Distri-bution	Cumulated From Highest
				(percent)
Less than $10,000...	.6	100.0	.2	100.0
10,000 - 20,000...	6.4	99.4	5.3	99.8
20,000 - 30,000...	11.8	93.0	11.3	94.5
30,000 - 40,000...	12.0	81.2	11.8	83.2
40,000 - 50,000...	10.9	69.2	10.6	71.4
50,000 - 75,000...	16.2	58.3	16.9	60.8
75,000 - 100,000...	6.7	42.1	7.1	43.9
100,000 - 200,000...	11.9	35.4	12.4	36.8
$200,000 or more.....	23.4	23.4	24.3	24.3
Totals....	100.0		100.0	

August 31, 1988

1/ These estimates generally do not incorporate behavioral responses that may affect the level and distribution of income and taxes.

Note: These are the author' s own estimates and are not official estimates of the Unites States Treasury Department.

Table 8

Effective Rates Of Individual Income Tax Under Major Stages Of Tax Reform In The United States 1/

(1988 Law And Levels Of Income)

	1	2	3	4	5
Income Class	Before Tax Reform	Column (1) PLUS Expand the Tax Base	Column (2) PLUS Increase Fixed Allowances	Column (3) PLUS Tax Credit and Minimum Tax Changes	Column (4) PLUS Tax Rate Changes
					(percent)
Less than $10,000...	1.6	2.0	.9	.2	.5
10,000 - 20,000...	5.7	6.1	4.6	4.0	4.4
20,000 - 30,000...	8.3	8.8	7.4	7.5	7.5
30,000 - 40,000...	9.5	10.3	9.1	9.3	8.7
40,000 - 50,000...	11.1	12.3	11.4	11.6	10.1
50,000 - 75,000...	13.3	15.4	15.0	15.2	13.1
75,000 - 100,000...	15.7	18.8	18.8	19.1	15.6
100,000 - 200,000...	19.3	23.8	24.1	24.5	18.9
$200,000 or more......	22.8	34.8	35.5	35.9	22.3
Totals	11.8	14.4	13.7	13.8	11.1

August 31, 1988

1/ Tax liabilities divided by modified expanded income, a broad-base income concept. These estimates generally do not incorporate behavioral responses that may affect the level and distribution of income and taxes.

Note: These are the author's own estimates and are not official estimates of the United States Treasury Department.

Table 9

Maximum Individual And Corporation
Income Tax Rates In 1988

For Selected Industrialized Countries

(Rates Include All Levels Of Government)

Country	Maximum 1988 Individual Income Tax Rate	Maximum 1988 Corporation Income Tax Rate
		(percent)
France 1/	57	42
United Kingdom	40	35
Germany 1/	56	56
Canada 1/2/	45	48
United States 1/3/	33	39
Japan 1/	76	52

August 31, 1988

1/ Source: Pechman, Joseph A., editor. World Tax Reform, A Progress Report. 1988.

2/ Proposed rates. Include estimates of average Provincial taxes. Excludes temporary 3% of Federal tax surcharge.

3/ Include estimated State and local income tax rates equivalent to 5 percentage points (net) for both individuals and corporations.

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Notes

1/ Although current estimates of revenue impact of tax reform over the 5-year 1987-1991 budget period show a net revenue loss of $23 billion (as shown in Table 5), the overall program must still be considered revenue neutral when considered in the context of the huge tax changes involved. The $23 billion net loss is the result of tax increases totaling more than $600 billion being roughly offset by tax decreases totaling more than $600 billion.

2/ It should be noted that the high share of corporation income taxes to total income taxes in Japan results in large measure from the fact that under Japanese tax law there may be incentives to incorporate successful businesses because the top rates of tax for individuals are substantially higher than those for corporations. Also, the corporate tax share in Japan is influenced by the fact that personal tax revenues are relatively low.

3/ Care should be taken to treat these changes as rough estimates, giving only orders of magnitude, since long-term improvements in economic performance resulting from tax reform have not been factored into the forecast of the government's future tax revenues.

4/ For a full discussion of this point, see Fullerton, et. al., in Office of Tax Analysis, U.S. Department of the Treasury, **Compendium of Tax Research 1987.** For estimates which include other country experiences, see Alworth, Julian S., "The Impact of Taxation on the Cost of Capital in Industrial Countries," 1988.

5/ Another four states link their taxes directly to the amount of Federal income tax. Five states do not link their taxes to Federal law. Five states link their taxes only indirectly to Federal tax law. Seven states have no income tax.

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