THE WALL STREET JOURNAL.
WSJ.com

OPINION | MAY 26, 2011

A 62% Top Tax Rate?

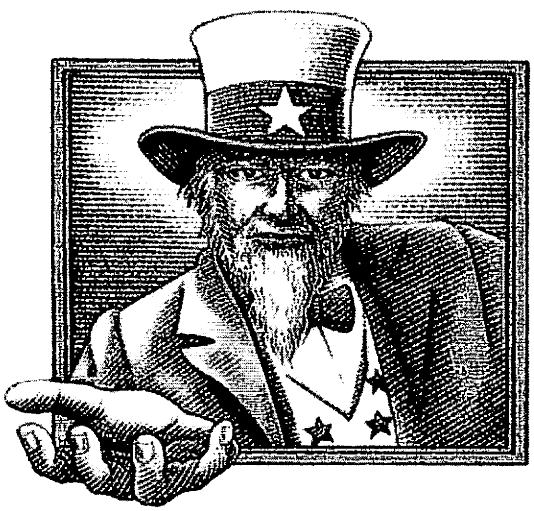
Democrats have said they only intend to restore the tax rates that existed during the Clinton years. In reality they're proposing rates like those under President Carter.

By STEPHEN MOORE

Media reports in recent weeks say that Senate Democrats are considering a 3% surtax on income over $1 million to raise federal revenues. This would come on top of the higher income tax rates that President Obama has already proposed through the cancellation of the Bush era tax-rate reductions.

If the Democrats' millionaire surtax were to happen—and were added to other tax increases already enacted last year and other leading tax hike ideas on the table this year—this could leave the U.S. with a combined federal and state top tax rate on earnings of 62%. That's more than double the highest federal marginal rate of 28% when President Reagan left office in 1989. Welcome back to the 1970s.

Here's the math behind that depressing calculation. Today's top federal income tax rate is 35%. Almost all Democrats in Washington want to repeal the Bush tax cuts on those who make more than $250,000 and phase out certain deductions, so the effective income tax rate would rise to about 41.5%. The 3% millionaire surtax raises that rate to 44.5%.



Images.com/Corbis

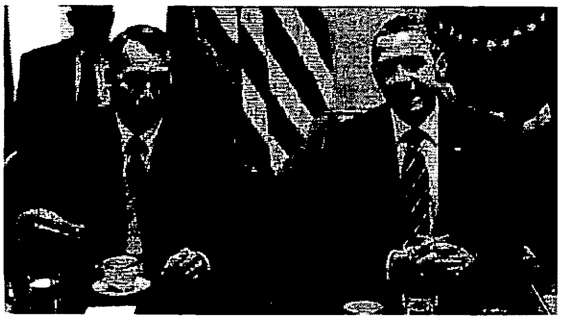
But payroll taxes, which are income taxes on wages and salaries, must also be included in the equation. So we have to add about 2.5 percentage points for the payroll tax for Medicare (employee and employer share after business deductions), which was applied to all income without a ceiling in 1993 as part of the Clinton tax hike. I am including in this analysis the employer share of all payroll taxes because it is a direct tax on a worker's salary and most economists agree that though employers are responsible for collecting this tax, it is ultimately borne by the employee. That brings the tax rate to 47%.

Then last year, as part of the down payment for ObamaCare, Congress snuck in an extra 0.9% Medicare surtax on "high-income earners," meaning any individual earning more than $200,000 or couples earning more than $250,000. This brings the total tax rate to 47.9%.

But that's not all. Several weeks ago, Mr. Obama raised the possibility of eliminating the income ceiling on the Social Security tax, now capped at $106,800 of earnings a year. (Never mind that the program was designed to operate as an insurance system, with each individual's payment tied to the benefits paid out at retirement.) Subjecting all wage and salary income to Social Security taxes would add roughly 10.1 percentage points to the top tax rate. This takes the grand total tax rate on each additional dollar earned in America to about 58%.

Then we have to factor in state income taxes, which on average add after the deductions from the federal income tax roughly another four percentage points to the tax burden. So now on average we are at a tax rate of close to 62%.

Democrats have repeatedly stated they only intend to restore the tax rates that existed during the Clinton years. But after all these taxes on the "rich," we're headed back to the taxes that prevailed under Jimmy Carter, when the highest tax rate was 70%.



Steve Moore of the editorial board on the prospects for tax reform in Washington.

Taxes on investment income are also headed way up. Suspending the Bush tax cuts, which is favored by nearly every congressional Democrat, plus a 3.8% investment tax in the ObamaCare bill (which starts in 2014) brings the capital gains tax rate to 23.8% from 15%. The dividend tax would potentially climb to 45% from the current rate of 15%.

Now let's consider how our tax system today compares with the system that was in place in the late 1980s—when the deficit was only about one-quarter as large as a share of GDP as it is now. After the landmark Tax Reform Act of 1986, which closed special-interest loopholes in exchange for top marginal rates of 28%, the highest combined federal-state marginal tax rate was about 33%. Now we may be headed to 62%. You don't have to be Jack Kemp or Arthur Laffer to understand that a 29 percentage point rise in top marginal rates would make America a highly uncompetitive place.

What is particularly worrisome about this trend is the deterioration of the U.S. tax position relative to the rest of our economic rivals. In 1990, the highest individual income tax rate of our major economic trading partners was 51%, while the U.S. was much lower at 33%. It's no wonder that during the 1980s and '90s the U.S. created more than twice as many new jobs as Japan and Western Europe combined.

It's true that the economy was able to absorb the Bush 41 and Clinton tax hikes and still grow at a very rapid pace. But what the soak-the-rich lobby ignores is how different the world is today versus the early 1990s. According to the Organization for Economic Cooperation and Development, over the past two decades the average highest tax rate among the 20 major industrial nations has fallen to about 45%. Yet the highest U.S. tax rate would rise to more than 48% under the Obama/Democratic tax hikes. To make matters worse, if we include the average personal income tax rates of developing countries like India and China, the average tax rate around the world is closer to 30%, according to a new study by KPMG.

What all this means is that in the late 1980s, the U.S. was nearly the lowest taxed nation in the world, and a quarter century later we're nearly the highest.

Despite all of this, the refrain from Treasury Secretary Tim Geithner and most of the Democrats in Congress is our fiscal mess is a result of "tax cuts for the rich." When? Where? Who? The Tax Foundation recently noted that in 2009 the U.S. collected a higher share of income and payroll taxes (45%) from the richest 10% of tax filers than any other nation, including such socialist welfare states as Sweden (27%), France (28%) and Germany (31%). And this was before the rate hikes that Democrats are now endorsing.