

Summary: *Federal income taxes represent only 42 percent of the total tax burden of U.S. taxpayers. The remainder is hidden, distorting taxpayers' awareness of their real tax burden and of the true cost of government. Only fundamental tax reform with an emphasis on visibility can ensure a fair tax code that allows taxpayers to evaluate whether they are getting their money's worth from government.*



The Road Map to Tax Reform™

HIDDEN TAXES:

How Much do You Really Pay?

Despite all the attention given to federal income taxes, they represent only 42% of the total tax burden Americans carry each year. There are at least \$657.5 billion in additional “hidden” taxes—\$2,462 per person — that are not visible to the people who pay them. These hidden charges violate a basic principle of taxation — that taxes should be evident so people can not only perceive how much government policies cost but can also make informed decisions in our democratic process.

In addition to the lack of visibility in the tax code, there is also a fundamental public misunderstanding of who actually pays taxes. For instance, many believe corporations pay taxes when economic reality demonstrates they do not. Income tax withholding and an employer’s share of payroll taxes are examples of the “clouded visibility” surrounding who really pays taxes and how much they pay.

Americans are subject to numerous taxes. Some are inadvertently hidden, but many are consciously designed to disguise the cost of government. If more Americans realized that their total tax burden equals 56 percent of annual personal consumption spending, there might well be a second Revolution.

HOW MANY TAXES ARE HIDDEN?

A hidden tax is one that is not expressly clear to the taxpayer. For example, sales taxes are not hidden taxes because their costs are clearly indicated on cash register receipts. Yet many regulations, mandates, and other government policies may be described as hidden because of the costs they impose on unsuspecting Americans. [See Table 1, next page]

CORPORATE INCOME TAXES

In 1997, federal, state, and local governments collected over \$215 billion in corporate income taxes, or about \$806 per person. On the surface, it can be argued that that figure represents money the rest of us don’t have to pay. But because corporations are actually people working as a legal entity, the imposition of corporate income taxes basically raises consumer prices, lowers payments to stockholders, and reduces both employee compensation and capital investment.

GAS AND OTHER TRANSPORTATION TAXES

It will surprise most consumers to know that the actual cost to produce and deliver petroleum products is much lower than

Table 1 HIDDEN TAXES IN THE UNITED STATES

HIDDEN TAX	COST (BILLIONS)	COST/PERSON
Corporate Income Tax	\$215.3	\$806
Fuel Taxes	\$58.9	\$220
Other Excise Taxes and "Sin" Taxes	\$29.0	\$109
Employer Share of Payroll Taxes	\$230.2	\$862
Workers' Compensation Taxes	\$13.2	\$49
Unemployment Taxes	\$28.2	\$106
Import Taxes	\$18.7	\$70
Hotel-Room Taxes	\$6.7	\$25
Airline Taxes	\$4.0	\$15
State/Local Utility Taxes	\$16.0	\$60
Implicit Telecommunications and Electricity Taxes	\$11.0	\$41
Severance Taxes	\$4.6	\$17
Insurance Premium Taxes	\$9.0	\$34
Licenses (Occupation, Corporate, Utility, Alcohol, and Amusement)	\$12.6	\$47
Total	\$657.5	\$2,462

Source: 1996 data except for 1993 Workers' Compensation from U.S. Bureau of the Census 1997 *Statistical Abstract of the United States*.

the amount posted at the pump. For instance, the average price of a gallon of gasoline last August was \$1.48 — and 43 cents represented taxes.

Unlike sales taxes, gasoline taxes do not appear on any receipt and very few motorists will find all state and federal charges posted near the pump. Because the total amount paid is hidden, most Americans don't recognize this 37% tax burden, and they certainly have no idea of the annual cost of gas taxes. In fact, in recent years gas taxes have been the fastest-growing federal tax imposed on middle-income Americans. Annual fuel taxes cost \$58.9 billion, or \$220 a person.

SIN TAXES

While policymakers generally do not discriminate against producers of specific goods or services, a notable exception is the tax on items considered unhealthy such as products containing alcohol or tobacco. Even though these "sin" taxes produce a major source of revenue, the extent of their impact is often hidden from consumers.

For instance, 43 percent of the cost of a six-pack of beer can be attributed to taxes. Combined federal, state, and local taxes on distilled spirits are 45 percent. The federal tax on a pack of cigarettes will be 39 cents next year and state taxes range from 2.5 cents to one dollar a pack. That's about \$45 billion in revenue through fiscal year 2005.

TELECOMMUNICATION TAXES

For more than a century, federal and state officials have continued to assess taxes primarily to subsidize high-cost areas of service. Traditionally the cost was hidden in the typical phone bill. As part of the move to deregulate the industry, the 1996 Telecommunications Act was supposed to make these costs explicit. Instead, it opened the door for even bigger increases.

The Act suggested that residents in low-cost areas should continue to pay more to underwrite the provision of service to high-cost (rural) areas. In addition, the Act authorized

subsidized access to the Internet for all public schools and libraries. The impact of these taxes is significant. About \$2.25 billion was raised just last year. And the combination of fees and mandates forces cellular users to pay 20 to 30 percent more than the actual cost of the service. Moreover, it's been estimated that the total cost of federal universal access policies will require a 10 percent tax on interstate services on top of the preexisting 3 percent tax. Many rural states want an even bigger subsidy.

PAYROLL TAXES

INCOME TAX WITHHOLDING

Every spring millions of Americans are delighted to receive a refund check from the government — even though they're just getting their own money back at no interest. Most Americans don't associate withholding as a hidden tax and yet for that very reason it has become one of the nation's most insidious levies. Taxpayers would be much more vocal if they had to write a check once a year to cover their income taxes instead of relying on a system that deducts small amounts of money each pay period so that the loss is not as apparent.

EMPLOYER SHARE OF PAYROLL TAXES

Another example of a hidden tax of which most Americans are completely unaware is the share of payroll taxes presumably paid for by employers. According to the government, payroll taxes for Social Security and Medicare are to be shared equally by employer and employee, with each currently paying 7.65 percent. While that may be true for accounting purposes, economists agree that "both halves" of the payroll tax come out of employee compensation. In other words, though half is hidden, you pay it all.

The government collected half a trillion dollars in Social Security and Medicare payroll taxes in 1997. Allowing for the amount contributed by self-employed workers, which is not

Table 2 FEDERAL EXCISE TAX REVENUE (MILLIONS)

	(MILLIONS)
“GENERAL” REVENUE	
Alcohol	\$7,257
Tobacco	\$5,873
Telephone	\$4,543
Ozone Depleting Chemicals	\$130
Transportation Fuels	\$7,107
Other	\$2,921
“TRUST FUND” REVENUE	
Highway	\$23,867
Airport and Airway	\$4,007
Black Lung Disability	\$614
Inland Waterway	\$96
Superfund	\$71
Oil Spill Liability	\$1
Aquatic Resources	\$316
Leaking Underground Storage Tank	\$23
Vaccine Injury Compensation	\$115
Total excise taxes	\$56,924

Source: Office of Management and Budget, *Historical Tables, Budget of the United State Government, Fiscal Year 1999.*

hidden, leaves approximately \$460.5 billion in combined employer and employee taxes. The hidden portion of that amount is \$230.2 billion, or \$862 per person.

Payroll taxes have increased dramatically since 1937. Since 1977, the payroll tax rate has grown by nearly one-third, from 11.7 percent to 15.3 percent. According to an earlier study by the Institute for Policy Innovation, over 90 percent of American workers pay more in payroll taxes than they do in income taxes.

TRAVEL TAXES

HOTEL AND CAR RENTAL TAXES

Politicians are finding it increasingly attractive to impose taxes on those who are unable to vote. This process, known as “exporting taxes,” is behind the popularity of hotel and car rental taxes across the nation. Policy makers can tax out-of-town voters — often at a stiff price — to help finance local projects such as a new sports stadium. A typical American traveler can expect room taxes ranging up to 17 percent plus an additional 8.24 percent car rental levy for every leg of a journey.

For instance, nationwide bed taxes average 11.7 percent but are as high as 17 percent in areas such as Houston and average more than \$24 a night in New York City. As of 1997, bed taxes cost \$6.7 billion, or \$25 per person.

AIRLINE TICKET SALES

The CEO of a major airline recently lamented the effect of hidden taxes in ticket sales. He said that consumers are not aware of the total fare. But if they perceive that the fare is too high, they blame the airline and not the government. Moreover, the airline suffers the economic consequences if that consumer chooses not to travel or opts for another mode of transportation.

Currently airline ticket taxes are 7.5 percent of the fare plus \$2.75 for each segment of a domestic flight. Taxes on international flights recently doubled to \$12 per passenger and then extended to apply to return flights. The government imposes many other hidden costs on air transportation, including a \$4.50 per person passenger facility charge, which is actually levied by local governments but approved by Washington.

OTHER HIDDEN TAXES

BRACKET CREEP

Perhaps the hidden tax that most fundamentally violates the principle of visibility is bracket creep. One side effect of inflation is that in a progressive tax system, taxpayers will be bumped into higher tax brackets even if their real income is unchanged. This hidden “inflation tax” falls hardest on lower-income taxpayers because inflation pushes them into higher brackets. Those already paying maximum rates remain unaffected by bracket creep.

SEVERANCE TAXES

Most states impose a variety of severance taxes on natural resources (oil, gas, timber, etc.) when producers “sever” them from the earth. While these taxes are visible to the producer, they are hidden from consumers who buy the finished goods made from these resources. State severance taxes cost Americans \$4.6 billion in 1997, or \$17 a person.

UTILITY TAXES

Public utilities provided state and local governments with \$16 billion in revenue in 1997, about \$60 per person. Moreover, utility regulations force some users to pay higher prices in order to subsidize other users. The Department of Energy estimates these subsidies at about \$6 billion.

INSURANCE PREMIUM TAXES

State taxes on insurance premiums cost Americans \$9 billion in 1997, about \$34 per person.

LICENSING

Most states impose a broad range of licensing requirements on different segments of the economy. One example is occupational licensing. While the justification is to protect consumers' health and safety, in reality the licenses are hidden taxes that restrict competition for the regulated profession. In addition to driving up taxes for consumers, these fees limit opportunities to enter many professions. Several studies have concluded that licensing is especially detrimental to those from minority groups. In 1997, state licensing for professionals and corporations cost consumers \$12.6 billion, or \$47 a person.

ELECTRONIC COMMERCE

With Internet access growing exponentially, so does the opportunity for on-line sales of goods and services — a development that has not escaped the attention of taxing authorities. Already some states tax access to Internet service providers like America Online, a questionable practice because the providers may be located in another state.

PHASE-OUTS OF DEDUCTIONS

Similar to bracket creep, deduction phase-outs have a visibility of nearly zero. While other hidden taxes have been described in dollars, there are many policies buried in the federal tax code that serve as hidden taxes by forcing people to pay higher-than-normal marginal tax rates — the rate paid on an additional dollar of income.

In fact, two taxpayers with similar incomes may face very different marginal tax rates. Older Americans, for example, can face marginal tax rates as high as 90 percent. Currently 33.2 million taxpayers face effective marginal tax rates that differ from the statutory rate.

EMPOWERING VOTERS WITH INFORMATION

Hidden taxes cost Americans \$657.5 billion — more if you include income tax withholding. When taxes are not visible, Americans are unable to evaluate whether they're getting their money's worth from the government. As a result, hidden taxes help boost the size of government.

While governments have an incentive to hide the cost of taxes, there are opportunities to make taxes more visible without requiring government action. For instance, utility companies can include the cost of taxes as a line item on their monthly billing statements. Gas stations could prominently display the costs added to each gallon.

Unfortunately, only 15 percent of all corporations follow this type of policy. In an age when millions of Americans are

joining the ranks of individual investors, such information is critical to understanding the bottom line.

On the payroll side of this issue, there exists a "Right to Know Payroll" form that employers can include with paychecks. The form shows the hidden costs of policies such as "employer's share" of payroll taxes and the cost of mandated workers' compensation and unemployment insurance. This form is neither anti- nor pro-government. It merely informs people.

While these options are encouraging, much more needs to be done. As many different factions continue to debate which type of tax reform is best for America, all sides would do well to remember that one of the fundamental tenets of tax reform must be visibility. Without it, tax reform cannot truly be successful.

CONCLUSION

While the numerous hidden taxes discussed in this study are not responsible for every inequity contained within our current tax code, they do contribute significantly to the most complex and inherently unfair system of taxation ever placed upon the American public. Overhaul is imperative, and the fundamental focus must be on visibility. That's because a hidden tax is an unknown tax, and an unknown tax is one that cannot be evaluated and judged by those who pay it.

This study is a summary of IPI Policy Report # 160, *Hidden Taxes: How Much do You Really Pay?* by Bryan Riley, Adjunct Scholar at the National Taxpayers Union Foundation (NTUF); Eric V. Schlecht, Senior Policy Analyst at NTUF; and Dr. John Berthoud, President of the National Taxpayers Union and NTUF.

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