Paying for Universal Health Care with Progressive Tax Reform

Almost every other industrial country spends less than the U.S. does on health care and still gets better health outcomes in return. Surely, there are a lot of ways we could reform our system. If we succeed, we could end up paying less overall for health care, but a larger percentage of the funding could take the form of taxes paid to the federal government rather than premiums and deductibles paid to insurance companies and health care providers. Sure, a tax increase might be involved, but if we pay less overall, then who cares?

And it’s not necessary to impose new taxes on people who cannot afford to pay them. A recent report from Citizens for Tax Justice explains that Congress could simply eliminate unfair preferences, special breaks and loopholes that riddle the tax code and that benefit wealthy individuals and powerful corporations.

Americans may not know the details of every tax break enjoyed by corporations or wealthy individuals, but they might be particularly keen to focus on them after providing Wall Street (and thus the richest people in America) the biggest taxpayer-funded bailout in history.

Americans Are Paying to Make Wall Street Healthy, Now Wall Street Should Return the Favor

After propping up major corporations and their CEOs and shareholders, Congress might find it reasonable to make the following deal. Main Street is paying to make Wall Street healthy. Wall Street, when it is healthy, will return the favor. This is the message that the Rebuild and Renew America Now (RRAN) coalition is taking to America. CTJ is working with the religious organizations, service-providers, unions and other types of organizations that belong to RRAN to educate Congress and the public about the myriad ways that we can raise substantial sums of revenue without hurting struggling families and without harming the economy.

These progressive financing options include the many revenue-raising provisions the President proposed in his budget to fund health care and other initiatives as well as the additional options that CTJ formulated in its recent report on health care financing.

We Already Have a Tax for Health Care — But Paris Hilton Is Exempt!

For example, Congress might want to expand the Medicare tax, given that it is the one tax we currently have that is dedicated to health care. But there is a much better way than simply increasing the single rate (currently 1.45 percent paid by employees and another 1.45 percent paid by employers) that applies to all wages and salaries. As the CTJ report on health care financing options explains, the Medicare tax currently only applies to wages and salaries. This means that a wealthy person whose income takes the form of capital gains, stock dividends and interest could pay no Medicare tax at all in a given year, while someone who works for a living but has a much smaller income will pay the Medicare tax on every dollar earned.
To address this obvious unfairness, Congress could extend the Medicare tax to apply to the investment income that is currently exempt. CTJ’s report includes a version of this that would raise about $500 billion over ten years, even while exempting most of the investment income of seniors. This would primarily impact just the richest one percent of taxpayers and would end an unfair defect in our tax system.

Myriad Other Progressive Revenue Options

CTJ, in its communications with lawmakers and media, also offers other progressive financing options. For example, CTJ points out that the Medicare tax is not the only tax that unfairly subsidizes investment income. The problem also exists in the federal income tax. Reducing or eliminating the subsidy provided through the tax code for capital gains and corporate stock dividends could raise tens of billions of dollars a year.

One option would set the top rate for capital gains at the rate enacted under Reagan — surely no conservative will doubt Mr. Reagan’s wisdom! — which was 28 percent. This is a full eight points higher than the rate that will be in place after 2010, when the Bush tax cuts expire.

President Obama’s Proposal to Limit Itemized Deductions for the Rich

There are plenty of other progressive revenue options that Congress can turn to, including the President’s proposal to limit the benefits of itemized deductions to 28 percent. Currently itemized deductions subsidize certain activities (like buying a house) through the tax code, and it subsidizes them at a higher rate for high-income people than it does for middle-income people.

For example, the itemized deduction for home mortgage interest is supposed to encourage home ownership, but it does so in an outrageously unfair manner. Someone rich enough to be in the 35 percent income tax bracket will save 35 cents for each dollar they spend on mortgage interest, while a family in the 15 percent tax bracket will save only 15 cents for each dollar they spend on mortgage interest. The President would reduce, but not eliminate, this disparity by limiting the savings for each dollar of deductions to 28 cents.

Progressive Tax Reform Is the Place to Start

Tax increases may be necessary to finance a health care system that is less costly overall, and recent surveys show that Americans are willing to pay more in taxes for health care reform. Given all that, we might as well start by closing the unfair loopholes and preferences that exist in our current tax system.
On May 4, President Obama proposed several measures to address overseas tax avoidance and tax evasion. The corporate community claims that these measures are unfair and would limit economic growth in America. They’re wrong. Here are the facts that CTJ has been bringing to lawmakers over the past few months.

**Myth:** The practices that the Obama administration is trying to stop are not illegal, so the U.S. government should not interfere with them.

**Fact:** The practices that concern the Obama administration and others include both legal and illegal practices, and they all damage our ability to raise revenue in a fair manner to pay for public services.

First, there are tax abuses by American individuals that involve hiding income from the IRS. These tax abuses are always illegal, meaning they constitute tax evasion.

Second, there are tax abuses by American corporations that involve manipulating tax laws to reduce or eliminate their U.S. taxes in ways that Congress never intended. These tax abuses may be legal, meaning they constitute tax avoidance, but many of these practices ought to be illegal.

**Myth:** The first category of abuses listed above (involving individuals hiding income from the IRS) is no different than the sorts of steps everyone takes to pay as little tax as they can get away with.

**Fact:** Many people take legal means to lower their taxes through strategies that use various deductions and credits. But most Americans have no opportunities to actually hide their income from the IRS, which is very different (and very illegal).

For most of us who receive a wage or salary, our employers report our income to the IRS on W-2 forms. So if we try to hide our earnings from the IRS, there’s a good chance we’ll get caught.

A teenager mowing lawns for the summer might decide to not report the income to the IRS, and he might get away with that. But for the most part, the options for tax evasion are pretty limited for most Americans.

But it’s a whole different story for wealthy people and corporations with access to complicated tax-planning schemes involving foreign countries. They can rely on accountants and lawyers to structure complex transactions that shift their income and income-generating assets into a country that has low or no business taxes and that has bank secrecy rules that prevent its financial institutions from telling the U.S. government which American citizens are among their clients and what they’re up to.

In other words, wealthy American individuals wishing to hide their income from the IRS can turn to “tax havens.” There is no official definition of a tax haven, but they generally have strict bank secrecy laws and no (or very low) income taxes.

**Myth:** The second category of abuses listed above (involving American corporations manipulating, but not necessarily violating, U.S. tax laws) are all steps that companies have to take in order to avoid double-taxation of their foreign income.
Fact: The foreign tax credit already protects against double-taxation. If an American individual or corporation has income that is taxed by a foreign government, the individual or corporation gets a credit against their U.S. tax. No one is proposing to repeal the foreign tax credit.

The U.S. taxes all of the income of its citizens, residents and corporations, no matter where it is earned. But individuals and corporations can take a credit against their U.S. taxes for foreign taxes that they pay, to avoid double-taxation.

Corporations get an additional benefit, which is that they get to “defer” U.S. taxes on the income they earn abroad until they bring that income back to the United States (until they “repatriate” that income).

The President proposes to limit “deferral” for corporations because it has been abused a great deal to reduce taxes in ways that Congress never intended to allow. But even if the President and Congress repealed deferral entirely (which would probably be a better policy), American individuals and American corporations would still be able to use the foreign tax credit, so there would be no fear of double-taxation.

It is true that one of the President’s proposals would make changes to the foreign tax credit, but these changes would only ensure that the credit does its job of preventing double-taxation. Currently, American multinational corporations can use the credit against their U.S. taxes for taxes they paid to a foreign government on income that is not even taxable in the U.S. This is clearly not the purpose of the credit.

Myth: Proposals to crack down on offshore tax abuses by corporations will make U.S. businesses less able to compete abroad.

Fact: Most of the corporate practices the administration wants to crack down on probably don’t even involve companies that are truly competing abroad. Rather, they involve companies operating within the United States but using sham transactions to make their income appear to be earned abroad, so that the U.S. taxes on that income can be “deferred” (meaning “not paid.”)

Even in cases where U.S. multinational companies are carrying out real business in a foreign country, their competition with other companies in that country is generally based on the price they charge for their products. Corporate income taxes don’t affect the price a foreign subsidiary can charge so much as they affect the dividends the U.S. owners receive.

Myth: Even if everything explained above is true, it’s still a bad idea to crack down on these practices because corporations will simply leave the United States and take jobs with them.

Fact: The U.S. tax system is probably not a significant factor in a company’s decision to relocate jobs. To the extent that the U.S. tax system is a factor, the current rules encourage investors to move jobs offshore more than the rules that would exist if the President’s reforms were enacted.

The fact that a U.S. corporation can defer taxes on income earned by its foreign subsidiaries might make it slightly more likely that it will base more of its operations abroad than here in the U.S. President Obama’s proposal to limit deferral would make it less likely that companies will base operations and jobs offshore. ◆
Anti-tax activists all over the country are promoting what they call “Fair Tax” legislation, which would eliminate corporate and individual income taxes, replace the lost revenue with increased sales taxes on a wide range of services, and eliminate most current sales tax exemptions. Over the last few months ITEP has weighed in against this flawed idea.

In Missouri, “Fair Tax” advocates claimed that the state’s individual and corporate income taxes could be replaced with a 5.11 percent state sales tax (up from the current 3 percent rate) on all consumer services and bring in as much revenue as is currently collected. ITEP look a closer look at this legislation in a report titled Assessing the “Fair Tax” Plan and found that, even if every dime of personal consumption were taxed, a 5.11 percent rate is simply insufficient to achieve revenue neutrality.

In fact, ITEP estimated that Missouri’s basic sales tax rate would have to be increased from 3 to just under 10 percent — thus bringing the combined state and local rate to approximately 12.5 percent — in order for this proposal to be revenue-neutral.

ITEP also found that making these changes would impose tax hikes on the poorest 95 percent of the income distribution, with especially large tax hikes falling on middle-income Missourians. For example, Missourians in the middle 20 percent of the income distribution would see an average tax increase of $2,036. By contrast, the top 1 percent of Missourians, whose incomes average over $1 million, would see an average tax cut of more than $22,500. The legislation did pass the Missouri House of Representatives, but failed to move in the Senate.

In Kentucky, similar legislation was proposed by Representative Bill Farmer and presented to an Interim Joint Committee on Appropriations and Revenue. Rep. Farmer’s bill called for the elimination of personal and corporate income taxes, as well as Kentucky’s limited liability entity tax (LLET); a reduction in the sales tax rate from 6.0 to 5.5 percent; and an expansion of the sales tax base to include a variety of services.

ITEP analyzed the proposal and published its results in Tax Reform in Kentucky: Serious Problems, Stark Choices. ITEP found that the legislation would ultimately cost the state as much as $850 million annually. In addition, the proposal would overwhelmingly benefit the very wealthy at the expense of the poor. Had the measure been in effect in 2007, the poorest 20 percent of Kentuckians would have seen their taxes rise by $136 on average, while the richest 1 percent would have received an average tax cut of $40,910.

If implemented, so-called “Fair Tax” proposals would dramatically alter the way states raise money and further shift state taxes onto the backs of low-and middle-income working families. ◆
In March, ITEP released a report detailing the impact of capital gains tax loopholes in the nine states offering the largest such tax breaks (Arkansas, Hawaii, Montana, New Mexico, North Dakota, Rhode Island, South Carolina, Vermont and Wisconsin). The report, entitled *A Capital Idea: Repealing State Tax Breaks for Capital Gains Would Ease Budget Woes and Improve Tax Fairness*, found that these nine states lost $663 million to this flawed policy in tax year 2008 alone.

Despite the costs of these poorly targeted tax cuts, earlier this year Georgia’s legislature passed last-minute legislation that ultimately would have created a 50 percent exclusion for capital gains income. ITEP estimated that, in 2008, such a move would have cost $340 million, with 77 percent of the tax cut going to the very wealthiest 1 percent of Georgians. Newspaper editors, bloggers, and advocates across the state, armed with these figures, urged Georgia’s Republican Governor, Sonny Perdue, to veto the legislation. Ultimately (and surprisingly), he did, saying, “I do not believe this legislation … can be afforded at this time.”

In more good news, Vermont policymakers recently enacted legislation designed to reduce their capital gains tax break from a 40 percent exclusion to a flat dollar exclusion of up to $5,000 for nearly all taxpayers, starting in 2011. This change sharply reduced the size of the capital gains tax break for Vermont’s wealthiest residents.

Capital gains tax preferences are costly, inequitable, and ineffective. In the current fiscal and economic climate, state policymakers are wise to avoid implementing this flawed policy, and should be encouraged to eliminate or scale back these breaks where they already exist. ◆

**ITEP Promotes and Defends Progressive Income Tax Changes**

Virtually every state in the nation imposes, in one form or another, a requirement on its legislature that it produce a balanced budget. As a result, when the economy falters, state policymakers are left with two difficult choices: reduce spending or increase taxes. While neither of these choices is politically palatable, one is clearly preferable from an economic standpoint. In particular, economic theory and practice suggest that tax increases on upper-income taxpayers place the least amount of drag on aggregate demand, since the taxpayers that experience such increases are much more likely to cut back on saving than on consumption.

Across the country, several states are following that basic guidance and adopting progressive personal income tax increases as a means of closing projected budget gaps. New York earlier this year enacted two new temporary top income tax brackets, one with a rate of 7.85 percent for married couples with taxable income in excess of $300,000 ($200,000 for single filers) and another with a rate of 8.97 percent for taxable income in excess of $500,000 (all filers); in addition, taxpayers with adjusted gross incomes over $100,000 will gradually lose the benefit of lower tax brackets as long as these temporary brackets are in place. Likewise, Hawaii put in place, for the next seven years, three additional top brackets with rates of 9, 10, and 11 percent on taxable incomes above $300,000, $350,000, and $400,000 respectively. (These amounts are for married couples; they are halved for single filers). While not as targeted as the changes adopted by the Empire and Aloha States, the Golden State (California) also raised each of its income tax rates by one quarter of one percent for the next two years.

Other states are either on the verge of making similar changes or are very actively considering them. In June, the Oregon Legislature passed a measure that would create two new, but temporary, top income tax brackets,
applying to married taxpayers with incomes above $250,000 and $500,000 (or half those amounts for other filers). These brackets, which would feature rates of 10.8 percent and 11.0 percent respectively, would only apply through 2011, but would be succeeded by a new permanent top rate of 9.9 percent. New Jersey and Delaware, upon the recommendations of Governors Jon Corzine and Jack Markell, and Connecticut, the opposition of Governor Jodi Rell notwithstanding, are weighing increases in their top rates as well.

Illinois is constitutionally barred from enacting a graduated rate structure, but progressive income tax changes are still a possibility there. As ITEP documented in its May report *Ready, Set, Reform*, combining an increase in Illinois’s current flat income tax rate of 3 percent with new and expanded tax credits could improve both tax equity and adequacy. Bringing Illinois’ income tax rate to 5 percent, increasing its version of the Earned Income Tax Credit to 15 percent of the federal credit, replacing its existing property tax credit with a more targeted “circuit breaker” type credit, and introducing a new “tax forgiveness” credit would have generated $3.5 billion in additional revenue in 2008 while also lowering taxes for the bottom three-fifths of the income distribution. Illinois Governor Pat Quinn had put forward much-needed income tax reforms at the start of the year, but, to date, has been stymied by an intransigent legislature.

In an effort to derail these changes and to reduce the likelihood of similar changes in other states, those opposed to tax fairness and functional government have sought to portray prior state income tax increases as economically counterproductive. For instance, some have seized upon a recent assertion by Maryland Comptroller Peter Franchot that, for tax year 2008, “… returns with taxable income over $1 million filed by April 30 … have fallen by about a third” as evidence that Maryland’s new “millionaires tax” (a personal income tax rate of 6.25 percent on taxable income in excess of $1 million) was driving the wealthy into the welcoming arms of Virginia and Pennsylvania.

As ITEP demonstrated in its May publication *Where Have All of Maryland’s Millionaires Gone?*, Maryland millionaires may have moved, but their most likely destination was a different income group. Data from the Comptroller’s Office indicate that, while the preliminary number of returns with taxable income over $1 million fell by 13 percent, the number of returns with taxable income ranging from $500,000 to $999,999 rose by 8 percent; the $250,000 to $499,999 band of taxable income grew even more, expanding by 17 percent. Such growth occurred despite the fact that taxpayers in those income range were also subject to higher income taxes in 2008, suggesting that the affluent aren’t quite as responsive to tax changes as some might argue.

In *That’s Rich: Laffer and Moore’s Assertions about State Tax Increases Don’t Hold Much Water*, ITEP deconstructed similar claims put forward by two prominent conservative economists on the pages of the *Wall Street Journal*. In brief, Mssrs. Laffer and Moore maintained that state tax increases in Connecticut, New Jersey, and New York in the early part of the decade severely curtailed the rise of the investor class in those states. Yet, a more careful examination of Internal Revenue Service (IRS) data for the period from 1997 to 2006 reveals that the number of “rich” taxpayers (federal income tax filers with adjusted gross incomes in excess of $200,000) rose considerably in Connecticut, New Jersey, and New York over the course of that ten year period, including in the years immediately following state income tax changes in those states. In fact, at both the start of that ten-year period and at its conclusion, Connecticut, New Jersey, and New York were generally “richer” than the national average — that is, they had a greater concentration of federal income tax filers with adjusted gross incomes in excess of $200,000 than the country as a whole — again suggesting that state tax policy changes do little to drive away wealthy residents.◆
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