Contact: Bob McIntyre

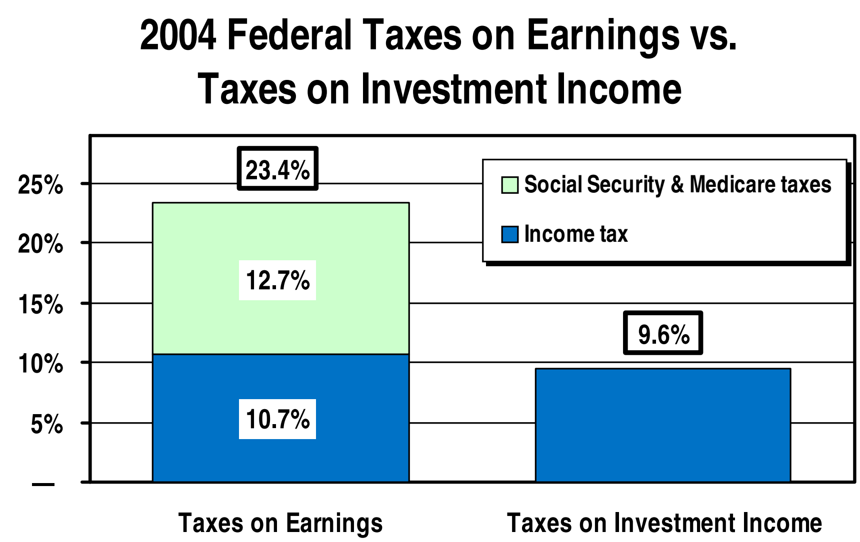
Do Fat Cats Pay Lower Tax Rates than Workers?

The federal tax code has become so skewed in favor of investors over workers that personal taxes on earnings are now two-and-a-half times greater than personal taxes on investment income. That is the central finding of a new **analysis** by the Institute on Taxation and Economic Policy (ITEP), released today by Citizens for Tax Justice (CTJ).

Specifically, the ITEP study finds that in 2004:

■ Total federal personal taxes paid on wages and other earnings — including both income taxes and Social Security and Medicare taxes — now average 23.4 percent.

■ In contrast, federal personal taxes on investment income average only 9.6 percent.

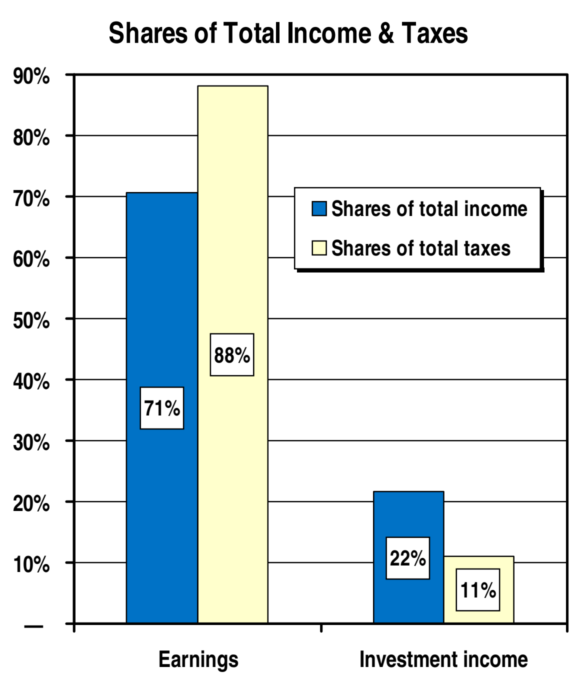


Put another way:

■ Wages and other earnings are 71 percent of total personal income, but taxes on earnings make up 88 percent of total federal personal taxes.

■ In contrast, investment income is 22 percent of total personal income, but taxes on investment income are only 11 percent of total personal taxes.

“The huge disparity in taxation between earnings and investment income should shock average American taxpayers, who get most of their income from wages,” said CTJ director Robert S. McIntyre. “This outrageous tilt primarily benefits the best-off one percent of Americans, the only income group that gets most of its income from investments.”



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Why Is Investment Income Taxed So Much Less Than Earnings?

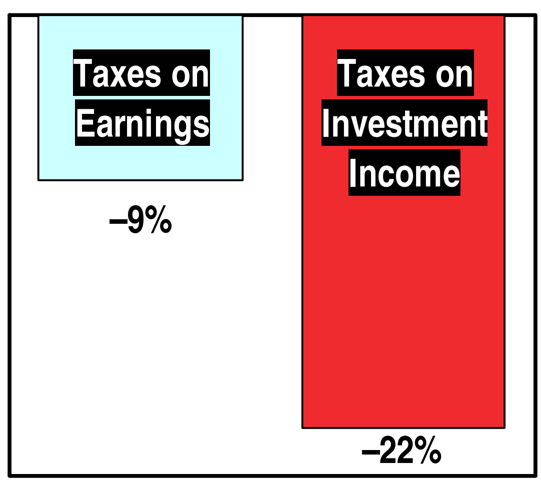
The ITEP study points to several reasons why earnings are taxed so much more heavily than investment income.

- First of all, earnings are taxed twice at the personal level. The 2.9 percent Medicare tax applies to all reported wages and self-employment income. The 12.4 percent Social Security tax applies to earnings up to $87,900 per worker. Overall, Social Security and Medicare taxes actually take a larger share of earnings (12.7 percent) than do income taxes (10.7 percent). But investment income is exempt from helping to support Social Security and Medicare.
- Second, several types of investment income are explicitly taxed at lower income tax rates than earnings. In particular, realized long-term capital gains and eligible dividends are taxed at a maximum rate of 15 percent—compared to a 35 percent top income tax rate on earnings—and interest on state and local bonds is untaxed. Capital gains and dividends taxed at special low rates make up almost a third of total reported investment income. Tax-exempt interest, if taxable, would increase reported investment income by 4.5 percent.
- Third, while almost all earnings are reported on income tax returns (due to wage withholding), a large share of investment income is not reported. This under-reporting reflects not only legislated tax breaks, for real-estate income, business profits, and so forth, but also tax evasion. The ITEP study conservatively estimates that a quarter of total investment income is not reported on tax returns due to legal and extra-legal under-reporting.

The Role of the Bush Tax Cuts

The ITEP report notes that President Bush deserves some of the blame for this situation. His new tax breaks for capital gains and dividends, along with his cuts in income tax rates generally, have lowered personal taxes on investment income by 22 percent. In contrast, Bush has reduced taxes on earnings by only 9 percent. On top of that disparity, Bush's tolerance for tax shelters and cheating has encouraged even more upper-income tax avoidance and evasion on investment income.

Percent Changes in Taxes on Earnings & Investment Income From the Bush Personal Income Tax Cuts (in 2004)



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But ITEP's report also notes that things have been moving in a Bushian direction for decades. Before Ronald Reagan took office, the top income tax rate on most investment income was 70 percent, compared to a 50 percent top rate on earnings. The top capital gains tax rate, now 15 percent, was more than 35 percent. And payroll taxes were almost a quarter lower than they are today.

"Back then, our lawmakers seemed to understand that working is harder than coupon-clipping," said McIntyre.

"But these days," McIntyre said, "radicals in and out of the White House think that even our current low taxes on investment earnings remain far too high. Their affection for a 'flat tax' is not just its single rate, but even more important, its full exemption for all investment income. Some of them, such as antitax activist Grover Norquist, have publicly stated that they expect that if there's a second Bush term, they may get their way."

What's at Stake?

The ITEP report notes that taxing investment income like earnings could raise $338 billion annually at 2004 levels — enough to cut this year's expected budget deficit by two-thirds or more, and go a long way toward ensuring the future stability of Social Security and Medicare.

"The public needs to understand," McIntyre said, "that the taxes well-off people aren't paying on their investment income translate directly into a combination of higher taxes and reduced public services for the vast majority of Americans."

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Note: a copy of the full ITEP report, ***Federal Taxation of Earnings versus Investment Income in 2004***, is available at ITEP's website: **www.itepnet.org**.