Tax and Revenue Decisions Facing Congress and the President

Presented for Ecumenical Advocacy Days,
March 24, 2012

Steve Wamhoff
Citizens for Tax Justice

Citizens for Tax Justice is a non-profit organization that does research and advocacy and has worked for 30 years to promote tax policies that are fair for ordinary Americans.
The first question that comes up when we talk about taxes is whether we need more or less of them. Many politicians claim that the U.S. is overtaxed. We are actually undertaxed. The most recent data from the Organization for Economic Cooperation and Development (the industrialized countries that are America’s main trading partners and competitors) shows that we’re one of the least tax countries of the bunch.
If We Need More Tax Revenue, Who Should Pay More?

• You may have heard people say that the richest one percent or richest 5 percent are paying a disproportionate share of taxes in America.

• You’ve also heard about some very rich Americans who don’t pay much in taxes.

• The truth is that overall, our tax system is progressive, but just barely.

When you consider all the different types of taxes that Americans pay, our tax system as a whole is not nearly as progressive as people think it is.
My organization, Citizens for Tax Justice, estimated all the different types of taxes Americans pay, including all federal, state and local taxes.

We found that the share of total taxes paid by people in each income group is pretty close to the share of total income received by people in each group.

For example, the richest one percent pay 21.6 percent of total taxes in 2011 (that’s all federal, state and local taxes). That might sound like a lot until you consider that the richest one percent also received 21 percent of the total income in the U.S. that year.

So the share of total taxes paid by the rich was just a tiny bit higher than their share of total income.

Similarly, the poorest fifth of Americans (the lowest 20 percent) paid 2.1 percent of total taxes in 2011. You might think they’re getting off easy until you see that they received just 3.4 percent of total income that year.

So the share of total taxes paid by the poorest fifth of Americans was just a bit lower than their share of total income in the U.S.
Virtually Everyone in America Pays Some Kind of Taxes

Incomes and Federal, State & Local Taxes in 2011

<table>
<thead>
<tr>
<th></th>
<th>Average cash income</th>
<th>Shares of Total income</th>
<th>TAXES AS A % OF INCOME</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$13,000</td>
<td>3.4%</td>
<td>Federal taxes</td>
</tr>
<tr>
<td>Lowest 20%</td>
<td></td>
<td>2.1%</td>
<td>State &amp; local taxes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total taxes</td>
</tr>
<tr>
<td>Second 20%</td>
<td>26,100</td>
<td>7.0%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>42,000</td>
<td>11.4%</td>
<td>13.9%</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>68,700</td>
<td>18.7%</td>
<td>17.1%</td>
</tr>
<tr>
<td>Next 10%</td>
<td>105,000</td>
<td>14.2%</td>
<td>18.5%</td>
</tr>
<tr>
<td>Next 5%</td>
<td>147,000</td>
<td>10.1%</td>
<td>19.7%</td>
</tr>
<tr>
<td>Next 4%</td>
<td>254,000</td>
<td>14.3%</td>
<td>20.6%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>1,371,000</td>
<td>21.0%</td>
<td>21.1%</td>
</tr>
<tr>
<td>ALL</td>
<td>71,600</td>
<td>100.0%</td>
<td>17.6%</td>
</tr>
</tbody>
</table>

Addendum:

| Bottom 99% | $58,500 | 79.1% | 78.3% | 18.5% | 11.0% | 27.5% |

Citizens for Tax Justice, April 2012

Here are the numbers in more detail.

You often hear politicians and pundits say that a large percentage of Americans are not paying any taxes. This is untrue, or at best it’s highly misleading, because these politicians and pundits are only talking about one type of tax, the federal personal income tax.

The federal personal income tax is progressive, meaning it takes a larger share of income from a rich person than it taxes from a low- or middle-income person. It even includes refundable tax credits like the Earned Income Tax Credit and the Child Tax Credit which can result in no income tax liability or even negative income tax liability for struggling Americans.

But remember that the federal personal income tax is just one tax that people pay. For example, everyone who works must pay federal payroll taxes. (And remember, the EITC and the Child Tax Credit are only available to people who work.) Everyone pays state and local taxes, which are generally regressive, meaning they take a larger share of income from low- and middle-income people than they take from the rich.

For example, everyone who buys things in stores pays sales taxes that are imposed in most states. Anyone who owns a home or rents a home pays state and local property taxes. (Even people who rent pay property taxes because their landlords pass them on in the form of higher rents.)
Some Multi-Millionaires Pay Lower Effective Tax Rates than Working People

<table>
<thead>
<tr>
<th>Total Reported Income</th>
<th>$60k-$65k</th>
<th>$10 million or more</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share of Taxpayers Making $60k-$65k</td>
<td>Average Effective Tax Rate** for Taxpayers Making $60k-$65k</td>
</tr>
<tr>
<td>More than half of reported income is investment income.</td>
<td>2.3%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Between one tenth and half of reported income is investment income.</td>
<td>7.3%</td>
<td>14.1%</td>
</tr>
<tr>
<td>Less than one tenth of reported income is investment income.</td>
<td>90.4%</td>
<td>21.3%</td>
</tr>
</tbody>
</table>

Source: Institute on Taxation and Economic Policy tax model, October 2011

Even though I just said that the tax system overall is progressive (just barely progressive) there are situations in which very high-income individuals get away with paying a lower effective tax rate than working class people.

The billionaire investor Warren Buffett has said it’s unfair that someone as rich as him pays a lower effective tax rate than his secretary, who was said to make around $65,000 a year.

We looked at the numbers to see how often this sort of thing happens.

The cause of this phenomenon is the fact that investment income is taxed at lower rates than income from work (like wages or salaries). Most investment income goes to the richest taxpayers. It’s possible for someone who makes around $65,000 a year to get most of their income from investments rather than work. But it’s more common for a multi-millionaire to get most of their income from investments.

We found that if you look at people who make over $10 million a year, a significant portion — about a third — of them get the majority of their income from investments, and as a result pay just 15.3 percent of their income in federal personal income taxes and federal payroll taxes.

We then looked at people who make between $60,000 and $65,000 (what Warren Buffett’s secretary is said to make) and found that 90 percent of them get less than a tenth of their income from investments, and as a result they pay 21.3 percent of their income in federal personal income taxes and federal payroll taxes.

In other words, a third of the multi-millionaires have an effective tax rate that is lower than the group that includes 90 percent of the taxpayers in the $60,000-$65,000 income group. This is the unfairness that Warren Buffett and President Obama have been talking about lately.
Partly a Philosophical or Moral Question

- Do we believe the richest Americans obtained their wealth entirely through hard work?
- Or do we believe that they depend a lot on government to generate their wealth?
- Do we believe income inequality that existing before the New Deal didn’t damage society?
- Or do we think income inequality damaged society enough to warrant collective action to address it?

This debate can’t be determined entirely by numbers because not everything can be measured.

How much do the rich benefit from the public investments that taxes pay for? Do they get nothing from the government? Or do they benefit more than everyone else?

Think for a moment about the richest Americans, who own businesses and own stocks in corporations. The government provides education for most of their employees. The government provides the roads that their companies use to bring goods and services to customers. The government protects their property, which would not be worth anything if anyone could grab it and run off with it. The government provides a national defense that makes it possible for us to carry on business without worrying that an invasion will destroy everything we’re doing and building here.

Taxes pay for these public investments which seem to benefit the rich more than anyone else, but this is not easy to quantify. There are all sort of numbers concerning government benefits for the poor and middle-class (like the cost of welfare programs, the amount of Social Security benefits and Medicare benefits paid out each year) and these numbers get a lot of attention. But because the benefits of government for the rich are not as apparent and not as easy to quantify, they get less attention.
Here are the different types of federal taxes. I’m going to leave out state and local taxes and just focus on federal taxes. Otherwise, we’ll be talking about this all day.

Now, there’s something strange about how Congress decides which of these taxes are too high.

When George W. Bush was president and Congress wanted to cut taxes (and this included many Democrats as well as Republicans) the tax they really went after was the estate tax. The estate tax is a tax that only affects millionaires and used to make up 1.5% of revenue, but the law they passed shrunk it over several years until making it disappear entirely in 2010.

Then President Bush and his allies made huge cuts in the personal income tax, which I’ve said is quite progressive and is disproportionately paid by the rich.

Now think about the taxes that disproportionately affect low- and middle-income people, the social insurance taxes (payroll taxes that fund Social Security, Medicare and unemployment insurance). They didn’t bother to cut these. We eventually did get a payroll tax holiday under President Obama, but there was an awful lot of controversy over that. Which is startling compared to how quickly Congress was ready to cut the taxes that disproportionately affect the rich.

You can also see that the corporate income tax makes up about 8 percent of revenue. It used to contribute about twice that much but over the past 50 years its contribution to total revenue has dropped, partly because loopholes in the corporate income tax, including loopholes that allow companies to shift their profits overseas.
Debates Over the Personal Income Tax

• The Bush income tax cuts — disproportionately, but not entirely, went to the richest taxpayers.

• Refundable credits that were expanded as part of the Bush tax cuts, then expanded again under Obama.

• The Buffett Rule.

• Tax subsidies and tax loopholes — for individuals and businesses.

First, Congress has to decide what to do about the personal income tax cuts that were first enacted under President George W. Bush, and were extended under President Obama through the end of 2012.

Most of these disproportionately benefit the rich, but they include a few provisions that help poor working families, like the expansions of the EITC and the Child Tax Credit, which President Obama built upon when he further expanded the EITC and Child Tax Credit in the economic recovery act in 2009.

Those who think the wealthiest Americans are the ones who can afford to contribute more believe that the parts of the income tax cuts that go to the rich should expire. Those who believe that the poor are not contributing enough believe that the income tax cuts benefiting the rich should be extended, but the expansions of the EITC and the child tax credit should expire.

There is also talk about legislation to enact the “Buffett Rule,” which is the idea that we should eliminate or reduce those situations I talked about in which millionaires pay lower effective tax rates than working class people. While this is important, I would point out that the legislation proposed so far to do this would raise a relatively small amount of revenue. I would suggest that there are a lot of people besides millionaires who need to pay more in taxes if we’re ever going to get our budget in order.

A more long-term debate is taking place over the various tax loopholes and tax subsidies that are in the personal income tax. There are many, any not all of them are necessarily bad. The EITC can be considered a tax subsidy, but I would argue it’s a good one because it offsets a lot of the other taxes that low-income working people pay that are truly regressive taxes.

On the other hand, one big tax subsidy that I think is unfair is the lower tax rates for capital gains income, which is the reason many wealthy investors pay lower effective tax rates than middle-income people.
Debates Over the Corporate Income Tax

- Statutory tax rate of 35% vs. effective tax rate of 18.5%.

- Tax subsidies and tax loopholes.

- GE, Wells Fargo, Boeing and others — corporations that don’t pay the corporate income tax.

- Should corporate tax reform raise revenue?

You may have heard politicians say that our corporate income tax rate is 35%, which is among the highest in the world. What they’re not telling you is that 35% is the statutory corporate tax rate. The effective corporate tax rate is the percentage of profits that corporations actually pay in taxes once you account for all the loopholes that reduce their taxes.

My organization studied most of the Fortune 500 corporations that were profitable in each of the three years from 2008 through 2010, which was about 280 corporations. We found that their average effective corporate income tax rate over that period was just 18.5 percent, a lot lower than what people think.

We also found that 30 of these corporations paid nothing over the three-year period.

We have gotten a lot of politicians, both Democrats and Republicans, to agree that this situation is not OK, that corporate tax loopholes need to be closed and that corporations like GE shouldn’t get away with avoiding corporate income taxes entirely.

We still have a problem though. Most members of Congress, including the Republicans and most of the Democrats, have been saying that we should close the corporate tax loopholes and then give the revenue savings back to corporations by reducing the statutory corporate income tax rate from 35% to some lower rate. So they would close loopholes but they would lower the tax rate, and the end result would be no change in revenue. So they’re proposing “revenue-neutral” reform of the corporate income tax.

Last year we got 250 organizations, including organizations from every state, to join a letter to Congress calling for revenue-positive reform of the corporate income tax. We think that it’s unfair when lawmakers say we must cut programs like Social Security and Medicare and education funding to balance the budget, but they’re not even going to bother to get more tax revenue from large, profitable corporations.
Debates Over Social Insurance Taxes

- Payroll tax holiday.

- Tax subsidies and tax loopholes.

- Are these taxes high enough to pay for the social insurance programs they fund?

- The Medicare tax reform included in health care reform.

After a cantankerous debate, the payroll holiday which reduces the Social Security payroll tax and which was enacted for 2011 was extended through the end of 2012.

We hope this debate is over because we probably can’t afford to cut this tax anymore. Congress wrote the bill so that the payroll tax holiday does not reduce funding for Social Security, but we wonder how long they can keep doing that if the holiday is extended again.

There are some loopholes and tax subsidies in the social insurance taxes, although you don’t hear about these as much. For example, there’s a loophole that John Edwards and Newt Gingrich used to characterize some of their income from work as investment income so that the Medicare tax would not apply.

Even when the payroll taxes return to normal and the holiday is over, there is still a long-term question of whether or not the payroll taxes should be raised a little to pay for the programs they fund. Social Security won’t have a funding problem for several decades but Medicare’s funding problems are more immediate, so it might make sense to raise the Medicare tax a bit.

One improvement has been made in the Medicare tax. A reform we worked hard on and that was enacted as part of health care reform, will come into effect in 2013. This reform will make the Medicare tax a bit higher for the rich and in effect apply the Medicare tax to investment income, which until now has been exempt from it.
Debates Over the Estate Tax

• The Bush estate tax.

• Partially extended through 2012.

The estate tax was cut and eventually repealed as part of the Bush tax cuts.

When President Obama agreed to extend the Bush tax cuts for two years, this included a partial extension of the estate tax cut. I say partial extension because it didn’t extend the full repeal of the estate tax. It allowed the estate tax to come back in a very scaled back form that reduced the revenue by more than half.

We would argue that the cut in the estate tax should expire entirely, meaning the estate tax would just revert to the rules that existed before the Bush tax cuts. These rules would mean the estate tax never affects any estate worth less than $1 million, or $2 million for married couples, and usually even bigger estates would be exempt from the tax because of other breaks that exempt the vast majority of estates.

Or Congress could enact legislation that would make the rules pretty close to this, and there’s a bill from Congressman McDermott of Washington State that would do this.
Short-Term Issues

• The Bush income and estate tax cuts expire at the end of 2012.

• This includes expansions of refundable credits, and Obama’s further expansions, which all expire at the end of 2012.

• Possible debate over the Buffett Rule.

• The Medicare tax reform comes into effect after the end of 2012.

What I call short-term tax issues are the ones Congress is likely to debate and deal with this year. Congress does like to procrastinate for various reasons, so it’s likely that these issues won’t be settled until the end of the year, during the “lame duck” session of Congress, which refers to the period between the November election and the very end of the year.

At the end of 2012, under current law, the following will expire and Congress has to decide whether to just allow them to expire or to extend them partially or completely:

- The Bush income tax cuts, which were completely extended by President Obama through the end of 2012
- Obama’s expansions of the EITC and Child Tax Credit, which were enacted in the 2009 recovery act and then extended through the end of 2012,
- The Bush estate tax cut, which was partially extended through the end of 2012.
- The payroll tax holiday.

We think the payroll tax holiday may be allowed to expire but members of Congress are going to fight a lot over the rest.

Also, the reform in the Medicare tax that I mentioned will come into effect in 2013. Some politicians will try to prevent this reform from coming into effect.
Long-Term Issues — Tax Reform

• Reform of the personal income tax.
  – Should the personal income tax raise more revenue overall?
  – Who should pay more?

• Reform of the corporate income tax.
  – Should the corporate income tax raise more revenue overall?
  – How do we end tax incentives for corporations to shift jobs and profits overseas?

• How much should we raise revenue by ending tax subsidies and tax loopholes rather than raising tax rates?

The issues I call long-term tax issues are the ones that Congress will likely not settle this year but in the next two to four years.

Basically, many politicians and observers are calling for a comprehensive tax reform that would remove many tax loopholes in both the personal income tax and corporate income tax. Some believe that the entire tax reform should be “revenue-neutral,” meaning any revenue saved from closing loopholes should be used to pay for a reduction in tax rates. Others believe that the reform of the personal income tax should be revenue-positive but also think that the corporate income tax reform should be revenue-neutral, as I mentioned.

I believe that both reform of the personal income tax and reform of the corporate income tax should be revenue-positive because, as the figures I’ve shown here demonstrate:
- The U.S. overall is actually undertaxed by international comparisons,
- well-off individuals are not overtaxed in the U.S.
- Corporations are not overtaxed in the U.S.