AMERICANS FOR TaxFairness

BEYOND THE BUSH TAX CUTS: FIVE OPTIONS FOR RAISING MORE REVENUES

There is a push in Washington to reduce the federal deficit by $4 trillion over the next 10 years, primarily by cutting government spending. But federal spending was already cut by $1.5 trillion in the first round of deficit reduction negotiated in 2011 – with 60 percent of the cuts coming from programs important to our families, such as education, food safety, environmental protection and law enforcement.[1] Another $1.2 trillion in spending will be axed if across-the-board sequestration cuts kick in after the first of the year.[2]

There is a better way: end the Bush tax cuts for the richest 2 percent. This would generate nearly $1 trillion in savings that could be used to cancel the sequestration cuts.[3]

FIVE OPTIONS FOR RAISING MORE REVENUES OVER 10 YEARS	
1. End Special Low Tax Rates for Income from Stocks and Other Assets	$533 billion
2. Increase Income Tax Rates Paid by Millionaires and Billionaires	$450-$800 billion
3. Restore a Robust Estate Tax (above the 2009 level)	$135-$253 billion
4. End Tax Breaks for Shifting Jobs and Corporate Profits Offshore	$168-$583 billion
5. Establish a Small Financial Transaction Tax on Wall Street Trading	$353 Billion (Nine Years)

For those seeking additional deficit reduction or investments in jobs and services to rebuild our economy, we identify five options to raise additional revenues from the wealthiest Americans and big corporations by ending special-interest tax breaks and loopholes.

Wealth at the top has soared in recent years as the income of the middle class has stagnated. The average federal tax rate for the top 1 percent of households declined from 35.1 percent to 28.9 percent between 1979 and 2009.[4] Corporate America's contribution to federal revenue has plummeted by 60 percent in the last 50 years[5] while its profits have soared. Meanwhile, federal revenue as a share of the economy has averaged about 15 percent in the past five years, nearly 5 percentage points below where it was from 1998-2001, the last time the federal budget was balanced.[6]

The five revenue-raising options below are based on several tax reform principles:

- Changes to individual and corporate tax systems should not be revenue neutral; higher tax rates on the wealthy and more revenues from corporations are required to raise the money needed to reduce the deficit and invest in a stronger economy.

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- Tax fairness must increase and income inequality must decrease.
- We need to promote job creation at home and greater investment in America.
- Wall Street should contribute to strengthening Main Street and unproductive speculation should be discouraged.

1. End Special Low Tax Rates for Income from Stocks and Other Assets

Revenue: $533 billion over 10 years (Citizens for Tax Justice)

The reason very wealthy Americans like Warren Buffett and Mitt Romney pay a lower tax rate than millions of middle-class Americans is because most of their income is from selling assets like stocks and bonds, and from dividends, all of which are taxed at a special low 15 percent rate. This income is also exempt from Social Security payroll taxes that working people pay on their wages. Workers who get most of their earnings from salaries or wages often pay a higher tax rate than the rich, especially when payroll taxes are included.

These special low tax rates promote inequality and divert resources to unproductive tax shelters that would never exist but for the tax benefits. Capital gains income from stocks and bonds overwhelmingly goes to the wealthiest taxpayers. The richest 1 percent of taxpayers receive 71 percent of all capital gains, while the bottom 80 percent only get 10 percent of all capital gains.[7] Even among the elderly, capital gains and dividend income is highly concentrated at the top.

Taxing capital gains at the same rates as other income is the fairest solution. Ronald Reagan signed such a measure into law in 1986.[8] However, the rates for capital gains and other types of income diverged again in the 1990s and in 2003, when tax cuts enacted under President George W. Bush lowered the top capital gains rate from 20 percent to 15 percent and lowered the tax rate for corporate stock dividends to 15 percent, from the ordinary income tax rate.

When the Bush tax cuts expire at the end of 2012, the top capital gains tax rate will go back to 20 percent and dividends will once again be taxed at the ordinary income tax rates. President Obama proposes to allow this to happen for capital gains and dividends in the top two income tax brackets only, where most of this income is concentrated. Congress could go even further and tax capital gains at the ordinary income tax rates, which would generate $533 billion over 10 years.[9]

2. Increase Income Tax Rates Paid by Millionaires and Billionaires

- **Revenue Option 1: $450 billion over 10 years from a 5.6 percent surtax on income over $1 million (Tax Policy Center)**
- **Revenue Option 2: $800 billion over 10 years from higher tax brackets for millionaires and billionaires (Citizens for Tax Justice)**

The richest 1 percent hold 35 percent of the nation's wealth and the bottom 90 percent owns just 23 percent.[10] The top 1 percent have seen their average after-tax income rise four-fold since 1979, while the income of the middle 60 percent rose just 40 percent.[11] Despite these staggering differences, the U.S. tax code only has six income tax rates, with the top marginal rate of 35 percent applied equally to a professional couple making $400,000 a year and a CEO making $20 million. (Because of the capital gains tax break, a hedge fund manager making $1 billion pays an even lower rate!) That is not right, nor does it make good economic sense.

It is time for the very rich and the super-rich to contribute their fair share by paying higher marginal tax rates. There are two approaches that could be pursued. One is a surcharge on income over $1 million a year, such as the 5.6 percent surcharge that was proposed in the American Jobs Act voted on in the Senate in 2011.[12] This measure would raise $450 billion over 10 years and affect just 3 out of 1,000 households.[13]

An alternative would be to create new tax brackets for income starting at $1 million and ending with $1 billion or more. Rep. Jan Schakowsky (D-IL) made such a proposal (H.R. 1124) in 2011 beginning with a 45 percent rate at income of $1 million to $10 million and ending with a 49 percent rate for income at $1 billion and higher. Her proposal, which also would tax capital gains and dividend income at ordinary income rates, was estimated to raise at least $800 billion over 10 years.[14]

These proposed rates aren't particularly high by historical standards; from 1932 to 1986, the top marginal tax rate was at or above 50 percent.[15] Throughout the late 1940s and 1950s, when economic growth was high, the top marginal rate was typically above 90 percent. A recent non-partisan congressional report found no evidence that tax cuts for the rich increase economic growth, but did find that such tax cuts appeared to be associated with the increasing concentration of income at the top.[16]

3. Restore a Robust Estate Tax

Revenue: $135 billion to $253 billion over 10 years [Various Sources]

The estate tax is an important source of federal revenue, encourages billions of dollars in charitable donations each year, and is a means to make the tax system modestly progressive so that the wealthy pay a fairer share of taxes. Repealing the estate tax, or weakening it beyond its 2009 parameters, would add huge sums to future deficits and be fiscally irresponsible.

Currently, after temporary cuts in the estate tax expire in 2013, the estate tax will have a top rate of 55 percent and will apply to the value of estates exceeding $2 million for a couple. If the law is not changed, the estate tax will raise $536 billion over 10 years.[17] It will subject only the largest 2 out of 100 estates to taxes.[18]

The temporary cut in the estate tax that is in effect this year (and which was originally part of the Bush-era tax cuts) includes a lower estate tax rate (35 percent) and applies the tax only to the value of estates exceeding $10 million for a couple. If Congress makes this tax cut permanent, the estate tax would raise only $148 billion over 10 years.[19] Only 2 out of 1,000 estates would be subject to the tax.[20]

As part of his proposal to allow the expiration of the Bush tax cuts only for the wealthiest Americans, President Obama proposes to partially extend this tax cut, allowing the estate tax to apply to the value of estates exceeding $7 million for a couple and setting the estate tax rate at 45 percent. (These rules were in effect for one year, in 2009.) Under this proposal, the estate tax would raise about $280 billion over ten years[21] and affect fewer than 3 out of 1,000 estates.[22]

Another proposal (H.R. 3467), introduced by Rep. Jim McDermott (D-WA), would largely allow the pre-Bush estate tax rules to come back into effect, but would adjust the exemption amounts for inflation each year and make other reforms. Under that proposal, a top rate of 55 percent would be assessed on the value of estates above $2.6 million per couple raising $418 billion over ten years and affecting fewer than 2 percent of estates.[23]

The revenue estimates for restoring a robust estate tax assume that the estate tax will return to its 2009 level, as part of allowing the Bush-era tax cuts for the richest 2 percent to expire as proposed by President Obama. Congress could go even further and restore the estate tax to its pre-Bush level adjusted for inflation, raising $418 billion over 10 years or an additional $135 billion above the 2009 level. Congress could also allow the estate tax to return to its pre-Bush level without adjusting for inflation, raising $536 billion over 10 years, or an additional $253 billion above the 2009 level.

4. End Tax Breaks for Shifting Jobs and Corporate Profits Offshore

Revenue: $168 billion to $583 billion over 10 years [Joint Committee on Taxation]

U.S. corporations are allowed to “defer” (delay) paying taxes on the profits from their overseas subsidiaries until those profits are “repatriated” (brought back to the U.S.). “Deferral” of U.S. taxes on offshore corporate profits can give companies an incentive to move U.S. operations and jobs overseas. It also creates an incentive for companies to use dodgy accounting schemes to make their U.S. profits appear to be generated by a foreign subsidiary (sometimes consisting of nothing more than a post office box) in a country that has no corporate income tax or an extremely low corporate income tax (i.e., an offshore tax haven).

President Obama has proposed several measures to limit deferral, which together would raise $168 billion over 10 years.[24] One of the most significant measures would end the practice of companies taking immediate deductions against their U.S. taxes for interest expenses associated with their offshore operations even though they can defer (not pay) the U.S. taxes on the resulting offshore profits indefinitely. Another would help ensure that the foreign tax credit, which is supposed to prevent double-taxation of foreign profits, does not exceed the amount necessary to achieve that goal. Still another would reduce abuses involving intangible property like patents and trademarks, which are particularly easy to shift to tax haven-based subsidiaries that are really no more than a post office box.

These measures and others proposed by the President will raise significant revenue and prevent some abuses of our international tax rules. But the way to completely remove the tax incentives to send jobs and profits offshore is to simply repeal deferral. This would raise $583 billion over ten years and would mean that the profits of American corporations are taxed by the U.S. no matter where they are reported.[25] U.S. corporations would continue to receive a credit for foreign taxes paid on their offshore profits (the foreign tax credit) so that they would never pay combined U.S. and foreign taxes at a rate exceeding the U.S. corporate tax rate.

5. Establish a Small Financial Transaction Tax on Wall Street Trading

Revenue: $353 Billion over Nine Years (Joint Committee on Taxation)

It's time for Wall Street to help Main Street. A Financial Transaction Tax (FTT) is a very small tax on Wall Street trading in stocks, bonds, foreign currency bets, derivatives and other financial products. A tax of just 3 pennies on each $100 worth of trades (0.03 percent) would raise $353 billion over nine years, according to the Joint Committee on Taxation.[26]

Besides raising much-needed revenue, the FTT would reduce dangerous financial market speculation and encourage longer-term productive investment. It would hit high-volume, high-speed trading the hardest, serving to discourage short-term speculation, as well as the proliferation of ever more complex financial instruments that increasingly destabilize financial markets. By reducing the volume and profitability of short-term trading that serves no productive purpose, the tax would encourage Wall Street to find new ways to make money from longer-term, productive investments. That will mean more jobs on Main Street and an economy based on producing things rather than on speculating. Eleven European Union (EU) governments have now agreed to implement an FTT.

Endnotes

[1] Center on Budget and Policy Priorities (CBPP), "Congress Has Cut Discretionary Funding by $1.5 Trillion Over Ten Years," Sept. 25, 2012. http://www.cbpp.org/cms/index.cfm?fa=view&id=3840

[2] CBPP, "How the Across-the-Board Cuts in the Budget Control Act Will Work," Apr. 27, 2012. http://www.cbpp.org/cms/index.cfm?fa=view&id=3635. The sequester cuts about $1 trillion directly from programs; these cuts produce about $200 billion in interest savings.

[3] CBPP, "Joint Tax Committee, Raising Threshold for Bush Tax Cuts from $250,000 to $1 Million Would Lose $366 Billion – Nearly Half the Revenue," May 20, 2012. http://www.cbpp.org/cms/index.cfm?fa=view&id=3785

[4] Congressional Budget Office (CBO), "The Distribution of Household Income and Federal Taxes, 2008 and 2009," (Table 1), July 10, 2012. http://www.cbo.gov/publication/43373

[5] Corporate taxes have declined from 22.2 percent of federal revenue in 1961 to 7.9 percent in 2011. Office of Management and Budget, Fiscal Year 2013 Budget, Historical Tables (Table 2.2). http://www.whitehouse.gov/omb/budget/Historicals

[6] Ibid. (Table 1.2).

[7] CBPP, "Chart Book: 10 Things You Need to Know About the Capital Gains Tax," Sept. 20, 2012. http://www.cbpp.org/cms/index.cfm?fa=view&id=3798

[8] Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085 (1986).

[9] Institute on Taxation and Economic Policy micro-simulation tax model, as noted in Citizens for Tax Justice, "Policy Options to Raise Revenues," March 8, 2012, p. 5. http://ctj.org/pdf/revenueraisers2012.pdf
There is a debate between non-partisan Congressional agencies over how much revenue can be raised from increasing tax rates on capital gains. The Joint Committee on Taxation (JCT) assumes large behavioral effects on the part of investors, who (the argument goes) would be inclined to hold onto their assets longer if they will be taxed more upon selling them, resulting in fewer capital gains to be taxed. JCT finds these behavioral effects to be so large that it might estimate no revenue gain from taxing capital gains at the same rates as "ordinary" income. On the other hand, the Congressional Research Service (CRS) has reviewed quantitative research and concluded that JCT significantly overestimates these behavioral impacts. (See Jane Gravelle, Congressional Research Service, "Capital Gains Tax Options: Behavioral Responses and Revenue," August, 2010). CTJ follows the more reasonable approach supported by CRS and estimates that ending the preference for capital gains would raise $533 billion over a decade even assuming the greatest plausible behavioral effects.

[10] Economic Policy Institute, *The State of Working America, 12th Edition*, 2012, (Table 6.1), p. 379. http://stateofworkingamerica.org/subjects/wealth/?reader

[11] The National Economic Council, "The Buffett Rule: A Basic Principle of Tax Fairness," April 2012, p. 4, http://www.whitehouse.gov/sites/default/files/Buffett_Rule_Report_Final.pdf

[12] S.B. 1660, 112th Cong. § 401 (2011).

[13] Tax Policy Center (TPC), Table T11-0369: Senate Version of American Jobs Act of 2011: 5.6 Percent Surtax on Millionaires, Oct. 6, 2011. http://www.taxpolicycenter.org/numbers/Content/PDF/T11-0369.pdf

[14] Citizens for Tax Justice, unpublished estimates, April 2011. Details about the Schakowsky legislation, H.R. 1124, are available at http://schakowsky.house.gov/index.php?option=com_content&view=article&id=2877%3Aschakowsky-introduces-bill-to-tax-millionaires-and-billionaires&catid=22%3A2011-press-releases&Itemid=44.

[15] Citizens for Tax Justice, "Top Federal Income Tax Rates Since 1913," November 2011. http://www.ctj.org/pdf/regcg.pdf.

[16] Congressional Research Service, "Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945," Sept. 14, 2012. http://tpmdc.talkingpointsmemo.com/PDF/0915taxesandeconomy.pdf

[17] CBO, "An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022," August 22, 2012. See Excel file at: http://www.cbo.gov/publication/43546 . As cited in OMB Watch, "Extending Current Estate Tax Rates Force Spending Cuts in Education and Health in 2013," Oct. 2, 2012. http://www.ombwatch.org/files/budget/estate-tax-analysis-oct12.pdf

[18] TPC, Table T11-0156: Estate Tax Returns and Liability Under Current Law and Various Reform Proposals, June 2, 2011. Calculation is 52.5/2,636 = 1.99%. As cited in OMB Watch.

[19] OMB Watch estimate based on Committee for a Responsible Federal Budget (CFRB), "Where Is the Estate Tax Heading?" September 21, 2012. http://crfb.org/blogs/where-estate-tax-heading.

[20] TPC, *supra* note 18. Calculation is 4.0/2,636 = 0.15%. http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3037 as cited in OMB Watch.

[21] OMB Watch estimate based on CFRB estimate, *supra* note 19.

[22] TPC, *supra* note 18. Calculation is 7.5/2,636 = 0.28%.

[23] OMB Watch estimates.

[24] Joint Committee on Taxation (JCT), "Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2013 Budget Proposal," (JCX-27-12), pp. 9-10. https://www.jct.gov/publications.html?func=startdown&id=4413

[25] JCT, "Estimated Revenue Effects of S. 3018, the Bipartisan Tax Fairness and Simplification Act of 2010," Nov. 2, 2010, p. 3 item 10. http://www.wyden.senate.gov/priorities/wyden-coats-tax-plan.

[26] Sen. Tom Harkin, Press Release, "Lawmakers Write Deficit Reduction Committee on Revenue Benefits of Wall Street Tax," Nov. 8, 2011. http://www.harkin.senate.gov/press/release.cfm?i=334699