

Taxing the Rich: Less, More or Just Right?

Presentation to Sorensen Policy
Seminar Series

Eric Toder

October 18, 2012



Topics

- Background on federal tax system
- The fiscal cliff
- Tax proposals of Obama and Romney
- Economic arguments pro and con
- Myths about taxing the rich

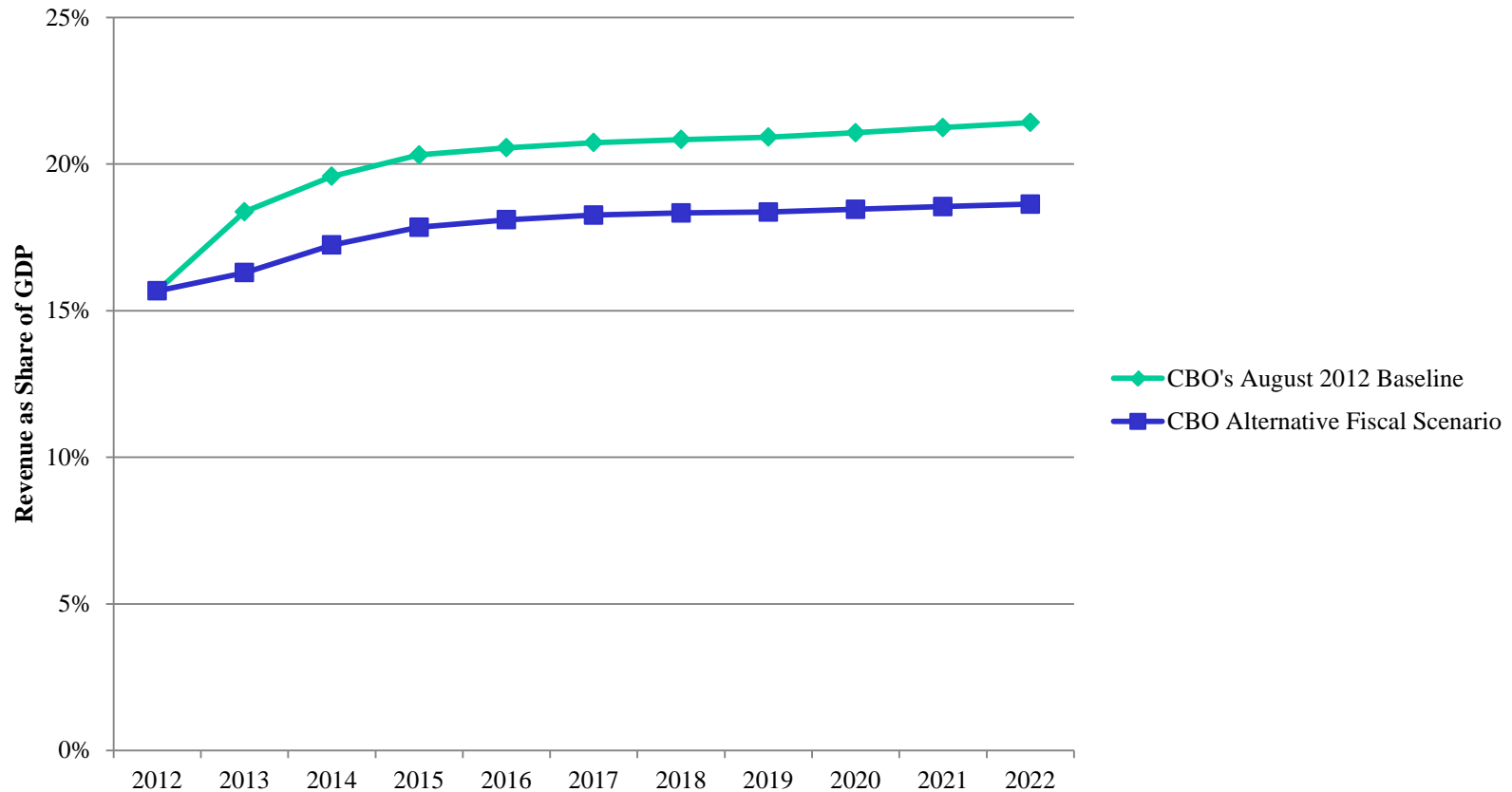


Revenue as share of GDP under Two CBO Baselines

<u>Baseline</u>	2012	2013	2015	2018	2022
Current Law	15.7%	18.4%	20.3%	20.8%	21.4%
Alternative Fiscal Scenario	15.7%	16.3%	17.8%	18.3%	18.6%



Revenue as Share of GDP Under Two CBO Baselines



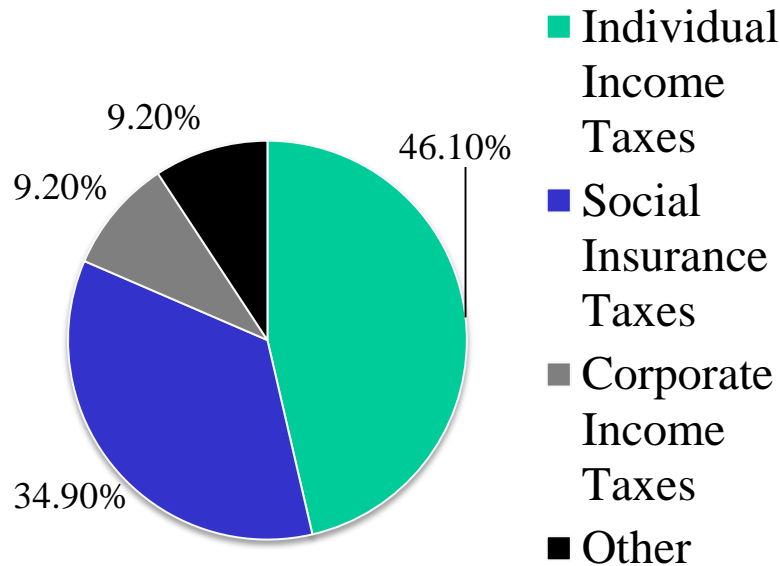
Sources of Federal Tax Receipts: Current Law Baseline

	2012	2022
Individual Income Taxes	46.1%	54.2%
Social Insurance Taxes	34.9%	29.1%
Corporate Income Taxes	9.2%	9.7%
Other	9.2%	7.5%

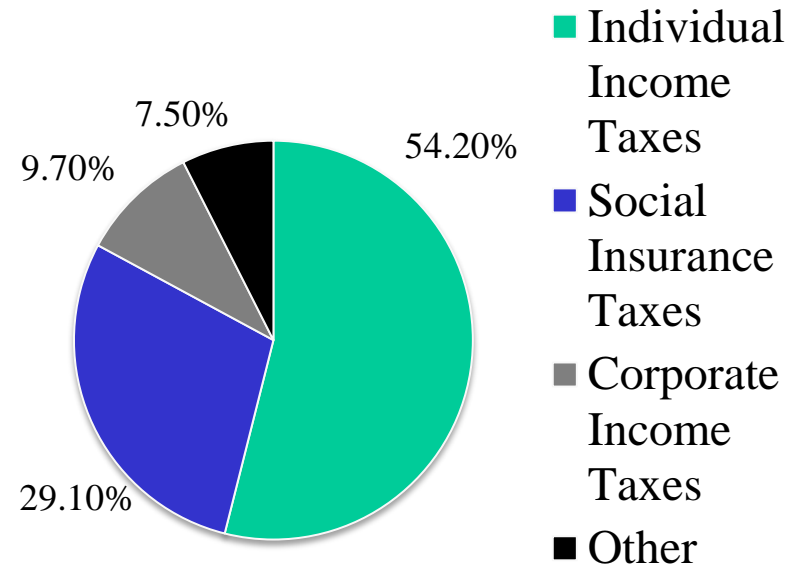


Sources of Federal Tax Receipts: Current Law Baseline

2012



2022



Individual Income Tax

- Graduated Rates
- Tax Rates on Investment Income
- Benefits for low-income families
- Alternative Minimum Tax
- Tax Expenditures
- Many Provisions change on 1/1/2013



Individual Income Tax Rates

	2012 Law Extended	2013 Law
Ordinary Income	10-35 percent	15-39.6 percent
Capital Gains	0-15 percent	10-20 percent
Dividends	0-15 percent	15-39.6 percent



Benefits for Low-Income Taxpayers

- Standard deduction (reduced for married couples in 2013)
- Personal exemptions
- Child credit (reduced in 2013)
- Earned income tax credit (reduced in 2013)
- Benefits for older taxpayers

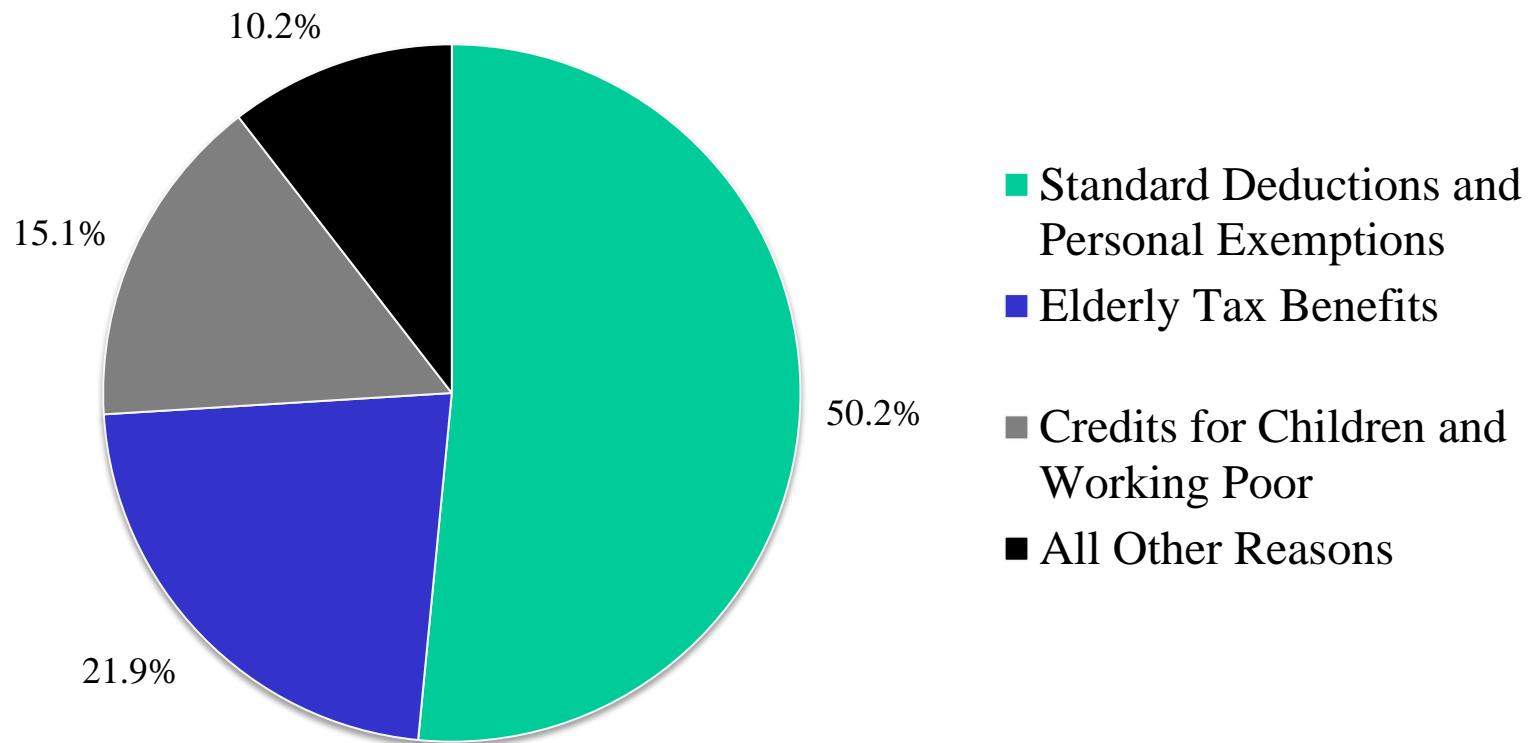


Why 46.4 Percent Paid No Income Tax in 2011

- Standard deductions and personal exemptions – 50.2 percent
- Elderly tax benefits – 21.9 percent
- Credits for children and working poor – 15.1 percent
- All other reasons* – 10.2 percent
 - *Exclusion of cash transfers, other credits and deductions, tax-exempt interest, capital gains and dividends



Why 46.4 Percent Paid No Income Tax in 2011

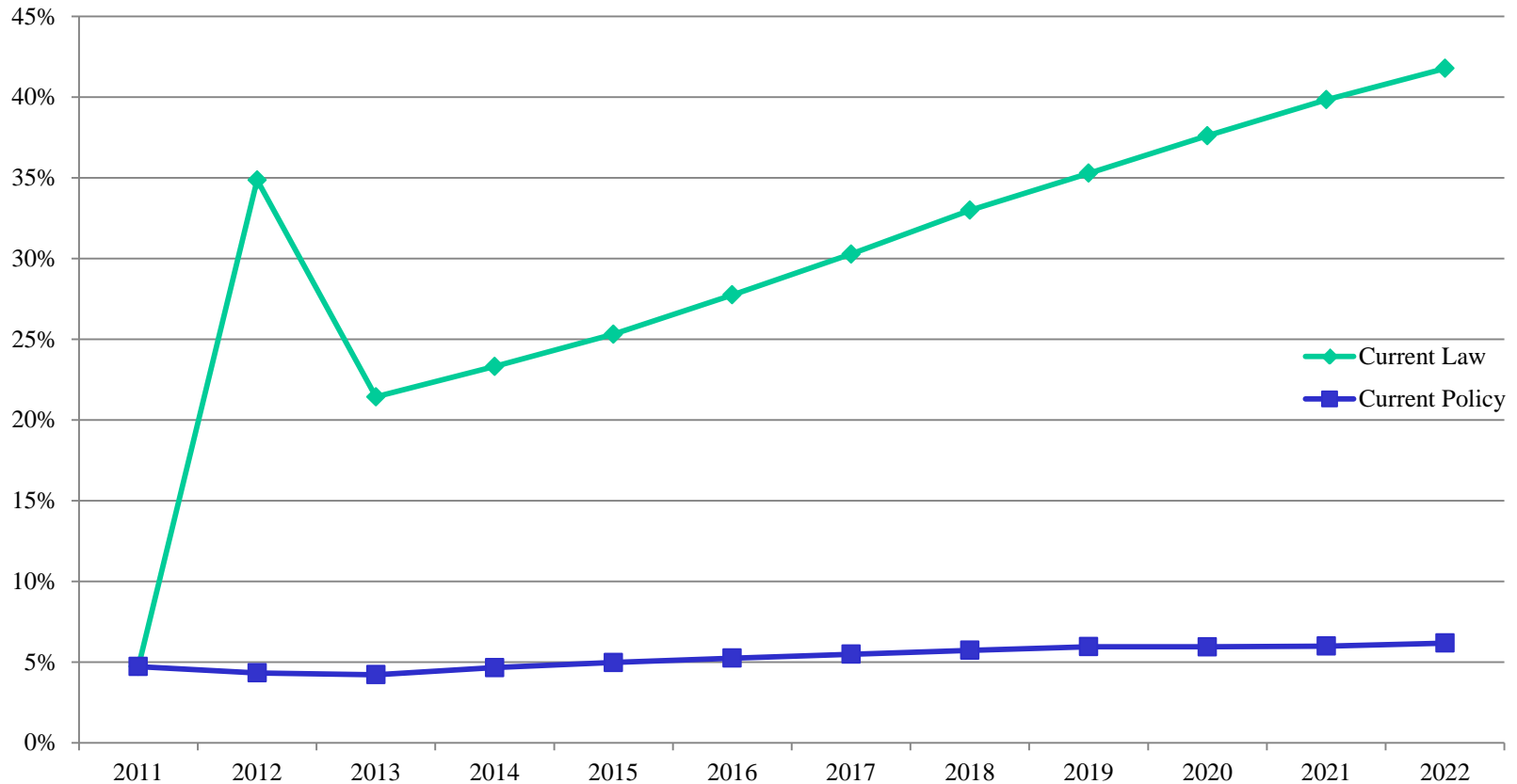


Impact of AMT

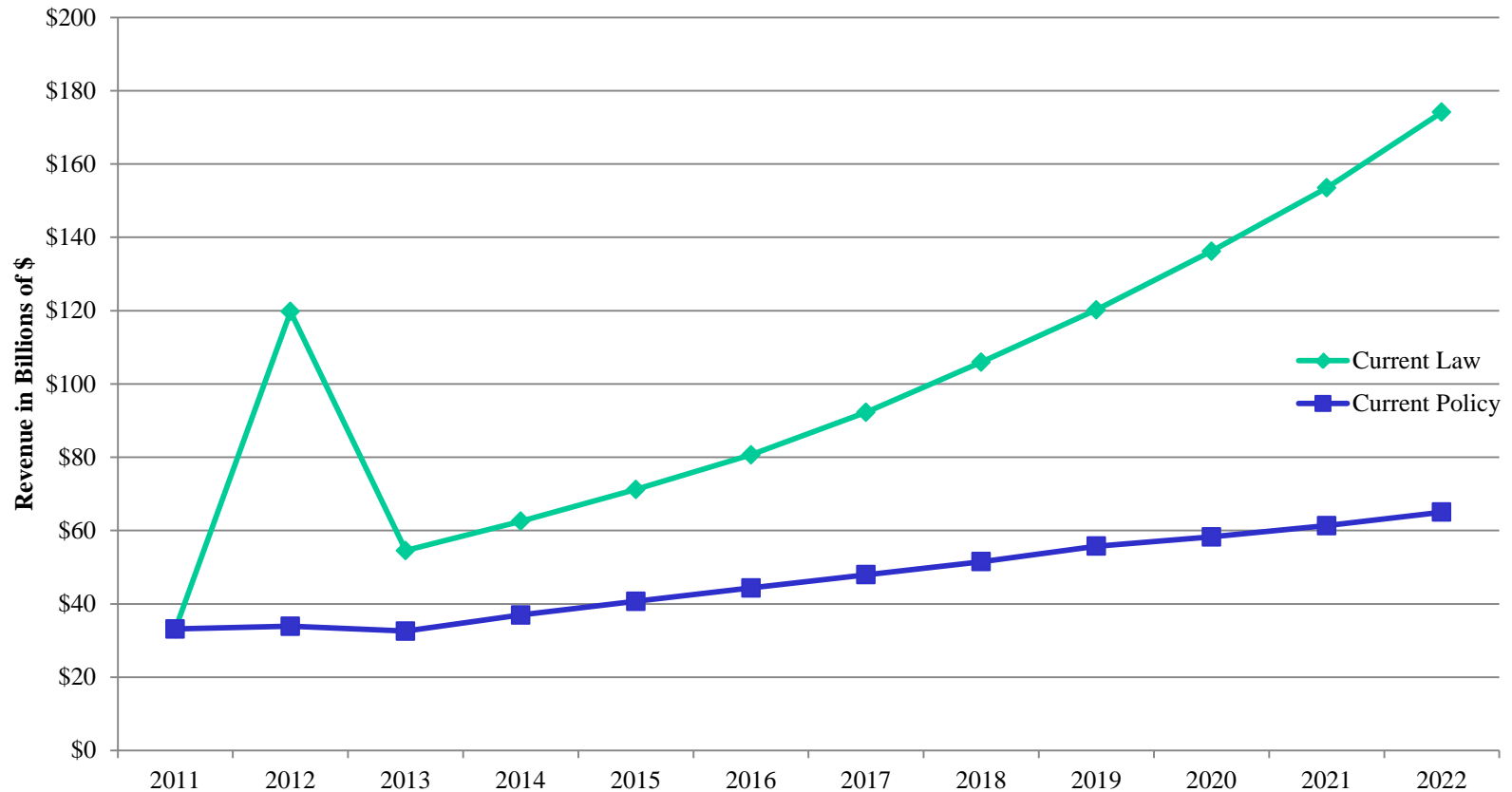
	2011	2012	2013	2022
Percent affected – current law	4.7%	34.9%	21.4%	41.8%
Percent affected – current policy	4.7%	4.3%	4.2%	6.2%
AMT revenue – current law	\$33.2b	\$119.8b	\$54.5b	\$174.1b
AMT revenue – current policy	\$33.2b	\$33.9b	\$32.6b	\$65.0b



Percent of Tax Payers on AMT



AMT Revenue (in billions of \$)



10 Largest Tax Expenditures in \$billions, 2013-17 (OMB)

Tax Expenditure Provision	Revenue Loss
Exclusion of employer health insurance contributions	\$1,012.3 billion
Tax benefits for employer sponsored retirement plans	\$726.8 billion
Deduction for home mortgage interest	\$606.4 billion
Deduction for non-business state and local taxes	\$435.7 billion
Accelerated depreciation of machinery and equipment	\$374.6 billion
Exclusion of imputed rent on owner-occupied homes	\$337.4 billion
Preferential tax rates for capital gains	\$321.5 billion
Deduction for charitable contributions	\$293.2 billion
Earned income tax credit	\$260.2 billion
Exemption of interest on public purpose SL bonds	\$227.5 billion



Payroll Taxes

- Imposed on earnings and self-employment income
 - One half each from employers and employees
 - Most economists think labor bears the burden
- 12.6 percent rate on OASDI
 - Ceiling of \$110,100 in 2012
- 2.9 percent on HI
 - Beginning in 2013, additional 0.9 percent tax on higher earners



Corporate Income Tax

- 35% maximum rate
 - Most tax paid by largest corporations
- Combined state-federal average highest in OECD
- Preferences reduce effective tax rate
- International tax issues
- Individuals bear burden, but whom?



Distribution of Tax Burden by Cash Income Percentile (TPC)

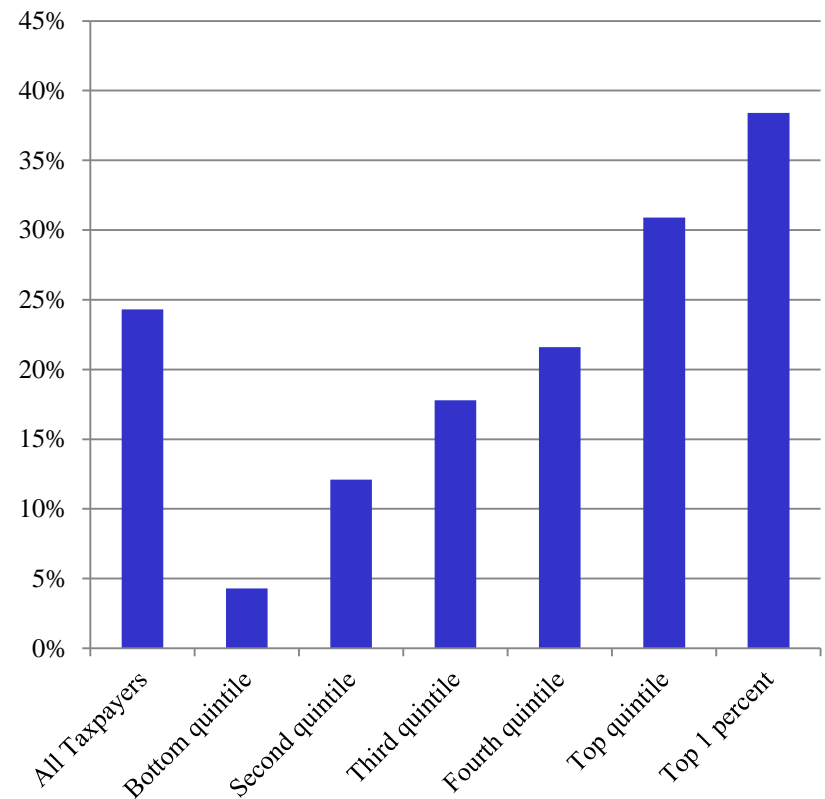
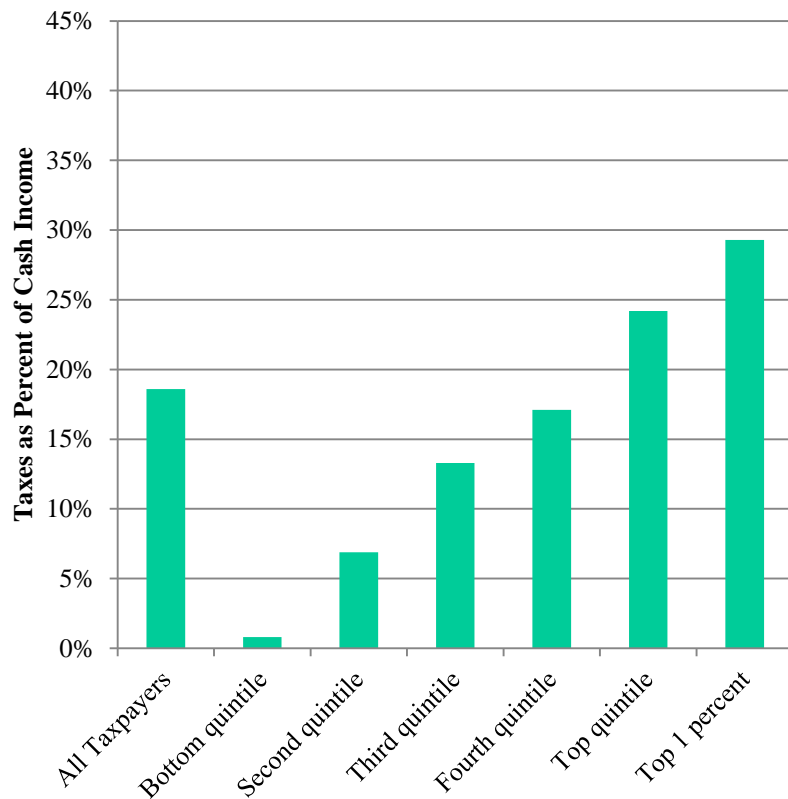
<u>Taxes/Cash Income</u>	<u>2011</u>	<u>2013</u>
All Taxpayers	18.6 percent	24.3 percent
Bottom quintile	0.8 percent	4.3 percent
Second quintile	6.9 percent	12.1 percent
Third quintile	13.3 percent	17.8 percent
Fourth quintile	17.1 percent	21.6 percent
Top quintile	24.2 percent	30.9 percent
Top 1 percent	29.3 percent	38.4 percent



Distribution of Tax Burden by Cash Income Percentile (TPC)

2011

2013



Shares of Income and Taxes Paid

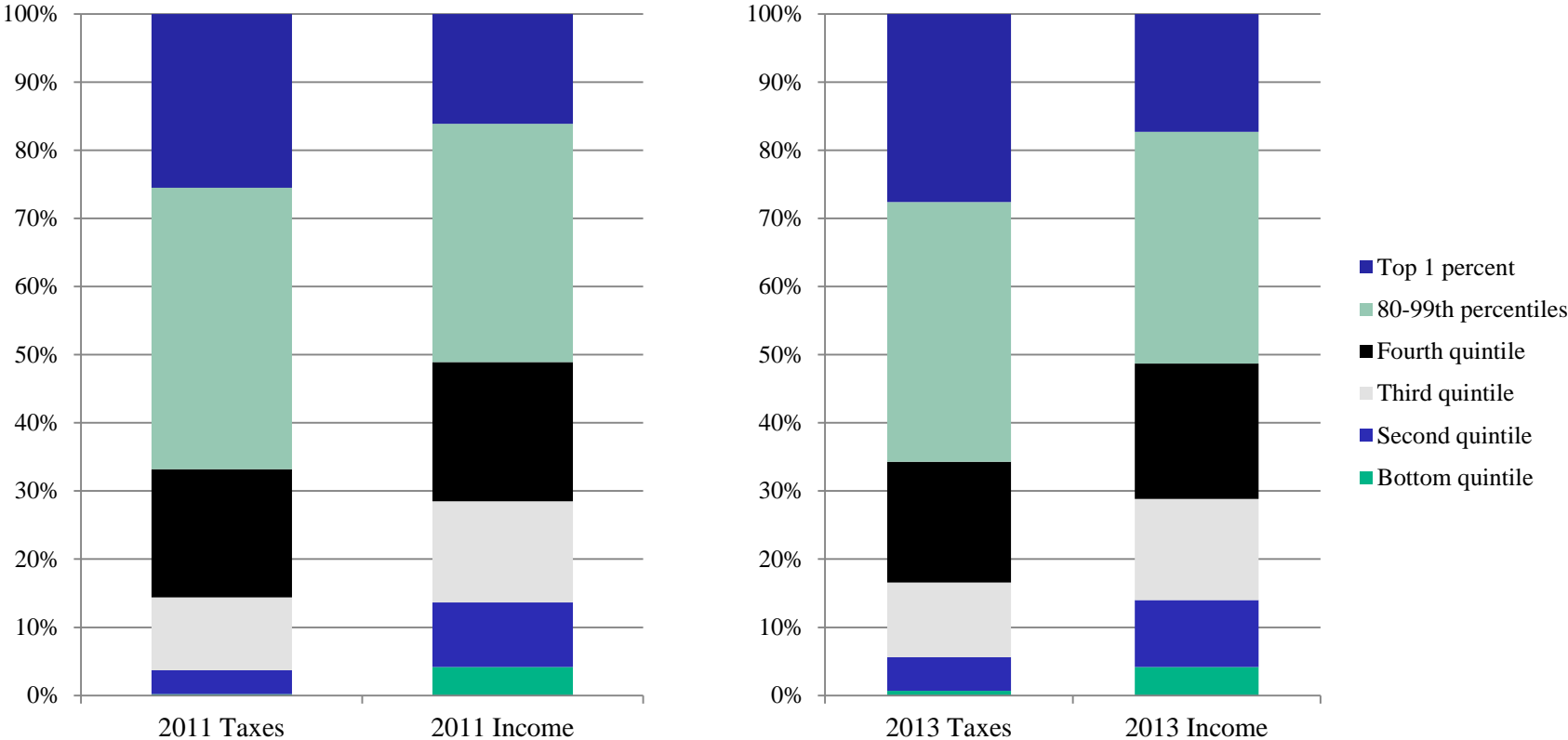
<u>Income Group</u>	<u>2011 Taxes</u>	<u>2011 Income</u>	<u>2013 Taxes</u>	<u>2013 Income</u>
All Taxpayers	100.0%	100.0%	100.0%	100.0%
Bottom quintile	0.2%	4.2%	0.7%	4.2%
Second quintile	3.5%	9.5%	4.9%	9.9%
Third quintile	10.7%	14.9%	10.9%	14.9%
Fourth quintile	18.8%	20.5%	17.7%	20.0%
80-99 th percentiles	41.3%	35.1%	38.0%	34.2%
Top 1 percent	25.5%	16.2%	27.5%	17.4%



Shares of Income and Taxes Paid

2011

2013

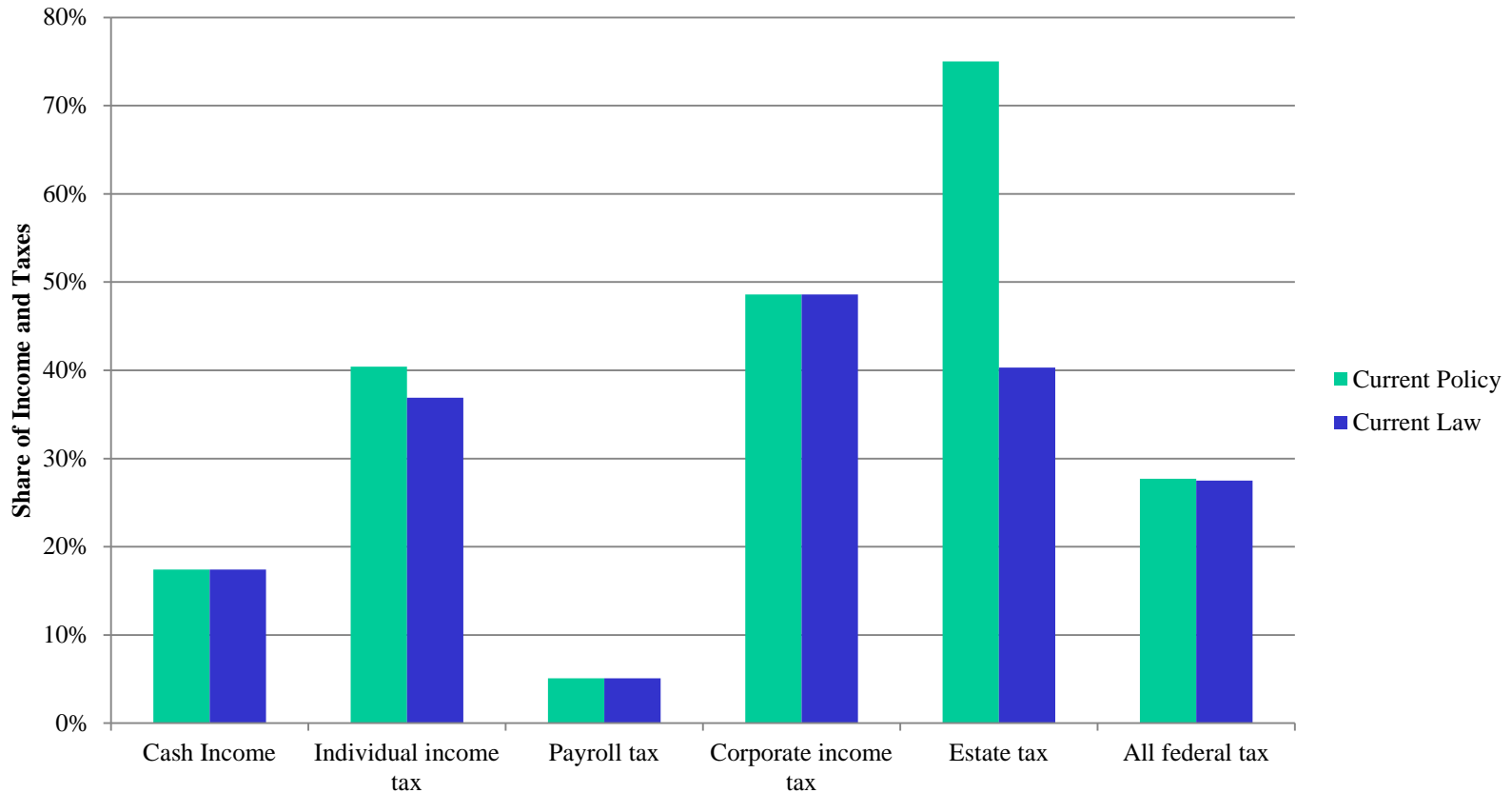


Shares of Tax Paid by Top 1%

<u>Shares of Income and Taxes Paid by Top 1%</u>	<u>Current Policy</u>	<u>Current Law</u>
Cash Income	17.4%	17.4%
Individual income tax	40.4%	36.9%
Payroll tax	5.1%	5.1%
Corporate income tax	48.6%	48.6%
Estate tax	75.0%	40.3%
All federal tax	27.7%	27.5%



Share of Income and Taxes Paid by Top 1%



The Fiscal Cliff

- Taxes go up because of:
 - Expiration of past year tax cuts
 - New taxes
- Sequesters for Domestic and Defense Spending
- Cut in Medicare reimbursement rates
- Federal debt ceiling approaching



Tax Components of Cliff (\$536b)

- Payroll tax cut - \$115b (21%)
- New health care law taxes - \$24b (4%)
- 2001-03 high-income tax cuts - \$52b (10%)
- 2009 stimulus tax cuts - \$27b (5%)
- “Extenders” - \$75b (14%)
- Estate tax cuts - \$31b (6%)
- Other 2001/03 tax cuts - \$171b (32%)
- AMT patch -\$40b (7%)

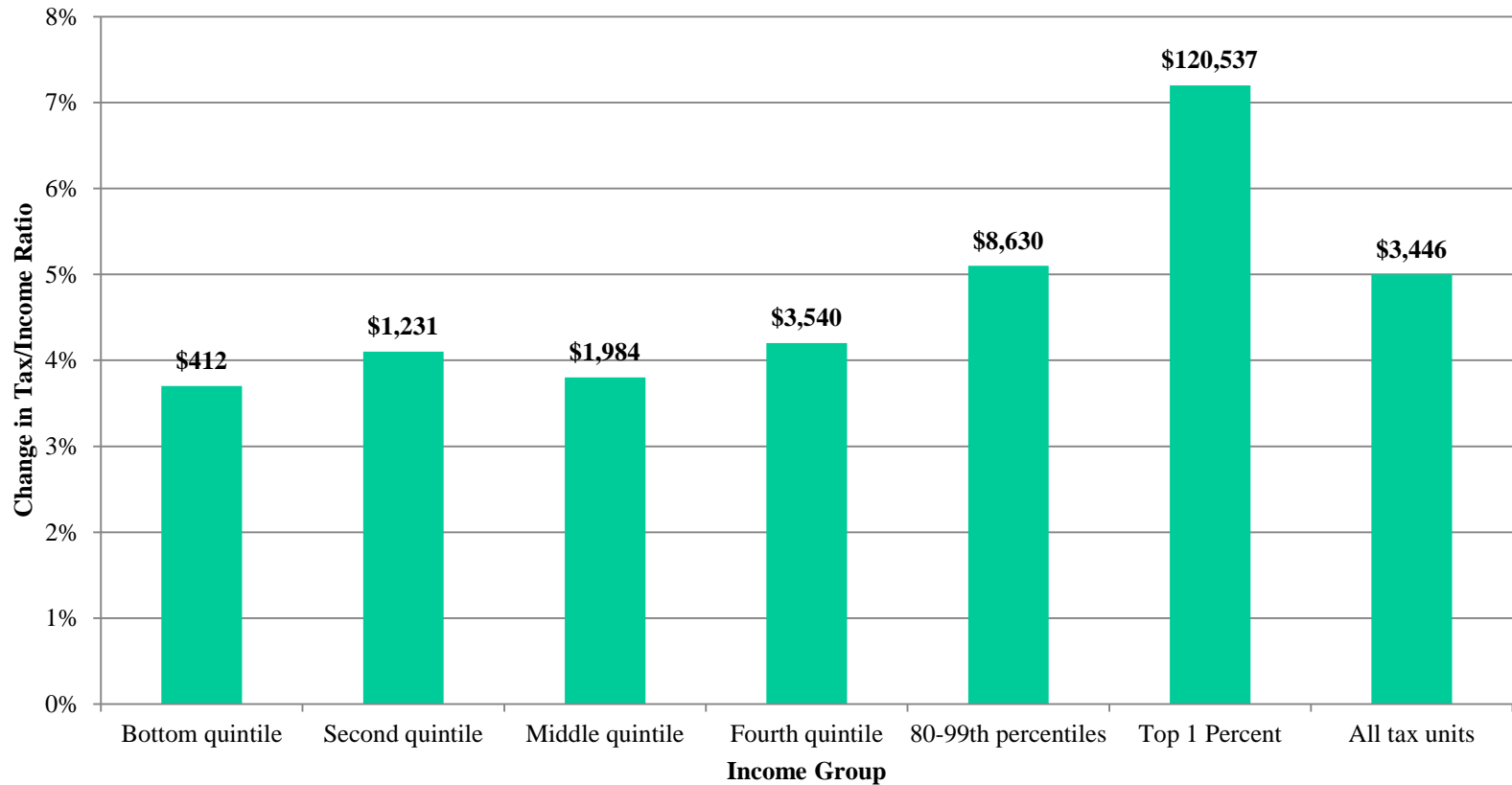


Who Pays Higher Taxes

Income Group	Average Tax Change (\$)	Change in Tax/Income
Bottom quintile	\$412	3.7 percent
Second quintile	\$1,231	4.1 percent
Middle quintile	\$1,984	3.8 percent
Fourth quintile	\$3,540	4.2 percent
80-99 th percentiles	\$8,630	5.1 percent
Top 1 Percent	\$120,537	7.2 percent
All tax units	\$3,446	5.0 percent



Who Pays Higher Taxes



Summary Points: Fiscal Cliff

- Largest peacetime tax increase ever
 - About 90% of tax units affected
 - 99% in top 3 quintiles pay more
 - Some seniors and low-income singles unaffected
- Average tax increase about \$3500
 - \$120,000 for top 1%, \$2,000 for middle
- Differences among provisions
 - Rich: high-income Bush tax cuts and estate tax
 - Low/middle: Other 2001 and 2009 tax cuts and payroll
 - Upper middle: AMT patch



What would candidates do?

- Relative to “current policy” baseline
 - Obama would increase taxes
 - Romney would be “revenue neutral”
 - But hasn’t said how tax rate cuts he proposes would be paid for
- For high-income people
 - Obama would raise taxes substantially
 - Explicit Romney proposals would cut taxes



Comparison of Plans

Provisions	Romney proposal	Obama budget
2001-03 tax cuts	Extend all	Extend, except high income
2009 stimulus cuts	Allow to expire	Extend
Health reform taxes	Repeal	Allow to take effect
Capital gains and dividends	15% top rate; zero at incomes <\$200K	20% for capital gains; 39.6% for dividends
Other individual	20% rate cut, no AMT, unspecified pay-fors	Cap tax benefits at 28% rate
Corporate	25% corporate rate territorial tax	On balance, reduce preferences
Estate tax	Eliminate	Extend 2009 provisions

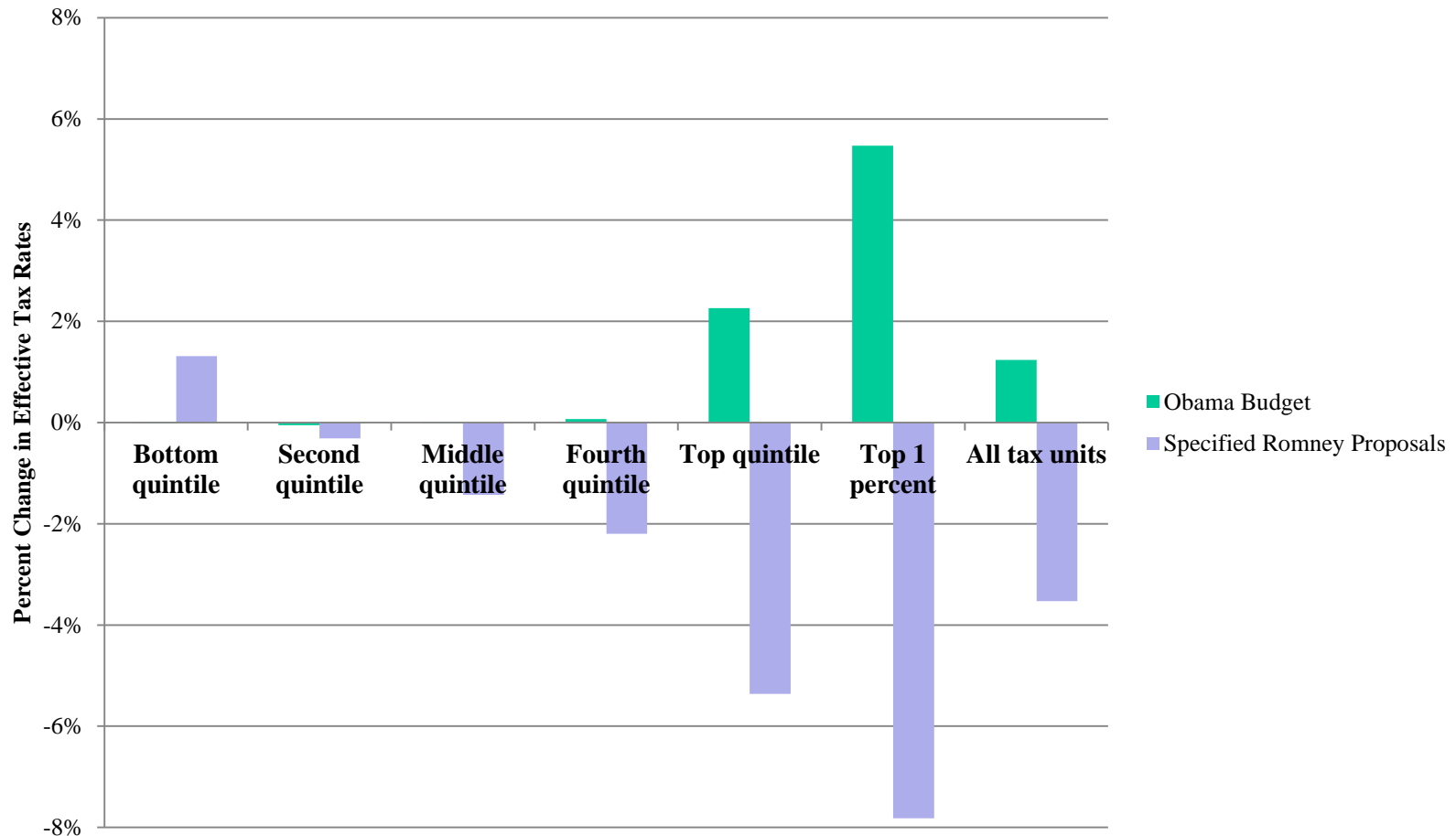


Changes in Effective Tax Rates, Tax Year 2015

Income Group	Obama Budget	Specified Romney Proposals
Bottom quintile	-0.02 percent	+1.31 percent
Second quintile	-0.05 percent	-0.31 percent
Middle quintile	-0.02 percent	-1.43 percent
Fourth quintile	+0.07 percent	-2.20 percent
Top quintile	+2.26 percent	-5.36 percent
All tax units	+1.24 percent	-3.53 percent
Top 1 percent	+5.47 percent	-7.82 percent



Changes in Effective Tax Rates, Tax Year 2015



Economic Effects of Higher Taxes on the Rich

- Two Sources of Economic Growth
 - Increased productive capacity
 - Comes from work effort, human capital, saving, investment, innovation
 - Full utilization of productive capacity
 - Requires sufficient demand to purchase outputs businesses can produce
- Short term needs in recession differ from long-term needs



Anti-Recessionary Fiscal Policy

- Increased fiscal stimulus
 - Lower taxes, especially on people who will spend
 - Maintain Federal spending
- Effects of taxes on rich
 - Higher taxes reduce demand somewhat
 - Lower taxes won't spur investment if businesses can't sell their goods



Taxing the rich in the long-run

- Adverse effects of higher marginal rates
 - Reduces work effort and saving
 - Encourage unproductive tax avoidance
- It matters not only how much, but how
 - Less distortion with lower tax rates on a broader tax base
- Deficits harmful to national saving and long-term growth



Myths About Taxing the Rich

- Higher individual income tax rates will destroy jobs by killing small business
- Fiscal stability can be restored by taxing the rich
- Income tax rate cuts for the rich can be paid for by closing “loopholes”
- A reform that reduces tax rates must necessarily benefit the rich

