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CTJ Citizens for Tax Justice

Legislative Agenda for 2010

America's tax system is in crisis. The tax code is riddled with special breaks and loopholes for wealthy investors, which leaves less revenue to be invested in the public good. This is especially harmful right now. As we live through the worst economic downturn since the Great Depression, public resources must be invested in the American people.

If the federal government does not have the resources to ensure that all families can afford food and necessities, that's not just a problem for poor families. That also contributes to the drop in consumer demand, which makes employers less likely to start hiring again. If the federal government does not have the resources to guarantee education and health care, that's not just a problem for the individuals who can't get to college and can't obtain health insurance. That also makes it more difficult for employers to create a productive and healthy workforce, which is vital to our recovery.

Most of the changes made to the tax code over the past decade have made this problem worse. Massive tax cuts were enacted to benefit wealthy investors, draining away revenue that could otherwise be invested in the common good. President Obama has committed to reduce at least some of these special breaks and loopholes for wealthy investors, but Congress can do even more.

There are two bare minimum requirements for avoiding larger budget deficits and restoring fairness to the tax code. First, Congress must <u>not</u> extend any more of the Bush tax cuts than President Obama proposes to extend. Second, Congress must raise at least as much revenue as President Obama has proposed ($760 billion over ten years) through loophole-closers and other reforms. Congress can achieve these goals by taking the following steps:

1. **Allow the Bush income tax cuts for the wealthy to expire at the end of 2010.**
2. **Prevent offshore profit-shifting by U.S. corporations.**
3. **Help law-abiding taxpayers by stopping tax evasion.**
4. **Hold corporations accountable for costs of taxpayer-funded bailouts.**
5. **Eliminate special breaks and loopholes for large corporations.**
6. **Eliminate special breaks and loopholes for wealthy investors.**
7. **Maintain a robust federal estate tax.**
8. **Improve tax credits for low-income Americans.**

1. Allow the Bush income tax cuts for the wealthy to expire at the end of 2010.

President Obama has proposed extending the Bush income tax cuts for married couples with adjusted gross income (AGI) below $250,000 and singles with AGI below $200,000. He favors allowing the very expensive tax breaks for the richest Americans to expire, as they are scheduled to do at the end of 2010. This means that the Bush tax cuts would be extended for 97.9 percent of taxpayers.

Some lawmakers want to also extend the Bush tax cuts for the richest 2.1 percent. This would cost an additional $678 billion over the 2011-2020 period, according to the budget figures released by the administration.[1]

If anything, Congress should allow the Bush tax cuts to expire for *more* high-income taxpayers than just the richest 2.1 percent.

2. Prevent offshore profit-shifting by U.S. corporations.

Our tax system encourages U.S. corporations to shift their profits offshore. Sometimes this means corporations move physical operations (and jobs) offshore, but other times it involves accounting gimmicks and transactions that only really exist on paper. U.S. corporations use these offshore "investments" to reduce their total taxes, meaning they effectively provide a negative tax rate.

President Obama has put forth a set of proposals that would crack down on these offshore tax avoidance schemes used by corporations. His proposals would raise around $122 billion over a decade, but stronger reforms could probably raise more revenue. Congress should, at very least, enact the President's proposals to address this problem.

3. Help law-abiding taxpayers by stopping tax evasion.

Most Americans pay the taxes they owe. There are a few who find ways to hide income from the IRS so that they can evade taxes. This is a crime, and it's one that most middle-income people don't even have an opportunity to commit. For example, only the wealthy have access to high-priced lawyers and accountants who help them hide their income in foreign countries that don't cooperate with U.S. tax enforcement efforts. When someone dodges his U.S. taxes, the rest of us have to pay more or live with a lower level of public services as a result. Law-abiding taxpayers are, in effect, subsidizing those who evade their taxes.

A Senate committee investigating this problem recently concluded that somewhere around $100 billion a year in revenue is lost because of offshore tax evasion. A legislative proposal recently crafted by the chairmen of the House and Senate tax-

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[1] U.S. Department of Treasury, "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals," February 2010. http://www.treas.gov/offices/tax-policy/library/greenbk10.pdf

writing committees is a step in the right direction, but would only make a tiny dent in the problem by recouping an estimated $8.5 billion over a decade.

4. Hold corporations accountable for costs of taxpayer-funded bailouts.

As one of his last major acts in office, President Bush signed into law the financial rescue program, which allowed the government to spend hundreds of billions of dollars to purchase "troubled assets" from financial institutions. Most economists agree that this probably averted a much deeper recession, but it came with some very problematic side-effects.

The biggest banks, those that were considered "too big to fail," have insufficient incentive to avoid the sort of risk-taking that led to the collapse. The implicit government guarantee gives them a special advantage that smaller banks don't have, since banks that are not considered "too big to fail" are less likely to be bailed out by the federal government.

To address this, President Obama proposes a new annual fee of 0.15 percent of the value of the riskier assets held by the 50 largest financial institutions (those with assets of more than $50 billions each). The fee would be in place for at least ten years and the Administration estimates that it would collect around $90 billion over a decade. If the $700 billion distributed through the financial bailout (the Troubled Asset Relief Program, or TARP) is not entirely paid back by that time, then the fee would remain in effect for additional years.

The proposal would discourage the excessive risk-taking that helped cause the recession and at the same time would require large banks to help pay for the implicit government guarantee that they now seem to have.

5. Eliminate special breaks and loopholes for large corporations.

When Congress creates a special tax break to benefit a particular industry or a particular corporation, the effect is just as if Congress decided to give a grant of cash to the industry or corporation. A special tax break, just like a direct grant of cash, results in more money for the companies and less revenue that Congress can spend on priorities like education, health care, and infrastructure. Corporate tax breaks cost well over a hundred billion dollars annually. Nevertheless, many are created and extended every year with nowhere near the scrutiny applied to decisions about funding public services.

Congress should recognize that these tax breaks and loopholes that benefit corporations are subsidies provided through the tax system, and ordinary taxpayers are footing the bill. When viewed this way, many of these corporate tax subsidies can be eliminated because they drain public revenue without producing any corresponding benefit for the public.

For example, the deduction for domestic manufacturing enacted in 2004 will cost over a $100 billion in lost revenue over a decade but provides no discernable benefit to our economy. The Obama administration has proposed to stop oil and gas companies from using this deduction, but repealing it altogether would be more sensible.

To take another example, the "last-in, first-out" or LIFO, inventory rule allows companies to manipulate their inventory accounting to make their profits appear smaller than they actually are. This corporate tax break costs tens of billions of dollars over a decade and does not seem to benefit the economy or the taxpayers in any way. The Obama administration has, reasonably, proposed repeal of LIFO.

6. Eliminate special breaks and loopholes for wealthy investors.

Taxpayers whose income takes the form of capital gains and corporate stock dividends are currently taxed at rates lower than taxpayers who earn wages. As a result, a wealthy person who lives off of his or her investments can actually pay federal income taxes at lower rates than a middle-income person who works.

Taxes should be levied based on ability to pay. The rich can afford to pay a greater portion of their income than the poor. But there is no logical reason why taxes should be levied differently based on the *type* of income one has. Investment income should be taxed at the same rates as all other income, as was the case for several years under the tax reform signed into law by President Reagan in 1986.

President George W. Bush expanded the tax subsidies for investment income by lowering the special top rate for capital gains and creating a new break for stock dividends. President Obama has proposed allowing the Bush capital gains tax break to expire for the wealthy (which would still leave a sizable capital gains tax break that existed before Bush) and he wants to partially extend the Bush tax cut for dividends.

Congress can take several steps to further reduce these tax subsidies for investors. For example, lawmakers could set the top capital gains tax rate higher than President Obama proposes, and they could allow the Bush tax cut for dividends to completely expire. They could also close the "carried interest" loophole, which allows managers of buyout funds to manipulate the capital gains preference in order to pay lower taxes than other investment managers doing similar work. These would all be steps in the right direction, but the simplest and most thorough solution to this unfairness is for Congress to reform our tax system so that investment income is once again taxed at the same rates as all other types of income.

7. Maintain a robust federal estate tax.

The tax cut legislation enacted by President Bush and his allies in Congress in 2001 set the estate tax to gradually shrink until disappearing altogether in January 2010. But, like all the Bush tax cuts, the repeal of the estate tax expires at the end of 2010, meaning the estate tax will reappear in 2011 at the pre-Bush levels if Congress simply does nothing.

Families who have several million dollars to leave to the next generation have benefited the most from the infrastructure, educated workforce, stability and other public goods that taxes make possible. So it's entirely reasonable that these families pay a tax on the transfer of their enormous estates from one generation to the next, particularly since the majority of the value in these estates is capital gains income that has *never* been taxed.

Congress should reinstate the estate tax for 2010 at least at the levels that existed in the previous year. In 2009, the estate tax exempted $3.5 million in assets (and $7 million for married couples) and is expected to impact only the largest one in 500 estates of people who died during that year.

Any permanent changes to the estate tax should set the rules closer to those that existed before the Bush tax cuts. In years after 2010, the estate tax should exempt no more than $2 million per spouse and have a rate of at least 45 percent, with an additional 10 percent applied to taxable assets in excess of $10 million.

8. Improve tax credits for low-income Americans.

America's tax system overall (including federal, state and local taxes) is not particularly progressive. State and local taxes take a greater share of income from low- and middle-income taxpayers than rich taxpayers in almost every state.[2] It is therefore vital that the federal tax system be extremely progressive to offset the regressive impact of state and local taxes.

This requires some federal income tax provisions that benefit the poorest Americans. Families too poor to owe federal income taxes can benefit from refundable federal tax credits like the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). Recent legislation temporarily expanded the EITC for married people and families with three or more children and made it possible for poorer families with children to benefit from the CTC. At a minimum, these improvements in the refundable tax credits should be made permanent, as President Obama proposes.

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[2] Institute on Taxation and Economic Policy (ITEP), *Who Pays: A Distributional Analysis of the Tax Systems in All 50 States, Third Edition*, November 2009. http://www.itepnet.org/whopays.htm