CTJ Citizens for Tax Justice

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The Revenue Impacts of the Buffett Rule and Other Policy Options

The revenue impact of the Buffett Rule, as proposed by President Obama, depends on how it is implemented and whether or not the Bush tax cuts are extended again. Ending the breaks for investment income in the personal income tax would be a more straightforward approach that raises more revenue.

Revenue Impact Depends on the Extension or Expiration of the Bush Tax Cuts

The Buffett Rule would raise about $25 billion annually in years after 2012, while ending tax preferences for investment income would raise around $70 billion annually. These estimates assume the Bush tax cuts *expire* after 2012 as scheduled.

In 2012, or in any year in which the Bush tax cuts are *in effect*, the Buffett Rule would raise around $50 billion while ending tax preference for investment income would raise around $100 billion.

In other words, either of these policy options (the Buffett Rule or ending tax preferences for investment income) would raise more revenue if the Bush tax cuts are extended — but not nearly enough to offset the cost of extending those tax cuts.

This is illustrated in the table on the right, which shows the impacts of different policy options in 2014, which is likely to be a representative year of the next decade.

Both of these policy options (the Buffett Rule or ending tax preferences for investment income) would reduce tax breaks that are expanded in any year in which the Bush tax cuts are in effect. This is why they have a greater revenue impact in years in which the Bush tax cuts are in effect.

Revenue Impact of Tax Policy Options, Compared to Current Law, in 2014

Policy Option	Revenue Impact ($billions)
Current law (Bush income tax cuts expire)	$ —
Current law but enact Buffett Rule*	$ 25.3
Current law but end cap gains break**	$ 70.5
Extend Bush income tax cuts	$ –313.5
Extend Bush income tax cuts but enact Buffett Rule*	$ –267.9
Extend Bush income tax cuts but end cap gains break**	$ –218.9

*The Buffett Rule is assumed to be a minimum tax equal to 30 percent of AGI minus charitable deductions and phased in between incomes of $1 million and $2 million.

**Under current law (what happens after the Bush tax cuts expire) long-term capital gains are taxed at a top rate of 20 percent. Under the Bush tax cuts, capital gains are taxed at a top rate of 15 percent and qualified stock dividends are subject to this rate also.

For example, the permanent income tax rules that will be in effect when the Bush tax cuts expire provide a break for long-term capital gains, which will be taxed at a top rate of 20 percent instead of the rates of up to 39.6 percent that apply to other income.

Under the Bush tax cuts, long-term capital gains are taxed at a top rate of just 15 percent while other income is taxed at rates of up to 35 percent, and stock dividends are taxed at a top rate of 15 percent also. The ability of wealthy people with investment income to pay lower effective rates than people with ordinary income is therefore greater in any year in which the Bush tax cuts are in effect. And any policy option to remedy that problem will therefore have a larger revenue impact during any year in which the Bush tax cuts are in effect.

Of course, the Bush tax cuts include benefits that go far beyond breaks on investment income, and that's why extending the Bush tax cuts would be extremely costly even if the Buffett Rule was enacted or all tax preferences for investment income were eliminated. This is illustrated in the table above.

Revenue Impact Depends on How the Buffett Rule Is Implemented

We assume the Buffett Rule is a minimum tax of 30 percent. Because the administration has specifically said it does not want the Buffett Rule to discourage charitable giving, we assume it applies to adjusted gross income less charitable contributions.

We also assume that the Buffett Rule would be phased in for people with incomes between $1 million and $2 million. Otherwise, a person with AGI (not counting charitable deductions) of $999,999 who has effective tax rate of 15 percent could make $2 more and see his effective tax rate shoot up to 30 percent. Tax rules are generally designed to avoid this kind of ridiculous result.

Of course, the proposal could raise more revenue or less revenue depending on the phase-in rules.

The Need for the Buffett Rule

A previous report from Citizens for Tax Justice explained how multi-millionaires like Romney and Buffett who live on investment income can pay a lower effective tax rate than working class people.[1]

As the report explains, there are two reasons for this. First, the personal income tax has lower rates for two key types of investment income, capital gains and stock dividends, as already explained. Second, investment income is exempt from payroll taxes (which will change to a small degree when the health care reform law takes effect).

The report compares two groups of taxpayers, those with income in the $60,000 to $65,000 range (around what Buffett's famous secretary makes), and those with income exceeding $10 million.

For the first group, about 90 percent have very little investment income (less than a tenth of their income is from investments) and consequently have an average effective tax rate of 21.3 percent. For the second group (the Buffett and Romney group) about a third get the majority of their income from investments and consequently have an average effective tax rate of 15.2 percent. This is the problem that the Buffett Rule would solve.

Implementing the Buffett Rule in the way the administration has suggested (as a minimum tax on millionaires) is one way to solve the problem. A more straightforward approach (and one that would raise more revenue, as already explained) would be to simply eliminate the special rates for investment income in the personal income tax.

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[1] Citizens for Tax Justice, "How to Implement the Buffett Rule," October 19, 2011. http://www.ctj.org/pdf/buffettruleremedies.pdf