CTJ Citizens for Tax Justice

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Guiding Principles for Tax Reform

Raise Revenue, Enhance Fairness, Stop Corporate Tax Avoidance

There is widespread agreement in Congress and among the American people that the U.S. tax system needs reform. Yet some proposed federal tax changes defy what most Americans would consider reform. This policy brief outlines three sensible, broad objectives for meaningful federal tax reform and discusses specific policies that can help achieve these objectives.

1. Tax Reform Should Raise Revenue

The most basic task of any tax system is to raise enough revenue to fund needed public investment, but the federal tax system has consistently failed to achieve this minimal goal. In 35 of the past 40 years, the federal government has failed to collect enough tax revenue to pay for all federal spending, so in each of these years the nation has run a budget deficit. These continual deficits are not driven by federal spending growth. In fact, in fiscal year 2014, federal spending as a percentage of the nation's Gross Domestic Product was lower than in any year of Ronald Reagan's presidency. In the past five years alone, discretionary spending has fallen by almost a third as a share of the economy.[1]

The nation's deficits are primarily the product of our persistently low federal tax revenues. In each of the past four years, federal revenues have been lower as a share of the economy than at any time since the early 1970s.[2] As a result, U.S. tax collections are well below those of most other nations. In 2013, the most recent year for which complete data are available, the U.S. collected less tax revenue as a percentage of its economy than did any other economically developed country besides Chile, Korea and Mexico.[3]

Budget deficits can, of course, be eliminated through a mix of revenue increases and spending cuts. But the main driver in the nation's ongoing budget deficits is declining federal tax revenues, driven by sweeping tax cuts enacted more than a decade ago. Thus, a sensible, primary goal of comprehensive tax reform should be to raise federal revenues substantially above their currently depressed level.

Revenue-raising reforms must strengthen our tax system in both the short run and the long term. Unfortunately, some current congressional proposals emphasize raising revenue in the short run at the expense of sustainable long-term tax revenue. For example, proposals to enact a "tax holiday" for trillions of dollars in cash that American corporations are currently holding offshore would provide a small short-term revenue boost, but it would mean forgoing a much larger long-term revenue stream if these companies paid their fair share of the corporate tax when they eventually repatriate these profits. [4]

A sensible litmus test for any proposed revenue-raising plan is whether it would help provide sustainable long-term tax revenue or undercut this goal.

2. Tax reform should not exacerbate income inequality

Fairness is in the eye of the beholder, but Americans generally agree that a fair tax system should not tax poor people further into poverty. Contrary to the "skin in the game" rhetoric used by some presidential candidates, Americans at all income levels pay a substantial share of their income to support public services.

In fact, the poorest 20 percent of Americans will pay, on average, 19.3 percent of their income in federal, state and local taxes in 2016. The average annual income in this group is about $15,100, so even families living significantly below the federal poverty threshold pay a significant percentage of their income in taxes.

Mitigating poverty and creating conditions in which more citizens can participate and contribute to our nation's economy is a necessary social policy goal. Requiring the poorest Americans to spend a fifth of their income on taxes is tantamount to making the poor poorer. For this reason, a minimal goal of revenue-raising federal tax reform should be to avoid increasing taxes on the most vulnerable Americans beyond their current level.

At the other end of the economic spectrum, our tax code contains special carve outs that allow the wealthiest Americans to avoid paying their fair share. For example, the tax code treats income derived from wealth more favorably than income derived from work. The top tax rate on capital gains income is 23.8 percent, well below the 39.6 percent top tax rate on salaries and wages. Two-thirds of all capital gains are enjoyed by the top 1 percent of Americans.[5] More so than virtually any other feature of the tax code, the capital gains tax break exacerbates widening economic inequality in our nation.

In spite of these inequities, the federal tax system helps offset the regressive nature of state tax systems, all of which take a greater share of income from their lowest-income residents than from their wealthiest residents. The share of total taxes paid by each income group is roughly equal to the share of total income received by that group. For example, the poorest 20 percent of taxpayers will pay only 2.1 percent of total taxes this year, which is roughly on par with their share (3.3 percent) of total income this year. Meanwhile, the richest 1 percent of Americans will pay 23.6 percent of total taxes and receive 21.6 percent of total income in 2016.[6] In other words, the nation's collective tax system is relatively flat or proportional rather than progressive.

Tax reform should avoid pushing low-income working families further into poverty and make the very wealthiest Americans pay their fair share. Policies such as preserving and expanding targeted tax credits such as the Earned Income Tax Credit and the Child Tax Credit would reward work and help low-income families make ends meet. And taxing capital gains and dividends in the same way that salaries and wages are taxed would raise some revenue, add fairness and progressivity to the tax code as well as ease widening income inequality.

3. Tax reform should close corporate tax loopholes and ensure corporations pay their fair share

Fortune 500 corporations are aggressively seeking to avoid all income tax liability, lobbying intensely for new tax breaks while simultaneously engaging in an aggressive effort to shift their U.S. profits into low-rate foreign tax havens.

Some of the biggest Fortune 500 corporations find ways to shelter their U.S. income from taxes altogether. A 2014 CTJ/ITEP report found that 111 Fortune 500 companies were able to avoid all federal income taxes in at least one profitable year between 2008 and 2012,[7] and a companion report found a similar pattern at the state level.[8] In many cases, these zero-tax corporations are simply claiming generous tax breaks that have been enacted by Congress (at the behest of corporate lobbyists) over the years. All too often, these tax provisions lavish huge tax cuts on the most profitable corporations while offering little to smaller businesses with less lobbying clout.

Paring back tax breaks for accelerated depreciation, research and development and manufacturers could help achieve a level playing field for businesses of all sizes.

Many of the same big multinational corporations are aggressively seeking to avoid taxes by claiming, for tax purposes, that their U.S. profits are earned in offshore tax havens.

This widespread income-shifting stems largely from an arcane feature of the U.S. corporate tax law: American multinational corporations are allowed to "defer" paying U.S. taxes owed on the profits of their offshore subsidiary companies until those profits are officially brought to the U.S.

Deferral encourages American corporations to shift profits overseas. By using accounting gimmicks, they can make their domestic profits appear to be generated by subsidiary companies in countries with very low or no corporate taxes.

The most straightforward policy solution to stop this sham is to end deferral. This would mean that all the profits of American corporations are subject to the U.S. corporate income tax whether they are domestic profits or foreign profits generated by offshore subsidiaries. This change would eliminate the incentive for an American corporation to move its operations offshore or to make its U.S. profits appear to be generated in an offshore tax haven.

Putting it All Together

Our tax system chronically underfunds public investments the American people collectively support and want—and does so in a way that pushes low-income families further into poverty while allowing huge corporations and the wealthy to avoid paying their fair share. True tax reform should raise revenue in the short run, to help meet the country's pressing budgetary needs, while simultaneously creating a sustainable long-term revenue stream to meet tomorrow's needs. Tax reform should also avoid making inequality and poverty greater problems than they already are. Each of these goals can be achieved by closing unwarranted loopholes for capital gains and offshore corporate profits, while preserving and expanding valuable low-income tax credits.

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[1] Office of Management and Budget, Historical Tables, October 20, 2015. https://www.whitehouse.gov/omb/budget/Historicals

[2] Ibid.

[3] Citizens for Tax Justice, The U.S. Is One of the Least Taxed Developed Countries, April 7, 2016. http://ctj.org/ctjreports/2016/04/the_us_is_one_of_the_least_taxed_developed_countries_1.php

[4] Citizens for Tax Justice, $2.1 Trillion in Corporate Profits Held Offshore: A Comparison of International Tax Proposals, July 14, 2015 http://ctj.org/ctjreports/2015/07/21_trillion_in_corporate_profits_held_offshore_a_comparison_of_international_tax_proposals.php

[5] Citizens for Tax Justice, Ending the Capital Gains Tax Preference would Improve Fairness, Raise Revenue and Simplify the Tax Code, September 20, 2012. http://ctj.org/ctjreports/2012/09/ending_the_capital_gains_tax_preference_would_improve_fairness_raise_revenue_and_simplify_the_tax_co.php

[6] Citizens for Tax Justice, Who Pays Taxes in America in 2016?, April 12, 2016. http://ctj.org/ctjreports/taxday2016.pdf.

[7] Citizens for Tax Justice, The Sorry State of Corporate Taxes, February, 25, 2014. http://www.ctj.org/corporatetaxdodgers/

[8] Citizens for Tax Justice, 90 Reasons We Need State Corporate Tax Reform, March 19, 2014. http://ctj.org/90reasons/