CTJ Citizens for Tax Justice

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Reforming Tax Breaks Is Not a Substitute for Higher Tax Rates: Both Are Necessary to Raise Adequate Revenue

The revenue goals set out by President Obama are alarmingly low, but unfortunately most proposals circulating around Washington today would fall far short of them. The $1.6 trillion of revenue that the President proposes to save over the next decade depends on allowing the Bush-era reductions in tax rates to expire for high levels of income *and* limiting deductions and other breaks. Doing one or the other will not raise enough revenue. Congress should allow the rate reductions for high income levels to expire as President Obama proposes, and then turn to reforming targeted tax breaks to raise much more revenue.

President Obama, Congressional Democratic leaders and Congressional Republican leaders have all proposed to cut trillions of dollars from federal revenue by extending all or most of the tax cuts first enacted under President George W. Bush. But they all hide this fact by comparing the revenue outcomes of their proposals to what would happen if all the Bush tax cuts were extended.[1] Using this standard, President Obama says that his proposals would "raise" $1.6 trillion over a decade.

Most of this supposed new revenue ($1.4 trillion) would come from the President's major proposals for the personal income tax. These include extending the Bush income tax cuts only for the first $250,000 of income married couples make and the first $200,000 of income single taxpayers make, and limiting the savings of each dollar of itemized deductions and certain exclusions to a maximum of 28 cents.[2] If enacted, these proposals would raise $1.4 trillion over a decade compared to what would happen if Congress simply extended all of the Bush tax cuts and made no other changes to the tax code. Other suggestions circulating around Washington would save considerably less revenue, as illustrated in the table below.

Revenue Savings from Different Tax Proposals, Compared to Simply Extending All Bush Income Tax Cuts

Proposal	Revenue impact (in billions) in calendar year 2013	Revenue impact (in billions) of measure if enacted for ten fiscal years (2013-2022)	As a percentage of Obama's major personal income tax proposals
Obama's Major Personal Income Tax Proposals (Extend Bush Income Tax Cuts for $250k/200k, allow max 28¢ of savings for each dollar of deductions & certain exclusions)*	$ 103.6	$ 1,433.1	100%
Extend Bush Income Tax Cuts for $250k/$200k of Income*	$ 68.9	$ 848.9	59%
Extend Bush Income Tax Cuts for $500k of Income	$ 53.8	$ 662.9	46%
Extend Bush Income Tax Cuts for $1 Million of Income	$ 39.9	$ 491.6	34%
Extend Bush Income Tax Cuts for $250k/$200k but Have Top Rate of 38% instead of 39.6%	$ 57.6	$ 710.3	50%
Senate Democrats' Approach (extending Bush income tax cuts for $250k/$200k except dividends in top two brackets taxed as capital gains rather than ordinary income)	$ 61.6	$ 758.5	53%
Senator Corker's Approach (extend all Bush income tax cuts but cap itemized deductions at $50,000 per tax return)**	$ 58.8	$ 749.0	52%
Extend All Bush Income Tax Cuts and Use Bubble Rate to Recapture Benefits of Lower Rates in Brackets Below the 35% Bracket		(Insufficient details known.)	

*10-year revenue estimates for the first two options are from page 203 of the Treasury Department's "green book," http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf
** 10-year revenue estimate from documents circulated by Senator Corker, presumably from the Joint Committee on Taxation.
Other revenue estimates are from the Institute on Taxation and Economic Policy (ITEP) microsimulation tax model.
One-year revenue estimates are presented in calendar years while ten-year revenue estimates are presented in fiscal years.

The President's proposals to save $1.6 trillion (under the odd accounting standard that he and many lawmakers use) are spelled out in his budget proposal for fiscal year 2013. Besides his major personal income tax proposals that would "save" $1.4 trillion, the President has also proposed measures to limit offshore tax dodging by corporations, close certain tax loopholes used by businesses, and apply a new tax on the largest banks, among other measures.[3]

As the figures in the previous table illustrate, President Obama's proposal to allow the expiration of the Bush tax cuts for income in excess of $250,000/$200,000 would, by itself, constitute only 59 percent of the total savings from his total major personal income tax proposals (which also include limiting the tax savings of each dollar of deductions and certain exclusions to a maximum of 28 cents).

The figures also demonstrate that several other tax proposals being discussed in Washington would result in less revenue than the President proposes. The bill approved by Senate Democrats to extend most, but not all, of the Bush tax cuts deviates from the President's proposal by extending more Bush tax cuts for stock dividends received by high-income Americans, and therefore raises less revenue[4]. Other proposals often discussed involve extending the income tax cuts for even higher levels of income ($500,000 or $1 million are the thresholds frequently discussed) and would produce even less revenue.[5]

Proposals Actually Lose Revenue Compared to What Would Happen if Congress Simply Did Nothing

Every one of the current tax proposals being talked about by lawmakers would extend most or all of the income tax cuts first enacted under President George W. Bush, and would therefore cause a huge loss of revenue under any honest accounting standard. The non-partisan Joint Committee on Taxation, the official revenue estimators for Congress, and the non-partisan Congressional Budget Office, would "score" all of these proposals as losing trillions of dollars in revenues.

The table below illustrates the revenue impact compared to current law (compared to what would happen if Congress merely allowed the tax cuts to expire as scheduled).

Revenue Savings from Different Tax Proposals, Compared to Current Law (compared to Congress doing nothing)		
Proposal	Revenue impact (in billions) in calendar year 2013	Revenue impact (in billions) of measure if enacted for ten fiscal years (2013-2022)
Obama's Major Personal Income Tax Proposals (Extend Bush Income Tax Cuts for $250k/200k, allow max 28¢ of savings for each dollar of deductions & certain exclusions)	$ –193	$ –2,431
Extend Bush Income Tax Cuts for $250k/$200k of Income	$ –228	$ –3,015
Extend Bush Income Tax Cuts for $500k of Income	$ –243	$ –3,201
Extend Bush Income Tax Cuts for $1 Million of Income	$ –257	$ –3,372
Extend Bush Income Tax Cuts for $250k/$200k but Have Top Rate of 38% instead of 39.6%	$ –239	$ –3,154
Senate Democrats' Approach (like extending Bush income tax cuts for $250k/$200k except dividends in top two brackets taxed as capital gains rather than ordinary income)	$ –235	$ –3,105
Senator Corker's Approach (extend all Bush income tax cuts but cap itemized deductions at $50,000 per tax return)	$ –221	$ –3,115
Extend All Bush Income Tax Cuts and Use Bubble Rate to Recapture Benefits of Lower Rates in Brackets Below the 35% Bracket	(Insufficient details known.)	
Source: Institute on Taxation and Economic Policy (ITEP) microsimulation tax model, the Treasury Department's "green book" and calculations by ITEP.		

These figures demonstrate that all of the tax proposals being discussed today would result in far, far less revenue than would be collected if Congress simply did nothing and went home early for the holidays. At very least, this should be an indication that even if lawmakers do enact President Obama's proposals, they must come back to Washington in January prepared to advance reforms that raise real and significant revenue.

Limiting Itemized Deductions

Senator Bob Corker of Tennessee proposes to extend the Bush income tax cuts going solely to the richest two percent of taxpayers and replace most of the revenue loss by limiting the amount of itemized deductions that taxpayers can claim. (His proposal would also, just like President Obama's, extend all of the other Bush tax cuts without offsetting their cost.) Senator Corker's proposal would cap the amount of itemized deductions claimed on a tax return to a maximum of $50,000.

Whereas President Obama's broader plan would both limit itemized deductions and allow the expiration of the Bush tax cuts for the rich, Sen. Corker's proposal would do the first but not the other. The proposal is an attempt to lock in the lower income tax rates for the rich, thereby limiting the amount of revenue that could possibly be raised by reforming the tax code. As a result, this proposal only saves 52 percent as much revenue as the combination of President Obama's major personal income tax proposals.

This is only the beginning of the many problems with Senator Corker's proposal. Another is that it would create the impression that Congress has acted to reform the tax code and limit tax expenditures while doing nothing to limit the most regressive and problematic tax expenditure of all, the special, low income tax rate for capital gains.[6]

Another problem is that there are several political and policy reasons why lawmakers may not be willing to leave in place a law capping all itemized deductions.[7] For example, members of Congress could easily fall to pressure from very large charities to remove the limit from the deduction for charitable donations in order to maintain the tax incentive for very wealthy individuals to donate. This erosion of the Corker proposal could then lead to a situation in which the lower income tax rates for the rich remain in place but the revenue savings from limiting deductions quickly plummet.

Finally, Senator Corker's proposal is not as progressive as President Obama's major personal income tax proposals. As the table below illustrates, President Obama's major personal income tax proposals would result in an average net tax increase for the richest one percent of taxpayers compared to current law (under which all the Bush income tax cuts expire). Senator Corker's proposal not only fails to save as much revenue as the President's plan, but it also would maintain a net tax cut for the richest one percent of taxpayers compared to current law.

Average Tax Changes Under Personal Income Tax Proposals of President Obama and Senator Corker, *Compared to Current Law*, in 2013

	Obama Extend inc tax cuts to $250k/$200k, limit deductions/exclusions at 28%	Corker Extend all income tax cuts, cap itemized deductions at $50k	Obama vs. Corker
Income Group	Average Tax Change	Average Tax Change	Average Difference
Poorest 20%	$ –118	$ –117	$ –1
Second 20%	–517	–516	–0
Middle 20%	–828	–827	–1
Fourth 20%	–1,573	–1,559	–14
Next 15%	–3,805	–3,659	–146
Next 4%	–6,312	–5,550	–763
Richest 1%	+9,831	–15,243	+25,074
ALL	$ –1,313	$ –1,506	$+192

Note: Figures on President Obama's major personal income tax proposals do not include his proposal to extend the 2009 provisions expanding the EITC and child tax credit, which provide larger benefits to taxpayers in the low- and middle-income groups.
Source: Institute on Taxation and Economic Policy (ITEP) microsimulation tax model, November 2012.

"Bubble-Rate" to Recapture Benefits of Lower Rates from the Rich

Perhaps the silliest suggestion that has been made is to extend the Bush reductions in the top income tax rates (resulting in a top rate of just 35 percent) but somehow apply the 35 percent rate to *all* of the income of very well-off taxpayers.[8]

It is true that taxpayers in the top income tax bracket, the 35 percent income tax bracket, do not pay 35 percent of all of their taxable income in personal income taxes. Taxable income (what's left over after subtracting deductions and adjustments from income) is taxed at progressive rates so that a portion is taxed at the lowest rate, a portion taxed at the second lowest rate and so forth. So even the richest benefit from the lower rates that apply to part of their taxable income.

The proposal that is reportedly floating around Capitol Hill to remove the benefits of these lower tax rates for high-income taxpayers has not been fleshed out in enough detail to make analysis possible. The only way it could be accomplished would be to add a higher tax rate — higher than 35 percent — on taxable income in some range. For example, there could be a 51 percent marginal rate between $400,000 and $600,000, after which the rate would fall back to 35 percent. This would mean that the top marginal tax rate would not be on the very richest Americans, but on well-off people making less. Such a "bubble rate" was temporarily in place after the 1986 Tax Reform Act. It was widely reviled and was repealed in 1990.

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[1] For example, see Citizens for Tax Justice, "President Obama's 2013 Budget Plan Reduces Revenue by Trillions, Makes Permanent 78 Percent of Bush Tax Cuts," February 14, 2012. http://www.ctj.org/pdf/obamabudgetfy2013.pdf

[2] Under current law, a high-income taxpayer in the 39.6 percent tax bracket would save almost 40 cents in taxes for each dollar of deductions or exclusions. President Obama's proposed reform would reduce this to a maximum of 28 cents. For a detailed description of the President's proposal to limit the value of tax deductions and tax exclusions, see Citizens for Tax Justice, "Revenue Provisions in the President's Jobs Bill," September 19, 2011. http://ctj.org/pdf/americanjobsact.pdf

[3] See Department of the Treasury, General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals, February 2012. http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf

[4] Citizens for Tax Justice, "Senate Democrats Consider Extending More Tax Breaks for Rich Taxpayers with Dividends than Obama Proposes," July 17, 2012. http://ctj.org/pdf/dividends2012.pdf

[5] Citizens for Tax Justice, "First Look: Extending the Bush Tax Cuts for Income up to $1 Million," May 24, 2012. http://ctj.org/pdf/1millionthreshold.pdf

[6] The capital gains tax preference is the reason why wealthy investors like Warren Buffett and Mitt Romney are able to pay a lower effective tax rate than many middle-income people. Any overhaul of the tax code that leaves the capital gains preference in place is not worthy of the term "reform." For more details, see Citizens for Tax Justice, "Ending the Capital Gains Tax Preference would Improve Fairness, Raise Revenue and Simplify the Tax Code," September 20, 2012. http://www.ctj.org/pdf/cgdiv2012.pdf

[7] See Chye-Ching Huang, Chuck Marr, and Joel Friedman, "Restraining Tax Expenditures Should Complement, Not Replace, Letting High-Income Bush Tax Cuts Expire," Center on Budget and Policy Priorities, November 29, 2012. http://www.cbpp.org/cms/index.cfm?fa=view&id=3867

[8] Jonathan Wiseman, "Seeking Ways to Raise Taxes but Leave Tax Rate as Is," November 22, 2012. http://www.nytimes.com/2012/11/23/us/politics/congress-looks-at-ways-to-leave-top-tax-rate-as-is.html?pagewanted=all&_r=0