A RIGGED SYSTEM: THE COST OF TAX DODGING
BY THE WEALTHY AND BIG CORPORATIONS

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A RIGGED SYSTEM: THE COST OF TAX DODGING BY THE WEALTHY AND BIG CORPORATIONS

TUESDAY, APRIL 18, 2023

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in the Dirksen Senate Office Building, Hon. Sheldon Whitehouse, Chairman of the Committee, presiding.


Also present: Democratic staff: Dan Dudis, Majority Staff Director; Dan Ruboss, Senior Tax and Economic Advisor and Member Outreach Director; Tyler Evilsizer, Senior Budget Analyst; Sion Bell, Tax Policy Advisor.

Republican staff: Chris Conlin, Deputy Staff Director; Erich Hartman, Director of Budget Policy & Review; Nick Wyatt, Professional Staff Member.

Witnesses:
Dr. Kimberly Clausing, Eric M. Zolt Chair in Tax Law and Policy, University of California, Los Angeles School of Law
Dr. Danny Yagan, Associate Professor of Economics, University of California, Berkeley
Dr. William McBride, Vice President of Federal Tax Policy & Stephen J. Entin Fellow in Economics, Tax Foundation

OPENING STATEMENT OF CHAIRMAN WHITEHOUSE 1

Chairman WHITEHOUSE. If we could call the hearing to order. We'll proceed in the usual fashion with opening statements by myself and Ranking Member Grassley, followed by my introduction of the three witnesses, and then each of you will have five minutes to make your opening statement.

Your full testimony will be made a part of the record. I urge you to confine your remarks to those five minutes so we have a chance to engage with you, and I also want to welcome Chair Murray and Senator Braun to the Committee hearing.

This is about the tax injustices that are presently baked into our Tax Code. As everybody knows, there are two sides to the budget, spending and revenues. And while some of our colleagues only want to look at the spending side, the U.S. has never run a bal-

1 Prepared statement of Chairman Whitehouse appears in the appendix on page 31.
anced budget in the modern era without revenues nearing 20 percent of GDP, and of course, most revenues come through the tax system.

Today’s hearing will tell of two distinct sets of tax rules that produce a rigged, corrupted and deficient tax system. Under one set of rules for most Americans, paying taxes is immediate and automatic. Taxes are withheld from every paycheck to fund the public goods that contribute to our happiness and security, roads, schools, parks, veterans care, the military.

Under this set of rules, taxes also are paid on all income for Social Security and Medicare, programs that let Americans retire with dignity and afford medical care. Under these rules, a typical teacher or ironworker in Rhode Island might pay a federal tax rate over 200 percent, as would a married couple running a small business, earning salaries of $150,000 a year.

But it’s different rules for the wealthy and well-connected. Billionaires and large multinational corporations get special rules that let them pick when and even if they pay taxes. This corrupted Tax Code lets billionaires pay an average tax rate of just 8.2 percent, less than half the rate of a typical teacher or firefighter.

Thanks to the Trump tax law, large multinational corporations average even less, just 7.8 percent. Some pay zero. Simple fairness is reason enough to end this rigged system. But the tax-dodging also blows a hole in our federal budget. The Center for American Progress reports that tax cuts for the wealthy have been a primary driver of deficits for decades, accounting for more than half of the debt increase as a share of the economy.

Letting wealthy business owners avoid Medicare taxes on their full income costs Medicare $250 billion in lost revenue. Letting billionaires pay low or zero tax rates costs America $550 billion. Letting multinational corporations shift profits to tax havens leaves a trillion dollar bill for everyone else to pay.

Common sense reforms can make our Tax Code fairer, while reducing the deficit. First, to protect the long-term solvency of Social Security and Medicare, I’m filing legislation to require contributions to Social Security taxes on all income above $400,000 however earned.

Right now the cap on contributions means someone making a million dollars effectively stopped paying into Social Security February 28th of this year. People living on investment income pay no Social Security contribution. Respecting the Biden tax pledge, my Medicare and Social Security Fair Share Act will require Social Security contributions on all income above $400,000 however earned.

This legislation includes the Biden budget tax plan we saw to extend the solvency of Medicare by 20 years. Second, billionaire Warren Buffet famously highlighted the rigged Tax Code by pointing out that he paid a lower tax rate than his secretary. So I’m also reintroducing the Paying a Fair Share Act, to codify the so-called Buffet rule, with a minimum 30 percent tax rate beginning on income over $1 million per year, whatever the source.

Third, American multinationals recently reported $60 billion in profits in the Cayman Islands in a single year, ten times the size of that entire economy. That is a scam. It costs American jobs, and it’s very unfair to American businesses large and small that don’t engage in overseas tax games.
My No Tax Breaks for Outsourcing Act would make offshore companies pay the same tax rate domestic companies pay here at home. House MAGA Republicans have yet to release a budget for the American people to see, but they sure made clear who they want to protect.

Their first vote was to protect wealthy tax cheats by hobbling IRS enforcement, adding $114 billion to the debt. Then they filed legislation to make the Trump tax cuts permanent, a $3 trillion cost, with over 40 percent of the benefit to the top five percent in income. Some have even proposed a new 30 percent sales tax on everything.

The conservative American Enterprise Institute says this all could add $18 trillion of debt. Behind all this secrecy and mischief lurks a crew of Republican dark money donors who don’t want to pay taxes, and are so rich they don’t care about Medicare, Social Security or the economic well-being of wage earners.

Selling their poison to the public is hard. But if you put Americans’ priorities first, it gets pretty easy, and the math works. So I look forward to hearing the testimony today about fixing a tax system rigged for wealthy political donors. I turn now to our distinguished Ranking Member, Senator Grassley.

OPENING STATEMENT OF SENATOR GRASSLEY

Senator Grassley. Republicans know that Social Security and Medicare are a part of the social fabric of America, and we’re committed to maintaining it as that part of social fabric. We also know that it needs to be dealt with sooner than later, because the sooner it’s dealt with, the easier it’s going to be handled than if we wait too long as Reagan and Tip O’Neill did in 1983, when it was about busted.

But they made a bipartisan decision that probably at the time they thought it was maybe only good for a couple of decades. But it’s turning to be an agreement that has kept Social Security as a sound program through at least 2033. So let’s hope that we don’t wait as long as they did to find a solution to it, and when we do find a solution to it that it’s good for the next 60 years.

So Mr. Chairman, I thank you for holding this hearing today. Revenues to the federal government are a fundamental part of the budget, and a subject that is—that this Committee ought to be studying. However, I want to stress that the fundamental problem that we have in the federal budget is not one of under-taxation but overspending, and I hope through this day that I’ll be able to show that as a necessary part of what we’re doing.

The last time the federal budget was balanced was in 2001. Revenues at that time were 18.9 percent of gross domestic product. Last year, federal revenues amounted to 19.6 percent GDP. Yet we still managed to run a deficit of 1 and 4/10ths trillion. That’s because even though tax collections have increased by 2 and 9/10ths trillion since 2001, spending has grown by 4.4 trillion.

Another issue that we should address is the difference between tax avoidance and tax evasion. Tax avoidance is the legal minimization of tax liability. Tax evasion is the failure to pay taxes that

\(^2\)Prepared statement of Senator Grassley appears in the appendix on page 33.
you—that everybody knows you owe, including the taxpayer. Tax evasion is a crime. Tax avoidance is legal, and frequently encouraged by Congress.

The Tax Code is full of various credits, deductions and other incentives that are usually tied to a behavior Congress decided to incentivize. In fact, taxpayers have a right to pay only what tax is legally due. It's also important to remember that a tax loophole is an ambiguity in the law exploited in a way not intended or foreseen.

It's not simply a policy with which one disagrees; when it comes to closing actual loopholes and cracking down on tax cheats, my record as a former chairman and/or ranking member of the Finance Committee is second to none. One only needs to look at my investigation uncovering tax cheats in the conservation easement program, and my creation of the IRS Whistleblower Office has reclaimed billions from tax fraud, to name just two examples.

That bill passed in 2005 I think would add up to about $6 billion coming in as a result of that legislation. I also want to stress that the U.S. has a progressive tax system, nothing I think members on the other side of the aisle is willing to look at.

But we have an analysis published by the Biden Treasury Department that quote-unquote has these words in between the quotes. “Total federal taxes are progressive.” Families at the bottom of the income spectrum often have a negative federal tax liability due to refundable credits.

In contrast, those in the top one percent pay close to one-third of their income in federal taxes. Nonpartisan experts at the Congressional Budget Office and the Joint Committee on Taxation have to come similar conclusions. So have outside groups like the Tax Foundation and the Tax Policy Center.

IRS data also bears out the progressive nature of our tax system. Based on tax year 2020 returns, the top one percent of the taxpayers by adjusted gross income paid more than 42 percent of the total federal income tax. Now some people would say 42 percent isn't enough.

I'd like to have somebody that says it's not enough, when is enough enough? I have a hard time getting an answer to that question. If it's 43 percent, maybe we'll join in doing it if we can have a stop to the demagoguery that goes on arguing about that.

Congress should regularly examine tax incentives, just as we should review spending programs, to ensure that we're working—that they are working as we intend. If my Democratic colleagues are on the hunt for tax subsidies that benefit large corporations and the wealthy, they need look no further than legislation that was enacted on a purely partisan basis just last August.

Their ill-named Inflation Reduction Act included hundreds of billions of dollars in new or expanded tax incentives. Included in this legislation are novel new tax features such as quote-unquote “direct pay,” and quote-unquote “transferability.” We had a deal that was added in the 1980's and intended to be a really bad policy that two years later we changed. That actually made now—this direct pay and transferability actually made it easier for corporations and wealthy investors to pay little or no tax.
These provisions will not only further complicate the Tax Code and primarily benefit the affluent, but recent estimates suggest that costs could be far greater than Congress was originally led to believe. We helped create the tax avoidance problem, and last year's Democrats made it even worse.

As one former Finance Committee Chairman used to say “Many taxpayers accept complexity that favors them.” If we really want to diminish the advantage that wealthy taxpayers and large corporations have, we should address the complexity of the Tax Code. This is a bipartisan problem, but fortunately solving it is within our control. Thank you.

Chairman Whitehouse. Thank you Senator Grassley, and agreed on the complexity problem. I want to welcome the witnesses. Dr. Kim Clausing is the Eric M. Zolt Chair in Tax Law and Policy at the University of California-Los Angeles. Clausing is an economist who previously served as the Deputy Assistant Secretary for Tax Analysis at Treasury.

She is an expert on international corporate profit shifting. Kind of unfortunate there has to be expertise in that particular behavior, but there we are.

Our second witness is Dr. Danny Yagan, who is an Associate Professor of Economics at the University of California-Berkeley, and Research Associate with the National Bureau of Economic Research. Yagan previously served as the chief economist at the Office of Management and Budget. His research focuses on the individual income tax and taxation of capital gains.

Dr. William McBride is the Vice President of Federal Tax Policy and Stephen J. Entin Fellow in Economics at the Tax Foundation, where he leads efforts to research, model and reform the U.S. Tax Code. While at PriceWaterhouseCoopers, Dr. McBride conducted economic impact and general quantitative analyses and researched the economics of taxation and issues related to tax reform at the state, federal and international levels.

In a prior stint at the Tax Foundation, he wrote extensively on the economics of taxation, particularly regarding business investment. Dr. McBride holds a bachelor of science in Electric Engineering, and a bachelor of science in Physics and a Ph.D. in Economics.

I welcome you all, and why don’t we begin with Dr. Clausing and proceed across the table?

STATEMENT OF DR. KIMBERLY CLAUSING, ERIC M. ZOLT CHAIR OF TAX LAW AND POLICY, UNIVERSITY OF CALIFORNIA, LOS ANGELES SCHOOL OF LAW

Dr. Clausing. Chairman Whitehouse, Ranking Member Grassley, Members of the Committee, thank you so much for inviting me today to share my views on corporate tax avoidance. In my testimony today, I will discuss four key flaws in U.S. law, and I will suggest simple reforms that can improve the tax system across those dimensions.

First, current law contains large tax preferences for offshoring and profit-shifting. Imagine the incentives of a U.S. multinational
company. If it earns income in Iowa or Rhode Island, it pays tax from the first dollar at 21 percent.

On the other hand, if it earns income in a zero tax rate jurisdiction abroad, the first ten percent return on tangible assets is completely free of U.S. tax, and the return above that is taxed at a 50 percent discount relative to U.S. income.

This provides a large incentive to earn income offshore rather than in the United States. Somewhat astonishingly, there’s even an incentive to earn income in France or Japan relative to the United States, and those are both countries with a higher corporate tax rate. The reason is that if you earn income in France or Japan, you accumulate tax credits, which can be used to offset the income that would have been due on the zero tax rate jurisdiction income.

This means that a savvy taxpayer can blend income from high tax and low tax jurisdictions, and get to a rate that’s approximately half the U.S. rate. I often call this an America Last tax system, since all foreign income is preferred to U.S. income. In my written testimony, I show that this system has large effects on the behavior of U.S. multinational companies.

A second flaw in the current system is that we forego large amounts of tax revenue by failing to reform it. If you look at scores from JCT or Treasury, you’ll see that there are hundreds of billions of dollars available and left on the table from not fixing these offshoring and profit-shifting incentives.

A third flaw in the current system is that it favors large multinational companies relative to small businesses, and these large companies often wield significant market power. These tax preferences reduce the ability of small businesses to compete in a fair and level playing field with big businesses. U.S. multinationals often pay single digit tax rates, far lower than those faced by smaller businesses.

A tax system that favors the big companies relative to the small companies will tax economic rents, or rents, or profits above the normal rate at a much lower rate than the normal profits. And economists on both the right and the left of the political spectrum agree that it’s more efficient to tax these above-normal profits than to tax normal returns to capital.

A final flaw in the current system is that corporate tax avoidance reduces the fairness of our tax system, and benefits corporate shareholders at the expense of middle class taxpayers. In recent decades, corporate profits have been much higher as a share of the economy at the same time that the labor share of income has shrunk, and economic inequality has increased substantially.

Our tax system too often turbocharges these trends by lowering the tax burden on capital income and on rents, and disproportionately targeting tax cuts towards the top of the distribution. Fortunately, there are reforms at the ready that can address these flaws in the current law, and Senator Whitehouse’s proposal and his sponsored legislation shows one promising path forward.

For example, the No Breaks for Outsourcing Act would end the offshoring incentives that are baked into current law, raising revenue in a fair and efficient manner. These reforms are consistent with the spirit of the international tax reforms that have been suggested by the Biden administration.
We should note that international tax reform just got a lot easier than it used to be because many other countries are in the process of implementing strong country by country minimum taxes. This means that U.S. reforms will not disadvantage U.S. companies, and they will better align with what the rest of the world is doing.

Today, the United States is facing a challenging fiscal situation. As I detail in my testimony, large deficits and debt require fiscal responsibility. This means looking for new sources of tax revenue. Spending cuts alone will not be sufficient. In this regard, I would also commend Senator Whitehouse for his great leadership on climate, alongside several of his peers on this Committee.

Congress took important action on the climate through the Inflation Reduction Act. These policies are an important step forward for climate change mitigation. In the future, these steps will be even more effective if they are accompanied by legislative measures that levy a fee on carbon emissions, and that end the fossil fuel subsidies that are already in our current Tax Code.

A carbon fee can easily be designed to avoid adverse consequences on consumers, and it would be an enormously effective tool to combat carbon emissions, while raising much-needed revenue at the same time. Thanks.

Chairman WHITEHOUSE. Thank you very much, Professor. Dr. Yagan.

STATEMENT OF DR. DANNY YAGAN, ASSOCIATE PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY

Dr. YAGAN, Chairman Whitehouse, Ranking Member Grassley and Members of the Committee, thank you for the opportunity to testify before you. Today on Tax Day, I describe two simple ways that the wealthy legally avoid taxes, and how curbing them would raise three-quarters of a trillion dollars to pay for Congressional priorities and protect our fiscal path.

First, the wealthy often label their income in ways that trigger less tax. The “Gingrich-Edwards loophole,” so named after two prominent users, is a focus of Chairman Whitehouse’s new bill today, and also my academic research.

The Gingrich-Edwards loophole enables high end workers to classify their labor income as what is called “passthrough income,” and thereby escape Medicare taxes. Co-authors and I have shown that U.S. top earners are dominated by lawyers, consultants and also managers of everyday medium-sized businesses like car dealership chains and beverage distributors.

If you’re a lawyer, consultant or a business manager and get paid in W–2 wages like the rest of us, you owe Medicare taxes on that income. But if you do that same work and also own part of the business you work at, you can get paid in Schedule E passthrough income and thereby escape Medicare taxes. Same labor income, but labeled in a way that triggers less tax.

The result is what the Treasury Inspector General has called a “multi-billion dollar employment tax shelter” that is unavailable to everyday Americans. Closing the Gingrich-Edwards loophole for high end workers would raise $306 billion over the next ten years.

Prepared statement of Dr. Yagan appears in the appendix on page 45.
Second, in research now forthcoming in the Oxford Review of Economic Policy, Greg Leiserson and I estimated that the Forbes 400 wealthiest Americans from 2010 to 2018 paid an average federal individual income tax rate of eight percent on their full income, including capital gains on unsold stock.

How is that possible? Top business owners make most of their income in the form of rising stock values. They do not pay individual income tax on that income until they sell, and if they never sell and instead bequeath the stock to their heirs, no one ever pays income tax on those billions of "unrealized capital gains."

Think of two people who created enormous personal wealth during their lifetimes, entertainer Frank Sinatra and Walmart owner Sam Walton. At current federal tax rates, Frank Sinatra would pay about 40 percent in federal income tax on his wage income, much more than Sam Walton would pay on his stock income under low effective individual tax rates, even after factoring in corporate income taxes.

Congress has three options for raising effective top rates on top business owners and closing the gap between a Sinatra tax burden and a Walton tax burden. It can raise effective corporate income tax rates, raise dividend and capital gains rates, or broaden the capital gains tax base by taxing unrealized gains as in Senator Wyden's Billionaires Income Tax proposal.

Here, I will discuss that proposal's child, President Biden's billionaire minimum income tax, which has 55 co-sponsors in the House, would cover the 20,000 households with wealth over $100 million and in its latest version, would raise $436 billion over ten years.

My written testimony contains a plain English FAQ, but here's how the minimum tax would work. If the covered household is already paying 25 percent of their income, including unrealized gains like a say a star entertainer earning wages, they would pay no extra tax. But if tax-free unrealized gains allows them to pay less than 25 percent, they would owe a top-up payment to meet the 25 percent minimum.

Those top-up payments could be paid over five to nine years, and would be a prepayment of capital gains tax owed upon sale, gift or bequest. Charity would be exempt. Illiquid taxpayers could opt out of prepayments on their private stock gains and instead pay later with interest.

Slow and partial prepayment on public stock gains combined with prepayments for liquid taxpayers on their private stock gains, would preserve incentives to take companies public. The minimum tax is flexible, and makes space for compromise. For example, Congress could dial the minimum tax rate down to 15 percent. Entrepreneurs taking a company public could be granted 20 years to pay. Thank you. I look forward to your questions.

Chairman WHITEHOUSE. Thank you, Professor, and Dr. McBride.
STATEMENT OF DR. WILLIAM MCBRIDE, VICE PRESIDENT OF
FEDERAL TAX POLICY AND STEPHEN J. ENTIN FELLOW IN
ECONOMICS, TAX FOUNDATION

Dr. McBride. Thank you, Chairman Whitehouse, Ranking Mem-
ber Grassley and Members of the Committee. I appreciate the op-
portunity to speak with you. My testimony will focus on the size
and distribution of the federal tax burden. Last year, the federal
government collected an all-time high of $4.9 trillion in taxes.

At 19.6 percent of GDP, this is the highest level in 22 years, and
prior to that World War II. The largest source of revenue for the
federal government is individual income taxes, which surged 29
percent last year to reach $2.6 trillion or 10 1/2 percent of GDP, the
highest level on record.

This is partly explained by surging capital gains revenue and
partly by the longer-term rise of passthrough business income. Now
about half of business income under the individual income tax code,
as owners of partnerships, S corporations and other passthrough
businesses report profits on their individual income tax returns.

The remainder of business income is subject to the corporate in-
come tax. Nonetheless, corporate income tax collections last year
also came in at an all-time high of $425 billion. As a share of GDP,
corporate income tax collections reached 1.7 percent, about equal to
the average level for the last 30 years.

Combined, corporate and individual income taxes reached 12.2
percent of GDP last year. That’s the highest level in over 50 years.
Most of the federal income tax burden is paid by high earners, as
is the majority of the entire federal tax burden.

According to the latest IRS data, of all federal individual income
taxes collected, the top five percent of individual taxpayers paid a
62.7 percent share, while the top one percent of individual tax-
payers paid a 42.3 percent share, a larger share than the bottom
95 percent of individual taxpayers combined. The top one percent
share of taxes is the highest in at least 20 years.

High income taxpayers also pay the highest tax rates, according
to the IRS. The average individual income tax rate in 2020 was
13.6 percent. The top five percent of taxpayers paid a 22.4 percent
average tax rate, while the top one percent of taxpayers paid a 26
percent average rate, more than eight times higher than the aver-
age rate paid by the bottom half of taxpayers.

When accounting for all federal taxes, including taxes on cor-
porate income, payroll, estates and other resources, the federal tax
code remains very progressive. According to the latest data from
the CBO, the top one percent of households paid about 25 percent
of all federal taxes in 2019, and had an average federal tax rate
of 30 percent.

In contrast, the bottom 20 percent of households paid about a 0.1
percent—about 0.1 percent of all federal taxes, and had an average
federal tax rate of 0.5 percent. There’s nothing simple about the
way in which the federal government collects these taxes, espe-
cially individual and business income taxes, which in many ways
are inherently complex, and various credits and preferences add to
the complexity.

Prepared statement of Dr. McBride appears in the appendix on page 53.
The Tax Code currently totals about four million words, such that no taxpayer can reasonably be expected to fully comprehend it. In 2022, Americans spent more than 6½ billion hours trying to comply with the Tax Code, equating to about $313 billion a year in lost productivity.

This does not include the cost of tax planning or of uncertainty in the law, which makes planning for taxes as well as investment and other economic activities difficult and costly. The increasing complexity of the Tax Code has contributed to an overwhelming administrative challenge for the IRS. Last year, for instance, the IRS answered only about 13 percent of the 173 million phone calls it received from taxpayers asking for help.

There are also the substantial and well-documented economic costs of high marginal income tax rates arising from disincentives to work, save and invest. For instance, researchers at the OECD examined data from 63 countries and concluded that corporate income taxes are the most economically damaging way to raise revenue, followed by individual income taxes, then consumption taxes and property taxes.

One of the most problematic and economically destructive aspects of the U.S. Tax Code is the double taxation of corporate income, first by the corporate income tax and then also the book minimum tax, and then by shareholder taxes on capital gains and dividends, yielding a combined top tax rate that approaches 50 percent after accounting for federal and state, corporate and individual income taxes.

In short, we as a country have built a federal tax system that is inherently complex, costly and controversial.

To the extent it is comprehensible at all, taxpayers do not perceive it as fair. The IRS has real challenges administering such a complicated tax system, but boosting the IRS budget will not fix the underlying problem that causes millions of taxpayers, millions of taxpayer calls to the IRS every year seeking help.

As top priority, lawmakers should simplify the Tax Code, so that taxpayers can understand the laws and the IRS can administer them with minimum cost and frustration.

Second, lawmakers should reduce the economic drag caused by the Tax Code, particularly as economic growth is expected to slow to a halt this year, according to CBO.

My written testimony outlines several revenue-neutral reforms that would greatly simplify the Tax Code and improve economic growth. I’m happy to discuss those further in follow-up questions. Thank you for your time and attention.

Chairman WHITEHOUSE. Thank you very much. One of the things that I have experienced in my time in the Senate is the extent to which Congress is responsive to big special interests and to extremely wealthy individuals. And my experience is echoed by academic studies that show there’s zero statistical significance to what the public wants and what Congress does, and very high statistical significance between what wealthy individuals and special interests want and what Congress does.

I watched that get dramatically worse after the Citizens United decision, when wealthy special interests could spend unlimited amounts of money in politics, and even hide that it was them, so
that money flows through anonymizers like Donors Trust which, Dr. McBride, is a big donor to your organization, and you don’t know who’s really behind it.

So this combination of huge amounts of political money flowing into the system from big special interests kept secret from the American public, has dramatically added to the long-term difficulty of trying to have fairness in Congress, and I see it particularly in the Tax Code.

We fight a lot about the appropriated budget, but if you can get something into the Tax Code, you don’t have to fight for that appropriation next year. It’s in and it’s buried in the complexity that Dr. McBride and our Ranking Member have talked about. And so it’s largely hidden and rooting it out is extremely, extremely challenging.

But what you end up with is a tax system that I think is extremely unfair. Dr. McBride just said that the top one percent pay 25 percent of the federal taxes. Do I have that number correctly? Well, they get 22 percent of the national income.

If you believe in a progressive tax system, they should be paying a lot more than 25 percent, because when one percent of the population gets 22 percent of the entire country’s income, more than the entire lower 50 percent, that is such a massive economic dislocation that you would think that reasonable, progressive tax rates would address that.

And instead, it’s the opposite. A florist in Cranston, a pizza shop owner on the east side of Providence, a small business selling goods to tourists in Newport, Rhode Island will pay a higher tax rate than the biggest taxpayers, and what rolls into this is is this question of offshoring and profit-shifting.

I’d like to ask Dr. Clausing to talk a little bit more about who takes advantage of it. Does the florist, retail shop and the pizza guy take advantage of being able to relocate profits to the Cayman Islands or like Apple to Ireland and duck taxes?

Or do they have to face competition from big mega-corporate chains that may be selling flowers through across the Internet, they may be selling frozen pizza in markets, that may be retailing through Amazon sales and is able to charge lower prices because they’ve hidden, hidden their actual income and are paying lower tax rates, cheating the small business community at the expense of big business?

Dr. Clausing. Yes, you’re exactly right, Senator Whitehouse. The multinational companies can take advantage of their multinational structure to shift income offshore, and that gives them an enormous tax break relative to small domestic companies.

Chairman Whitehouse. Which they can put into a pricing advantage and crush small businesses with a pricing advantage that they only got by hiding revenue offshore?

Dr. Clausing. Absolutely, and if you look at the corporate community in the United States, about 500,000 taxpayers file as C corps, and really there are fewer than 2,000 of them that account for about 80 percent of the base.

So that corporate base is also very concentrated. You talked about the individual income being very concentrated at the top. This is also true among the business community, and just like our
individual Tax Code favors capital income by those who aren't at the very top, our corporate system also favors the income of the very few taxpayers that control the vast majority of the activity.

Chairman WHITEHOUSE. And I would argue control the vast majority of the political activity that creates these glitches in the Tax Code that disadvantage regular people in favor of the billionaires and the big wealthy special interests behind the glitches.

With that, let me turn to my distinguished Ranking Member. We'll probably do a second round, and then Senator Kaine I believe is next, unless we have return of an earlier member of the Committee. Senator Grassley, you are recognized.

Senator GRASSLEY. Thank you. If I could, just as a matter of seeing how I've made my point that there's a lot of things in the Tax Code that anybody can take advantage of, we have the Gingrich-Edwards loophole, and I think I ought to point out that it's very public, it's a matter of public record that President Biden himself aggressively took advantage of it to save himself as much as $500,000.

I want to ask my first question of Dr. McBride. Some have argued that the Tax Cuts and Jobs Act advantaged multinational companies at the expense of U.S. domestic companies. However, recent studies by researchers at Duke University and elsewhere actually found tax reform primarily benefited domestic firms and likely reduced incentives to shift earnings overseas.

I'd like to have you elaborate on whether or not our tax reform laws, that specific law, encouraged more business investment in the United States.

Dr. McBride. Certainly. That was the purpose of the law. The Tax Cuts and Jobs Act's explicit purpose was to incentivize greater investment and to deal with, in particular with the very high corporate tax rate that existed prior to the law, at 35 percent federal corporate tax rate. Combined with state corporate taxes, that gave the U.S. the highest corporate tax rate in the OECD.

That corresponded to high effective tax rates as well, according to several studies. It resulted in all sorts of distortions and behaviors that were very clear showing in news stories of the day. I was studying tax—at the time at the Tax Foundation, and seeing the wave of inversions, for instance, that were occurring in direct response to that very high corporate tax rate.

Inversions are where corporations change the location of their headquarters for tax purposes. So major brand name companies in the U.S. were changing their headquarters locations to exit the U.S., and get out from under the very high corporate tax rate, as well as the burdensome tax on foreign income that applied prior to the law.

So there was also an attempt to address that effect that was causing, for instance, corporate profits to be locked out of the U.S., and a variety of games being played in regards to foreign income. So there were reforms there as well. Not entirely simple reforms as our witnesses have discussed. There's certainly some complicated features of the guilty provision in particular.

But nonetheless, the goal was to address that very clear problem was recognized on a bipartisan basis by the Obama administration for instance. We had a real problem with competitiveness in the
corporate tax, and the solution was to get the corporate tax rate down to somewhere close to the middle of the range found in OECD countries, and that meant bringing it down dramatically.

So it’s at 21 percent currently, including state level corporate taxes, giving the combined rate somewhere close to 26 percent. That remains slightly above average for OECD countries, which in the OECD the average is about 24 percent. The average EU country has a corporate tax rate of about 22 percent I believe.

So that was an effective way, and really the only way to effectively deal with the very bad competitive situation the U.S. was facing due to our corporate tax. So the law succeeded in that regard, did lots of other things. But that was its major success I would say.

The CBO, for instance, and several other researchers including us and other modelers, found that the effect of that, in particular lowering the corporate tax rate, as well as improving the base of the corporate tax and the passthrough business tax, improving the base by allowing companies to immediately write off investment in equipment, that’s bonus depreciation.

So improving the base of the tax and lowering rates combined, have the effect of lowering the marginal effective tax rate on investment in the U.S., on domestic investment. So the prediction, according to CBO, us and others, was that this would boost investment, and that’s in fact what we saw.

In 2018, there was a large surge in investment, particularly in IP investment. It faded towards the end of 2018 and into 2019. Several other policies, of course, that confound the issue, other policies and other issues. One was the trade war that was kicked off in 2018, as well as the higher tax rates implemented by the Fed, interest rates by the Fed.

And then of course in subsequent years we had all sorts of other confounding effects, including the pandemic. But we can look at the pre-pandemic year of 2019 and see that the economy was in fantastic shape actually by many measures. Now very difficult to identify what portion of that is attributable to the law, to the tax law.

But there was in fact the lowest unemployment rate in 50 years, particularly the lowest on record for minorities, and for instance, wages, real wages were growing at the fastest pace in over a decade. So very clear the economy was in great shape following the law, but again empirically very difficult to identify what portion that is attributable to the Tax Cuts Jobs Act.

Chairman Whitehouse. Senator Kaine.

STATEMENT OF SENATOR KAINE

Senator Kaine. Thank you Mr. Chairman. Thanks to the witnesses. Today is Tax Day, so let me start with a softball. Should policymakers be concerned about or prioritize efforts to enable the IRS to be more customer-responsive in helping people file tax returns and getting their questions answered in a prompt way?

Dr. Clausing. Absolutely. I don’t know if you want a longer answer.

Senator Kaine. No, no. One word answer is fine.

Dr. Yagan. 100 percent.

Dr. McBride. Completely agree.

Senator Kaine. Good, okay. So we all agree on that. Here's a bit of good news, Mr. Chair. The Fiscal Times today has an article that says “IRS Cites Big Improvement in Customer Service.” I'd like to introduce it for the record.6

Chairman Whitehouse. Without objection.

Senator Kaine. And let me just read the most important quote. “The average wait time for callers looking for help from the IRS has fallen to four minutes this year, the Treasury Department said Monday. The average wait time was 27 minutes last year when the tax agency earned its worse customer service ratings on record.

“The Treasury Department attributed the improvement to the additional funding it received from Congress this year, ‘thanks to the 5,000 new hires already made possible by the Inflation Reduction Act.’ IRS customer service representatives answered more than 6.5 million taxpayer calls this year, which is 2.4 million more live calls than during the same period last year.”

The IRA provisions dealing with the IRS got some attention, particularly the enforcement provision. I was a strong supporter of those because in ten years in the Senate, I've had a lot of Virginians complain about responsiveness because we've been underfunding the IRS.

I'm hearing anecdotally on the road in the last two weeks, and my staff is too that the IRS has dramatically improved. Dropping wait times on phone calls from 27 minutes to four minutes is a pretty good indication that's going on. More to do, but I'm heartened to see it.

I'd like to ask a question about carried interest, and maybe I'll start with you, Dr. Yagan. I have never understood that economic rationale for the dramatically discounted tax rate applied to carried interest with respect to wages and salary. Do you agree with me that there's no good reason to give such a steep discount to folks who earn their income via carried interest?

Dr. Yagan. Thank you, Senator. Yes, similar incomes should be taxed similarly. Labor income of teachers, of Senators, of professors, we all make income from our labor.

We face ordinary income tax rates, and it’s a principle of economics of taxation that if you don't tax similar incomes similarly, you induce economic distortions that raise the economic burden per dollar of revenue that the Congress, that the Treasury gets to take in.

That's bad. Hedge fund managers work for a living and that's labor income. It should be taxed ordinary rates.

Senator Kaine. Are others wanting to weigh in on that, Dr. Clausing or Dr. McBride?

Dr. Clausing. I agree completely with Dr. Yagan.

Senator Kaine. Dr. McBride.

Dr. McBride. I think the carried interest issue is a complicated one. There are several different scenarios. It's not just hedge funds that are using this provision. I know, for instance, there's a local restaurant chain that used this provision from years ago to set up.

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6 Document submitted by Senator Kaine appears in the appendix on page 92.
It’s a way to share profits for folks that fund start-up companies of all sizes. I think you have to be careful in trying to address this provision, so that it doesn’t have the knock on effects of hurting, you know, start-ups and other entrepreneurship.

But agree generally with the principle that, that one clear way to simplify the Tax Code would be to tax all sorts of income at the same rate. We do have a, recently have analyzed a proposal that does that. It taxes both capital income and labor income at the same rate, 20 percent in particular.

This is—this has a lot of good qualities. It leads to a lot of simplification, a lot of administrative simplification.

Senator Kaine. I very much support simplification strategies. I still think having it progressive would make sense, but I’d like to treat income as income, and eliminate the distortions that Dr. Yagan testified to. I’m a co-sponsor of a bill that Senator Baldwin has that would equalize the carried interest tax.

I know the Chairman has a bill that would do the same thing in a slightly different way. I hope we might be able to do that. I think it would be a really efficient way to promote equity and also raise revenue that could be used for valuable priorities like childcare or other things that are frankly very needed to get people back in the workforce today. With that, I'm at the end of my time. I yield back to Mr. Chair.

Chairman Whitehouse. Senator Murray.

STATEMENT OF SENATOR MURRAY

Senator Murray. Thank you very much, Chairman Whitehouse, for really—for holding this important hearing. I know there’s a lot of hard-working families in my home state of Washington who are doing their part. They’re playing by the rules, paying their fair share in taxes. They deserve to know that everyone else is as well.

There really is no reason that an investor on Wall Street should be paying less in taxes than a firefighter in Spokane or a nurse in Seattle, and there really is no reason that companies making billions in profit should pay less in taxes than mom and pop stores across Washington state or across the country.

It’s not fair and I don’t think it’s American. We really need to close the loopholes and make sure that the wealthy pay their fair share, and we need to make sure that they play by the same set of rules as everyone else. I just don’t think that’s controversial.

And yet some Republicans, as we know, have constantly pushed for bigger corporate handouts and bigger loopholes and giveaways to the wealthy that they can take advantage of. In fact, the Trump tax bill was chocked full of freebies and handouts for those at the top, lined the pocket of Wall Street and loaded the national credit card with trillions in debt.

And still after that debacle, when it came time to raise the debt ceiling under the last President, Congress did the responsible thing. We worked together in a bipartisan way to raise the limit like we’ve done so many times before and like we should do again now.

The full faith and credit of the United States should never be held hostage to score political points, period. Now in stark contrast to the Trump tax giveaway for the rich and wealthy, I’m very
proud that Democrats were able to pass steps in the Inflation Reduction Act to help working families by lowering costs and leveling the playing field.

That included steps like making sure billion dollar companies who are paying at least the same 15 percent tax rate, as small businesses already pay, taxing stock buyback schemes that enrich Wall Street executives, and getting the IRS, as my colleague just alluded to, the funding it needs to enforce the law, close the tax gap and make sure that wealthy taxpayers are complying with the same rules as everybody else does.

I should note, that funding is improving customer support for everyone, making it easier for our constituents to get help, to get answers and to get their tax refunds. What we’re talking about here is common sense and basic fairness. You don’t get to ignore the law just because you’re rich.

Those big billion dollar companies, I don’t know about anybody else, but I never want to see a list of the largest companies in America that pay nothing in federal corporate income taxes again. It is just not fair. Wealthy Wall Street investors, they should pay taxes and play by the rules, just like the hard-working people in this country.

Everyday Americans, they should not be stuck footing the bill for billionaires who can pay lawyers to run circles around the IRS, instead of paying their taxes like everybody else. So I’m really glad, Mr. Chairman, that President Biden has put forward a road map to help move us even closer to a tax system where everyone pays their fair share, and I look forward to hearing more from the witnesses today about how we can do that.

My question would go to Dr. Clausing and Dr. Yagan. The economic theory behind the Trump tax cuts was that cutting corporate taxes would rev the economy because these cuts would allegedly trickle down to benefit workers. Well, it’s been almost six years since that legislation was passed. Do you think the Trump tax cuts are working as promised?

Dr. Clausing. I’m happy to start. Thank you for that question Senator, and I appreciate your earlier comments as well. The Trump tax cuts did raise deficits a lot. That’s one thing we know for sure. If you look at the revenue intake from both the corporate and the individual level, it’s much lower than it would have been.

If you search for positive effects on investment or on the economic growth, they’re very difficult to find. Research by the IMF and by academics has looked through the time series, and it’s true that those tax cuts were passed during a time of very robust economic growth, and that robust economic growth continued.

But you can’t see an incremental effect of the tax cut on spurring investment, and that’s particularly surprising because there were expensing provisions included as well as those massive corporate tax cuts. But I think one reason that we can point to for why it didn’t have the—any positive effects on investment or growth is that is companies that were really benefitting from this tax largesse are companies that already had more than enough cash on hand to undertake any worthwhile investment, right?

So if you’ve got a company that’s earning above normal profits, and you give them an even greater return, they’re not going to
have any reason to take that and invest it. Instead, we saw record stock buybacks and we saw a big run-up in the stock market in anticipation of that legislation. So really, the shareholders are the ones who benefitted from that.

Senator MURRAY. Yeah. Dr. Yagan, you want to add anything.

Dr. YAGAN. No.

Senator MURRAY. Okay. Thank you very much, Mr. Chairman.

Chairman WHITEHOUSE. Senator Johnson.

STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman. I think Dr. McBride pretty well laid out the solution here. It would be to simplify and rationalize our Tax Code. Unfortunately, we’ve done a pretty miserable job here in Congress of attempting to do that. But Dr. Yagan, you know, Dr. McBride also laid out, you know, the facts, according to the IRS in terms of what percentage of the total income of the top one percent versus the bottom 50 percent make, so I won’t repeat that.

It is interesting that JCT looks at it slightly different. The top one percent of the floor of the income level there is $548,000 worth of income. JCT looks at people making over $500,000 and they say that they make about 22.7 percent of income, pay about 51.8 percent of total income taxes, 32.6 percent of total taxation, okay?

So the question I have for both Dr. Yagan and Dr. Clausing, assuming the top one percent makes about 22 percent of the income, what percent share of the total income tax should they pay? What would that be a fair share, because we obviously hear from the other side. What would be fair?

Right now, they’re paying, you know, almost double. Well according to JCT, they’re paying more than double taxation versus income. What would be fair? When are you going to be satisfied?

Dr. YAGAN. Thank you, Senator.

Senator JOHNSON. And I want a percentage. I don’t want to— really, what percent? Should be 51.8 percent? Should it be 60 percent, 70 percent, 80 percent?

Dr. YAGAN. You and your colleagues have earned millions of more votes than I have. I’m an economist and I can speak to the economics of the policies. One key thing is that state and local taxes are actually regressive and so when we talk about total tax burdens, that would be flat over the income distribution.

Senator JOHNSON. Dr. Clausing. Dr. Clausing, would you give me a figure on that then? I can never get this out of people. I mean what, what would be a fair share? If you’re making 22 percent of income, how much percent of the income tax should you be contributing?

Dr. CLAUSING. A lot of the statistics that you and others have raised on this issue concern labor tax burdens, and one of the things that both Dr. Yagan and my own testimony point to is that there’s a vast discrepancy between how we tax labor income and how we tax capital income.

Senator JOHNSON. Okay, okay. So moves into my next——

Dr. CLAUSING. So the capital——

Senator JOHNSON. So again, JCT shows 30, 23 percent of income, but about 33 percent of total tax.
Dr. CLAUSSING. Yeah.

Senator JOHNSON. So should that 50 percent of what?

Dr. CLAUSSING. The top, according to Treasury data, the top one percent of taxpayers have 52 percent of the positive capital income, and that’s the income that’s really undertaxed, both at the individual level as we see in Dr. Yagan’s——

Senator JOHNSON. Okay. Well so I’m not, I’m not going to get answers. So let me move on. I think Dr. Yagan, you were talking about turning what you don’t think is passthrough income; it’s really salary type of income, and turning it into passthrough and avoiding the Medicare tax. I mean is that correct?

So I mean an example of that would be let’s say you’re being paid royalty on a book, which in that case I would actually from my standpoint, having been a manufacturer operating passthrough income businesses, and when you’re making income off of manufacturing, I would think that’s like real business income and should be treated as passthrough.

But a royalty on a book, I would say that probably should be attributed to people as real like salaried income, would you agree?

Dr. YAGAN. Yeah, labor income.

Senator JOHNSON. So what you’re talking about in terms of that tax dodge is exactly what President Biden did when he turned royalty income into, I think it was Subchapter S into passthrough income and didn’t pay the Medicare tax; correct? Now that’s what you’re talking about in terms of people turning what should be Medicare taxable income into passthrough income, right?

Dr. YAGAN. Yes, and same for, you know, a private practice physician or others. They’re all legally using the Tax Code and it’s just——

Senator JOHNSON. So let me ask you this question. Social Security is—we tax that, and there’s a limit to it because the deal on Social Security you’re basically pre-funding your own retirement fund. That’s the—I know it’s not really what happens, but I mean that’s sort of the——

Wouldn’t you say that’s sort of the same thing true for Medicare? You’re paying—all your lifetime, you’re paying the Medicare tax to provide your Medicare benefit, but we don’t limit the Medicare tax, so I would argue that’s somewhat unfair. If you want to, you know, change the deal, this isn’t really a payroll tax for your retirement. You’re, you know, Medicare then ends up just being a general fund type of a program; correct?

Dr. YAGAN. If I understood the question right, so Social Security benefits are a function of how much you pay in, so the more I pay in, the more I get. Medicare is a flat benefit, and so you know, that has different——

Senator JOHNSON. Yeah, but again if you’re turning passthrough income where it could be, in a business could be millions of dollars with no limit on that, you’re paying an awful lot for health care in your retirement age.

But let me just move in, because I think the other solution, in terms of what you’re talking about, trying to tax capital gains, which I think violates a basic principle of taxation, wherewithal to pay, Senator Kaine I think wrote favorably about what I was talking about in 2017, a true Warren Buffet tax, where we convert all
business income into passthrough income and tax business income at the shareholder level.

I would do it based on a cash basis income, but wouldn’t that also solve the problem? Now you’re not going to have this build up inside C corps of, you know, non-distributed income. So if you just tax all business income at the shareholder level.

By the way, I’ve talked to Warren Buffet about this. I talked to the shareholder service, it’s entirely possible. You collect the tax on a backup withholding like you do the payroll tax, and would you agree that that would be something we really ought to explore, some system like that?

Dr. YAGAN. There are multiple ways to skin the cat here, and you know, the Sinatra tax burden and the Walton tax burden is different now. What you can’t do to equalize those tax burdens is both lower corporate tax rates and keep individual tax rates low. But as you say, if you would tax all corporate income in the year it’s earned as ordinary income, that would equalize.

Senator JOHNSON. To the shareholders. Again, tax at the shareholder level as we do with 95 percent of American businesses. So I’d love to work with the Chairman in terms of working on that type of proposal, because it solves an awful lot of the problems that you’re talking about here. So I’ll look forward.

We’ve got a couple of years to work on this because unfortunately, 95 percent of American businesses are facing a severe tax increase in 2026, and that’s also small businesses, you know, the people that are engines of innovation in our economy. So thank you Mr. Chairman.

Chairman WHITEHOUSE. Senator Braun.

STATEMENT OF SENATOR BRAUN

Senator BRAUN. Thank you, Mr. Chairman. When I was here earlier, the discussion was about the fact that 20 percent of GDP is maybe some magic number in terms of where we should be generating revenue. I look at statistics. The most salient one I’ve seen is that over 50 years, regardless of the tax rate, we average about 17½ percent, maybe 18 percent of our GDP.

Our system is such that high tax rates, you’re going to get a better fiscal out of it out the gate. But you generally kind of attenuate into a one to one and a half percent economic growth rate. Lower rates out of the gate have a negative fiscal to it, which I almost got the CBO to acknowledge.

We were paying for the Trump tax cuts, which were chump change back then, $150 billion per year for ten years, 1.5 trillion. There you get a two to three percent growth rate. But how can we expect to tax into a level that other than a couple of years during the Clinton administration, it is so statistically stubborn that with our system as it is, we generate 17½ to 18 percent of our GDP in federal revenue?

Start with on the left and move to the right, and in like about 30 seconds to 40, because I’ve got another question as well.

Dr. CLAUSING. It’s quite clear—sorry. It’s quite clear that our Tax Code does have a big impact on revenues. So if you look at both the Bush tax cuts and the Trump tax cuts, in both cases they had persistent effects on deficits and debt in the long run. There’s a re-
ident analysis at the Center for American Progress by Bobby Kogan that traces through those.

If you look at the big contributors to debt in this country, there are two factors. There’s the big one-time shocks of responding to the 2008 financial crisis, but also responding to the COVID crisis. Both of those caused level changes in the amount of debt. But also these persistent tax cuts have helped contribute to the fiscal imbalance that we see before us.

Senator Braun. So are you saying that you would be able to generate consistently 20 percent of our GDP in federal revenues, where that’s not been the case other than just a couple of years when rates have been, you know, higher?

Dr. Clausing. I think there are very sensible tax policy reforms that can generate additional revenue to help balance the budget, and I think 20 percent of GDP would be a good target, you know. It’s a political process that determines exactly where you want to land that.

But I think one thing to bear in mind is that the United States is a very low tax country, relative to our peer nations and a very high deficit country right now. So we really need to look at all solutions to that, and that includes a more robust fiscal system that raises the tax revenue that’s needed, and that’s partly about funding the IRS, it’s partly about leveling the treatment of labor and capital income, it’s partly about leveling the treatment of domestic and offshore income, and all of those would contribute to reducing the deficit in a helpful fashion.

Dr. Yagan. Yes. I would just echo that the United States, you know, is below the median in terms of total tax revenues as a share of GDP among other peer industrialized countries.

So you know, it can be done, and actually Congress had enacted a pre-programmed rise in expenditures with an aging population, you know, from my generation and actually had done the same for taxes too, the way that tax brackets were set up and other features of the Tax Code.

Which were then undone through legislation in the 2000’s and 2010’s. So I think there would have been a pre-programmed rise in revenues as a share of GDP had it not been for those acts, that would have risen, you know, above those historical levels.

Dr. McBride. Referencing the cross-country comparison here, the ways other countries are raising so much revenue than us, particularly in Europe, is primarily through the value-added tax, not through income taxes. This is—we don’t understand this concept here of course, but we don’t have a value added tax. We have, we have retail sales taxes at the state level.

Value added tax is essentially the same idea, but it’s designed better so that it doesn’t result in taxes on business inputs. It collects a ton of revenue as the primary revenue source in most European countries.

The second way they do is through higher payroll taxes than we have. So these are, these are both taxes on essentially on labor income at the end of the day, rather than capital income. So that is where the money is——

Senator Braun. So Dr. McBride, do you think we can generate 20 percent of GDP in federal revenues without depressing the eco-
And then what's the trade off there in statistically again, even before the Bush tax cuts and the Trump tax cuts, if you go back 50 years, we still only generate 18 percent of GDP in tax revenues?

Dr. McBride. I agree with you. There's an amazing sort of regression to that level. No matter what the top individual rate is for instance and it's fluctuated quite a lot through the 80's and the 90's and through today. I think it does point to a lot of behavior responses to those top tax rates and, you know, one is what I described in my testimony about the economic incentives to work, save and invest that are related to that marginal tax rate on those activities.

The other is reporting of income. So there's, you know, particularly with the higher capital gains rates we saw in the 80's, and the changes in the 90's that brought the capital gains rate down, there was a huge response——

Senator Braun. I'm out of time here, and I might note that our current spending is now not at 20 percent. It's about 25 percent of GDP, and when you look at nearly seven trillion in our total federal budget, there's nothing that that's going to lead to other than chronic deficits that regardless of the rate, we've got to get that back down to where it is normal.

I've got another question regarding Medicare. Go ahead? Okay. So I've been probably the most outspoken Senator that we've got a broken health care system. It's like an unregulated utility in my mind. One side of the aisle maybe wants government to take it over completely. You're still going to be dealing with a broken system, just a payor that may have a little more clout.

I found in my own business and did this nearly 15 years ago, that there are ways, even though it's opaque, even though there are barriers to entry. There's not inherent competition built into the system. I did it from the demand side, and number one, we became the insurance company and saved about 25 percent.

That's how much insurance companies were making on small businesses, but the biggest thing I did was turned all my employees into health care consumers, trying to draw out value in a system that doesn't offer it. That's the biggest part of our GDP, it's the part that has grown the most, and whether it's a private payor or a government payor, it's a broken system.

What could we do, in your opinion, to take—reform health care, not by giving more of it to government or giving more of it to the private sector in terms of how you pay for it? What could we do by getting rid of all barriers to entry, full transparency, full competition to actually bring the cost down to where instead of being 18 percent of our GDP, imagine if we just got it halfway to the world average, which is about 12 percent?

We're freeing up four percent of our GDP. That would pay for all of our deficits that we currently run as a country, probably federally and in terms of benefitting the private sector as well. Start on the same end and tell me what you think about that.

Dr. Clausing. I think there's a lot of low-hanging fruit with respect to reforming the health care system to save money. I think there were some important steps in the Inflation Reduction Act to
lower costs for seniors in Medicare and also for those consuming
drugs like insulin, and I think those are important steps forward.

I think there’s a lot more that could be done, and that there are
proposals the Biden administration has but also others, you know,
in think tanks and elsewhere that I think should be thought of. I
think you’re right, that insurance companies are responsible for a
lot of those costs, and if you look at the difference between the
American system and those abroad, that extra layer of cost is very
salient.

And unfortunately, our health care outcomes are also worse than
we see in other countries. So I wholeheartedly agree that this is
an area where we need more reform.

Dr. YAGAN. And I’ll agree with that. How much of my own time
have I wasted on the phone talking to a health insurance company?
There are definitely ways to align incentives, reduce paperwork
burden, make sure that the plumbing works so that electronic
records can save the time of insureds and physicians and their
staffs.

And competition does play a role. There is evidence that in
locales with only one hospital system that consumers are hurt by
that. So there’s many ways to look at this, and we’ll have to look
at all of them.

Dr. MCBRIDE. Well, sticking to the tax base, the single largest
tax expenditure, as documented by the Joint Committee and Treas-
ury, is the exclusion for employer-sponsored health insurance. And
so this is a full exclusion of any tax, any income or payroll tax paid
at the entity level, the business or at the individual level.

This is the way it’s been for decades. It’s grown to be a tax ex-
penditure that is costing several trillion actually over a decade. So
this is a huge, a huge pot of money here. I don’t—I think we have
to be careful with how we address it, but the—in my written testi-
mony, I outline a reform that fully eliminates it, along with several
other reforms.

It is a large tax increase to subject that fully to income and pay-
roll tax. We estimate it would raise about $4 trillion over ten years,
for instance. You need to offset that with some other reforms, tax
cuts that smooth that transition for workers. But the problem with
the current exclusion is that it creates a huge distortion in the
health care market, in which employers or health insurances for
most Americans, it’s tied to our work.

Furthermore, it incentivizes insurance companies and third party
payers have a larger role than they otherwise would play.

Senator BRAUN. And with as hard as it’s been to hire people, it’s
a very tricky area when you start messing with fringe benefits. I’d
love for the Senator and I to look at—in my own business, a key
was minor health care. That’s done through insurance.

Scratches and dents were never meant to be part of an indem-
nification, and the key, when the insurance companies told me that
almost all of the excess in health care is due to over-utilization and
the fact that you’re paying insurance for minor repair.

That should be directly between the provider and the individual,
only qualified by those that can’t afford it, to where you’d have
maybe some type of health savings account. But the key was when
we took minor health care out of being part of insurance, it started
cascading all kinds of positive benefits, and insurance was never intended to pay for, in anything, minor repairs. We need to think about that in terms of a way that would easily lower health care costs.

Transparency, competition, low skin in the game from those that can afford it on their minor health care. I think you and I could singlehandedly put a bill out there, Sheldon, that might get the movement in the right direction. How about that?

Chairman WHITEHOUSE. Mike, I would actually really like working with you on this. As you know, there's substantial overlap in our thinking and in our experience. Mine had a lot to do with reform work that changed the incentives for the industry and for the participant, and in particular the one that flags for me is the accountable care organizations that were set up.

I'm particularly proud of Rhode Island's two lead accountable care organizations. They were called Integra, originally Rhode Island Primary Care Physicians, and then Coastal Medical. Both of them were complete champs at lowering cost and delivering better care, and dramatically improving the experience of their patients.

In a small state like Rhode Island, if you've got a major private practice group that is improving the experience of its patients, you know about it. For these two to be competing to be the best in the country essentially at all of this, they returned millions of dollars to Medicare as a result of these improvements.

So I think there's an enormous opportunity here. A lot of it involves getting off of fee for service, getting skin in the game at a whole variety of levels, and I think the ACO model is one that has really proven itself.

So let's keep going. I will share with you something we've talked about privately, that we are trying to make sure that CBO, which this Committee has some authority over, pays more attention to taking a look at how health care savings of that nature can be scored, because as you know, I've got my little chart that I use that projects $7 trillion in health care savings.

That's a pretty big number. I want to know why that happened, and I want to be able to do more of what caused it to happen. I think ACOs, health care reforms, getting away from the fee for service treadmill, paying more attention to quality and outcomes, all of that has had a role in savings.

And you're absolutely right about the numbers. You're absolutely right about the comparisons to our foreign OECD competitors. We pay way more than our second, than the second worst one, we being the worst one, and we have just below average outcomes——

Senator BRAUN. Right.

Chairman WHITEHOUSE [continuing]. For that huge, huge cost. So and it's a huge part of our deficit, and if we play this right, you're not taking benefits away from people.

Senator BRAUN. No.

Chairman WHITEHOUSE. You are providing them better health care.

Senator BRAUN. In our own business, we did not, because we took what we had then, lowered family cost by 50 percent and have not had a premium increase in 15 years, and we have a healthier
bunch of belly buttons, which they call it in the health care business, employed. So it can be done.

Chairman WHITEHOUSE. Yep. I had a similar experience with our workers compensation system in Rhode Island years ago reforming that, and half of that is wages, but half of that is health care.

We made, it worked for both. We're 50 percent, 5-0 percent cheaper than we were beforehand, without taking benefits away from people, just by making systems work better. So I really look forward to working with you on that, and I'm glad we had the chance with just the two of us here to have a longer exchange than hearings regularly permit.

I want to add a couple of points in closing. The first is with respect to Senator Kaine's point. I met with our Taxpayer Advocate while we were back over the break, and the Taxpayer Advocate has new employees because of the bill, so they're able to take more calls from taxpayers who have problems.

Now it's fine they hired up quickly, but they're an intermediary with the IRS. What they're seeing is that the IRS is staffing up now, so that they're getting quicker responses and they can serve Rhode Island taxpayers better. It's not enough to have more people in the Taxpayer Advocate's Office if you still have jam-ups in the IRS divisions.

And they are seeing, as the hiring takes place, those jam-ups in the IRS divisions beginning to clear. So I am seeing what Senator Kaine talked about also in Rhode Island, that service by the IRS is immediately and noticeably improving as a result of those added resources. I wanted to add that to the record.

I also wanted to get some more clarification from Dr. Clausing. You were talking about the difference between 22 percent of labor income and 52 percent, I think your phrase was “positive capital income,” and you got cut off in your answer. If you'd like to finish while Senator Kennedy gets himself in his seat. I'll turn to him as soon as you're done with your answer.

Dr. CLAUSING. Thank you for that, Senator. The data I refer to are available on the Treasury website, and it looks at the distribution of different forms of income. The top one percent of the distribution has 52 percent of the positive capital income.

Chairman WHITEHOUSE. Meaning what? Positive capital income is what?

Dr. CLAUSING. Positive capital income is income that originates not from labor, but it also takes away in the analysis people who may have had losses. So if you just focus on those, that are earning above zero as opposed to losing money, which is a nice kind of snapshot of those who have gained from positive capital income.

I think one thing the testimony of both Dr. Yagan and my own testimony point to is the ways in which our tax system as a whole fails to tax capital income adequately. It's a difficult problem to fix. I think the entity level of taxation, or corporate taxation, has an important role to play, because a lot of capital income isn't taxed at the individual level at all.

If you look at income that's held in pension or retirement accounts that are tax-deferred, or income held in foreign hands that may or may not be taxed by the foreign government, the U.S. government doesn't reach any of that capital income for individual tax-
ation. When it does reach taxed accounts, that tax is often deferred indefinitely or perhaps forever due to step-up in basis at death.

So if you can first tackle capital income by looking at the business layer of taxation, that’s your first attempt to take a wholesale approach to reaching this income, and reforms at the individual level are helpful as well.

But that can help raise the amount of revenue that we can, achieve and close deficits without resorting to higher labor tax burdens, because that differential between labor and capital is causing a lot of the problem, because it leads to a lot of avoidance and less revenue than you would get otherwise.

Chairman WHITEHOUSE. Senator Kennedy.

STATEMENT OF SENATOR KENNEDY

Senator KENNEDY. Thank you, Mr. Chairman. Dr. Yagan, am I saying your name right? Tell me if you were king for a day and you could rewrite America’s Tax Code, tell me the three changes you would make?

Dr. YAGAN. Number one, I would equalize labor and capital tax burdens at the top. There are a couple of ways of doing that. The billionaire minimum income tax is one that would move in that direction. I won’t rehash those details. Senator Johnson actually talked about a corporate tax integration type of—

Senator KENNEDY. What’s number two?

Dr. YAGAN. Sure. Number two, part of closing the labor and capital disparity is closing the Gingrich-Edwards loophole, and number three is ending abuse of trusts. So the estate tax has been eviscerated. Many of those you take assets that you know are worth a lot, right now they’re purportedly worth a little because you haven’t taken the company public. You put them into a trust—

Senator KENNEDY. Do you support a wealth tax? Do you know what I mean by a wealth tax?

Dr. YAGAN. I know what you mean by a wealth tax. The billionaire minimum income tax taxes income, and that I think is the way forward in that space.

Senator KENNEDY. Well, let me be a little more precise. Do you think appreciation of assets that are not sold, unrealized gain, should be taxed?

Dr. YAGAN. I think you should have to prepay tax on it that will eventually be due at sale, gift or bequest.

Senator KENNEDY. What do you mean “prepay the tax”?

Dr. YAGAN. Sure. If I have $5 billion of unrealized capital gains, I have $5 billion of taxable income. I’m currently paying 1½ billion on that, so that’s a 15 percent overall tax rate.

Senator KENNEDY. Well now let’s make—no, no, no. Let’s not complicate this. I want to understand what you’re saying.

Dr. YAGAN. Sure.

Senator KENNEDY. Let’s suppose an American owns a piece of real estate they inherited from their father or their mother, and it was—when they inherited it, they get a step up in basis. It’s worth $100,000, and all of the sudden the interstate came through, and the property is now worth a million dollars if they sell it.
But they don’t plan to sell it. They’re going to leave it to their kids. Do you think that, that Americans should have to pay tax on the unrealized gain, the increase in value?

Dr. YAGAN. In general no. At that level of wealth, for example housing——

Senator KENNEDY. You think only wealthy people should.

Dr. YAGAN. At the very top, it’s hard to tax, you know——

Senator KENNEDY. Well, let me be sure I understand what you’re saying.

Dr. YAGAN. Sure.

Senator KENNEDY. All right. Let’s suppose that’s not just an average American. Let’s suppose that’s an American—what do you define as “rich”?

Dr. YAGAN. In the minimum income tax, it’s $100 million of wealth or more. That’s the——

Senator KENNEDY. Okay. So you think if you’re really wealthy, you should have to pay a tax on your unrealized gain?

Dr. YAGAN. I think you should have to partially prepay if you’re liquid, if you have liquidity to pay, and then——

Senator KENNEDY. Do you think, do you think somebody—why can’t you economists answer questions? Should someone, should any American have to pay tax on unrealized gain, or can’t you just answer me?

Dr. YAGAN. Yes, there are some who should.

Senator KENNEDY. Who?

Dr. YAGAN. The ultra-wealthy who have liquidity should prepay some taxes.

Senator KENNEDY. What if they don’t have liquidity?

Dr. YAGAN. They should not have to pay, and they will owe at sale, bequest or gift.

Senator KENNEDY. So if you have cash, you ought to have to pay, but if you don’t, you don’t have to pay?

Dr. YAGAN. To prepay. I have a—in my testimony there are examples of how this works, so that you can preserve incentives to build a new company, take it public while——

Senator KENNEDY. Okay. What do you think Dr. McBride? Do you think we should start taxing unrealized gain, and what do you think that will do to the economy?

Dr. McBRIDE. Well, I have several concerns about the approach, the first of which is it’s completely untested. It’s never been tried in this country. We have 100, more than 100 years of history with the income tax and——

Senator KENNEDY. Europe has tried it, haven’t they?

Dr. McBRIDE. No. They’re tried wealth taxes. Their experience of wealth taxes has been——

Senator KENNEDY. Yeah. How did that turn out? How did that turn out?

Dr. McBRIDE. Bad.

Senator KENNEDY. Why is that?

Dr. McBRIDE. It resulted in a lot of taxpayers exiting the country for one thing. In France, for instance, other countries that have tried it, and you suddenly lose a big chunk of your tax base that you’re trying to tax there.
We have that option in this country as well. The result has been that most of those countries in Europe that have tried a wealth tax have rolled them back, including France, because they were administratively challenging. The basic challenge is trying, is what you’re describing, trying to value assets without real market transactions.

So this is a valuation dispute. It means we get the IRS engaged in yet another challenge. We’re currently doing this with the estate tax. Those estates that are—that are the subject of the estate tax, those valuations—

(Simultaneous speaking.)

Senator KENNEDY. I need to ask—I need to ask one more. Can I have 30 more seconds?

Chairman WHITEHOUSE. Proceed.

Senator KENNEDY. Dr. you said Clausing?

Dr. CLAUSING. Yes.

Senator KENNEDY. Clausing.

Dr. CLAUSING. Yes, yeah.

Senator KENNEDY. Why do you—why do you and Dr. Yagan, why do y’all want to punish wealthy people?

Dr. CLAUSING. I think I can speak for both of us, that we’re not interested in punishing anyone. We’re interested in having a fiscal system——

Senator KENNEDY. Well, you’re interested in taxing the hell out of them more than anybody else.

Dr. CLAUSING. I think the reforms that——

(Simultaneous speaking.)

Senator KENNEDY. What makes you think—what makes you think that making tax policy on the basis of class or status makes sense?

Dr. CLAUSING. I think it’s a very American phenomena throughout the history of the income tax. We have valued progressivity and our current income tax does that. We used to rely on things that tariffs to raise revenue. Tariffs are regressive consumption taxes that disproportionately hurt the poor.

We believe in this country that those with the greater ability to pay should pay more of the burden, and that’s part of what a healthy capitalism does, is it enables people to gain from things like trade and technological change and business innovation, and to contribute a little more to the fiscal system when they are very successful in doing so. I think that’s a very legitimate way to structure the tax system.

Senator KENNEDY. Let me ask you a question.

Dr. CLAUSING. Yes.

Senator KENNEDY. Why do you think so many wealthy people are leaving New York City?

Dr. CLAUSING. New York City is, you know, an incredible city of innovation, immigration, entrepreneurship.

Senator KENNEDY. Yeah, but why are so many wealthy people leaving?

Dr. CLAUSING. I think there are big advantages to living near centers of entrepreneurial activity, and we see that on the——

Senator KENNEDY. Do you think they’re leaving to be nearer to centers of entrepreneurial activity do you?
Dr. CLAUSING. Well, I don't think there are a lot of people, you know, fleeing New York City. New York City has——

Senator KENNEDY. Sure there are, there are thousands. I mean there have been study after study after study. Why are so many wealthy people leaving New York City?

Dr. CLAUSING. I think there's an enormous number of wealthy people who are in New York City and continue to live there.

Senator KENNEDY. But why are so many leaving?

Dr. CLAUSING. I can't speak to why particular people are leaving.

Senator KENNEDY. I can tell you why, it's taxes. You know that as well as I do. It's taxes.

Dr. CLAUSING. I think if you look at the economic——

Senator KENNEDY. Some of it's crime, but most of it is taxes.

Dr. CLAUSING. Well——

Senator KENNEDY. People vote with their feet. The same reason that people are leaving California and moving to Austin.

Dr. CLAUSING. If you look at Californians, one of the most successful economies in the world, and it continues to be so. It attracts people——

Senator KENNEDY. But they're losing people.

Dr. CLAUSING. I don't think it's in any danger of decline, nor is New York City, and these are very vibrant places——

Senator KENNEDY. Okay. I don't think we're going to ever agree. I don't think we're going to ever agree, but I appreciate the time of all three of you.

Dr. CLAUSING. Thank you.

Chairman WHITEHOUSE. To be fair, there also are people moving the other way. There are people who move to New York. They just don't all leave from New York. It's a two-way street, in and out of New York, and it's a two-way street between Austin and California. People leave Texas and go to California, and some of them do very well.

Senator KENNEDY. Well, that's true Sheldon, but I can show you study after study after study, as you well know, and as the professor knows. It shows that people are leaving high tax states and moving to low tax states. All you have to do——

Chairman WHITEHOUSE. Well, they have to leave——

Senator KENNEDY. All you have to do is look at the demographics. Take, pick the nine states that have say a state income tax, and compare that—or that don't have a state income tax, and compare that to the states that do. It's called tax avoidance, and there's nothing wrong with it. It's perfectly legal.

Dr. CLAUSING. People have different preferences, you know. If you look at where immigrants choose to live in the United States, they often go to those same places that you were talking about. You know, so I do think that, you know, there's movement in both directions.

Senator KENNEDY. Yeah, but here's what—here's my point. Here's what I think rational people do, and here's what I bet all three of you would do, and I bet Sherrod would do, I mean Sheldon would do it because he's a smart guy, okay.

If he, if he won the lottery tomorrow and won $10 million and paid his taxes and has $6 million left, he's going to at least con-
sider, you are too, moving to Florida, because they don’t have a state income tax.

Chairman WHITEHOUSE. For the record, no I wouldn’t. Never crossed my mind.

Senator KENNEDY. Well most *rational*—well, I don’t mean you’re irrational. No, you know that.

Chairman WHITEHOUSE. It could be quite rational to not want to move to Florida right now.

Senator KENNEDY. But when you’re liquid, when you’re liquid and you don’t have to pay a six percent off the top versus zero percent, it’s a rational economic move, is it not?

Dr. McBRIDE. Yeah, I agree it’s rational. I mean the thing about taxes that we’re talking about is they’re a cost or price, and so claiming that this cost or price doesn’t matter is essentially throwing out the very basic law of demand basics, the basic fundamental idea in economics that prices matter, that cost matters.

Senator KENNEDY. See, this is what this always boils down to and there’s no—there’s no way we’ll ever agree, okay? But at least two of you believe that government, all things being equal, can spend a dollar better than people can. And that’s your—this is America. You can believe that.

Chairman WHITEHOUSE. For the record, that’s not in their testimony.

Senator KENNEDY. I just—I just don’t agree with you. I think people can spend a dollar better, all things being equal, and all you have to do if you know the history of government, you know that I’m right. But I don’t expect you to agree with me, because you’re professors, okay? Thanks Sheldon.

Chairman WHITEHOUSE. Always entertaining. Senator Kennedy, thank you so much for being here. Which kind of just to close out the loop here, takes us back to the question of offshoring. If we allow companies and wealthy Americans to avoid paying taxes by going offshore, we can assume that they will follow that incentive, at least many will.

And where there are negative effects on the country by allowing that to happen because jobs have moved offshore and revenues that would otherwise support American initiatives are lost, that’s a problem that needs solving. I think that’s a large part of what Dr. Clausing’s testimony is about.

Dr. McBride, we have had a witness from the—chosen by the Republican side say that it’s very important that in order to evaluate a witness’ testimony, you have to know who’s funding their organization and their research.

So I think that’s a logical thing to follow up on, and it’s my understanding that the Tax Foundation almost inevitably argues for lower corporate tax burdens; is that correct?

Dr. McBRIDE. That’s correct. As my testimony describes, the corporate tax, according to many studies, is very economically destructive. That’s the primary reason why we argue against it. This is dozens and dozens of studies by OECD researchers and others that find this the most damaging tax.

Chairman WHITEHOUSE. And your board is made up almost entirely of corporate executives and corporate lawyers?
Dr. McBride. I have to think about that. We have a variety on our board. It’s on our website.

Chairman Whitehouse. And it’s not clear who funds your organization, because there’s a lot of non-transparency.

So I’m going to ask the question for the record, if you’d go back and let us know where the financial support for the Tax Foundation comes from. I don’t expect you to have that off the top of your head, but when donations come in from groups like Donors Trust, you don’t know who the real donor is because Donors Trust is simply a passthrough vehicle for removing the identity of the true donor and masking it behind the label “Donors Trust.”

So if you could take that question for the record and answer it how you wish.

Dr. McBride. Happy to review that request when it comes in.

Chairman Whitehouse. Very good. With that, I think we have an additional—so your questions for the record are due by noon tomorrow, and if you can take mine as a QFR, we’ll also get it to you.

The answer we’ve asked witnesses to get within seven days of receipt when we get it to you.

I want to thank the witnesses for appearing. Their entire full testimony will be included in the record. I think it is extremely important that we decorrupt and derottenize our Tax Code. And where it has been structured over many, many years to favor the wealthy and allow them to pay lower tax rates than regular working Americans, I think we have a problem on our hands of propriety. I just think it’s wrong.

I think we have a problem of economic injustice. I think we have a problem of an unfortunate circularity between wealth and political influence, using political influence to create more wealth for those people who already have it, and as we pointed out, there’s also a problem of revenue.

And while we’re running deficits, to run an unjust tax system that creates bigger deficits for the sake of wealthy political influence is not a good place for the United States of America to be. So with that, we are concluded. I thank all the witnesses.

[Whereupon, at 11:39 a.m., Tuesday, April 18, 2023, the hearing was concluded.]
Opening statement of Chairman Sheldon Whitehouse  
Senate Committee of the Budget  
“A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations”  
April 18, 2023

There are two sides to the budget: spending and revenues. While some colleagues only want to look at the spending side, the US has never run a modern-era balanced budget unless revenues nearly 20% of GDP. Most revenues come through the tax system. Today’s hearing tells of two distinct sets of rules, that produce a rigged, corrupted and deficient tax system.

Under one set of rules, for most Americans, paying taxes is immediate and automatic. Taxes are withheld from every paycheck to fund the public goods that contribute to our happiness and security: roads, schools, parks, veterans’ care, the military. Under this set of rules, taxes also are paid, on all income, for Social Security and Medicare, programs that let Americans retire with dignity and afford medical care. Under these rules, a typical teacher or ironworker in Rhode Island might pay a federal tax rate over 20%. As would a married couple running a small business earning salaries of $150,000 a year.

But it’s different rules for the wealthy and well-connected. Billionaires and large multinational corporations get special rules that let them pick when— even if— they pay taxes. This corrupted tax code lets billionaires pay an average tax rate of just 8.2%— less than half the rate of a typical teacher or firefighter. Thanks to the Trump tax law, large multinational corporations average even less, just 7.8%. Some pay zero.

Simple fairness is reason enough to end this rigged system. But the tax dodging also blows a hole in our federal budget. The Center for American Progress reports that tax cuts for the wealthy have been a primary driver of deficits for decades, accounting for more than half of the debt increase as a share of the economy.

Letting wealthy business owners avoid Medicare taxes on their full income costs Medicare $250 billion in lost revenue. Letting billionaires pay low or zero tax rates costs America $550 billion. Letting multinational corporations shift profits to tax havens leaves a $1 trillion bill for everyone else to pay.

Common sense reforms can make our tax code fairer while reducing the deficit.

First, to protect the long-term solvency of Social Security and Medicare, I’m filing legislation to require contributions to Social Security taxes on high-end income. Right now, the cap on contributions means someone making $1 million effectively stopped paying into Social Security February 28th this year. People living on investment income pay no Social Security contribution. Respecting the Biden tax pledge, my Medicare and Social Security Fair Share Act will require Social Security contributions on all income above $400,000, however earned. This legislation includes the Biden budget tax plan we saw to extend the solvency of Medicare by 20 years.

Second, billionaire Warren Buffet famously highlighted the rigged tax code by pointing out that he paid a lower tax rate than his secretary. So I am also re-introducing the Paying a Fair Share
Act to codify the “Buffett Rule” with a minimum 30% tax rate on income over $1 million per year, whatever the source.

Third, American multinationals recently reported $60 billion in profits in the Cayman Islands in a single year—ten times the size of its entire economy. That’s a scam, it costs American jobs, and it’s unfair to American businesses large and small that don’t engage in overseas tax games. My No Tax Breaks for Outsourcing Act would make offshoring companies pay the same tax rate domestic companies pay here at home.

House MAGA Republicans have yet to release a budget for the American people to see, but they’ve sure made clear who they want to protect. Their first vote was to protect wealthy tax cheats by hobbling IRS enforcement, adding $114 billion to the debt. Then they filed legislation to make the Trump tax cuts permanent: a $3 trillion cost, with over 40% of the benefit to the top 5% in income. Some have even proposed a new 30% sales tax on everything. The conservative American Enterprise Institute says this all could add $18 trillion of debt.

Behind all this secrecy and mischief lurks a crew of Republican dark-money donors who don’t want to pay taxes and are so rich they don’t care about Medicare, Social Security, or the economic well-being of wage-earners. Selling their poison to the public is hard. Put Americans’ priorities first, and this gets pretty easy. And the math works! I look forward to hearing the testimony today about fixing a tax system rigged for wealthy political donors.
Prepared Opening Statement by Senator Chuck Grassley of Iowa

Ranking Member, Senate Budget Committee

Hearing on “A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations”
April 18, 2023

Revenues to the federal government are a fundamental part of the budget and a subject that this committee ought to be studying. However, I want to stress that the fundamental problem we have in the federal budget is not one of under taxation, but of overspending. The last time the federal budget was balanced in 2001, revenues were 18.9 percent of our gross domestic product. Last year, federal revenues amounted to 19.6 percent of GDP. Yet, we still managed to run a deficit of $1.4 trillion. That’s because even though tax collections have increased by $2.9 trillion since 2001, spending has grown by $4.4 trillion.

Another issue I want to stress is the difference between tax avoidance and tax evasion. Tax avoidance is the legal minimization of tax liability. Tax evasion is the failure to pay taxes owed. Tax evasion is a crime. Tax avoidance is legal—and frequently encouraged by Congress. The tax code is full of various credits, deductions, and other incentives, which are usually tied to a behavior Congress decided to incentivize. In fact, taxpayers have the right to pay only what is legally due.

It’s also important to remember that a tax loophole is an ambiguity in the law exploited in a way not intended or foreseen. It’s not simply a policy with which one disagrees. When it comes to closing actual loopholes and cracking down on tax cheats, my record as a former chairman and ranking member of the Finance Committee is second to none. One only needs to look at my investigation uncovering tax cheats in the conservation easement program and my creation of the IRS Whistleblower Office that has reclaimed billions from tax fraud to name just two examples.

I also want to stress that the U.S. has a progressive tax system. According to an analysis published by the Biden Treasury Department: “Total federal taxes are progressive.” Families at the bottom of the income spectrum often have a negative federal tax liability due to refundable credits. In contrast, those in the top one percent pay close to one-third of their income in federal taxes.

Nonpartisan experts at the Congressional Budget Office and the Joint Committee on Taxation have come to similar conclusions. So have outside groups like the Tax Foundation and Tax Policy Center.

IRS data also bears out the progressive nature of our tax system. Based on tax year 2020 returns, the top one percent of taxpayers by adjusted gross income paid more than 42 percent of total federal income taxes.

Congress should regularly examine tax incentives—just as we should review spending programs—to ensure they’re working as intended. If my Democrat colleagues are on the hunt for tax subsidies that benefit large corporations and the wealthy, they need look no further than legislation they enacted on a purely partisan basis last year.

Their ill named Inflation Reduction Act included hundreds of billions of dollars in new or expanded tax incentives. Included in this legislation are novel new tax features, such as “direct pay” and “transferability,” that actually make it easier for corporations and wealthy investors to pay little or no tax. These provisions will not only further complicate the tax code and primarily benefit the affluent, but recent estimates suggest their costs could be far greater than Congress was originally lead to believe.
We helped create the tax avoidance problem, and last year’s Democrat bill made it even worse. As one former Finance Committee chairman used to say, “Many taxpayers accept complexity that favors them.” If we really want to diminish the advantage that wealthy taxpayers and large corporations have, we should address the complexity of the tax code. This is a bipartisan problem, but fortunately solving it is within our control.
Testimony of

Kimberly A. Clausing
Eric M. Zolt Professor of Tax Law and Policy
University of California, Los Angeles

Before the
U.S. Senate Committee on the Budget

18 April 2023

Chairman Whitehouse, Ranking Member Grassley, Members of the Committee: Thank you for inviting me to share my views on corporate tax avoidance. Simple reforms to our business tax system can improve the system across multiple dimensions: generating more revenue, reducing offshoring incentives, enhancing competition and economic efficiency, and resulting in a fairer tax system. Given the importance of today’s high levels of deficits and debt, it is particularly important to reform the tax system in a way that counters systematic sources of tax avoidance.

In my testimony today, I will discuss four crucial flaws in today’s corporate tax system. First, current law contains large tax preferences for foreign income relative to domestic income, fueling offshoring and profit shifting. Second, as a consequence of current law incentives, we give up large revenues by failing to reform our tax system. Third, the current system favors a small number of large multinational companies, companies that often wield significant market power; these tax preferences inhibit the ability of smaller businesses to compete in free and fair markets. Finally, tax avoidance reduces the fairness of our tax system, benefiting corporate shareholders at the expense of middle-class taxpayers.

Fortunately, a few relatively simple reforms can address all of these problems; Senator Whitehouse’s sponsored legislation shows one promising path forward.
Four Key Flaws of the Current System

1. **Current Law Generates Large Offshoring Incentives**

   Current U.S. tax law provides perverse incentives to earn income offshore; indeed, I have often referred to this system as “America-last” tax policy. U.S. income is taxed at a 21 percent rate from the first dollar of taxable income earned. In contrast, compare the U.S. tax treatment of foreign income reported in a zero-tax jurisdiction. The first ten percent return on foreign tangible assets is tax-free, and subsequent income beyond that ten percent return is taxed at a 50 percent discount relative to domestic income. These rules provide strong incentives to move tangible assets offshore (to increase the tax-free return) and to book income offshore (to benefit from the 50 percent deduction). Consequently, it is hardly surprising that U.S. multinational companies report large profits in many jurisdictions with rock-bottom tax rates. Figure 1 shows the share of U.S. multinational company income in seven important low-tax rate jurisdictions. Despite changes in U.S. tax law, and some changes in tax laws abroad, that share has remained very high. In the five years prior to TCJA (2013-2017), the low-tax share averaged 61 percent; the present low-tax share is 56 percent.

**Figure 1: Share of U.S. MNC Foreign Earnings in Seven Important Low-Tax Jurisdictions**

![Graph showing share of US MNC foreign earnings in low-tax jurisdictions]

Source: U.S. BEA Foreign Direct Investment Earnings Data are available [here](source-url). The seven jurisdictions are Bermuda, Cayman Islands, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland.

Of note, the current U.S. tax system also favors the earning of income in high-tax countries abroad, relative to that in the United States; this is the “America-last” feature of the current U.S. tax system. Under the GILTI (for global intangible low-taxed income), foreign income is taxed on a globally blended basis. Income reported in France or Japan (both countries with rates above the U.S. rate) generates tax credits that offset tax due on low-taxed income, lowering the tax burden.
on both sources of foreign income to about half the U.S. rate. The GILTI tax also maintains the incentive for foreign countries to offer rock-bottom tax rates, since any GILTI tax due can be offset by tax credits from higher-tax foreign countries. Figure 2 shows the jurisdictions with the highest shares of U.S. multinational income in 2019. The jurisdictions with darker bars are all locations with historically very low corporate effective tax rates.

**Figure 2: The Top Twenty Locations for U.S. Multinational Foreign Profit in 2019**

![Bar chart showing the top twenty locations for U.S. multinational foreign profit in 2019.]

Source: IRS SOI Form 8975 data. The foreign total excludes income classified as stateless.

The foreign-derived intangible income (FDII) deduction does not rectify these incentives; instead, it has perverse consequences of its own. For instance, as companies’ domestic tangible assets increase, they receive lower FDII deductions, enhancing their incentive to undertake tangible asset investments abroad (which also generates tax-exempt foreign income under GILTI). Further, the FDII deduction provides a tax break for excess profits, tilting the tax playing field in favor of large companies with market power. Finally, the FDII also favors export income, a policy preference that has no policy rationale and that is inconsistent with WTO rules.2

2. **Current Law Facilitates Corporate Tax Base Erosion**

These large tax preferences for foreign income relative to U.S. income erode the U.S. corporate tax base, such that relatively modest reforms to the U.S. GILTI tax have large revenue potential. For instance, ten-year revenue estimates for a country-by-country reform of the U.S. GILTI tax (which taxes the foreign income of U.S.-based multinational companies) from four different

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1 These incentives are explained in more detail in my paper: “Profit Shifting Before and After the Tax Cuts and Jobs Act,” 2020, *National Tax Journal*, 73(4), 1233-1266.

2 These WTO rules benefit the United States and the world trading system by discouraging export subsidies.
independent sources range from $442 billion to $692 billion; this reform would also raise the GILTI rate and reduce the amount of exempt income.  

3. **Current Law Distorts Market Competition**

Under current law, U.S. multinational companies pay much lower average tax rates than smaller domestic companies. The U.S. Joint Committee on Taxation calculated that U.S. MNCs paid an average tax rate of only 7.8 percent on their worldwide income in 2018. These tax rates are far lower than those paid by domestic companies, and indeed far lower than tax rates faced by MNCs abroad.  

Recent decades have been characterized by rising market power of large businesses, and a great degree of concentration is evident in the U.S. corporate tax base. For example, 2019 data from the IRS indicate that less than 2,000 companies (under one-half of 1 percent of 500,000 U.S. corporations) account for 87 percent of the U.S. corporate tax base, with about 350 of these companies accounting for 69 percent of the tax base. Numerous scholars provide evidence of rising market power in the United States, and Figure 3 indicates that corporate profits are very high in recent decades when compared to prior decades.

A tax system that benefits larger, multinational companies relative to smaller firms will tax economic rents – or profits above the “normal” return to capital – more lightly than regular returns. In contrast, economic theory suggests that taxing rents is less distortionary than taxing the normal return to capital, since rents taxation will not alter optimal decisions regarding capital investment, employment, or economic activity. The strong case for taxing economic rents has been emphasized by many scholars, but absent international tax reform, the international mobility

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3 The GILTI rate would be 21 percent and the exemption for the first ten percent return on foreign tangible assets would be eliminated. Treasury scored the 2021 Biden reform here and a similar 2023 reform here. JCT scored a similar proposal here. Both the Tax Policy Center (here) and the American Enterprise Institute (here) scored the (very similar) Biden campaign proposal; the Tax Policy Center score covers only a nine-year window. These estimates are in line with my own empirical work in Clausing, Kimberly A. and Saez, Emmanuel and Zucman, Gabriel. Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals (January 20, 2021 Working Paper) and “Five Lessons on Profit Shifting from the US Country-by-Country Data.” 2020. Tax Notes Federal. 169(6), November 225-340. My prior work in Clausing, Kimberly, “Profit Shifting Before and After the Tax Cuts and Jobs Act.” 2020. National Tax Journal. 73(4), 1233-1266, also documents large revenue losses from profit shifting, using a range of data sources and methods (see Table 1).

4 JCT will likely update this number, but they have not released new estimates. For the analysis of the 2018 data, see Table 3 on page 58 here. JCT finds that our top ten trading partners levied an average tax rate of 18.1 percent. A recent Reuters study found that US multinational companies pay effective tax rates that are 8 percentage points lower than those of multinationals companies in other countries.

5 See the 2019 IRS SOI Publication 16, the “Corporation Income Tax Returns Complete Report.”

6 For an overview of the literature in this area, see my recent working paper “Capital Taxation and Market Power”. Note that Figure 3 includes both C corporations and other corporations; unfortunately, the National Income and Product Accounts (NIPA) data don’t allow a separate breakdown of C corporation profits, and public IRS data are incomplete. Fortune 500 data on top US corporations also indicate strong increases in corporate profits for the Fortune 500. For example, real profits (adjusted for inflation) rose 67 percent over the prior decade’s list, 2013-2022, in part due to a spike in profits in the final year of the list.
of the tax base makes it difficult to tax rents.\(^7\)

**Figure 3: Corporate Profits Before and After Tax, 1980-2022, as a share of GDP**

Stemming international tax avoidance is therefore an important part of ensuring healthy competition between smaller domestic companies and large multinational companies. As recognized since at least Adam Smith, market outcomes work best under competition, whereas market power can generate adverse consequences for workers, consumers, and the economy. At present, our tax system provides systematic tax preferences for the largest, most powerful multinational companies.

4. **Current Law Inhibits Tax Fairness**

Light taxation of corporate profits inhibits our efforts to build fair tax systems. The vast majority of capital income goes untaxed at the individual level by the U.S. government,\(^8\) and capital income is far more concentrated at the top of the income distribution than labor income.\(^9\)

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\(^8\) In particular, more than 70 percent of capital income goes entirely untaxed by the US government at the individual level since it is held by untaxable entities or in untaxed accounts. Rethinking such tax preferences may be desirable, but it would be exceedingly politically difficult. See, e.g., Burman, Leonard E., Kimberly A. Clausing, and Lydia Austin. 2017. “Is U.S. Corporate Income Double-Taxed?” National Tax Journal 70 (3): 679–706. Rosenthal, Steven M., and Theo Burke. 2020. “Who’s Left to Tax? US Taxation of Corporations and Their Shareholders” and analysis linked here. Even for taxable US accounts, taxation is often deferred indefinitely (until the capital gain is realized) or eliminated entirely (in the case of step up in basis at death).

\(^9\) For example, the top 1 percent of the US income distribution receives 12 percent of all labor income, but 52 percent of positive capital income. See US Treasury analysis here.
In recent decades, governments have shifted tax burdens away from capital income and toward labor income or consumption, making the tax system less progressive. At the same time, before-tax economic inequality has increased, making a stronger case for a progressive tax system. Business taxation has an important role to play in tax progressivity, since the corporate tax is a very progressive tax. All conventional models of corporate tax incidence assign the vast majority of the burden of the corporate tax to capital or shareholders, including models used by the Joint Committee on Taxation, the Congressional Budget Office, the U.S. Treasury, and the nonpartisan Tax Policy Center. The persistent advocacy by the business community for low corporate tax rates is consistent with their economic interests, corporate shareholders and top executives frequently benefit from corporate tax cuts.

Promising Business Tax Reform Solutions

Senator Whitehouse has shown leadership on international tax reform, sponsoring legislation that would address these concerns in the “No Tax Breaks for Outsourcing Act.” This legislation would completely level the tax playing field for U.S. multinational corporations, by fully taxing foreign income at the U.S. rate on a country-by-country basis and eliminating the tax-free return on foreign tangible assets. The legislation would also eliminate the foreign-derived income deduction, ending the perverse incentives associated with that provision. These changes would improve the competitive environment for smaller businesses in the United States, by requiring large multinational companies to face global tax burdens that are identical to the domestic tax burden, removing the large tax advantage that multinational companies presently enjoy.

The Biden proposals are a bit more modest than these, in that they merely reduce the tax preference for foreign income from 50 percent to 25 percent, but they were proposed in a similar spirit, working to lower the incentive to offshore, and building a tax system that reduces the advantages of large multinational companies relative to smaller businesses.

In both cases, by collecting more tax revenue on mobile capital income, international tax reforms would help build a fairer tax system. Asking multinational companies and their shareholders to pay a 21 percent tax rate on their income, regardless of where it is earned, is a very reasonable tax burden in light of the tax burdens faced by middle-class Americans. Workers face a 15 percent payroll tax rate on their earnings from the very first dollar earned (including employer contributions, which lower wages accordingly), and marginal federal income tax rates of 22 percent apply to earnings above about $44,000, rising at higher income levels.

10 In the United States, the federal government has implemented large cuts in the top income tax rates applied to dividend income and long-term capital gains, reductions in the reach of the estate tax, and sharp reductions in the corporate income tax rate in 1986 and 2017.

11 For ICT, see here. For CBO, see here. For Treasury, see here. (This source is again available on the Treasury website, after being removed in 2017.) For the Tax Policy Center, see here.
Finally, this is a particularly good time for international tax reform, as many other countries are currently implementing country-by-country minimum taxes, so U.S. reform would better align our tax system with what the rest of the world is doing, without disadvantaging U.S. companies.  

The Importance of Tackling Tax Avoidance in Today’s Fiscal Environment

At present, the United States is facing a very challenging fiscal situation. The Congressional Budget Office projects deficit to GDP ratios of more than 5 percent for the entirety of the coming decade, and projected deficits rise in the second half of the decade. Total stocks of debt relative to GDP rise from a level about equal to the size of the U.S. economy at present (97 percent) to 118 percent by the decade’s end. While these projections account for CBO’s best guess of the economic environment in the years ahead, they do not incorporate possible risks associated with unknown events such as recessions, public health emergencies, or international security risks.

This budget outlook makes new sources of revenue very important. It is simply not possible to tackle deficits and debt by relying on spending cuts alone. For example, a recent CBO analysis found that, if the Tax Cuts and Jobs Act provisions are extended past 2025, it is mathematically impossible to balance the budget in ten years without either tax increases or spending cuts in Social Security, Medicare, defense, or veterans’ programs. Even if the Tax Cuts and Jobs Act provisions are not extended, budget balance would require draconian (86 percent) cuts in every other program, should Social Security, Medicare, defense, and veterans’ programs be left untouched.

Of course, budget sustainability need not require budget balance, and spending cuts to some of the protected categories might be justified, but budget stability will be very difficult to achieve absent efforts to collect additional tax revenue. Beyond international tax reform, there are many good ideas to augment tax revenue, including Biden Administration budget proposals as well as some of the CBO revenue options. A few other proposals are also particularly worthy of mention.

- Senator Whitehouse has shown great leadership on climate, alongside several of his peers on the committee. Congress took important action on the climate through the clean energy transition subsidies that are in the Inflation Reduction Act; these policies are an important step forward for climate change mitigation. These policies would be even more effective if they were accompanied by legislative measures that ended current tax subsidies that favor fossil

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12 For more details on the agreement, see my recent policy brief from PIFIE on "The International Tax Agreement of 2021: Why it’s Needed, What it Does, and What Comes Next?".
13 See February 2023 CBO forecasts here.
14 See here.
15 The FY2024 Biden proposals are here and the CBO budget options are here.
funds. Congress should also charge a fee for carbon emissions; this policy could be designed to protect consumers from energy price increases by exempting retail gasoline. Such a fee would be an enormously effective tool to combat carbon emissions, and it would raise much needed revenue at the same time. It would also better align the United States with policies that the rest of the world is implementing to address climate change. We are the only G7 country that does not price carbon, and excluding the United States, more than half of OECD country emissions are covered by some form of carbon price.

- Congress took important action to fund the Internal Revenue Service more adequately as part of the Inflation Reduction Act, yet projections indicate that there will still be an enormous tax gap in the years ahead. IRS funding should be protected, and it would ideally be complemented by legislative measures that enhance third-party reporting and counter abusive tax practices.

In the years ahead, Congress will have difficult decisions to make regarding the future of tax policy. In 2025, most of the Tax Cuts and Jobs Act tax cuts will expire, the only exceptions are the corporate tax law changes, the changed inflation measure, and a measure that reduced spending on low-income health insurance. This provides Congress with risks and opportunities. Simply extending these tax cuts would be very expensive, totaling over $3 trillion over ten years; restricting those extensions to just those below $400,000 would also be expensive, totaling about $1.8 trillion over ten years. Given the path of deficits and debt described above, these blanket extensions are simply unaffordable, especially if other sources of revenue are off the table.

At the same time, it is important for the U.S. government to focus on making key public investments that will enhance the competitiveness of our economic fundamentals: building solid infrastructure, educating workers, and investing in communities that have been left behind. As we take on these public investments, which can be expensive, we need to focus on ensuring that our investments are cost-effective. For example, permitting and other reforms that make it easier to build energy transition projects and infrastructure will help these investments yield more bang for the buck. In addition, while national security is an ever-salient motivation, the United States can work with other nations to address these concerns while also promoting an open and vibrant exchange of goods, services, talent, and ideas. Openness to international markets will help spread the benefits from U.S. technological innovation abroad and improve the efficiency of the energy transition. Finally, immigration reform has a particularly important role to play in addressing our economic challenges. 17

16 See Table 5.2 of the CBO May 2022 budget outlook, available here, which calculates a $2.1 trillion dollar cost for just part of the ten-year window, focusing on 2023-2032. (The tax provisions do not expire until 2026.) The Tax Policy Center calculates the 10-year cost from 2027 to 2036 as over $3 trillion, excluding additional interest payments due to greater borrowing; see here. About 40% of the benefits would go to those in the top 5 percent of the distribution, who they note “will make about $400,000 or more” in 2026.

17 Reversing recent declines in immigration, and providing more and better legal pathways for new Americans, would help address many key economic priorities in a cost-effective manner: reducing long-term fiscal imbalances (that are tightly linked to demographic factors), working to build or maintain our technological leads in semiconductor
Appendix: Responses to Common Concerns Regarding International Tax Reform

Does the new international tax agreement impede U.S. tax sovereignty?

The United States retains autonomy in international tax matters, and the proposed international tax reforms are a good idea regardless of the policy choices of other countries. However, it is harder for the United States to plug the holes in our tax system when other countries provide zero tax rate environments. In that light, the international agreement is actually restoring countries’ tax sovereignty, by enabling countries to set the tax policies that suit their economy, without a fear that other jurisdictions will lure activity away with zero-tax rate environments.

Won’t these reforms to our international tax system hurt the competitiveness of U.S. multinational firms?

There are multiple types of competitiveness and international tax reform could improve the U.S. competitive position along several dimensions. First, countries compete on fundamental economic strengths, based on the abilities of their workers, the soundness of their institutions and infrastructure, and their ability to foster innovation and entrepreneurship. Putting the U.S. fiscal system on sounder footing is a key part of focusing on fundamentals. Second, the U.S. location is an attractive place to locate activity and profit, but U.S. companies often decide to locate activities and profits in part based on tax incentives. These proposals would reduce or eliminate the tax advantage of foreign income relative to domestic income. Third, U.S. companies compete with foreign companies, often through global merger and acquisition bids. At present, the agreement on international taxation will ensure that foreign multinational companies pay at least 15% on their foreign income, bringing the tax treatment of U.S. companies, even at a 21% GILTI rate, much closer to that of the tax treatment faced by foreign companies.

Didn’t the Tax Cuts and Jobs Act Grow the Economy?

The TCJA did not alter underlying trends in either wage growth or investment, as confirmed by multiple sources.15 There was also no evidence that the TCJA made a noticeable difference in the path of U.S. economic growth; a report from the International Monetary Fund (IMF) found that increased corporate cash balances were largely directed toward stock buybacks (which reached

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record levels in the wake of the legislation) and dividend payouts. The international tax provisions had a small effect in reducing profit shifting, and some companies moved intellectual property income back to the United States, but the overall scale of the effect was largely unchanged, as seen in Figure 1.

With tough U.S. laws, won’t companies invert or move their headquarters overseas? Didn’t TCJA finally put an end to that practice? Shouldn’t we think twice before reigniting inversions?

Many countries are implementing the international tax agreement, so once those laws are in place, the advantage of foreign locations will be limited. In addition, simple anti-inversion measures, such as those suggested by Senator Whitehouse in his proposed legislation, can be quite effective in stemming the incentive to invert. Further, regulatory measures can be helpful here, as shown by the U.S. experience after the anti-inversion (and anti-income stripping) regulations of the late Obama years, which brought inversions to a halt.

Won’t raising taxes on corporations hurt the economy and jobs, especially during a time of macroeconomic uncertainty?

Unlike the 2017 tax law—which created new incentives to shift profits and jobs overseas—this reform ends these incentives, increasing the incentive for economic activity in the United States. In addition, the revenue from these reforms will enable more fiscal stability, allowing possible fiscal space for investments that would boost the long-term competitiveness of the U.S. economy.

Further, it is important to remember that the corporate income tax is a profits tax, and as such, it is strongly countercyclical. Companies only pay corporate tax when they are profitable, and companies earning losses (or carrying them forward from prior years) pay no corporate tax. In contrast, other sources of tax revenue fall more heavily on typical American workers and families, regardless of economic conditions.

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Prepared Testimony for the Senate Budget Committee

Danny Yagan  
Associate Professor of Economics, University of California, Berkeley  
Former Chief Economist of the Office of Management and Budget  
April 18, 2023

Oral Testimony

Chairman Whitehouse, Ranking Member Grassley, and members of the Committee, thank you for the opportunity to testify before you.

Today on Tax Day, I describe two simple ways that the wealthy legally avoid taxes, and how curbing them would raise three quarters of a trillion dollars to pay for Congressional priorities and protect our fiscal path.

First, the wealthy often label their income in ways that trigger less tax. The “Gingrich-Edwards loophole” – so-named after two prominent users – is a focus of Chairman Whitehouse’s new bill today and also my academic research.

The Gingrich-Edwards loophole enables high-end workers to classify their labor income as what is called “pass-through” income and thereby escape Medicare taxes.

Coauthors and I have shown that U.S. top earners are dominated by lawyers, consultants, and managers of everyday medium-sized businesses like car dealership chains and beverage distributors.¹

If you’re a lawyer, consultant, or business manager and get paid in W2 wages like the rest of us, you owe Medicare taxes on that income.

But if you do that same work and also own part of the business you work at, you can get paid in Schedule E pass-through income and thereby escape Medicare taxes. Same labor income. But labeled in a way that triggers less tax.

The result is what the Treasury Inspector General has called a “multibillion dollar employment tax shelter”² that is unavailable to everyday Americans. Closing the Gingrich-Edwards loophole for high-end workers would raise $306 billion over the next ten years.³

Second, in research now forthcoming in the Oxford Review of Economic Policy, Greg Leiserson and I estimated that the Forbes 400 wealthiest Americans from 2010 to 2018 paid an average Federal individual income tax rate of eight percent on their full income, including capital gains on unsold stock.\(^4\)

How is that possible? Top business owners make most of their income from rising stock values. They do not pay individual income tax on that income until they sell. And if they never sell and instead bequeath the stock to their heirs, no one ever pays income tax on those billions of "unrealized" capital gains.

Think of two people who created enormous personal wealth during their lifetimes: entertainer Frank Sinatra and WalMart owner Sam Walton. At current federal tax rates, Frank Sinatra would pay about 40 percent in federal income tax on his wage income – much more than Sam Walton would pay on his stock income under low effective individual tax rates, even after factoring in corporate income taxes.\(^5\)

Congress has three options for raising effective tax rates on top business owners and closing the gap between a Sinatra tax burden and a Walton tax burden. It can raise effective corporate income tax rates, raise dividend and capital gains rates, or tax unrealized gains as in Senator Wyden’s Billionaires Income Tax proposal.\(^6\) Here, I will discuss that proposal’s child – President Biden’s Billionaire Minimum Income Tax – which has fifty-five cosponsors in the House, would cover the twenty thousand households with wealth over one hundred million dollars, and in its latest version would raise $436 billion over ten years.\(^7\)

My written testimony contains a plain-English FAQ, but here’s how the minimum tax would work. If a covered household is already paying twenty-five percent on their income including unrealized gains – like a star actor earning wages — they would pay no extra tax. But if tax-free unrealized gains allows them to pay less than twenty-five percent, they would owe a top-up payment to meet the twenty-five percent minimum.

Those top-up payments could be paid over five to nine years and would be a prepayment of capital gains tax owed upon sale, gift, or bequest.\(^8\) Charity would be exempt. Illiquid taxpayers could opt out of prepayments on their private stock gains and instead pay later with interest.


\(^8\) Prepayment could also be implemented without the minimum income tax: all wealthy taxpayers could be equally subject to prepayment on their unrealized gains, regardless of how much they pay in standard income taxes. For more on the concept of capital gains prepayment (also called capital gains withholding), see: Suez, Emmanuel,
Slow and partial prepayment on public stock gains, combined with prepayments from liquid taxpayers on their private stock gains, would preserve incentives to take companies public.

The minimum tax is flexible and makes space for compromise. For example, Congress could dial the minimum tax rate down to fifteen percent. Entrepreneurs taking a company public could be granted twenty years to pay.

I look forward to your questions.

Frequently Asked Questions about the President’s Proposal to Impose a Minimum Income Tax on the Wealthiest Taxpayers (the “Billionaire Minimum Income Tax”)?

The President’s Fiscal Year 2024 Budget includes a proposal to Impose a Minimum Income Tax on the Wealthiest Taxpayers – colloquially called the Billionaire Minimum Income Tax. Here I answer some frequently asked questions about the proposal, drawing from the description in the Department of the Treasury’s Fiscal Year 2024 Greenbook.

What is the Billionaire Minimum Income Tax?

The Billionaire Minimum Income Tax would ensure that the wealthiest households pay at least 25 percent of their income, including net unrealized capital gains, in taxes as they earn it. It works by requiring some households with over $100 million of wealth to partially prepay their future capital gains tax to meet the 25 percent overall minimum.

In September 2021, Greg Leiserson and I estimated that America’s 400 wealthiest families between 2010-2018 paid an average Federal individual income tax rate of only 8 percent on their income, including income in the form of appreciation on unsold stock and other assets. This type of income is known as unrealized capital gains, and it is taxed only if and when the owners sell the assets. If the owners never sell, the income escapes income tax forever.10

The President’s proposal would ensure that the wealthiest households pay at least 25 percent of their income including unrealized gains in Federal income tax. If an ultra-wealthy household is already paying 25 percent on their income including unrealized gains, they would pay no extra tax. But if tax-free unrealized gains allows them to pay less than 25 percent, they would owe a top-up payment to meet the 25 percent minimum.

The minimum tax would apply to the top 0.01 percent, those with over $100 million in wealth.

Initial top-up payments could be paid equally over nine years. Thereafter, any additional top-up payments could be paid equally over five years. The top-up payments would be a prepayment of tax obligations that these households will owe when they later realize their gains, either at sale (as under current law) or upon


9 I am grateful to the numerous colleagues who contributed to this FAQ.

10 For simplicity, I refer to gains on both capital and ordinary assets as capital gains, and I use the term sales to include both sales and exchanges. When an asset with gains is given to someone else, the basis of the asset carries over and the gain could be subject to tax at a future date. However, it would only be taxed if and when the recipient sells or exchanges the asset.
gift or bequest (under another Presidential proposal limited to the extremely wealthy). Illiquid taxpayers
could opt out of the prepayments entirely on their nontraded assets and instead pay later with interest.

The Treasury Department estimates that the minimum income tax would raise $437 billion over ten years.

**What would the minimum income tax achieve?**

The minimum income tax would prevent the wealthiest Americans from shielding their income from
income tax. Under the minimum income tax, the ultra wealthy would pay at least 25 percent in Federal
income taxes on their income as they earn it.

Assessing a minimum tax as capital gains income accrues would also reduce the so-called “lock-in effect,”
which would encourage investment decisions based on the productivity of the investment rather than the
structure of the tax code. The current tax system encourages the wealthy to hang on to low-return
investments, rather than reallocate that capital to higher-return investments like a promising start-up. The
reason is that, by deferring capital gains taxes, the wealthy effectively get a zero-interest loan from the
government in the amount of the deferred tax. Earning a low return with this zero-interest loan can be more
profitable than earning a higher return without this loan – creating incentives to lock in capital in the low-
return investment. The minimum income tax would reduce the amount of tax that the wealthy can defer,
thereby reducing the lock-in effect and potentially freeing up capital for more productive and efficient
investments.

**How would the minimum tax work, in practice?**

The following paragraphs walk through the example detailed in Tables 1 and 2 below. Throughout, this
FAQ assumes that other proposals included in the President’s Budget would also be in effect, including a
proposal that would tax gains for high-wealth taxpayers upon gift or bequest and thus end the provisions
that allow them to never pay income tax on their gains.

Take an example of someone who has $5 billion in taxable income (which excludes unrealized capital
gains) and pays $1.5 billion in income tax (excluding the minimum tax). Let’s say this billionaire also holds
publicly traded stock with $5 billion net unrealized gain accumulated over many years.\footnote{In practice, an affected taxpayer’s taxable income would likely be substantially smaller than their unrealized gains, but using the same value helps simplify the numbers in this example and better illustrate the operation of the tax.}

In the first year under the minimum income tax, the billionaire’s current income tax rate including
unrealized gains would be computed as 15 percent: $1.5 billion divided by $10 billion (taxable income plus
net unrealized capital gain). That billionaire would therefore owe a $1.0 billion top-up tax to meet the 25
percent minimum. $1.5 billion plus $1.0 billion equals $2.5 billion in income taxes, which is 25 percent of
his or her $10 billion in income. That $1.0 billion top-up tax would be a prepayment of the capital gains tax
owed at future sale, gift, or bequest of the publicly traded stock.

Since it is the billionaire’s first year subject to the minimum income tax, he or she could pay that $1.0
billion top-up tax over nine years – that is, $111 million per year for nine years. The first column of Table
1 walks through this first-year example.
Table 1: Example Prepayments under the Minimum Income Tax

<table>
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<th>Description</th>
<th>Year under the minimum income tax</th>
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</thead>
<tbody>
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<td>First</td>
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<tr>
<td>Taxable income (excludes unrealized gains)</td>
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<td>Cumulative net unrealized gains</td>
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<tr>
<td>Income tax (excluding the minimum tax)</td>
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<td>Income including cumulative net unrealized gains</td>
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<td>Income tax rate including unrealized gains in income and excluding the minimum tax</td>
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<td>Income tax rate including unrealized gains in income before new minimum tax assessment</td>
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</tr>
<tr>
<td>Income tax rate under the minimum tax</td>
<td>25%</td>
</tr>
<tr>
<td>Years over which new minimum tax assessment can be paid</td>
<td>9</td>
</tr>
<tr>
<td>Annual installment due under new minimum tax assessment</td>
<td>$0.111</td>
</tr>
<tr>
<td>Total top-up payment collected this year</td>
<td>$0.111</td>
</tr>
</tbody>
</table>

Notes: All dollar figures are in billions.

Now let’s move to the second year. Let’s say that everything looks the same as in the first year. The billionaire again earns $5 billion in taxable income (which excludes unrealized gains) and again pays $1.5 billion in income tax (excluding the minimum tax). His or her publicly traded stock position is unchanged, meaning it still reflects $5 billion in cumulative net unrealized gains.

In the second year, the system would compute the income tax rate as exactly 25 percent because the income tax paid in this computation is deemed to include the minimum tax incurred in prior years (even if not fully paid). Thus, there would be no change to the billionaire’s scheduled installment payment from last year. He or she would pay his or her $1.5 billion in tax on taxable income plus the second annual installment of $111 million, as determined in the first year, as a prepayment of future capital gains tax.
There is a simple formula for new minimum income tax payments. The new minimum income tax in any given year equals 25 percent of the sum of taxable income and net unrealized gains, minus the sum of income tax (excluding any new minimum tax assessment) and any prior year minimum income top-up tax that was assessed (even if still being paid in installments). In the second year in the system, this formula would show that the example billionaire owes zero new top-up tax: 25 percent of $10 billion, minus the sum of $1.5 billion and $1 billion.

Now let’s move to year three. Let’s say that the billionaire’s stock portfolio rises by $500 million, while everything else remains the same. The system would assess a new top-up tax of $1.25 million payable over five years in equal installments to keep the income tax rate from dropping below 25 percent. That $25 million per year for five years would be in addition to the remaining seven years of $111 million annual installments assessed in the first year.

Finally, let’s say that in year four, the billionaire sells all his or her stock and recognizes $5.5 billion of net capital gains. Let’s say that the top capital gains tax rate is 44.6 percent, as it would be under the President’s FY 2024 Budget. The billionaire would owe $2.453 billion in capital gains tax on the recognized capital gains.

In our example, the billionaire would have already prepaid $358 million of that capital gains tax under the minimum income tax. That $358 million would be allowed as a credit and reduce his or her capital gains tax due in year four from $2.453 billion to $2.095 billion. Table 2 walks through this fourth-year example. All remaining top-up tax installments due on gains in years one and three would no longer be due.

This example shows how the minimum income tax would ensure that the ultra wealthy pay at least 25 percent of their income including unrealized gains in taxes.

Table 2: Credit of Example Prepayments under the Minimum Income Tax

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Realized capital gains in year four</td>
<td>$5.5</td>
</tr>
<tr>
<td>Capital gains tax in year four</td>
<td>$2.453</td>
</tr>
<tr>
<td>Credits (cumulative paid-in prepayments under the minimum tax prior to year four)</td>
<td>$0.358</td>
</tr>
<tr>
<td>Capital gains tax due in year four</td>
<td>$2.095</td>
</tr>
<tr>
<td>Remaining top-up tax installments scheduled</td>
<td>$0</td>
</tr>
</tbody>
</table>

Notes: All figures are in billions. The top capital gains rate (inclusive of surtaxes) under the FY 2024 Budget would be 44.6 percent.

In the previous example, what would have happened in the third year if the value of the stock portfolio had fallen by $500 million rather than risen?

The system would have reduced the billionaire’s remaining installment payments by $125 million in total. Before this adjustment, the billionaire’s tax rate including all previously assessed top-up tax payments would be 26 percent. Reducing the remaining installment payments by $125 million reduces that tax rate to 25 percent.

Stocks are volatile. Won’t those subject to the minimum income tax pay huge amounts of tax in boom years and get huge refunds when their unrealized stock gains turn into losses?
A key feature of the minimum income tax is that it collects only partial prepayment of capital gains tax and does so gradually over several years. As a result, payments are smoothed over time, and taxpayers will often have paid less than their eventual income tax bill even when stock prices fall, making large refunds rare.

For example, during the tech boom of the late 1990s, tech stocks grew dramatically and then collapsed quickly. Taxpayers who bought in early and saw their wealth rise with the bubble likely would not have paid enough tax by 1999 in order to require any refund at all in 2000. In a stylized example of a taxpayer who saw their assets rise sharply beginning in 1994, he or she would have prepaid only about 9 percent of their unrealized gains in tax by 2000. If the tech stocks fell by half, that 9 percent prepayment would have translated to a 19 percent tax rate. Because the tax rate would remain less than the long-term capital gains rate, there would be no overpayment and therefore no refund necessary.

However, in some instances, some taxpayers may overpay, such as a wealthy investor who bought into the stock market in 2000, prepaid some tax in 2007, and then saw all gains wiped out in 2008. Without selling their stocks, such taxpayers would receive a refund, just as ordinary taxpayers do when they overpay via withholding or estimated tax payments. Refunds would equal the amount by which paid-in prepayments exceed the long-term capital gains rate (inclusive of surtaxes) times unrealized gains.

Charitable gifts could also trigger a refund of prior prepayments. For example, giving all of one’s appreciated assets to charity would trigger a full refund of any paid-in prepayments because the taxpayer would no longer hold assets with net unrealized gains.

What about nontradable assets? Will owners of private businesses have to sell their stock in order to pay this tax? How would valuation of nontradable assets work?

No. The minimum income tax is designed so that taxpayers would not need to sell their private business stock to pay the tax, while also limiting incentives to hold nontradable assets to avoid taxes.

Taxpayers would be treated as “illiquid” if tradable assets held directly or indirectly (e.g., via hedge funds) by the taxpayer make up less than 20 percent of the taxpayer’s wealth. Illiquid taxpayers could elect to exclude nontradable assets from their minimum income tax liability calculation and instead pay in full at realization with interest. The interest charge would not exceed ten percent of the unrealized gain. As a result, illiquid taxpayers would not need to sell nontradable assets to pay the minimum income tax.

Fully exempting nontradable assets would create strong incentives to hold wealth in nontradable assets. However, under the minimum income tax, nontradable assets would not be fully exempt. Liquid taxpayers would owe minimum income tax payments on the unrealized gains of their nontradable assets. While illiquid taxpayers would not have to make any minimum income tax prepayments on their nontradable assets, they would owe prepayments on their tradeable assets, and would owe an interest charge on the tax due on gains on nontradable assets when they realize them.

Suppose the minimum income tax had been in force by 1994. Consider a taxpayer at the end of 1994 with a portfolio of public tech stocks worth $1 billion, with $1 billion of basis. Suppose that the value of that portfolio doubled each year for the next five years and was thus worth $22 billion at the end of 1999, with $21 billion of unrealized gains. Assuming conservatively that the taxpayer had no other assets or income (which could reduce their minimum tax prepayments), they would have made $2.85 billion in minimum tax payments through tax year 1999, equal to 9.2 percent of the taxpayer’s $31 billion in unrealized gains. Suppose the portfolio declined by half in 2000 and was thus worth $16 billion at the end of 2000, with $15 billion in unrealized gains. The already-paid-in amount of $2.85 billion would be 19 percent of the taxpayer’s $15 billion in unrealized gains, far below the proposed capital gains rate.
As an example, some ultra-wealthy people hold most of their wealth in tradable assets like public company stock, while also owning sports teams that are private companies. Those taxpayers can easily prepay some tax on their teams’ unrealized gains.

Valuations of nontradable assets would not be needed annually, and modest undervaluation would be acceptable because the minimum tax merely collects partial prepayment of tax that will ultimately be collected in full later. The tax would rely on measurements of value that the taxpayer already has—such as valuations for investment, borrowing or financial statement purposes—and increase those by a conservative floating annual return in between valuations, with avenues for appeal.

**Does the law tax non-cash income in other contexts?**

Yes, regularly. For example, if Berkeley were to compensate me with a new car this year instead of cash, the law would treat that new car as income and I would pay income tax on it, just as I would for cash compensation.

There are several instances in which the tax code has for decades taxed capital gains regardless of whether the underlying assets have been sold. Gains on futures contracts are already fully taxed annually, regardless of whether they have been sold. Gains on financial securities and derivatives held by securities dealers other than for inventory are also fully taxed annually, regardless of whether they have been sold. In addition, for certain types of debt, the tax code taxes the interest earned as if there were regular interest payments even when such payments are not actually made.
Written Testimony before the U.S. Senate Committee on Budget

April 18, 2023

William McBride
Vice President of Federal Tax Policy and Stephen J. Entin Fellow in Economics, Tax Foundation

Written Testimony to the United States Senate Committee on Budget, U.S. Congress

The Size and Distribution of the Federal Tax Burden

Chairman Wyden, Ranking Member Grassley, and distinguished members of the Senate Budget Committee, thank you for the opportunity to provide testimony on the distribution of the federal tax burden. I am William McBride, Vice President of Federal Tax Policy and Stephen J. Entin Fellow in Economics at the Tax Foundation, where I focus on how we can improve our federal tax code.

Today, my testimony will focus on four points. First, I will describe the current federal tax system, showing that tax collections are near an all-time high and the burden is highly progressive. Second, I will describe how the tax code’s increasing complexity adds to this burden, raising compliance costs for taxpayers and administrative costs for the Internal Revenue Service (IRS). Third, I will describe the economic costs of the tax code’s high marginal income tax rates, which slow economic growth and reduce living standards.

Finally, I will recommend ways to reform the federal tax code to reduce complexity and improve economic incentives, grow the economy, benefit low- and middle-income workers, and raise sufficient revenues at or above current levels.

Federal Tax Collections are Near Record Highs

As a result of the economic recovery coming out of the pandemic and surging inflation, federal tax collections hit an all-time high of $4.9 trillion in fiscal year (FY) 2022 that ended September 30, topping the prior year’s record collections by $850 billion.\(^1\) As a share of gross domestic product (GDP), federal tax collections in FY 2022 reached a multi-decade high of about 19.6 percent, up from 17.9 percent in the prior fiscal year and approaching the last peak of 20.0 percent set during the dot-com bubble in FY 2000.

Only two other years in U.S. history saw federal tax collections as a share of GDP exceed the FY 2022 level, both during World War II: in 1943, federal tax collections reached 20.6 percent of GDP before falling to 19.9 percent in 1944. FY 2022 tax collections exceeded the post-war average of 17.2 percent of GDP by 2.4 percentage points.

In the most recent fiscal year, individual income tax collections contributed the most to the surge in federal tax collections, growing 29 percent to $2.6 trillion in FY 2022 from $2.0 trillion in FY 2021. Payroll taxes grew 13 percent to $1.5 trillion in FY 2022 from $1.3 trillion in FY 2021, while corporate taxes grew 14 percent to $425 billion from $372 billion, and other revenues grew 13 percent to $356 billion from $316 billion.

Individual income tax collections reached 10.5 percent of GDP in FY 2022, the highest level on record. That level substantially exceeded the prior record of 9.9 percent of GDP set in FY 2000 as well as the World War II-era record of 9.2 percent of GDP set in FY 1944.3

The surge in individual income tax revenue is partly attributable to growth in capital gains revenue due to booming stock and housing markets in 2021, itself a function of inflationary fiscal and monetary stimulus during the pandemic.4 The Congressional Budget Office (CBO) estimates that capital gains realizations and revenue roughly doubled during the pandemic years: realizations grew to $2.0 trillion in 2021 and $1.7 trillion in 2022 from $881 billion in 2019 while revenues grew to $304 billion in FY 2021 and $378 billion in FY 2022 from $169 billion in FY 2019.4

Extreme economic volatility in recent years makes it difficult to assess how tax collections have been impacted by the Tax Cuts and Jobs Act (TCJA), which was enacted in 2017. Among other changes,

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the TCJA reduced the corporate tax rate percent to 21 percent from 35 percent. Corporate and other federal tax revenues were relatively low in 2018 through the first year of the pandemic but have since rebounded with the economy and inflation. Average federal tax collections in the five years since the TCJA’s enactment are about 17.3 percent of GDP—higher than the 16.7 percent forecasted by the CBO following its passage, higher than most years before the TCJA, and higher than the post-war average of 17.2 percent.  

As the inflationary boom of 2021 has turned into a bust over the course of the last year, and as the Federal Reserve continues to raise interest rates to fight the inflation, growth in federal tax collections is likely to slow in FY 2023. On a preliminary basis, the CBO reports that federal tax collections in the first half of FY 2023 (October 2022 to March 2023) are down 3 percent from the same period in FY 2022, with individual income tax revenue down 8 percent. However, based on current projections, federal tax collections as a share of GDP will likely remain above the historical average in FY 2023.

Most of the Federal Tax Burden is Paid by High Earners

By any objective measure, the U.S. tax code is extremely progressive and very redistributive. According to the latest IRS data for 2020, the top 5 percent of taxpayers (about 7.9 million filers that earn more than $220,521) paid in aggregate $1.1 trillion in income taxes, amounting to 62.7 percent of all income taxes paid that year. The top 1 percent of taxpayers (about 1.6 million filers who earn more than $548,336) paid $723 billion in income taxes, or 42.3 percent of all income taxes paid—a larger share than the bottom 95 percent of taxpayers combined.

The share of federal income taxes paid by the top 1 percent is higher than it has been in at least 20 years, according to IRS data. In 2001, the top 1 percent’s share of income taxes paid was 33.2 percent, then fluctuated with the business cycle and the ups and downs of the housing and stock markets, before rising steadily to its current high of 42.3 percent in 2020. The top 1 percent’s share of income taxes could well go higher in 2021 and 2022 due to growth of capital gains revenue, which is paid primarily by high earners.

High income taxpayers also pay the highest tax rates, according to the IRS. The average income tax rate in 2020 was 13.6 percent. The top 5 percent of taxpayers paid a 22.4 percent average rate while the top 1 percent of taxpayers paid a 26.0 percent average rate—more than eight times higher than the 3.1 percent average rate paid by the bottom half of taxpayers. The top 0.001 percent, or the richest 1,575 tax returns filed in 2020, paid nearly $71 billion in income taxes and had an average tax rate of 23.7 percent.

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7 Internal Revenue Service, Statistics of Income, “Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates,” Table 1, and “Number of Returns, Shares of AGI and Total Income Tax, and Average Tax Rates,” Table 2, https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-rate-and-tax-shares.

FIGURE 2.  
The Top 1 Percent’s Share of Income Taxes Has Increased Over Time

 Shares of Income Taxes by Income Group, 2001–2020


FIGURE 3.  
High-Income Taxpayers Paid the Highest Average Income Tax Rates

Average Federal Income Tax Rate by Income Group,

The average tax rate for the top 0.001 percent is slightly lower than that of the top 1 percent because a larger share of the top 0.001 percent’s income is capital gains, which face a lower rate schedule. One justification for the lower rate is that capital gains income is earned in an environment where other taxes have already been applied. In particular, shareholder taxes on capital gains and dividends essentially apply on top of the corporate income tax of 21 percent. That is, the same dollar of corporate income is first taxed by the corporate income tax and then taxed again when distributed to shareholders in the form of capital gains and dividends. Note that the shares and average tax rates cited above do not reflect the additional burden of the corporate income tax.\footnote{The IRS statistics on shares and average tax rates also do not include the outlay portion of refundable tax credits, such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), which if included would reduce further the average tax rates paid by low-income filers and increase the share of federal income taxes paid by high-income filers.}

Analysis from the CBO provides a more complete picture of the distribution of the federal tax burden. When accounting for individual income taxes—including the outlay portion of refundable tax credits—corporate income taxes, payroll taxes, estate taxes, and excise taxes, CBO finds that the federal tax system, as a whole, is progressive.\footnote{Congressional Budget Office, “The Distribution of Household Income, 2019,” Exhibit 16} The latest data indicates that households in the highest income quintile paid about 69 percent of all federal taxes in 2019, and the top 1 percent of households paid about 25 percent of all federal taxes.\footnote{In CBO’s analysis, the top 1 percent income group represents about 1.2 million households. Income thresholds defining each income group vary by household size. For example, a one-person household in the top 1 percent of income earns more than $447,200 in 2019 while a four-person household in the top 1 percent earns more than $914,400.} In contrast, the bottom quintile of households paid about 0.1 percent of all federal taxes.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure4.png}
\caption{The Top 1 Percent Pays About 25 Percent of All Federal Taxes\footnote{Congressional Budget Office, “The Distribution of Household Income, 2019,” Exhibit 16}}
\end{figure}
Like the IRS data on federal income taxes, the CBO analysis indicates the share of all federal taxes paid by high earners has grown over time. For example, the share of federal taxes paid by households in the top 1 percent has approximately doubled to about 25 percent in 2019 from roughly 12 percent in the early 1980s.

Furthermore, the CBO analysis indicates that average federal tax rates increase substantially with income. For example, the top quintile of households paid an average federal tax rate of 24.4 percent in 2019 and the top 1 percent of households paid an average federal tax rate of 30.0 percent. In contrast, the bottom quintile paid an average federal tax rate of 0.5 percent, reflecting the fact that refundable tax credits for this group almost entirely offset payroll taxes and other federal taxes.

The CBO notes that within the top 1 percent’s average federal tax rates are relatively flat at about 30 percent, as the effect of lower capital gains tax rates are offset by higher average corporate tax rates. For example, the top 0.01 percent of households paid an average federal tax rate of 30.2 percent in 2019.

Over time, the average federal tax rate paid by the top 1 percent has remained within a range of about 25 to 35 percent since 1979, and as of 2019 is about in the middle of that range and close to the average of 30.5 percent over the period 1979 to 2019. However, the average federal tax rate for the bottom quintile has declined substantially, to nearly zero in 2019 due to the introduction and expansion of refundable tax credits from a high of about 12 percent in 1984.

**FIGURE 5.**

*Average Federal Tax Rates Vary Highly by Tax Type and Income Level and are Progressive Overall*

*Average Federal Tax Rates by Tax Source, 2019*

*The highest quintile has an effective federal tax rate between 0.5 and 0.6 percent.*

*Source: Congressional Budget Office, “The Distribution of Household Income, 2019,” Exhibit 13*

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58 In CBO’s analysis, 25 percent of corporate income taxes are allocated to owners of capital in proportion to their income from interest, dividends, rents, and adjusted capital gains, and 25 percent to workers in proportion to their labor income.
Data from the Joint Committee on Taxation (JCT) confirms that average federal tax rates consistently rise with income. When including all federal taxes, the bottom 50 percent of taxpayers face an average federal tax rate of 6.3 percent, compared to an average rate of 24.8 percent for the top 1 percent of taxpayers. The federal income tax is the most progressive of the federal taxes, with corporate income taxes and estate and gift taxes also adding to federal progressivity. The progressive tax sources more than offset payroll taxes and excise taxes that apply higher average tax rates to lower income groups. The JCT data also shows average federal taxes rise within the top 1 percent, from an average tax rate of 22.6 percent for those in the 99th to 99.5th percentiles of income to 32.9 percent for the top 0.01 percent of earners, representing about 15,000 taxpayers in the United States.

**FIGURE 6.**
Average Federal Tax Rates Vary Highly by Tax Type and Income Level and are Progressive Overall

Average Federal Tax Rates by Tax Source and Income Group by Percentile, 2018


**Tax Code’s Complexity Adds to the Burden**

By any measure, the federal tax code is extremely complex. Totaling more than 6,000 pages and about 4 million words (plus about 15,000 pages of associated tax law interpretations), no taxpayer can reasonably be expected to fully comprehend it.\(^{13}\) The complexity derives in part from the basic challenge of defining and taxing income, an endeavor the country embarked on more than 100 years ago. Every Congress and administration since has revised and added to an accumulating pile of deductions, credits, and special provisions. By official measures, there are now more than 200 such special provisions known as “tax expenditures,” costing about $2 trillion annually. In the last three years alone more than 100 tax expenditures have been created or amended.\(^ {14}\)


While some tax expenditures are important structural elements of the tax code, many are complicated and disproportionately benefit specific industries or types of households. The CBO finds about half of the total income tax benefits of expenditures go to high-income households.\textsuperscript{15}

The Inflation Reduction Act (IRA), enacted last year, adds several complicated provisions to the tax code, including a book minimum tax, a stock buyback tax, and more than 20 different tax subsidies for green energy. All of these require extensive regulatory guidance which continues to roll out even as much of the law took effect at the beginning of this year.\textsuperscript{16} Taxpayers, too, have highlighted several remaining concerns and ambiguities in the law (e.g., reporting requirements and applicable financial statements for the book minimum tax, and domestic content rules for the green energy tax credits).\textsuperscript{17}

The uncertainty in the law also translates into uncertainty about the budgetary costs and distributional impacts. For example, researchers now estimate the budgetary cost of the IRA's green energy credits and subsidies will exceed $1 trillion over a decade, three times the original cost estimated by the CBO and the JCT, with the benefits accruing mainly to high earners.\textsuperscript{18}

In the same month the IRA was enacted, Congress passed the CHIPS and Science Act, which provides billions of dollars of targeted (and complex) incentives and investment tax credits for semiconductor manufacturing, along with a variety of eligibility and reporting requirements.\textsuperscript{19}

In 2022 (before the IRA or the CHIPS Act), Americans spent more than 6.5 billion hours trying to comply with the tax code, according to the latest estimates from the White House Office of Information and Regulatory Affairs (OIRA).\textsuperscript{20} Based on wage and benefits estimates for tax preparers and certified public accountants, we estimate the hourly compliance costs of the tax code equates to about $313 billion each year in lost productivity, or 1.4 percent of GDP.\textsuperscript{12} The compliance burden for individual taxpayers is nearly $74 billion annually, while the burden on corporate entities of complying with just their income tax returns is more than $60 billion. Much of the remaining $179 billions of

34 tax-compliance-costs-irs-regulations/.
costs comes from complying with hundreds of other business tax forms and regulations, such as those relating to depreciation and amortization. Compliance with income tax returns for estates and trusts costs $18 billion a year, approaching the amount of tax revenue raised by the estate tax.

Our estimate of compliance costs does not include the cost of tax planning, which is a significant industry on its own. Nor does it include the cost of uncertainty in the law for taxpayers, which makes planning for taxes as well as investment and other economic activities difficult and costly.

The majority of the compliance burden is from the complex taxing of business income, which involves tracking and reporting multiple items of income and expense to arrive at net taxable income and allowing offsets from net income to account for past losses (in a typical year roughly 40 percent of companies are in a loss position). In addition, the U.S. tax code contains several business credits, exclusions, and other special provisions that increase compliance costs. Multinational corporations face a slew of complex provisions that subject various types of foreign income and cross-border transactions to tax, including Subpart F, Global Intangible Low-Taxed Income (GILTI), Foreign-Derived Intangible Income (FDII), and Base Erosion and Anti-Abuse Tax (BEAT).

For individual filers, compliance costs generally increase proportionally with income, such that most of the compliance burden is borne by high earners. High earning individuals typically have multiple sources of income beyond wages, including capital gains, dividends, rents, royalties, and pass-through business income from partnerships and S corporations (income from these business forms is subject to individual income tax rather than corporate income tax).

Another aspect of the tax code’s complexity is the administrative costs and challenges for the IRS, an agency whose responsibilities have grown well beyond simple revenue collection to include administration of subsidies and benefits relating to children, health care, education, housing, energy, the environment, economic stimulus, and more. Pursuant to its expanded role, in FY 2021 the IRS processed some 261 million returns and forms and received some 4.7 billion pieces of information, detailing the composition and activities of nearly every American household and business. In recent years, the IRS has found itself literally buried in paperwork, resulting in processing delays, millions of returns backlogged, and poor customer service. Last year, for instance, the IRS answered only about 13 percent of the 173 million phone calls it received from taxpayers asking for help; those who got through waited an average of 29 minutes. Clearly, administrative challenges at the IRS are also problematic for taxpayers.

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A report from the Government Accountability Office (GAO) sheds light on the challenges faced by the IRS and taxpayers as a result of the increasing complexity of the code. The report finds that the average number of hours the IRS spends per audit has increased by about 30 percent in recent years, to 6.5 hours in 2021 from 5.0 hours in 2010. The increase is concentrated in high-income returns. Average hours per audit increased 209 percent for incomes of $5 million and above, to about 58 hours in 2021 from about 19 hours per return in 2010. Average hours per audit increased 118 percent for incomes between $500,000 and $5 million, to 34 hours from about 16, and 103 percent for incomes between $200,000 and $500,000, from about 10 to 21 hours. In contrast, audits for incomes below $200,000 took considerably less time—about 2 hours on average for incomes below $25,000, and 6 hours for incomes between $25,000 and $200,000. This remained stable over this period.

The GAO report notes that IRS officials attribute the increase in average audit hours to "greater complexity of higher-income audits and increased case transfers due to auditor attrition." The GAO report mentions several legislative changes that have added to the IRS’s responsibilities in recent years, including the Patient Protection and Affordable Care Act, the Foreign Account Tax Compliance Act, the TCJA, as well as some 496 million stimulus payments totaling $837 billion as part of the CARES Act and other pandemic relief packages. (Note the GAO report was published before enactment of the IRA or CHIPS Act.)

As a measure of the efficiency of audits, or the "bang for the buck," the GAO compared the recommended additional tax with hours spent on audits. The GAO found that audits of the highest income returns—those with income of $5 million or more—resulted in the highest amounts of recommended additional tax per audit hour ($4,880 in 2021), followed by audits of those claiming the EITC ($3,130) and those reporting less than $25,000 of income ($2,120). In aggregate, the majority of the total recommended additional tax came from audits of taxpayers with income below $200,000. On average, roughly half of recommended additional amounts are ultimately collected, however the collection rate for EITC returns exceeds 70 percent since these audits are typically done prior to issuing refunds.

Lastly, the GAO report documents that audit rates for individual income tax returns have decreased for all income levels, dropping to 0.25 percent in 2019 from an average of 0.9 percent in 2010, which IRS officials attribute mainly to reduced staffing as a result of reduced funding. Audit rates decreased the most for high earners because, according to IRS officials, these audits are generally more complex and require more staff time to complete.

Simplifying the tax code would reduce IRS resources required to more effectively administer it, including by reducing the time needed to audit the currently complex returns of high earners. A simpler tax code would also reduce taxpayer confusion so that there would be less need for the IRS to produce volumes of guidance and respond to millions of taxpayer calls for assistance. Less confusion on the part of taxpayers would also boost compliance. As the IRS Taxpayer Advocate explains: "The most efficient way to improve compliance is by encouraging and helping taxpayers to do the right thing."
thing on the front end. That is much cheaper and more effective than trying to audit our way out of the tax gap one taxpayer at a time on the back end.  

The Economic Cost of High Marginal Income Tax Rates

Decades of economic research amply demonstrates the steep cost of high marginal income tax rates that arises from disincentives to work, save, and invest. The economic harm of income taxes increases with the square of the tax rate, meaning high income tax rates come with a disproportionately large additional excess burden. This burden is over and above the tax revenue collected, manifesting itself over the course of several years as a drag on economic growth through less investment, less innovation, fewer jobs, and lower wages. 

A study based on postwar tax reforms in the United States found that reducing marginal tax rates on individual income for the top 1 percent of earners leads to increases in real GDP and declines in unemployment, with a 1 percentage point cut in the tax rate increasing real GDP by 0.78 percent by the third year after the tax change. Given the size of the U.S. economy today, that equates to about $204 billion in additional GDP for each 1 percentage point cut in the marginal tax rate on individual income earned by the top 1 percent. The study shows the benefits of the resulting economic growth would be felt throughout the economy.

In looking at the experience of developed countries over the period 1971 to 2004, researchers at the Organisation for Economic Co-operation and Development (OECD) concluded that “a reduction in the top marginal [individual] tax rate is found to raise productivity in industries with potentially high rates of enterprise creation. Thus, reducing top marginal tax rates may help to enhance economy-wide productivity in OECD countries with a large share of such industries.” The CBO modeled three types of tax increases to fund a permanent increase in government spending of 10 percent of GDP annually: a flat labor tax, a flat income tax, and a progressive income tax. The CBO found that a progressive income tax is the most economically damaging of the three options, reducing GDP by 10 percent after 10 years, and reducing lifetime consumption and hours worked, especially for younger households.

Corporate income taxes are generally more economically damaging than individual income taxes.

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36 Avishankar, Christopher Headley, Vern Arnold, Bert Bogg, Craig Development, & Laura Vartia, "Taxation and Economic Growth,”
since they make investment opportunities less profitable on an after-tax basis for corporations, reducing the likelihood that marginal investments will be pursued. In most countries including the U.S., business investment makes up the bulk of all private sector investment; more uniquely in the U.S., about half of business investment is done by corporations and the other half by pass-through businesses subject to individual income taxes.

An OECD study examining data from 63 countries concluded that corporate income taxes are the most economically damaging way to raise revenue, followed by individual income taxes, consumption taxes, and property taxes.\(^{38}\) A study on taxes in the United Kingdom found that taxes on consumption are less economically damaging than taxes on corporate and individual income.\(^{39}\) A study of U.S. tax changes since World War II found that a 1 percentage point cut in the average corporate tax rate raises real GDP per capita by 0.6 percent after one year, a somewhat larger impact than a similarly sized cut in individual income taxes.\(^{40}\) Based on U.S. state taxes, a study found that a 1 percentage point cut in the corporate tax rate leads to a 0.2 percent increase in employment and a 0.3 percent increase in wages.\(^{41}\)

Furthermore, several studies demonstrate that the corporate tax is borne in part by workers.\(^{42}\) For instance, a study of corporate taxes in Germany found that workers bear about half of the tax burden in the form of lower wages, with low-skilled, young, and female employees disproportionately harmed.\(^{43}\)

The corporate tax is also borne by owners of shares, including retirees earning considerably less than $400,000. In the short run, the JCT assumes owners of capital bear all of the corporate tax, yet that includes more than 90 million tax filers earning less than $200,000. In the long run, the JCT assumes workers bear a portion of the corporate tax, such that the burden falls on more than 150 million tax filers earning less than $200,000.\(^{44}\)

Another factor to consider regarding the corporate tax in particular is competitiveness with respect to our major trading partners, as corporate investment is highly mobile internationally and will flow to lower tax locations all else equal. The corporate tax rate reduction from the TCJA brought the U.S. closer to the average among developed countries accounting for federal and state level taxes, though it remains slightly above average. The U.S. combined federal-state corporate tax rate in 2022 was 25.8 percent, compared to 21.2 percent in the average EU country and 23.6 percent in the average OECD country.\(^{45}\)


Lastly, one of the most problematic and economically destructive aspects of the U.S. tax code is the double taxation of corporate income by the corporate income tax (and now also the book minimum tax) and shareholder taxes on capital gains and dividends. Accounting for federal and state corporate and individual incomes taxes, the top integrated tax rate on corporate income distributed as dividends is about 47 percent in the U.S., compared to an OECD average of about 42 percent. Several OECD countries have integrated corporate and individual tax codes to eliminate or reduce the negative effects of double taxation of corporate income. In the U.S., after decades of double taxing corporate income, a large share of business activity has migrated to pass-through form, which has only one layer of income tax as owners report pass-through profits on their individual income tax returns.

**Recommendations for Reform**

For several years, the Tax Foundation has observed and analyzed tax systems from around the world and evaluated them based on the principles of sound tax policy. Most tax policy experts agree that taxes should be simple, transparent, and stable over time so they are easy to understand, comply with, and administer. Another element of sound tax policy is neutrality: the tax code should generally treat taxpayers equally with minimum preferences, which extends to equal treatment of immediate versus delayed consumption via saving. A tax code that embodies these principles naturally supports economic flourishing, including plentiful jobs, growing wages, upward mobility, innovation, progress, and higher standards of living.

In our annual ranking of the most competitive tax systems, we found for the ninth year in row that Estonia has the best tax code in the OECD. This is in part because it has a fully integrated income tax system that avoids double-taxing corporate income through taxes at both the entity and shareholder levels. Instead of a complicated corporate income tax and separate rules that apply to pass-through businesses, all businesses are subject to a simple 20 percent tax on distributed profits (including dividends and stock buybacks). At the individual level, a simple flat tax of 20 percent applies to all individual income except dividends, since they are already taxed by the distributed profits tax. Capital gains are taxed as ordinary income at 20 percent. Rather than a complicated estate tax like ours that taxes accumulated savings at death, bequeathed assets are simply taxed as capital gains when sold by the heir with deductible basis determined only by costs incurred by the heir.

Simplicity and neutrality are the hallmarks of the Estonian income tax system. Taxes are so simple in Estonia that they can typically be filed in five minutes, and the cost of compliance for businesses
is among the lowest of any country. Estonia’s tax system is also very pro-growth, increasing small business entrepreneurship, investment, labor productivity and thereby wages. Estonia’s income tax system does all of this while generating substantial revenue comparable to other developed countries.

We recently analyzed the effect of a revenue-neutral reform of the U.S. tax code along the lines of the Estonian income tax system, keeping only certain features of the current code that benefit low-income households (such as the EITC and Child Tax Credit) and support saving (such as 401ks). By greatly simplifying the federal tax code, these reforms would substantially reduce compliance costs, potentially saving U.S. taxpayers more than $100 billion annually, comprised of more than $70 billion in reduced compliance costs for businesses and more than $30 billion in reduced compliance costs for individuals related to individual income and estate tax returns.

In addition to compliance cost savings, our modeling of the reform’s impacts on the U.S. economy indicates it would increase GDP by 2.3 percent in the long run, amounting to about $400 billion in additional annual output by 2032 and $1 trillion in the long run (both in 2023 dollars). These changes would increase the long-run capital stock by 3 percent, amounting to $2.1 trillion in 2023 dollars. Additionally, we estimate it would add 1.3 million full-time equivalent jobs and raise wages by 1.3 percent. By increasing GDP, we would reduce the debt burden as measured by the debt-to-GDP ratio by 5.9 percentage points over the long run.

Distributionally, we find the reform would increase after-tax income overall by 2.1 percent in the long-run, accounting for improved economic growth, with a larger boost of 2.7 percent for the bottom quintile of earners and 3.0 percent for the second quintile.

More generally, the U.S. could learn from the experience of other countries in the OECD, which rely more heavily on consumption taxes than the U.S. does. Value added taxes (VATs) are a major source of revenue in virtually every developed country except the U.S., and as the literature cited above indicates, VATs and other taxes on consumption are among the least economically harmful ways to raise revenue.

55. Over the last 10 years, Estonia’s central government tax collections from income and profit amounted to about 7.4 percent of GDP compared to 7.3 percent for the median OECD country and 8.4 percent averaged across OECD countries. See OECD Tax Revenue Statistics, https://stats.oecd.org/nfmx.aspx.
OECD countries have also tended to abandon more complicated means of taxing high earners such as wealth taxes due to their administrative and economic challenges. Rather than high capital gains taxes, or any attempt to tax unrealized capital gains, most OECD countries have lower capital gains tax rates than the U.S., and tax capital income overall at lower average tax rates.

Consumption taxes can be designed to progressively tax the consumption of higher earners without the administrative complexity and compliance costs of our current progressive income tax system. For example, by splitting the VAT base in two, businesses would pay taxes on their cash flow (sales less purchases and compensation paid), while households would pay taxes on compensation received. Applying a progressive rate schedule at the household level, with the top rate matching the rate on business cash flow, is a relatively simple way to achieve progressivity within a consumption tax. Under a more standard value-added tax, the most efficient way to increase progressivity would be to offer targeted relief to lower- and middle-income households.

**Conclusion**

We as a country have built a federal tax system that is inherently complex, costly, and controversial, one that is centered on taxing both individual and business income at progressive tax rates and littered with various preferences. To the extent it is comprehensible at all, taxpayers do not perceive it as fair. The IRS has real challenges administering such a complicated tax system, but boosting the IRS budget will not fix the underlying problem that caused Americans to call the agency 173 million times last year asking for help.

As top priority, lawmakers should simplify the tax code so that taxpayers can understand the laws and the IRS can administer them with minimum cost and frustration. As the IRS’s National Taxpayer Advocate states in their most recent report to Congress, “Simplifying the Code is the most important step Congress can take to reduce taxpayer compliance burdens. Simplification is essential to the integrity of the U.S. tax system and will enhance voluntary compliance.” We have outlined reforms that would reduce taxpayer compliance burdens by at least $100 billion per year.

Second, lawmakers should reduce the economic drag caused by the tax code, particularly as economic growth is expected to slow this year and most economists are forecasting a recession. The tax code is one of the most effective levers available to lawmakers to address this economic slowdown, but it should not be done through preferences that are targeted and complicated but instead by broadly improving

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62 See etc. de la Feria and Michael Wadpole, “The Impact of Public Perceptions on General Consumption Taxes,” British Tax Review 27.5 (Dec. 4, 2020), 657-669. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3724750 for a discussion on how other approaches, such as exemptions or reduced rates can, counterintuitively, increase regressivity by providing more benefits to higher-income households.
incentives to work, save, and invest through lower marginal tax rates on individual and corporate income.

We have shown that revenue-neutral tax reform can greatly improve economic growth, increasing GDP by 2.3 percent in the long run, adding 1.3 million jobs, and raising wages by 1.3 percent such that after-tax incomes for the bottom 40 percent of earners increase by nearly 3 percent on average. Additionally, the experience of other countries shows that taxing consumption as opposed to income raises substantial revenue in a more economically efficient way. To address distributional concerns, lawmakers can design consumption taxes to progressively tax the consumption of higher earners without the administrative complexity and compliance costs of our current progressive income tax system.

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CONTACT
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Vice President of Federal Tax Policy and Stephen J. Entin Fellow in Economics
wmcbride@taxfoundation.org

The Tax Foundation is the nation’s leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and global levels. We are a 501(c)(3) nonprofit organization.
Questions for the Record
From: Ranking Member Chuck Grassley
To: Dr. Kimberly Clausing
“A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations.”
April 18, 2023
Senate Budget Committee

Question #1:

You have been supportive of efforts by the Organization for Economic Cooperation and Development (OECD) to implement a 15% minimum tax rate on multinational enterprises, otherwise known as Pillar Two. I understand Treasury has asserted that Pillar Two is compliant with tax treaties, but it has failed to provide any legal analysis to justify that assertion. There is concern among many that the Pillar Two undertaxed payment rule (UTPR) is inconsistent with our bilateral tax treaties.

Treasury has justified its position that Pillar Two is consistent with tax treaties by merely pointing to “A consensus statement by all Inclusive Framework members that Pillar Two was intentionally designed so that top-up tax imposed in accordance with those rules will be compatible with common tax treaty provisions.”

So far there is no consensus as to whether Pillar Two is compliant with tax treaties, no ruling from any judicial body has been made, and a vigorous debate is still ongoing.1 Do you acknowledge that it remains an open question as to whether or not Pillar Two is in fact in compliance with our tax treaties?

Answer: My best understanding of the legal scholarship in this area is that Pillar Two is compliant with tax treaties. While I understand that there have been some creative arguments that disagree with this view, my understanding is that the best legal analysis finds Pillar Two compliance with tax treaties to be straightforward and clear. Some selected example articles are listed below.

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**Question #2:**

Senator Whitehouse has selectively expressed interest in the funding received by organizations represented only by Republican witnesses at the hearings. You are a nonresident senior fellow at the Peterson Institute for International Economics (PIIE). According to PIIE 2022 annual report, 40 percent of its operating revenue comes from corporate donors, including many large multinational corporations – such as Amazon and Google – that have been accused of using tax planning strategies to pay little or no income tax in certain years. PIIE also receives support from Chevron Corporation, Shell plc, and Exxon Mobile Corporation. While your own research is generally critical of large multinational corporations, PIIE performs a wide range of research in many areas, some of which may be beneficial to these companies. According to the chairman, these large donations affect the research and decisions made by the organization and its staff. Under the Chairman’s reasoning, these major multinational companies don’t just give large amounts of money to organizations for nothing. Do you agree that large multinational corporations may be trying to influence or actually do influence the work of PIIE or its researchers through large dollar donations? Given such a large portion of PIIE’s funding comes from large multinational corporations, can you be certain that PIIE management or its researchers haven’t been influenced by these donations? How?

**Answer:** When I was onboarded by PIIE, it was made clear to me that the research and opinions of nonresident senior fellows are independent and not subject to any review by its donors. I am free to select topics to work on and to write according to my own views, which reflect the evidence of my own independent research. As you note in your question, some of my work is critical of the effects of the current tax system, which excessively lowers the tax burdens of some of the companies that you list. For example, as a PIIE fellow, I have recently published a “policy brief” that makes the case for the importance of the international tax agreement in addressing excessively low multinational company tax burdens. This brief was not vetted by any PIIE donors. I view my affiliation with PIIE as useful for amplifying my own work and research, and I chose the PIIE affiliation because it aligned with my desire for open economic policies (toward trade, immigration, and multinational companies), something I have long argued for, including in my book *Open* (Harvard University Press, 2019). Although I cannot speak to donor motivations,
perhaps some multinational companies support PIIE in part because they also value open economic policies.

I would also refer you to the PIIE website, which lists their policies on disclosure and transparency, and the requirement for all authors to disclose any conflict of interest for a specific project. This page also notes that the diversity of their 150 funding sources helps assure their independence and intellectual integrity. A separate link on this page lists all their policies in more detail as well as a complete list of their funders, see https://www.piie.com/about/transparency-policy.

**Question #3:**

As I noted during the hearing, I have long been a strong proponent of cracking down on tax evasion. To this end I created the IRS Whistleblower Office. According to the FY 2021 annual report, it has led to the collection of more than $6 billion from tax cheats. Based on your time working at the Treasury Department do you support this office and efforts to improve its ability to act more quickly based on information from whistleblowers?

**Answer:** Thank you for your leadership in this area. The IRS Whistleblower Program plays an important role in addressing tax evasion, and I appreciate efforts to crack down on those evading taxes. In this regard, adequate funding for the IRS is also very important. Honest taxpayers benefit from IRS funding in (at least) two important ways. First, they receive better service: phone calls are answered, questions are addressed, and returns are processed in a reasonable time. Second, by collecting more of the tax that is due under current law, the tax gap (which measures the part of owed tax collections that are missing due to evasion) will shrink, freeing up fiscal resources for deficit reduction, lower tax burdens elsewhere in the system, or higher government services. Simply put, collecting the taxes that are due from dishonest taxpayers helps the honest taxpayers shoulder less of the fiscal burden.
**Answer to Senator Crapo (Question Pasted Below):** Under current law, QBAI exempts the first ten percent return on foreign assets, and thus, it is a direct tax preference for offshore investment. (There is no parallel exemption for a return on domestic investment.) The international tax agreement does not include an equivalent to QBAI. Instead, countries that advocated for substance-based carveouts wanted to provide these carveouts to domestic entities that are part of multinational groups. This is meant to protect some return on domestic assets from falling under the reach of minimum taxation.

In the international tax agreement, the purpose of the globally agreed upon minimum tax (Pillar 2) is to put in place a floor on multinational corporate taxation, in order to reduce the pressures of tax competition. To reach this agreement, of course, the economic interests of many countries had to be coordinated, and compromise was necessary. The substance-based carve-outs were one area of compromise, but they do not detract from the large achievements of the agreement as a whole, which still places serious limits on tax competition pressures.

In addition, my own research (and that of others) has shown that reported profits are more tax-sensitive to tax differences across countries than is real activity such as jobs and investment.

Finally, it is important to note that there is no requirement that countries provide substance-based carveouts for the purposes of the agreement, countries may choose whether to do so.
QUESTIONs FOR THE RECORD
From Senator Mike Crapo
For: Dr. Kimberly A. Clausing
April 18, 2023
Senate Budget Committee
A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations

Question 1:
In your testimony you state, “The first ten percent return on foreign tangible assets is tax free, and subsequent income beyond that ten percent return is taxed at a 50 percent discount relative to domestic income. These rules provide strong incentives to move tangible assets offshore (to increase the tax-free return) and to book income offshore (to benefit from the 50 percent deduction).” This statement refers to the exclusion for a return on tangible assets (qualified business asset investment or QBAI) provided for in the global intangible low-taxed income (GILTI) minimum tax.

The Organisation for Economic Co-operation and Development (OECD) Pillar 2 minimum tax includes a substance-based income exclusion similar to QBAI. That substance-based carveout under Pillar 2, calculated as a percentage of not only tangible assets but also payroll costs, reduces a company’s profits subject to the minimum tax.

Following a March 2021 Finance Committee hearing, I asked you in a question for the record if you believed the OECD Pillar 2 proposal would encourage domestic companies to invest in foreign jurisdictions. You responded with, “OECD negotiations are ongoing and the question of excluding a normal return on assets or employment is presently unsettled.” Since then, the OECD has published its Global Anti-Base Erosion Model Rules (Pillar Two), which maintains the substance-based income exclusion, which in many respects is more generous than QBAI by taking into account a certain percentage of payroll costs.

Isn’t this type of exclusion a normal feature of a global minimum tax because there is a recognition that profits attributable to hard assets are less susceptible to profit shifting, and returns on hard assets are normally taxed by the local jurisdiction? Do you believe the substance-based income exclusion under the OECD Pillar 2 proposal would encourage domestic companies to invest in foreign jurisdictions?
Questions for the Record
from Senator Wyden
for Dr. Kimberly Clausing
"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations*
April 18, 2023
Senate Budget Committee

Question #1:

The Finance Committee has been leading an investigation into the profit shifting tactics of major pharmaceutical companies. The lion’s share of the revenue earned by Big Pharma is coming from the pockets of Americans who pay huge prices for necessary drugs. While Americans are paying for these drugs, the profits are showing up in low-tax jurisdictions offshore.

A number of proposals on international tax – the international tax reform framework produced by, Senators Brown, Warner, and I, work by Chairman Whitehouse, legislation passed by the House of Representatives in 2021, and proposals from the Biden administration – all row in the same direction. These proposals raise the rates on offshore income, shift to a country by country system, and have a design that is smarter and with fewer incentives to offshore jobs and profit.

Would these proposals address the problem that our investigation is highlighting, of American companies selling high-priced drugs to American consumers and patients, but having all that profit show up in tax havens all across the globe?

Answer: Absolutely, these four proposals would certainly reduce the size of that problem. A root issue behind corporate tax base erosion and profit shifting is the mismatch between where economic activity is occurring and where profits are being reported for tax purposes. That mismatch is fueled by large discrepancies between the tax treatment of domestic income (which is taxed at the full domestic rate) and the tax treatment of foreign income reported in jurisdictions that offer very low, sometimes even zero, tax rates. Under the four proposals that you mention (the Finance committee’s framework, Chairman Whitehouse’s bill, the House passed 2021 legislation, and the Biden administration proposals), the incentive to shift profits (and activities) offshore would be reduced substantially relative to current law. In all cases, profit earned in a tax haven abroad would face an immediate minimum tax calculated on a country-by-country basis. This type of minimum tax would reduce the incentive to earn income offshore, and it would also reduce the incentive for offshore jurisdictions to offer rock-bottom tax rates in the first place, buttressing the domestic corporate tax base.
Questions for the Record
From: Ranking Member Chuck Grassley
To: Dr. Danny Yagan
“A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations.”
April 18, 2023
Senate Budget Committee

Question #1:

Dr. Yagan, in your testimony you discuss “two simple ways that the wealthy legally avoid
taxes.” I would like to discuss a third and even simpler method that existed prior to enactment of
the Tax Cuts and Jobs Act (TCJA). Prior to TCJA, millionaires could take advantage of an
unlimited state and local tax, or SALT, deduction to avoid paying hundreds of thousands of
dollars in federal taxes. TCJA fixed this by capping the SALT deduction at $10,000. However,
many of my Democrat colleagues now want to repeal this cap. Who would be the primary
beneficiaries of such a change?

Answer #1:

According to an analysis by the Tax Policy Center, the primary beneficiaries of such a change
would be families in the top quintile of the income distribution. Source:
https://www.taxpolicycenter.org/model-estimates/repeal-10000-state-and-local-tax-salt-
deduction-limitation-sep-2018/t18-0140-repeal

Question #2:

Senator Whitehouse has selectively expressed interest in the funding received by organizations
represented only by Republican witnesses at the hearings. You are Director of the Taxation and
Inequality Initiative of the Berkeley Opportunity Lab. Please provide the names of all individuals
and entities that have provided funding to the Berkeley Opportunity Lab and its Taxation and
Inequality Initiative as well as the amounts of those donations.

Answer #2:

Here is a list of all non-de-minimis contributions to the Berkeley Opportunity Lab since its
founding in 2016:

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Question #3:

As I noted during the hearing, I have long been a strong proponent of cracking down on tax evasion. To this end I created the IRS Whistleblower Office. According to the FY 2021 annual report, it has led to the collection of more than $6 billion from tax cheats. Based on your time working at the Office of Management and Budget, do you support this office and efforts to improve its ability to act more quickly based on information from whistleblowers?

Answer #3:

Tax evasion is illegal and worsens our fiscal path. Information provided by whistleblowers to the IRS Whistleblower Office is a useful tool in enabling the IRS to combat tax evasion, especially complex illegal tax schemes utilized by the wealthy. I support that office and would support additional efforts to improve the IRS’s ability to fairly and effectively implement the tax code.

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</table>
Questions for the Record
from Senator Wyden
for Dr. Danny Yagan
"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations"
April 18, 2023
Senate Budget Committee

Question #1:

There are two tax codes in America. The first is mandatory for workers who pay taxes out of every paycheck. The second is voluntary for billionaires who defer paying taxes for years, if not indefinitely.

These two tax codes allow billionaires to use untaxed income from wealth to build more wealth, while working families struggle to balance the mortgage against groceries, and utilities against saving for the future.

That’s why it’s time for a Billionaires Income Tax to ensure billionaires pay tax every year, just like working Americans. No working person in America thinks it’s right that they pay their taxes and billionaires don’t.

My Billionaires Income Tax would require billionaires to pay taxes on gains from assets like stocks every year. For assets that are harder to value like real estate or businesses, billionaires would have to pay interest on deferred tax when they sell, making up for the many years that they grew their wealth tax-free.

In your view, how would the Billionaire’s Income Tax help restore fairness to our tax code, and ensure the wealthiest Americans pay their fair share?

Answer #1:

Top corporate stock income is taxed at relatively low effective tax rates, and the Billionaire’s Income Tax would counteract that inequality. In research now forthcoming in the Oxford Review of Economic Policy, Greg Leiserson and I estimated that the Forbes 400 wealthiest Americans from 2010 to 2018 paid an average Federal individual income tax rate of eight percent on their full income, including capital gains on unsold stock. That finding indicates that top business owners pay lower effective tax rates than top laborers who earn a paycheck. At current federal
tax rates, top laborers like actors and athletes pay about 40 percent in federal income tax on their wage income—significantly higher than what top business owners pay on their stock income under low effective individual income tax rates, even after factoring in corporate income taxes. The Billionaires Income Tax would work to counteract that inequality in tax burdens by raising effective individual income tax rates on top business owners.
Questions for the Record
From: Senator Sheldon Whitehouse
To: Dr. William McBride

"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations."

Senate Budget Committee

April 18, 2023

Question #1:

Please disclose the identities of all individuals, corporations, donor-advised funds, charitable organizations, and any other entities that have provided funding to the Tax Foundation since the United States Supreme Court’s decision in Citizens United v. Federal Election Commission, 558 U.S. 310 (2010), as well as the amounts of those donations. For all donor-advised funds and other similar entities that have provided funding to the Tax Foundation during this period, please also disclose the original organization that made the contribution to that entity.

Tax Foundation receives support from a diverse group of generous contributors. As a 501(c)(3), we work diligently to adhere to all public disclosure obligations as required by law, which are well-documented in the public domain. Placing a high premium on the privacy of our charitable supporters and in adherence with the Donor Bill of Rights, we do not disclose information outside the scope of those documents.

Question #2:

Over the last five years, what percentage of the Tax Foundation’s funding has come from corporate sources?

Tax Foundation receives support from a diverse group of generous contributors. As a 501(c)(3), we work diligently to adhere to all public disclosure obligations as required by law, which are well-documented in the public domain. Placing a high premium on the privacy of our charitable supporters and in adherence with the Donor Bill of Rights, we do not disclose information outside the scope of those documents. In the interest of transparency, we disclose information regarding our financial status and health by publicizing our annual audits. These are accessible on the Tax Foundation website.
Question #3:

Of the ten members of your Board of Directors, how many have received money from a corporation for services provided while serving on the Board? Please provide the name of the board member, the corporations from which they have received money while a member of the Board, and the amounts paid while a member of the Board.

In the interest of privacy protection, Tax Foundation does not require a full financial disclosure from its board of directors but does require that each board member sign a conflict of interest policy annually, which requires disclosure of any potential conflicts of interest. Apart from this disclosure, Tax Foundation does not control, or have requirements related to, the employment or other personal financial matters of its directors. As officers of the organization, Tax Foundation’s directors are also subject to its annual audit; Tax Foundation relies on these independent auditors to identify and raise any issues of concern.
Questions for the Record
From: Ranking Member Chuck Grassley
To: Dr. William McBride

"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations."

Senate Budget Committee
April 18, 2023

Question #1:

Dr. McBride, last year several energy tax incentives were enacted as part of the so-called Inflation Reduction Act that Democrats rushed through Congress. Recent estimates suggest that these incentives could cost the federal government more than $1.2 trillion.

Can you comment on analysis from the liberal Tax Policy Center that has also been cited by Jason Furman, showing that these energy provisions will predominantly benefit wealthy taxpayers?

As noted in my written testimony, researchers now estimate the budgetary cost of the Inflation Reduction Act’s green energy credits and subsidies will exceed $1 trillion over a decade, three times the original cost estimated by the Congressional Budget Office and the Joint Committee on Taxation, with the benefits accruing mainly to high-income earners.

Much of the cost results from about a dozen different investment and production tax credits that subsidize certain companies engaged in eligible activities, subsidies that largely benefit shareholders in the short run and workers (to a degree) in the long run. For instance, the Tax Policy Center (TPC) finds that in 2027, about 26 percent of the benefits of the investment tax credits will accrue to individual filers earning over $1 million, and more than 60 percent will accrue to filers earning over $200,000. TPC finds that about 9 percent of the benefits of the production tax credits will accrue to individual filers earning over $1 million and more than 65 percent will accrue to filers earning over $100,000.

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The remainder of the cost is from various individual tax credits for electric vehicles (EVs), solar panels, and other climate-oriented luxury goods that appeal to high-income earners. According to TPC, about 5 percent of the benefits of the IRA green energy tax credits for individuals will accrue to filers earning more than $1 million, and more than 50 percent will accrue to filers earning over $200,000.

The benefits of the EV credits are likely further skewed to high-income earners as a result of recent regulatory guidance from the Biden administration. While the IRA legislation limited the full EV credit of $7,500 to filers earning below $300,000, and for cars with a sales price below $55,000 (and SUVs and trucks below $80,000), regulatory guidance has allowed consumers to avoid these limitations by leasing rather than owning. As detailed in a recent New York Times article, the share of EV consumers that lease rather than own has grown to 34 percent as of March, compared to 7 percent last September, the month after the IRA was enacted.

Based on analysis by TPC and the updated revenue estimates for the IRA’s green energy tax credits, Jason Furman estimates that the credits disproportionately benefit high-income earners. For instance, the top 1 percent of earners in 2027 receive a benefit of more than $11,000, raising their after-tax income by 0.5 percent. In contrast, the bottom quintile of earners receive a benefit of less than $100, raising their after-tax income by 0.3 percent.

**Question #2:**

Dr. McBride, your testimony highlights how complexity in our tax code often benefits the wealthy. Yet, many of the proposals advocated by the left to raise taxes on the so-called rich are themselves highly complex and prone to gaming. A prime example of this is the so-called billionaire’s minimum tax advocated by Dr. Yagan, which would subject “unrealized gains” to tax.

Can you explain the administrative complexity of such a tax and any of its unintended economic consequences?

The administrative complexity of the billionaire minimum tax on unrealized capital gains derives in large part from the challenge of establishing the value of the gains in the absence of a market transaction. This is one reason why the legal standard regarding income taxation for more than 100 years has been the realization principle, meaning that income is not subject to tax until it is realized, and the capital gain is realized when the asset is sold. Realization establishes a clear taxable event and taxable income amount with minimal controversy between the taxpayer and the IRS.

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In contrast, attempting to tax unrealized gains would require a new annual reporting and assessment of gains by the taxpayer (a new compliance cost), a corresponding alternative assessment by the IRS (a new administrative cost), and a process for appealing, adjudicating and settling the inevitable disputes (additional compliance and administrative costs). Administratively, this would be akin to expanding the estate tax to an annual wealth tax, as wealth and changes in wealth would need to be determined annually for some 20,000 filers, which is about three times the number of estate tax returns filed in a typical year. The administrative challenge and controversy around valuing estates results in disputes with tax authorities that can take a decade or more to resolve.

Like the estate tax, this tax would likely open up a new set of tax planning opportunities (e.g., the use of debt to offset net worth), requiring a new set of anti-abuse rules and corresponding administrative and compliance costs. Research has shown the compliance costs associated with the estate tax, currently estimated at $18 billion annually, approach and often exceed the amount of tax revenue collected.

Taxing unrealized gains would amount to an additional penalty on saving and investment and could particularly harm incentives for entrepreneurs to start new companies and build them into successful enterprises. It would give foreign savers, investors, and entrepreneurs an advantage, so foreigners would finance and own a larger share of U.S. investment.

The mobility of capital is one reason OECD countries have tended to abandon more complicated means of taxing high-income earners such as wealth taxes, as the administrative and economic challenges outweigh any benefits in terms of tax revenue. Rather than high capital gains taxes, or any attempt to tax unrealized capital gains, most OECD countries have lower capital gains tax rates than the U.S. and tax capital income overall at lower average tax rates.

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11 For example, the estate of Michael Jackson was in legal limbo for 12 years after his death with the final valuation at less than a quarter of the original estimated by the IRS. Anousha Sakai, “Michael Jackson’s Estate Won’t Face the IRS,” Los Angeles Times, May 3, 2021, https://www.latimes.com/entertainment/arts/business/la-fi-michael-jackson-estate-tax-war-20210503/.
Question #3:

Frequently, the Tax Cuts and Jobs Act enacted in 2017 is misleadingly described as “tax cuts for the rich.” However, the reality is that the 2017 tax reform bill lowered taxes across-the-board.

According to a 2021 CBO report, all income groups saw a tax cut in 2018 on average, and the share of federal taxes paid by the top 20 percent of households increased.

Can you expand upon how the 2017 tax bill lowered taxes for the vast majority of taxpayers and how many of its features promote economic growth and higher wages?

The Tax Cuts and Jobs Act (TCJA) reduced income tax rates broadly for individuals and corporations: for individuals through a set of tax cuts that apply from 2018 to 2025—including lower statutory income tax rates on individual income, a larger standard deduction, and a larger child tax credit—and for corporations mainly through a permanent reduction in the statutory corporate income tax rate from 35 percent to 21 percent as well as temporary 100 percent bonus depreciation (allowing companies to immediately deduct the full cost of investment in equipment) from 2018 to 2022, phasing out thereafter.

Similar to analysis by the CBO, in 2018 the Tax Foundation analyzed the distributional impact of the TCJA and found it would reduce taxes and raise after-tax incomes for all income groups from 2018 to 2025, the period in which the law’s individual income tax cuts apply. For example, we found the TCJA would raise real (inflation-adjusted) after-tax incomes for all quintiles of earners in 2022: by 0.9 percent for the bottom quintile, 1.6 percent for the middle quintile, and 2.4 percent for the top quintile.

Also similar to analysis by the CBO, we found that the TCJA would improve incentives to work, save, and invest by lowering marginal income tax rates that apply to labor and capital income, resulting in more investment, more labor supply, and faster economic growth. Lowering the corporate tax rate in particular improved the long-run health of the economy by reducing the tax burden on corporate investment, while bonus depreciation reduced the economic harm of both the corporate tax and individual income taxes on pass-through business income, boosting business investment incentives broadly, albeit on a temporary basis.

We found the TCJA’s positive impacts on the economy would build over time and by 2025 would result in a 3.0 percent increase in GDP, a 6.4 percent increase in the capital stock, and a 1.7 percent increase in real wages. The improved economic growth would translate into larger incomes for all income groups. For example, accounting for the growth effects, we found the TCJA would substantially raise real after-tax incomes for all quintiles of earners in 2025: by 3.9 percent for the bottom quintile, 4.1 percent for the middle quintile, and 4.9 percent for the top quintile.

Question #4:

At the conclusion of the hearing, Senator Whitehouse commented on the source of funding for the Tax Foundation and implied donors dictated the conclusions of your research and substance of your testimony. The Senator did not give you an opportunity during the hearing to correct his assumptions about the independence of your research and opinions.

To ensure an accurate record, is your research independent of donor influence? Please expand upon your explanation of how a vast body of empirical research supports your organization’s position on corporate income taxes.

Tax Foundation’s research is independent of donor influence. Our research agenda is guided instead by our vision for a world where the tax code doesn’t stand in the way of success. We believe that an ideal tax code follows the principles of sound policy—simplicity, neutrality, transparency, and stability—and our body of research on the application of the principles of sound policy is widely and publicly accessible.

There is a long history of economic studies showing that the corporate income tax is distorting to business investment decisions and has adverse effects on workers and wages. Research published by the OECD and many others finds that the corporate income tax is the most economically damaging way to raise revenue, followed by individual income taxes, consumption taxes, and property taxes, in that order. A study on taxes in the United Kingdom found that taxes on consumption are less economically damaging than taxes on corporate and individual income. A study of U.S. tax changes since World War II found that a 1 percentage point cut in the average corporate tax rate raises real GDP per capita by 0.6 percent after one year, a somewhat larger impact than a similarly sized cut in individual income taxes. Based on U.S. state taxes, a study found that a 1 percentage point cut in the corporate tax rate leads to a 0.2 percent increase in employment and a 0.3 percent increase in wages.

At the end of the day, the true burden of the corporate income tax falls on people: either shareholders, consumers, or workers. Several studies demonstrate that the corporate tax is borne in part by workers. For instance, a study of corporate taxes in Germany found that workers bear about half of the tax burden in the form of lower wages, with low-skilled, young, and female employees disproportionately harmed.

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The corporate tax is also borne by owners of shares, including retirees earning considerably less than $400,000. In the short run, the Joint Committee on Taxation (JCT) assumes owners of capital bear all of the corporate tax, yet that includes more than 90 million tax filers earning less than $200,000. In the long run, the JCT assumes workers bear a portion of the corporate tax, such that the burden falls on more than 150 million tax filers earning less than $200,000.28

Another factor to consider regarding the corporate tax in particular is competitiveness with respect to our major trading partners, as corporate investment is highly mobile internationally and will flow to lower tax locations (all else equal). The corporate tax rate reduction from the TCJA brought the U.S. closer to the average among developed countries accounting for federal and state taxes, though it remains slightly above average. The U.S. combined federal-state corporate tax rate in 2022 was 25.8 percent, compared to 21.2 percent in the average EU country and 23.6 percent in the average OECD country.27

Taxing corporations is a complex project that has become even more complex as business structures have evolved and as economies have globalized, resulting in escalating compliance costs for taxpayers. The corporate income tax is also a volatile revenue source. Policymakers should aim to develop a revenue mix that is sustainable over time.

Our work on the corporate income tax has focused on ways to limit its distortional effect on the economy. We have consistently focused our research on improving the treatment of capital investment through policies like full expensing, which has been shown in multiple studies to support business investment and hiring—particularly for smaller, credit-constrained businesses.28

We have also recently worked on proposals that would dramatically simplify the corporate income tax along the lines of successful reforms in other countries. Our modeling of the Estonian tax system showed that policymakers could dramatically reduce the complexity of the corporate tax, reduce the tax burden on investment, and raise revenue through other reforms.29

**Question #5:**

**Please discuss the Tax Foundation’s record of working with and recognizing tax policymakers in both parties.**

The Tax Foundation recognizes sound tax policy regardless of ideology or party affiliation. Permanent tax policy borne from broad, bipartisan agreement is the key to tax reform.

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27 Economic.

The Tax Foundation analyzed Sen. Ben Cardin’s (D-MD) progressive consumption tax, noting that his plan would “improve work, saving, and investment incentives in the United States, leading to several years of above-normal growth and to a permanent increase in the size of the U.S. economy.” Sen. Cardin’s plan is a pro-growth, revenue-neutral plan that reaches outside the box to reduce harmful individual and corporate income tax with a less harmful consumption tax while retaining progressivity.\(^\text{30}\)

Further, Senate Finance Committee Chair Ron Wyden (D-OR) put forth an energy tax reform package in 2021 that, in our words, contained “laudable aspects of this bill, both in concept and execution.” However, the bill also eliminates legitimate energy cost recovery provisions and retains the suboptimal approach to tax policy and the climate.\(^\text{31}\)

More recently, Rep. Jared Golden (D-ME) used Tax Foundation’s revenue estimates for his tax plan to balance the budget.\(^\text{32}\) We applaud Rep. Golden’s efforts to put forth a plan that would address structural budget deficits, even if some of the tax provisions would harm growth.

At our annual Tax Prom, we award our Distinguished Service Award to public figures for their efforts to advance sound tax policy. Over the past 10 years, we have honored 5 Democratic and 10 Republican officials including Sen. Ron Wyden, Sen. Max Baucus (D-MT), and Robert Stack, Deputy Assistant Secretary at Treasury Department under the Obama administration.\(^\text{33}\) Tax Prom is widely attended by elected officials and congressional staff of both parties and celebrates their hard work to improve our tax code.

At the state level, the Tax Foundation has worked with divided governments in numerous states, including Kentucky, Louisiana, North Carolina, and Pennsylvania to achieve pro-growth, sustainable tax reform that benefited taxpayers across the income spectrum and made their states more competitive. In each case, Tax Foundation experts conferred with policymakers to balance priorities and craft workable ideas that passed with significant support from both parties.


Questions for the Record
From: Senator Mike Crapo
To: Dr. William McBride

"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations."

Senate Budget Committee
April 18, 2023

Question 1

As the economy slowed in 2022 and signs are pointing to a continued slowdown this year, is it prudent to raise tax rates on job creators in this economy?

The short answer is no. It would not be prudent to raise tax rates on job creators in this economy. While forecasts are particularly murky right now, most economists are expecting a slowdown in the economy this year, rising unemployment, and potentially a recession. While the Federal Reserve is rightly focused on maintaining price stability (or returning to relatively stable prices) by raising interest rates, this has slowed, and will continue to slow, the economy. Fiscal policy should not simultaneously and unnecessarily further slow the economy by raising marginal tax rates on individual or corporate income, which would reduce incentives to work, save, and invest.

Raising income tax rates at this time would be particularly problematic because the economy is suffering from the aftermath of excessive fiscal and monetary stimulus from 2020 through 2022, which has contributed to an extreme labor shortage that continues to this day. Raising income tax rates on labor would further deter workers from entering the workforce and reduce hours worked. Raising business income tax rates, either on corporate or on pass-through businesses, would reduce incentives to invest at a time when many companies are already in retrenchment, reluctant to take on new risks and instead preserving cash in preparation for an economic slowdown.

Indeed, business taxes have recently increased in several ways, adding to the burden on investment at an inopportune time and likely contributing to the economic slowdown. The tax increases include provisions of the Tax Cuts and Jobs Act (TCJA) that went into effect last year—requiring companies to amortize R&D expenses (delaying deductions) and tightening limits on the deductibility of interest expenses— as well as this year—reducing 100 percent bonus depreciation to 80 percent (delaying deductions for equipment investment). The Inflation Reduction Act (IRA) worsened the environment for investment by adding a book minimum tax and stock buyback tax—novel tax ideas that have

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introduced a variety of uncertainties for business taxpayers as regulatory guidance continues to roll out even as the new tax liabilities are due.3

Instead, policymakers should be looking for ways to reduce the tax burden on investment and labor. One of the most readily available and effective policy solutions would be to address the scheduled business tax increases in the TCJA. We estimate that making permanent the TCJA business provisions that were in effect in 2021, including 100 bonus depreciation and full expensing for R&D, would increase GDP by 0.6 percent in the long run, increase the capital stock by 1 percent, boost wages by 0.5 percent, and add 105,000 jobs. Due to economic growth, making these provisions permanent would slightly reduce debt as a share of GDP in the long run.4

Policymakers should also consider more fundamental and holistic tax reform that simplifies the tax code, improves certainty for taxpayers, and lowers marginal tax rates on labor and capital income. We have recently worked on a proposal that would achieve these goals on a revenue-neutral basis, modeled after the successful income tax reforms that have been implemented in Estonia, which we find would enhance economic growth and opportunity broadly. Our modeling of these reforms implemented in the U.S. indicates GDP would rise by 2.3 percent in the long run, the capital stock would grow by 3 percent, wages would increase by 1.3 percent, and 1.3 million jobs would be added. In addition, the simplification of the tax code would save U.S. taxpayers over $100 billion a year in compliance costs.5

Questions for the Record
From: Senator Chris Van Hollen
To: Dr. William McBride

"A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations."

Senate Budget Committee

April 18, 2023

During the hearing, we heard testimony about how capital gains are only subject to income tax at all if the asset is sold during its owner’s lifetime. When someone dies with assets that increased in value during their lifetime, income taxes are never collected on these capital gains - even if their heirs sell the asset the next day. This is due to tax-free stepped-up basis at death, which is among the largest tax breaks in the entire tax code.

Assuming that we have a tax system that taxes capital gains, do you think it is good tax policy to allow wealthy people to avoid capital gains taxes completely for themselves and their heirs by not selling investments during their lifetime?

Our federal tax system does not tax capital gains in isolation, but rather involves several important interactions that lead to double taxation of income in many cases.1 Regarding taxes at death and the issue of step-up in basis for capital gains upon transfer of assets at death, the most important interaction is with the estate tax, which under current law subjects the assessed value of a decedent’s estate above an exemption of about $12 million to a 40 percent tax rate.2 To avoid double taxation at death through the application of both the estate tax and capital gains tax, capital gains transferred at death are given step-up in basis treatment, allowing the deductible basis to be stepped up to fair market value. This approach of avoiding (further) double taxation at death has been part of the federal tax code for decades, and as such it is better than the alternative of removing step-up in basis which would mean double taxing estates in a variable and unfair way that depends on the share of the estate that is attributable to capital gains.

President Biden has proposed policies that would repeal step-up in basis, raise capital gains tax rates, and subject estates to both capital gains tax and estate tax, such that effective estate tax rates would reach 60 percent or more in some cases.3 That is a substantially higher estate tax rate than those found in most developed countries.4 Rather than high capital gains taxes, or any attempt to tax unrealized capital gains, most OECD countries have lower capital gains tax rates than the U.S. and tax

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capital income overall at lower average tax rates.5

A good tax policy would be to eliminate entirely one or the other layers of tax on accumulated lifetime savings, either the estate tax or taxes on capital gains, thus simplifying the tax code and improving incentives to save. The Tax Foundation has analyzed an intriguing and greatly simplified solution to this problem implemented in Estonia, where there is no estate tax or other taxes triggered by death but instead bequeathed assets are subject to capital gains tax when sold by the inheritor and deductible basis is determined only by costs incurred by the inheritor (zero basis is transferred at death).6 This avoids the estate tax’s considerable compliance costs and taxpayer headaches as well as the wasteful tax planning and administrative costs associated with the estate tax, which has always yielded very little tax revenue for the federal government. In most years, the compliance costs alone from the estate tax approach the amount of revenue collected.7

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April 17, 2023

IRS achieved 87% Level of Service, answered 2 million more calls through live assistance, cut phone wait times by 85%

WASHINGTON - Thanks to Inflation Reduction Act resources, the IRS delivered dramatically improved service in Filing Season 2023. The IRS achieved 87% Level of Service, exceeding Secretary of the Treasury Janet L. Yellen’s goal of 85%. The agency also answered 2 million more calls through live assistance, cut phone wait times to four minutes from 27 minutes, served 100,000 more taxpayers in person, digitized 80 times more returns than in 2022 through the adoption of new scanning technology, cleared the backlog of unprocessed 2022 individual tax returns with no errors, launched two new digital tools, and enabled a new direct-deposit refund option. This marks a vast improvement over 2022, when, due to a lack of resources, the IRS hit just 15% Level of Service to taxpayers and millions of refunds were delayed for months.

SIGNIFICANTLY IMPROVED PHONE SERVICE – 2 MILLION MORE CALLS ANSWERED BY IRS CUSTOMER SERVICE REPRESENTATIVES, WAIT TIMES UNDER 5 MINUTES

• Thanks to the 5,000 new hires made possible by Inflation Reduction Act resources, IRS customer service representatives answered more than 6.5 million taxpayer calls this year, 2.4 million more calls with live assistance since the start of the year through April 7, compared to the same period in 2022.

• IRS cut phone wait times to four minutes, down from 27 minutes in Filing Season 2022.

• IRS achieved an 87% Level of Service with live assistance this filing season, exceeding the 85% goal set by Secretary Yellen last year. This is a more than fivefold increase in Level of Service over Filing Season 2022.

• The IRS integrated new technology features like customer callback options, which will be available for 95% of taxpayers calling for toll-free live assistance by the end of July 2023.

REOPENED TAXPAYER ASSISTANCE CENTERS (TACS) NATIONWIDE – 92% OF TAC’S OPEN BY EARLY APRIL

- IRS hired hundreds of new TAC employees, with 335 TACs open in this Filing Season including 17 new or newly re-opened TACs that were closed last year. IRS served 428,000 taxpayers in-person as of March 31—107,000 more taxpayers than during the same period last year. (92% of TACs were open as of early April, with several scheduled to open in the coming weeks.)

- Since the beginning of the year, the IRS reopened TACs in Casper, Wyo.; Binghamton, N.Y.; West Nyack, N.Y.; Overland Park, Kan.; Longview, Texas; Santa Fe, N.M.; Queensbury, N.Y.; Charlottesville, Va.; La Crosse, Wis.; Cranberry Township, Pa.; Colorado Springs, Colo.; Joplin, Mo.; Jackson, Tenn.; Augusta, Maine; Bellingham, Wash., and Trenton, N.J. IRS also opened a new TAC in Greenville, Miss.

- The IRS hosted Taxpayer Experience Days in more than 100 TAC locations to provide Saturday in-person help, a key service for taxpayers who are unable to visit a TAC during the week.

- IRS in 2024 will continue to expand in-person services to reach more communities. IRS is working to give taxpayers information about wait times for on-demand service so they can better plan their visits and improve scheduling capabilities for in-person appointments.

EXPANDED DIGITIZATION TO ELIMINATE PAPER BACKLOGS – 80X MORE SCANNED RETURNS THAN 2022

- The IRS manually enters the numbers from paper returns into its computers one digit at a time. Automating this process is one of the highest priorities as the IRS upgrades technology.

- Thanks to additional Inflation Reduction Act resources, the IRS hit a major milestone in adopting new technology that will enable the automation of the scanning of millions of individual paper returns, scanning 470,000 940 forms as of April 13. In the first quarter of the year, IRS scanned 80 times more returns than in all of 2022.

- The IRS has expanded scanning to some of the most commonly used forms—1040 and 941—and has scanned 10,000 as of April 13. The IRS is on track to scan millions of returns this year, delivering significant service improvements for taxpayers, including faster processing and refunds.
NEW ABILITY TO RESPOND TO NOTICES AND FILE ONLINE - 9 NEW ONLINE FORMS, 72 NOTICES TO COME

- Taxpayers are now able to respond to notices online and have new online filing options. Until this filing season, when taxpayers received notices for things like document verification, they had to respond through the mail. Taxpayers are now able to respond to nine of the most common notices for credits like the Earned Income and Health Insurance Tax Credits online, saving them time and money.

- The IRS plans to expand this tool to allow taxpayers to respond online to 72 of the most common notices they receive through the mail. This will make it significantly easier for individuals and small businesses to resolve issues and get their refunds in a timely manner.

- The IRS launched an online portal to allow businesses to file Form 1099 series information returns electronically. These forms previously needed to be submitted through the mail. Small business owners often prepare their own taxes, rather than hire professional preparers, and this new tool is saving millions of small business owners time and money.

NEW DIRECT DEPOSIT REFUND OPTION

- IRS enabled a direct-deposit refund option for 1040X amended returns. These refunds were previously only available by paper check, delaying taxpayers’ receipt of their refunds.

FOR FURTHER INFORMATION:

- Strategic Operating Plan
- govt Tools
- Taxpayer Experience Days
- Taxpayer Online Account
- Tax Information in Non-English Languages