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EXAMINING HOW THE TAX CODE AFFECTS HIGH-INCOME INDIVIDUALS AND TAX PLANNING STRATEGIES

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED EIGHTEENTH CONGRESS

FIRST SESSION

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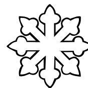

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EXAMINING HOW THE TAX CODE AFFECTS HIGH-INCOME INDIVIDUALS AND TAX PLANNING STRATEGIES

THURSDAY, NOVEMBER 9, 2023

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:07 a.m., in Room SD–215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Menendez, Carper, Cardin, Casey, Warner, Whitehouse, Hassan, Warren, Crapo, Cassidy, and Blackburn.

Also present: Democratic staff: Grace Enda, Tax Policy Analyst; Sarah Schaefer, Chief Tax Advisor; and Joshua Sheinkman, Staff Director. Republican staff: Courtney Connell, Chief Tax Counsel; Michael Gould, Tax Counsel; Gregg Richard, Staff Director; and James Williams, Tax and Economic Policy Advisor.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

This Congress, the Senate Finance Committee has investigated a number of tax schemes that the very wealthy, with the help of armies of high-priced tax lawyers and accountants, are using to pay virtually no Federal tax for years on end.

Today, we are going to examine one strategy called "buy, borrow, die." You can see those three words in back of the dais. Those three words on the chart behind me have an enormous impact from the standpoint of taxes. Here is how it works.

A corporate raider buys a business. Then, they borrow against its growing untaxed value to fund an extravagant lifestyle—everything from superyachts and luxurious vacations, expensive art deals, you name it. It just goes up and up in value, while not paying a dime in taxes. When they die, the assets are passed to the kids, often entirely tax-free, and this cycle I have described just continues.

Now let us contrast buy, borrow, die against the tax system mandated for everybody else in America. If you are a nurse or a firefighter living in Philomath, OR, you are required to pay taxes on every paycheck. Working people do not get to play by the same rules as billionaires. They do not get to call up an accountant every time they do not feel like paying taxes.

Right now, the average billionaire can wriggle their way to paying 8 percent as a tax rate, while the nurse or firefighter making

$45,000 is paying a 22-percent tax on their wages. How is that fair?

Americans overwhelmingly believe it is not fair. So it is time to look to solutions that restore fairness to the tax code, while still rewarding success. Success is what America is all about, and we want to reward it. That is what our country is founded on, that is, the idea that everybody—let me emphasize that—everybody has a chance to get ahead.

Fortunately, there is a solution that achieves both fairness and economic growth. It is called mark to market. And here is the kicker: there is already a version of mark to market in the Federal tax code. So what that means, colleagues, is we've got a blueprint right in front of us to use as a model for mark-to-market provisions that would apply to billionaires.

Put simply, mark to market would require billionaires to pay tax every year, just like everybody else. Buy, borrow, die is the primary mechanism billionaires use to avoid taxes. If left unchecked, you are inviting more gaming into the system. Ending buy, borrow, die is the best way to ensure that billionaires pay their fair share.

Tax laws just do not apply to billionaires in the same way they do to everybody else. They are optional for billionaires, where everybody else's tax rules are mandatory. It is time to close these loopholes and make sure that those at the very top are paying taxes on their income as it is earned, like everybody else.

Now, I will close with this. Our Finance team and I have been fighting tax injustices throughout this session. We investigated crooked Swiss bankers who are hiding wealthy Americans' income; $34 billion in unpaid taxes from millionaires who just do not feel like even filing a tax return; tax dodging schemes between Leon Black and Jeffrey Epstein; and Supreme Court Justice Clarence Thomas's wealthy buddy secretly forgiving a massive private loan. Americans deserve a tax system that is both fair and encourages success.

My hope is that this could be bipartisan. The invention of Roth IRAs, for example, was bipartisan, a Republican idea. Chairman William Roth helped working Americans save for the future and get ahead, and Chairman Roth, when you read the documents, always talked about being there for the people of modest means. My friend, Senator Carper, of course remembers Chairman Roth. But that is what the Roth IRA was about. It was for people of modest means.

Now the ultra-wealthy are abusing these to shield their vast fortunes from Federal tax. It is time to end this exploitation of current tax laws, and use the funds—that portion that is way, way, way up at the top for a handful—use that money to help families. For example, it could be used to get a jump start on child savings accounts, something that our colleague, Senator Bob Casey, has been working on for years.

So I have laid out just a few of the endless ways the superwealthy avoid paying their fair share, and I will close with a gut punch. Everything I have described is legal—everything; perfectly legal. I just know when I go home and I have a town meeting—I have had 1,060 of them—and I say that, people are just boiling.

"All that stuff is legal, Ron?" "Yep, all legal." And that is why people feel the deck is stacked against the working families.

Wealth continues to build up in the hands of the fortunate few, and so many are left behind. Over one-third of American families do not have the cash on hand to pay for a $400 emergency. Meanwhile, during the pandemic when families were forced to make tough choices between paying rent and buying groceries, billionaires increased their wealth by over a trillion dollars. So, time to set aside business as usual. There is growing support, in my view, in demands for solutions that restore fairness to the tax code, level the playing field for working families, and promote success.

I want to close by saying you can only have a successful economy if you have a tax code that treats everybody fairly. It is just that simple. It is past time to close the gap between those at the top and everybody else. I look forward to working with my colleagues on the committee.

It has been a busy week for the Finance Committee. Senator Crapo deserves enormous credit for yesterday, and we got a 26 to nothing vote on a really landmark health-care bill to rein in these middlemen. And probably here today we have some differing opinions, but I just want people to understand that I so appreciate Senator Crapo's willingness to debate these issues and find common ground where we can, which is quite often, as people saw yesterday.

Senator Crapo?

[The prepared statement of Chairman Wyden appears in the appendix.]

OPENING STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO. Well, thank you very much, Mr. Chairman, and I agree with you. You and I have a track record, I think, of finding the doable, where we can build consensus on a bipartisan basis. There will be a few areas where we disagree today, but I look forward to our discussion today on the effect of the tax code on individuals and families, as they work, save, and invest.

The scope of today's hearing provides members the opportunity to cover a broad range of topics, and we will no doubt hear a number of concerns raised about how the code treats high-income taxpayers. We should dispel the notion that there is any support for taxpayers who evade their tax obligations. We all agree that taxpayers should pay the tax they legally owe.

Senator Wyden indicated what he is talking about are legally undertaken activities. And for the gray areas of taxpayers who aggressively structure their affairs to reduce their tax liability, we should constantly assess how the code can better and more fairly target activities.

But framing this issue through the subjective lens of fairness often ignores the facts and turns a blind eye to favored initiatives or incentives. Rather than focusing on rhetoric, we should examine the data and how the code affects behavior. That includes examining provisions that primarily benefit a select group of the financially well off, including tax credits for those who can afford expensive electric vehicles, costly energy home efficiency upgrades, and

proposals to repeal the cap or expand the highly regressive deduction for State and local taxes. All of these primarily benefit the wealthy.

As for the data, these are the indisputable facts: most of the Federal tax burden is paid by high earners; Federal tax collections have been near all-time highs; the voluntary tax compliance rate is high and stable; and higher income taxes serve as disincentives to work, save, and invest.

My Republican colleagues and I remain focused on safeguarding taxpayers and their rights; reducing barriers to work, savings, and investment; and promoting opportunity and wealth to improve the quality of life for all Americans.

In 2017, the Republicans lowered individual tax rates across the board, with middle-income taxpayers getting the largest proportional benefit. Republicans also simplified filing for many, expanded the Child Tax Credit, and limited regressive tax spending like the SALT deduction.

Critics charged that letting Americans keep more of their earnings would stifle the economy, dry up Federal revenue, and favor the wealthy. Instead, it created one of the strongest economies in our Nation's history, including an unemployment rate that reached a generational low; increased Federal tax collections to near all-time highs; grew wages across the income spectrum; and expanded job participation. All Americans benefited.

Notwithstanding claims that high earners pay the least taxes, the reverse is actually true. According to the Biden Treasury Department, in 2023 the top 1 percent of all earners paid 42 percent of all Federal income taxes, the highest despite only earning 19 percent of all of the income. In 2001, the top 1 percent of earners contributed 33.2 percent of income tax revenue, 9 points lower. In other words, the country's income tax burden is more progressive today than it was decades ago.

Expanding the aperture to examine the top 5 percent of taxpayers, those with incomes above $200,000 a year, mirrors this same dynamic. Those Americans pay 65.3 percent of all Federal income taxes, while making only 34 percent of all income. Meanwhile, Federal tax collections have reached an all-time high of $4.9 trillion in Fiscal Year 2022, with individual income tax collections contributing the most, growing by 29 percent year over year.

In fact, individual income tax collections reached 10.5 percent of GDP in Fiscal Year 2022, the highest level on record. All of this is after the impact of the Republican-led tax reform. In arguing for tax code fairness, some have pointed to a recent tax gap projection from the IRS, which shows an increase over the previous estimate.

This growth actually shows one of the many effects of inflation. Despite headlines to the contrary, the tax gap is proportionately flat and historically average, relative to the economy's size. According to the Cato Institute's examination of the tax gap as a percentage of GDP, for 2021 that ratio was 2.9 percent, squarely in line with the 20-year average, and the voluntary tax compliance rate, around 85 percent, remains substantially unchanged.

While we should work to find bipartisan measures to narrow that tax gap, any such effort must not reduce economic growth. I look forward to hearing the perspective of today's witnesses on how the

individual tax system affects taxpayers from all income groups, and how increased taxes in the midst of high and sustained inflation would impact our economy.

Thank you, Mr. Chairman.

[The prepared statement of Senator Crapo appears in the appendix.]

The CHAIRMAN. Thank you, Senator Crapo, and I share your views that we are going to have a good debate, and I think the four witnesses that we have are going to reflect it. Let me introduce everybody. If I miss something about your background, we will make sure we get it in the full record.

Chye-Ching Huang is executive director of the Tax Law Center at NYU. I think you all are around the corner from the Strand Bookstore—I think. I know somebody there.

Senator CRAPO. You do.

The CHAIRMAN. Before starting at the Tax Law Center, she was senior director of economic policy for the Center on Budget and Policy Priorities. We have worked with her often and appreciate her expertise.

Our second witness will be Morris Pearl, chair of the Patriotic Millionaires, a group of high-net-worth Americans who support fair taxation of wealthy individuals and large corporations. He was a managing director at BlackRock, so we are going to get a very important perspective from a major investment firm leader.

Our third witness will be William McBride—we have worked with him often—vice president of Federal tax policy at the Tax Foundation. Previously, he was a manager in the National Economic and Statistics Group at PriceWaterhouse. We welcome Mr. McBride.

The fourth witness we have had often to this committee, Douglas Holtz-Eakin. I have known Dr. Holtz-Eakin for years and years, going back to our days at the CBO, and I very much appreciate having a chance to get his input. We are glad that he could be with us.

So, all our witnesses bring considerable experience in tax policy to the table. Your full statements are going to be entered into the record. We will ask that you keep your remarks to no longer than 5 minutes. And, Ms. Huang, why don't we start with you, and I think you are going to give us kind of the nuts and bolts for the operation of how this thing goes, because that is what people really want to know.

STATEMENT OF CHYE-CHING HUANG, EXECUTIVE DIRECTOR, TAX LAW CENTER, NEW YORK UNIVERSITY SCHOOL OF LAW, NEW YORK, NY

Ms. HUANG. Well, thank you, Chairman Wyden, Ranking Member Crapo, and distinguished members of the committee. I am really honored to join you today.

The highest-income filers receive tax breaks of income from wealth to the tune of hundreds of billions of dollars each year. Largely unknown to most Americans, these tax breaks increase deficits and deepen inequality. The outright tax breaks inevitably spur tax avoidance and evasion that harms the economy by locking

up capital on old investments where the tax breaks are the most lucrative, instead of it flowing to new and productive ventures.

Talent goes to waste dreaming up new tax shelters for the ultra-wealthy, instead of driving business and scientific innovation. Those who want to focus on work and entrepreneurship face competition from tax avoiders and evaders.

Here is how the system works. Tax breaks on wealth allow the highest-income filers to choose when to pay income tax, at what rate, and even whether to pay it at all. Most Americans make the bulk of their income from work, but the highest-income filers make the bulk of their income from their wealth. That is stocks and bonds, real estate, personal property like art, and ownership in pass-through noncorporate businesses. These assets throw off income, including dividends and the capital gains from when they increase in value.

But while the top rate on salaries is 40.8 percent, the top rate on long-term capital gains and dividends is dramatically lower, at 23.8 percent. And while most Americans pay taxes on salaries in the year that they earn the income, and often withheld in every paycheck, most capital gains are invisible to the tax system until they are realized; that is, when the asset that has increased in value is actually sold.

So the wealthiest filers can choose when capital gains show up on tax returns, and meanwhile they see that income in their banking statements, and they can borrow and spend against it. If they hold the assets that have gained in value until they die, then neither they nor their heirs will ever pay income tax on that gain, and that is how billions of dollars in income gets an income tax rate of zero.

These are large outright tax subsidies for wealth. JCT estimates that the zero and low rates on capital gains and dividends cost the Federal Government more than $200 billion last year, and that is more than the CHIPS and Science Act's entire investments in innovation over a whole decade.

That's also just the start of how wealthy filers can benefit from low rates on income from wealth. Their tax planning techniques can be complex, but they have a simple aim: just shift as much income from assets and work into the lowest possible tax rates on wealth. Carried interest is used by fund managers to get low capital gains rates on income from their services.

Pass-through businesses can help the wealthy to avoid income and payroll taxes, and there is an alphabet soup of other vehicles that are getting co-opted to shelter capital income from tax: things like private placement life insurance, the ETF loophole, HSAs, mega-Roths, many more.

These wealthiest filers have well-paid lawyers and accountants to set up spider webs of entities and transactions. And then sometimes this egregious but lawful tax planning goes from those gray areas and right on into tax evasion.

The complex and opaque tax system for the wealthy can also give cover to money launderers, sanctions evaders, and corrupt officials looking to hide assets and income. All income underreporting by the top 1 percent was $80 billion per year added to the tax gap of

taxes owed but not paid, and that is more than the annual budget of the Small Business Administration.

Lawmakers can move Federal and private resources away from tax breaks on wealth, and instead make better investments in the Nation's future. Various tax cuts for wealthy filers should expire as scheduled in 2025. That includes the pass-through deduction and the doubled estate tax exemption.

The IRS should have the resources and tools it needs to continue to ensure that wealthy filers pay more of the taxes that they owe, and various tax breaks on income from wealth can be repealed or scaled back so that the wealthy pay effective rates that are closer to the rates on salaries.

Members of this committee have responded over many years on a bipartisan basis to all the tax shelters that pop up to try to seek the benefit of those breaks. But they will continue to pop up unless the underlying problem is addressed.

My testimony lays out a menu of options, and I would be happy to take your questions.

[The prepared statement of Ms. Huang appears in the appendix.]

The CHAIRMAN. Very good, Ms. Huang. Thank you. And taking us through the nuts and bolts is what we are going to have to do, because I know when I bring this up at town hall meetings, people still have you take them through it once or twice. People say, "They can actually do that? It's legal?" And then you have to say, "Yes, it's legal." And so, we have some work to do to fix this, and we appreciate your leadership.

Mr. Pearl, welcome.

STATEMENT OF MORRIS PEARL, CHAIR, PATRIOTIC MILLIONAIRES, NEW YORK, NY

Mr. PEARL. Yes; thank you, Chairman Wyden and Ranking Member Crapo, and all the Senators, for giving me the honor of appearing before you today. I have had a long career on Wall Street. I currently serve as the chair of the Patriotic Millionaires. And most importantly for the purpose of this hearing, I am exactly the kind of person that our tax code is designed to advantage.

The cost of these advantages is a permanent upper hand for the wealthy over people who work for a living, the economic instability of an extreme concentration of wealth and income at the very top, an eroding consumer base and tax base, and social instability as more and more people realize that putting in a hard day's work is no longer a path to dignity and a financially stable life.

The original sin of our tax code is the way we value money and wealth above work and wages. Your constituents who work for a living have taxes deducted from their paycheck every single week. I earn money just by watching the numbers in my brokerage statement go up. I can decide to have that income become taxable if and when I feel like it.

We do not tax capital gains until the time of sale, which means for people like me, taxes are essentially optional. We can take out loans to fund living expenses and never realize capital gains—and never pay taxes on them. And when we die, thanks to the step up in basis, we are able to pass that wealth onto the next generation

completely free of income tax, and the whole buy, borrow, die process starts again.

The problem is, people who are rich do not need taxable income. They are already rich. We suggest the money made by investors should be subject to taxes, just like the money made by your constituents who work for a living, and that is the essence of the proposal from Chairman Wyden and the proposal from President Biden.

My own family benefited from the step-up basis rule, inheriting shares of stock at a gain of over 62,000 percent—62,000 percent—and we enjoyed millions of dollars of gains on which no one has ever paid any income tax, and on which no one ever will pay any income tax. And we did not need any army of lawyers or accountants. We simply followed the rules as they are written in the current tax code.

Even when I do choose to realize gains and pay taxes, the rate I pay is far below the rate of people who earn that much from their work. This is supposed to incentivize investment, but that fundamentally misunderstands what drives investors.

My options are to invest my money and get some growth or to stuff my money under my mattress or something, and mattresses do not have very high returns. Perhaps even more ridiculously, we give the same benefit to fund managers who are managing other people's investments, through the carried interest loophole. If we believe that we should be using the tax code to incentivize people to enter certain professions, I would put emergency room nurses above fund managers.

Even the wealthy people who earn most of their income from work do not experience a truly progressive tax code. Our top bracket for married couples starts at a little below $700,000. A lot of money, but we are not even talking about people in that tax bracket. We are talking about people who earn $7 million or $70 million or $700 million.

That couple earning $700,000, they pay Social Security tax on a substantial portion of their income. But the burden of that tax on a couple making $70 million is negligible, well under 1 percent of their income. Many people, including some of you on this committee, have offered serious solutions that would help reorient the way we tax the ultra-wealthy.

Your proposals to tax extreme wealth include Senator Warren's Ultra-Millionaire Tax and the OLIGARCH Act proposed by Representative Barbara Lee and others in the House. We also need to tax unrealized capital gains, as in Chairman Wyden's proposal or President Biden's proposal. To be clear, I am not against being rich. I lead an organization of millionaires. We know being rich is great. We recommend that everyone try it. [Laughter.]

But investors and businesspeople do not want a Nation with a few rich people and lots of people just struggling to get by. That is not where we can invest and build businesses. Money does not trickle down. Money trickles up from every mortgage payment and every phone bill payment you make to investors like me who invest in mortgages and phone companies. We need a Nation filled with people who have enough money to spend on things. That is what makes the economy work for everyone, including investors.

The tax code can and should be used to reduce and constrain inequality, as the status quo is doing the exact opposite.

Thank you; happy to answer any questions.

[The prepared statement of Mr. Pearl appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Pearl.

And just so we are clear, you were managing director at the major firm BlackRock, is that right?

Mr. PEARL. Yes. I was one of hundreds of managing directors there. Mostly I worked for the Federal Government, figuring out how much the bailout was costing the taxpayers when Citibank was bailed out.

The CHAIRMAN. Good.

Dr. McBride?

STATEMENT OF WILLIAM McBRIDE, Ph.D., VICE PRESIDENT OF FEDERAL TAX POLICY AND STEPHEN J. ENTIN FELLOW IN ECONOMICS, TAX FOUNDATION, WASHINGTON, DC

Dr. MCBRIDE. Thank you, Chairman Wyden, Ranking Member Crapo, and members of the committee. I appreciate the opportunity to speak with you. My testimony will focus on the size and distribution of the Federal tax burden. Over the last 2 years, we have seen an extraordinary rise and fall of Federal tax collections.

In Fiscal Year 2022, the Federal Government collected an all-time high of $4.9 trillion in taxes, nearly 20 percent of GDP, the highest level as a share of GDP in 22 years, and prior to that, World War II. In Fiscal Year 2023, Federal tax collections dropped to $4.4 trillion, or about 16½ percent of GDP.

In a typical year, more than half of Federal tax revenue comes from individual income taxes, which reached an all-time high of 10.4 percent of GDP in Fiscal Year 2022, before falling to 8.1 percent of GDP in Fiscal Year 2023. The volatility reflects broader fluctuations in the economy and financial markets, combined with the fact that a large share of Federal tax revenue comes from taxing capital gains, profits, and other volatile income sources mainly reported by high-income individuals.

The Federal tax burden over the last 2 years has, on average, been relatively high, with individual income tax collections as well as total collections well above their long-run averages since World War II, measured as a share of the economy. 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 1 percent of individual taxpayers paid a 42.3-percent share, a larger share than the bottom 95 percent of individual taxpayers combined. The top 1 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 1 percent of taxpayers paid a 26-percent average rate, more than 8 times higher than the average rate paid by the bottom half of taxpayers.

When accounting for all Federal taxes, including taxes on corporate income, payroll, estates, and other sources, the Federal tax code remains very progressive. According to the latest data from

the CBO, the top 1 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 0.1 percent of all Federal taxes, and paid an average Federal tax rate of 0.5 percent.

There is nothing simple about the way in which the Federal Government collects these taxes, especially individual and business income taxes, which in many ways are inherently complex—and various credits and preferences add to the complexity. The tax code currently totals about 4 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 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 received from taxpayers asking for help. Call volume declined this tax season, and the IRS answered a higher percentage of calls, but other metrics worsened, including longer processing delays and an increased backlog of identity theft cases.

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 concluded that corporate income taxes are the most economically damaging way to raise revenue, followed by individual income taxes, 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 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 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 taxpayer calls to the IRS every year seeking help.

As a 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 in the current environment of high interest rates and still-too-high inflation.

My written testimony outlines certain revenue-neutral reforms that would greatly simplify the tax code and improve economic growth. I am happy to discuss this further in follow-up questions.

Thank you for your time and attention.

[The prepared statement of Dr. McBride appears in the appendix.]

The CHAIRMAN. Thank you very much, Dr. McBride. I can tell you, you will have me at "hello" if we can get rid of buy, borrow, die and add some simplification to the tax system. That is a winner.

Okay. Doug Holtz-Eakin, welcome. You have been here often. Glad to have you.

STATEMENT OF DOUGLAS HOLTZ-EAKIN, Ph.D., PRESIDENT, AMERICAN ACTION FORUM, WASHINGTON, DC

Dr. HOLTZ-EAKIN. Well, thank you, Mr. Chairman, Ranking Member Crapo, and members of the committee. It is a privilege to be here to discuss these issues.

Let me begin by just putting them in context. The U.S. has two major policy problems, in my view. One is subpar economic growth over the long term; trend growth is about a percentage point lower than it was in the 20th century. And the second is, our fiscal house is fundamentally unsustainable looking forward.

Now, accepting the slower rate of growth in the 21st century has cost the average person in the United States $19,000 in real income. GDP per capita is $19,000 lower than it need be, and it means a sacrifice of about $12 trillion in Federal revenues.

So, improving economic growth will also be a route to improving our fiscal outlook. The fiscal outlook is dreadful. CBO's baseline includes $20 trillion of deficits over the next 10 years. Debt-to-GDP is going to rise from about 100 to 120 percent, and the structure of the Federal budget, these large deficits, is a headwind to growth, and threatens to further reduce the pace at which we grow.

Now, how should we address this? The bulk of the increase in deficits, as I outline in my written testimony, is going to occur on the spending side, in particular large mandatory spending programs in your jurisdiction: Social Security and Medicare. They more than explain the rising deficits over the next 10 years, and they, as a result, are the most important reforms that you can undertake.

Beneficiaries deserve having a financially sustainable social safety net. The red ink is a danger to the economy, and to reduce this will in fact improve economic growth. How does tax policy fit in this context? Well, it is imperative that we have faster and sustained economic growth, and tax policy should be, in a very disciplined way, focused on being progrowth.

That means where revenue needs to be raised, it has to be raised in the least economically damaging way possible. Consumption taxes, as Dr. McBride mentioned, are top of the list. Broadening the tax base to cover currently exempt consumption would serve to do that, and we should keep taxes on the return to saving, investment, and innovation as low and uniform as possible.

That is the recipe for supporting more rapid economic growth. It also turns out to be the recipe for getting rid of the tax avoidance that is troubling to Americans, the subject of this hearing. The recipe for putting together a tax shelter is to take advantage of the differential tax rates on corporate and noncorporate returns to capital income, to show it as interest, dividends, and capital gains. These are all legal, and they are the result of a tax code that is too complicated and sets up incentives for avoidance. It makes it

easy to do. The thing to do for economic growth is to reduce those taxes and make them more uniform. The thing to do to get rid of avoidance schemes is to reduce those tax rates and make them more uniform. So this hearing is right in line with what is necessary to support the problems that the United States faces going forward.

Finally—and I will just close—the avoidance is a very real product of the tax code as it is designed. The evasion is unforgivable, and so I think we need to simply have an IRS that is equipped, staffed, and has a mission focus that is to enforce the tax code in a fair fashion across the income distribution, and not focus mainly on high-income individuals.

Any examination of the tax gap shows that this occurs in both small businesses, large businesses, affluent, less-affluent Americans. We need an IRS that is looking for those dollars wherever they may be.

So, I thank you for the chance to be here today. I look forward to your questions.

[The prepared statement of Dr. Holtz-Eakin appears in the appendix.]

The CHAIRMAN. Thank you, Dr. Holtz-Eakin. And all of you are going to get some questions. I am going to try to take this whole tax debate, which sometimes sounds like prolonged root canal work, and put it into kind of English.

The little sign in back of us here is what is especially troubling. You can buy, you can borrow, you die, and billionaires can avoid taxes. Now, I want to ask Ms. Huang a little bit about how this actually goes down, and I want you to sort of flesh out the example that I am giving.

A corporate raider buys a business. Then the raider borrows against its growing, untaxed value, and they are doing that to fund an extravagant lifestyle. That means they can get superyachts, luxurious vacations, expensive art deals—you name it—and it just keeps going up and up in value, while not paying a dime in taxes.

Ms. Huang has been educating me on this, and when this person dies, their assets get passed to their kids, often entirely tax free. And what a surprise: the cycle just goes around and around and around. So, Ms. Huang, you are an expert in the field, and you teach it. Tell us a little bit more about how this takes place, because as far as I can tell, somebody who wants to do this, Mr. or Ms. Big, calls up their accountant and their tax lawyers and says, "Get over here." "What do you want to talk about?" "I want to make sure I do not have any taxable income this year. That is my goal. I want to make sure I do not have any taxable income this year."

So they set out to be able to do something very different than the firefighter and teacher. They do not want taxable income, and the accountant and the lawyers come over, and what do they do? I mean, how does it all go down?

Ms. HUANG. I mean, you've got it almost exactly right to start with. A couple of questions that people often ask are like, well, aren't they paying interest rates? So doesn't this cost them something? And usually the answer is, they get very low rates because they have a lot of wealth and a lot of collateral and a very low risk.

The CHAIRMAN. They get low interest rates from the bank?

Ms. HUANG. Exactly.

The CHAIRMAN. Okay.

Ms. HUANG. And then another question people ask is, well, how do they pay back those loans? And quite often they do not. They just roll them over again and again, and if they do, they might do it with some of their other sources of income that are taxed, such as dividends. Very, very wealthy people tend to have multiple sources of income.

And as you said—I mean, you could be working as a tax advisor. You laid it out so clearly. But as an advisor who works on these loans said, you can buy a boat. You can go to Disney World. You can buy a company. This is real income, and you can use it for real things, and you get stunning tax benefits because it escapes the income tax entirely.

The CHAIRMAN. And I gather there are tax lawyers and accountants who are experts at buy, borrow, die. I mean, there are people who, when they get called by a client who does not want to pay Federal income taxes, does not want to do what firefighters and nurses do, there is a pretty good squad of them who are ready to go?

Ms. HUANG. Exactly. And you know again, this is—you can do the basics of this pretty simply, but if you want to shove some of your labor income or your income for other types of assets into this scenario and also avoid the estate tax that is supposed to be a backstop on the system, that is where some of the more complex games come in.

The CHAIRMAN. Okay.

Question for you, Mr. Pearl. You come from the private sector, from a very large firm, and you basically said, you know, this idea that if you do something about fixing buy, borrow, die, that if you do, some critics will say western civilization is practically going to end, you know? We will lose investment, and there will be a parade of horribles that will be visited upon our Nation, which of course we do not want. We want people to be successful. We want everybody to be successful. I think what you have tried to do is put on the record that there is no way that is going to happen.

Well-to-do people that you have worked with are not going to, this weekend, rush out and put everything under their mattresses, to defend themselves from the U.S. Senate. They are still going to have plenty of opportunities to do well, to be successful, to invest. Is that essentially your argument?

Mr. PEARL. Yes, Chairman Wyden. We wealthy people invest money, and I would certainly rather invest my money at a high return and keep half and pay the other half in taxes, than get no return at all. Paying high taxes is great, because it means you have high income.

I think one of our issues is that many people think high-income—oh, a United States Senator has high income. No, we are not talking about people who earn a few hundred thousand dollars or a few million dollars a year. The people who would be affected by your proposals from mark to market are people who earn hundreds of millions or billions of dollars in economic income, but almost nothing in taxable income.

I think that part of the issue is, we have to redefine what we mean by taxable income as money you make regardless of how you make it. Whether it is from a paycheck or from just watching your stock market investments go up, you are making money, and you should pay taxes on that money the same as everyone else does.

The CHAIRMAN. I am well over my time.

Senator Crapo?

Senator CRAPO. Thank you very much.

It seems to me as I have listened to the testimony today, probably the major focus is on the differential in tax rates between capital gains and other taxable income. So, in thinking about this, it seems to me that the impression is that only rich people have capital gains.

But we all know that anybody who has been investing in a retirement plan for their future, anybody who owns a home, anybody who owns a capital asset, has a capital gain. So it seems to me that if the solution were to make the tax rate the same for capital gains and ordinary income, we would be putting a tax increase on a tremendous number of people who are not in the category of your millionaire's club, Mr. Pearl.

And I do not think that that is what anybody on this panel was suggesting either. So my question is—and I guess I will go to you, Dr. Holtz-Eakin—what is the solution? Have I identified the issue that is being raised here accurately, and what is the solution if differential tax rates are causing these kinds of problems?

Dr. HOLTZ-EAKIN. Well, the solution is to have tax rates equalized at as low a rate as possible, so that you do not build the ingredients of the tax avoidance schemes. I mean, this tax avoidance scheme hinges on interest deductibility and a low tax rate on capital gains and other sources of capital income. So that——

Senator CRAPO. So, if we were to make the tax rate on capital the same as the tax rate on ordinary income, we could then lower the tax rates, and people would not actually see, overall, a tax increase. Is that what you are saying?

Dr. HOLTZ-EAKIN. Yes, and I think the key is to—you know, this hearing is focused on the individual income taxes, but if you look at the scheme that the chairman described, it is the system. It is a corporate raider, and it is the tax treatment of both the entities and the individuals. The system has to collect taxes on capital and labor income, and that is not what we do very well.

Senator CRAPO. Now, what about the notion that you do not pay taxes, capital gains taxes, until you realize the gain? Do we have to make everybody realize the gain in their house every year? Do we have to make everybody realize the gain in their investments in their retirement fund every year?

Dr. HOLTZ-EAKIN. No. I am actually not a big fan of those strategies. There are approaches which focus on collecting such taxes at the entity level. Things like the X tax, personal progressive consumption taxes, all have a system where essentially the tax on capital income is collected at the entity level. It never gets out into financial markets.

You do not chase it around the globe and do all the expensive things that are being proposed here. You simply collect it efficiently

at the entity level, and it is collected on behalf of the individuals at that point.

Senator CRAPO. All right.

Dr. McBride, could you comment on this general set of questions?

Dr. MCBRIDE. Sure. I fully agree with these comments from Doug over here. It can be done, and it should be done as a general principle to pursue uniform taxation, and you can even go so far as to equate the tax rate on ordinary income and capital gains.

We have a plan that does that—or we have a plan that we have modeled. It is not a hypothetical plan. It is actually a real tax system that exists out in the real world in a small country called Estonia. They have a 20-percent tax rate that applies uniformly to all sources of income, including capital gains, wages, et cetera.

And it is a very simple system. It has a lot going for it. We have shown that if we implemented it in the U.S., it would produce a lot of growth, a lot of jobs, a lot of increase in wages, et cetera.

Senator CRAPO. So what does that plan do with regard to when gain is realized?

Dr. MCBRIDE. Well, no country has really experimented with that, as far as I know, not on the broad scale that is being contemplated here. It is true we do in very limited cases, in the current U.S. tax code, apply the tax to unrealized capital gains for some certain financial derivatives, et cetera.

But there is no country or jurisdiction that I am aware of in history that has tried to apply this approach broadly to a majority of assets held by any income class.

Senator CRAPO. All right; thank you.

Just one other really quick question. I am kind of shifting gears here rapidly, but an issue that comes up here often is, well, why don't we just tax corporations and not people, and so then, we have this endless source of income. Who pays corporate taxes? Could you answer that, either of you? Dr. Holtz-Eakin?

Dr. HOLTZ-EAKIN. Individuals pay the corporate tax. It is either the shareholders or the customers in higher prices, or the workers in lower wages.

Senator CRAPO. Yes. My understanding is that a pretty significant portion of it is paid by labor, and a pretty significant portion of it is paid by those who are in retirement plans, and a very small portion is paid by the actual individuals who own the corporation.

Dr. HOLTZ-EAKIN. Right.

Senator CRAPO. Other than through their tax——

Dr. HOLTZ-EAKIN. That is a fair summary, yes.

Senator CRAPO. All right. My time is up. Sorry.

The CHAIRMAN. I thank my colleague, and I look forward to working with you, Senator Crapo, to explore these issues.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Over the last decade, the IRS budget shrunk by 20 percent, resulting in 20 percent of its workforce being laid off. And because of the IRS's lack of resources, audit rates for those with incomes over $5 million dropped from 16 percent to just 2 percent over the same time period. And, while middle-class families and small businesses have borne the brunt of the IRS customer service problems, wealthy individuals and large corporations have been all too happy

to take advantage of the IRS's limitations and underpay taxes that they legally owe.

That is why the historic $80-billion investment we made in the Inflation Reduction Act has significantly improved customer service and ramped up the enforcement on the highest earners. But we have our colleagues on the other side of the Capitol, on the Republican side, continuing to propose cuts to this critical funding.

Ms. Huang, does cutting the IRS's budget for enforcement increase or decrease the Federal Government's revenue?

Ms. HUANG. It decreases the Federal Government's revenue and it overall adds to deficits.

Senator MENENDEZ. So it decreases the government's revenue?

Ms. HUANG. Decreases the government's revenue and adds to deficits.

Senator MENENDEZ. And who pays the price of tax evasion by the wealthiest and large corporations?

Ms. HUANG. Well, the addition to deficits means either underinvestment in pressing issues in the Nation, including raising workers' living standards, meeting global challenges, investing in innovation. It also could mean tax increases on other folks further on down the track to deal with those issues.

And it also means that honest filers have to compete with tax avoiders and evaders when they are just trying to focus on their business and real-world work.

Senator MENENDEZ. And obviously the corollary of that is, it affects negatively our national debt and annual budgeting abilities?

Ms. HUANG. Exactly.

Senator MENENDEZ. Now, I do not understand how some of our colleagues continue to push for a policy that makes it easier for tax cheats, which at the same time cuts resources that are projected to reduce deficit spending, which is what I want to talk about next.

There are just 8 days left for the government's funding before we no longer have the funds necessary to continue to operate the services that the Federal Government provides for its people. Some of our colleagues are threatening a shutdown in order to extract spending cuts in the name of fiscal responsibility. It seems hypocritical to me to threaten a shutdown and call for spending cuts on the backs of working families, when they have depleted the revenue side of the ledger over the last 5 years.

Ms. Huang, how much did the 2017 Republican tax law add to the Federal deficit over 10 years?

Ms. HUANG. When it was enacted, about $1.9 trillion over 10 years.

Senator MENENDEZ. $1.9 trillion. Did the bill pay for itself, as some of my Republican colleagues claim?

Ms. HUANG. Not at all. That estimate included any very small positive impact on the economy. That has been very hard to see in the reality.

Senator MENENDEZ. So, we have $1.9 trillion that is lost on the revenue side—and this is very basic. If you have a business, and revenue is not being produced, you have one of two choices. You either cut spending, or you find another revenue source to increase it. Here we have revenue being cut dramatically, and then at the

same time saying, well, we should have spending cuts for fiscal responsibility.

But the revenue side of the equation never seems to be part of the fiscal responsibility. That is why—you know, when I supported the Inflation Reduction Act, it actually cuts deficit spending while supercharging investments in some things that make our economy even greater.

Finally, it is important, I think, to understand why we ask large corporations and wealthy taxpayers to pay for their fair share of taxes. It is not to punish success or tax just for the sake of taxing. It is because we have real issues in front of us today, many of which impact our economic growth and our competitiveness on the global stage.

For instance, we are currently in the midst of a child-care crisis. Families across the country are forced to make impossible decisions, such as whether to leave the workforce altogether, or to leave their children in unsafe situations while they go to work. Child-care centers are being forced to close, and they pay invaluable teachers less than the minimum wage.

So, Mr. Pearl, from your perspective as an asset manager, isn't using some of this potential revenue source toward making child care affordable a worthwhile investment that increases economic activity and business productivity?

Mr. PEARL. Yes. Business in our country depends on consumers who are able to pay for things, depends on parents who are able to work, and work at their jobs. Even in New York, as we have increased child-care availability for their young children, that has increased greatly the number of mothers who are able to work and earn money, and has actually increased our tax revenues in the city where I live.

Senator MENENDEZ. Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague. So many members have come.

Senator Blackburn, you are next.

Senator BLACKBURN. Thank you, Mr. Chairman, and thank you all for being here.

Dr. Holtz-Eakin, I want to come to you. There is this term that came up in one of our hearings, and the chairman has heard me talk about this several times, and it was a new term that Commissioner Werfel used. It was "total positive income," and this came up in relation to that $400,000 threshold, where the administration claims they are not going to audit people who are making under $400,000 a year. Well, we also had Marjorie Rollinson in front of the committee in September, and she seemed to have a little bit of trouble giving us a clear definition of what is total positive income.

I had done a little digging through Tennessee. I think you know my State fairly well. The National Federation of Independent Business has just hundreds, thousands of members, small business owners. We are a very entrepreneurial State. And as I have looked and talked with businesses and reviewed this issue, it does not matter if it is a quilt shop or a tavern in east Tennessee, or if it is an independent electrician over in west Tennessee trying to do some work with BlueOval City, what people keep saying is, "What

is total positive income and who is going to be affected by these new audits that are coming on that?" Because a lot of LLCs, LPs, sub-S, they are all on that individual return.

And I would love to hear from you if you can give me a definition, a working definition of what that is supposed to be, and what is that benchmark, and small businesses, what should their concern be about this?

Dr. HOLTZ-EAKIN. I cannot give you a working definition or any other definition. It is a concept that they have developed and they are using.

I will say this: I cannot support this notion that the President's pledge to not raise taxes for people under $400,000 is the same thing as saying you are allowed to cheat on your taxes.

That is just not okay. It does not matter what your income is. And those audits ought to be applied on the basis of evasion, the probability of evasion, and the ability to collect taxes that are legally owed, and no other criteria should matter. It makes no sense. Total positive income, total negative income, hypothetical income, I do not care what the income measure is, apply it across the board and collect the taxes.

Senator BLACKBURN. Is there anybody on the panel who can give a definition of total positive income as it relates to this $400,000 threshold?

Ms. HUANG. I would agree with Dr. Holtz-Eakin that one of the things that you need to be very careful of is not setting a threshold that then allows the worse tax evaders to just file their returns pretending that they have income below that level and therefore avoid detection on audit.

And that is one of the tricky things about having a bright line. And I also agree with Dr. Holtz-Eakin that——

Senator BLACKBURN. And no one knows where that bright line really is, yes? Well, that has been perplexing for a lot of Tennessee businesses, thousands of them. They cannot figure out what is going to be coming at them.

Mr. Pearl, did you have something you wanted to say?

Mr. PEARL. No; I would agree. I think that everyone who should be potentially subject to examination by the Internal Revenue Service shouldn't be scared of the Internal Revenue Service if they are following the laws.

I think the changes we are talking about in these proposals are really things meant not even for the 1 percent, barely for the hundredth of 1 percent, for the few tens of thousands of the most wealthy people in our country, not for all these——

Senator BLACKBURN. That may be what the intention is, but I have to tell you, people are just really—if you all are confused about what this is, imagine how Main Street businesses are confused about what all of this means.

Now, talking about the audits, this July, GAO examined IRS audits of large partnerships and found that the agency is starting from a very weak position when they talk about bolstering these audits.

Much to the comments that you all have made, between 2010 and 2018, four out of every five of those audits resulted in no

change, and of those that changed, the company overpaid taxes and they were owed money back by the IRS.

So I think that what we need to do is have some clarity around this, when you are talking about this new wave of audits and being focused on these complex partnerships. And then the GAO does a study, and that is not where they found the problem to be. I think we need to be mindful of that.

Mr. McBride—well, my time has expired. Mr. McBride, I will submit a question to you on this issue for the record.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague, and I just want—because she has been a very, very constructive member of the committee, I want her to know I am going to stay at it until we get the official definition of total positive income from the IRS. They know that I feel strongly about it, and we are going to——

Senator BLACKBURN. Well, I appreciate that, because people are so confused on this, and they keep saying, "How does this affect me?" And I am in each of Tennessee's 95 counties every year, Mr. Chairman, and this is not a statutory definition. This is a Biden administration definition, but there is not a working framework on this.

And small businesses are trying to prepare for next year, and they are trying to make longer-term plans, and they are looking at business structures, and they have this undefined term that this administration refuses—it is like Jello. They refuse to define it.

The CHAIRMAN. I think it is more like a sandwich that they have said is built around one principle, which is: total positive income means that someone like a hedge fund manager cannot wipe out their millions with capital losses. In other words, that is how they define it. But Senator Blackburn has asked about this at a number of hearings. I think we all have a right to have this in writing, and we are going to insist on it, and then we will all share it at that time.

All right. Next up will be Senator Hassan.

Senator HASSAN. Well, thanks Mr. Chair, and to you and the ranking member for having this hearing. Thank you to our witnesses for being here.

Mr. Pearl, this is a question for you. A large part of the tax gap—that is the difference between what people or businesses owe versus what is actually collected—comes from major corporations and multimillionaires avoiding taxes by underreporting their income, underpaying what they owe, or just not filing tax returns at all.

Mr. Pearl, could you go over the recommendations you have for reducing the underreporting of income so that we can ensure that major corporations and the very wealthiest are paying their fair share?

Mr. PEARL. Well, yes. We believe that the Internal Revenue Service needs the funding to hire lawyers and experts who can deal with these things. Most of what I have been talking about, Senator, is not really people breaking the laws, but really the fact that the laws that we now have allow the wealthiest among us to pay for lower tax rates than their constituents who work for a living.

Senator HASSAN. Right. And so, just to follow up on that, when the tax laws allow major corporations or the highest earners in our economy to not pay taxes, what recommendations do we have for changing those laws?

Mr. PEARL. Well, what we are suggesting—along the lines of what the chairman proposed, and the President—is changing the law so that economic income, whether it is income from wages or income from your stocks going up in the stock market, is taxed the same way for the highest earners.

We do not even mean people who make $400,000 a year. We mean people who make millions of dollars a year. Those people should pay taxes on the money they make that increases their wealth, regardless of what form that income takes.

Senator HASSAN. Thank you.

Ms. Huang, the IRS needs to continue to improve services for taxpayers, such as making it easier for them to call the IRS and quickly get answers to their questions. And I would expect that every single Senator up here has a constituent service team that spends a lot of time talking with taxpayers who cannot get a hold of somebody at the IRS.

But the IRS struggles to do that, in part because of the need to devote significant resources to stopping tax avoidance by major corporations and the very wealthiest individuals. So how does underreporting of income by the ultra-wealthy divert resources away from improving taxpayer services at the IRS?

Ms. HUANG. It absolutely does that. We should not be focusing on the small amounts of money of many low- and moderate-income people who are just making errors on their tax returns. A person filling in a return for a Child Tax Credit, for instance, faces a series of instructions that are as complex as someone who has high income in filling in the alternative minimum tax.

Senator HASSAN. Well, thank you.

And then this is just really a question to the full panel. We are here today talking about this tax gap, and you have all made suggestions.

But I will start with Dr. Holtz-Eakin. We will just go down the row. What is your top recommendation to help close the tax gap? You have all hinted or said different things, but let us just go down the line.

Dr. HOLTZ-EAKIN. So just to be clear, the tax gap is evasion. It is illegal, and so that is an enforcement issue and comes down to having an effective audit strategy at the IRS and the resources to implement it. Most of what we are talking about today is avoidance, which is legal, and that means changing the tax code to reduce those opportunities.

Senator HASSAN. Right. Thank you.

Dr. McBride?

Dr. MCBRIDE. I would highly recommend radical simplification of the tax code. As I mentioned, there are examples around the world to look to with much simpler tax systems, and they have a greater rate of voluntary compliance and much lower administrative costs. And particularly, I am thinking of the country of Estonia, and you can find more information about that on our website.

Senator HASSAN. All right; thank you.

Mr. Pearl?

Mr. PEARL. Yes; thank you. I would also say that most of what we have been talking about is tax avoidance, which is legal. But if you are concerned about compliance, well sure, if you lower the tax rates to zero, you will get 100-percent compliance. But I do not think that will actually solve the real problem we are trying to solve, which is fairness in our country and funding to fund the government.

Senator HASSAN. Thank you.

And Ms. Huang?

Ms. HUANG. There is absolutely a line between avoidance and evasion. I think one of the things that is important to note is that a complex series of tax breaks push people into that gray area, and then sometimes over the line. So we both need to look at resources for enforcement, but also the tax breaks to sort of feed this planning activity.

Senator HASSAN. All right. Thank you very much.

Thank you, Mr. Chair.

The CHAIRMAN. Let's see. I believe Senator Warner is next.

Senator WARNER. Thank you, Mr. Chairman. I appreciate you holding this hearing, and I know this is an issue that you and a lot of our colleagues are passionate about, and I want to work with you and others to get to the solution that works.

I also want to echo what I think a number of my colleagues have said about IRS enforceability. The easiest way we can start down this path is to make sure the IRS gets back to the capabilities it had, for example, under President Bush, which means it is going to need some of these resources.

You know, I have been thinking a lot about this, and I think it is a hard thing to kind of come to a conclusion on. I think we have to appreciate the comments from the panel. If we are going to do this, it's got to be fair, it's got to be simple, it's got to be comprehensive.

We've got to find a way to make sure that folks do not game the system. As somebody who was lucky enough to be an entrepreneur myself and then as a venture guy funding a lot of entrepreneurs, I think we need to make sure we do not stamp out that growth piece of our economy.

I appreciate, Mr. Chairman, that you've actually got the buy, borrow, die platform up there, because that is where I want to dig in, and I think Mr. Pearl actually made reference to that. I want to focus on the borrow piece, because one of the things I still struggle with is some of the proposals that put a tax in place without a realization event, and I cannot find other examples of that in other nation-states.

But I do think the nature of our tax code is that you can borrow against your assets, oftentimes liquid stock assets, and some of the best billionaires around do that on a regular basis. And then they ultimately die and they pass on those assets without any realization of income. Yet they have used the system to fund their lavish lifestyles.

I guess I will start with Ms. Huang and maybe go down the panel, but this notion of—particularly if you are borrowing for life-

style as opposed to borrowing to make an additional acquisition, I think is an area that has some difference.

And I do think there has been some recent testimony that has indicated that there might be a lot more with the appropriate use of borrowing as a realization event, with assets of a certain size, that might obtain a lot more tax revenue than previously thought. So, Ms. Huang—then we will go down the list.

Ms. HUANG. So, I think you are just putting your finger on the fact that billionaires can spend their untaxed capital gains income, and that is most obvious when they are borrowing against it and they are purchasing things with it. It really just sort of puts a finger on the point that this is income in the real world. It is not just some theory that us lawyers and economists have dreamed up, but they are real-world resources that can be used, and it is just the tax system that is currently ignoring that resource. And you are correct that there are lots of options for addressing this.

Some of them include taxing those gains closer to when they are made. Some of them focus on that sort of consumption out of that wealth, and I think they deserve study. What is not sound is just a system where that income can evaporate out of the tax code altogether.

Senator WARNER. Which is obviously the case, and we can all list lots of people who use that tool.

Mr. Pearl?

Mr. PEARL. Yes, I agree with what Ms. Huang said. Essentially, if I am able to borrow money against my brokerage account, as long as the stocks that I own increase in value at a higher rate than the interest on the account, I am still becoming wealthier over time.

The broker is perfectly happy to see a debit balance increase indefinitely for my entire life, and it is essentially economically the same as a realization of that, except it is not taxable. And yes, so I agree with you.

Senator WARNER. Dr. McBride?

Dr. MCBRIDE. I would point out in these scenarios that are being described here that we are talking about corporate stock, I think, as the primary example, and that is because if you look at the wealthiest individuals in the country by whatever publication is doing that analysis, they do tend to be entrepreneurs who have built a business that is subject to—you got it—the corporate tax.

So I think that what is missing in the discussions is that even if the individual who holds shares in these companies—and we are talking about founders typically, who have a lot of shares—if they do not realize income by selling the stock in any given year, that does not mean they pay no tax, because every year the company that they own is subject to corporate tax, 21 percent on income.

Senator WARNER. Yes, but the actual tax, as you know, Dr. McBride, is functionally much, much lower than that. I probably should have gone the opposite way on this with Dr. Holtz-Eakin. I know my time is up, but please.

Dr. HOLTZ-EAKIN. Well, I mean the key, as you mentioned, is to maintain these incentives for growth. And so, we have had in the code, full expensing of investments—capital investments, invest-

ments in technologies and business models—and that is a fantastic growth incentive that is very important to have.

It also changes the effective tax rate on the normal rate of return to zero, which I think is fine. I am a zero-tax-on-capital guy. If you allow them to borrow and make that investment, the effective tax rate is negative. No. So given the growth incentive, do not also allow them to do the interest deductibility.

Get the effective tax rate down as low as possible, and get rid of these avoidance opportunities.

Senator WARNER. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Carper is next.

Senator CARPER. Welcome. I had a chance to talk to each of you before the hearing started, and I missed a good part of it. But I am here now and happy to see all of you today. Thank you all for spending this time with us.

I remember as Treasurer—I was elected Treasurer when I was 29 years old. Nobody else wanted to run. We had the worst credit rating in the country. We elected a Governor, a Republican named Pete DuPont. He turned out to be a great Governor and a good mentor for me.

And he—in spite of having large deficits—led an effort to reduce our personal income tax; led our effort, and we did. When I was Governor, I think for maybe my last 5 years as Governor, we trended back, I think five times, 5 different years.

So we ended up with instead of a 19-, almost 20-percent marginal personal income tax rate, when he stepped down as Governor, it was probably closer to 6 or 7, and we always balanced our budget—always balanced our budget. And when I was Governor, we had triple A credit ratings.

We still have triple A credit ratings. So the question is, can you go out and collect taxes that are needed to fund programs? Yes, we have shown you could do that in Delaware, and we make sure that people pay their fair share of taxes.

I remember when I used to hold—and I know my colleagues who served in the House with me, including the chairman, did—but I used to hold a ton of town hall meetings. Once a year I would do a meeting in each county, and we would invite the IRS to come.

We would invite the State Division of Revenue to come. We would actually provide services onsite on a Saturday to dozens, scores of people who would bring their taxes and say, "I need some help in filling them out." My last year as Governor, when the Delaware Quality Award was awarded, it was awarded to the Delaware Division of Revenue—the Delaware Division of Revenue.

And they won because they provided great service—great service. If people had an issue, they could call. They could come to a town hall meeting. And they had offices in all three counties—we only have three counties—where people could get the help that they need. I remember having, in one of my town hall meetings—we would actually do an exercise where we would invite constituents to come and balance the budget—balance the budget.

It could be, you know, entitlement spending, discretionary spending. I remember this one time we were doing this exercise, having

a hard time balancing the budget with the group. I kind of let them lead it, and I just shepherded a little bit.

But they could not balance the budget, and I said to them, "You know, revenues are a piece of the pie." I said, "It is an option." And this one—I will never forget—this one lady in the back of the room raised her hand, and she said, "I do not mind paying my fair share of taxes. I just want to make sure other people are as well." I have never forgotten those words—never forgotten those words.

And I have sat here on this committee for almost 20 years, and I cannot tell you how many times we have had our IRS Commissioner come before us and speak in terms of things that they thought they needed support from us for: technology, for people, the clarification of tax codes, and so forth.

But I think it has been a consistent message. But a big part of it is that we need the IRS. We need not just great leadership, and I think we have that with Danny Werfel. We need the right resources—human, technology—in order to do the job. And we need to be able to provide service, when people have questions—to provide service. They call us and they get an answer, and they get the straight answer.

We get a lot of calls in my offices in Delaware from people who need help, and we help them. We help them. So, with that having been said, I have a question or two here if I can find them. So, bear with me for just a minute. Here we go; all right. Thank you for your patience.

First question, and this is for Ms. Huang. How does funding the IRS bolster the fiscal health of our Nation? I think I have sort of set that up, but how would the proposed repeal of these investments impact taxpayer compliance?

Ms. HUANG. So the services that you were talking about are actually one way people think about compliance and enforcement as sometimes a scary thing, but sometimes it is as simple as having the IRS be able to answer a question for someone who wants to do their taxes well, and would make an error if they could not get a straight answer to what they need to be doing.

So that is part of it. That is the reopening of the in-person Taxpayer Assistance Centers across the country. The other part is going after more pernicious forms of evasion and avoidance. That requires highly skilled auditors who can pick through the returns of the wealthiest filers, which are often complex, and that all brings in far more per dollar spent than is actually devoted to those people.

Senator CARPER. All right; thank you.

Mr. Chairman, could I have another minute?

The CHAIRMAN. We are trying to get through——

Senator CARPER. I will just stick around. I will just stick around, if I can.

The CHAIRMAN. Oh, great; terrific.

Senator CARPER. Thank you.

The CHAIRMAN. Senator Cassidy would be next.

Senator CASSIDY. Thank you.

The CHAIRMAN. Depending on who else comes, the order would be Senator Cassidy, Senator Casey, Senator Whitehouse.

Senator Cassidy?

Senator CASSIDY. Okay; thank you all for being here. And I have been puzzling about this for a long time. So George Soros, George Soros, got a CARES Act check, meaning that he was earning less than $150,000. Now, to his credit, he gave it back. But the fact is that his income tax was such that he was only making $150,000, and this is George Soros.

Now, there are other examples, but I picked him because he is so well known. Would he be considered, Mr. McBride, among the top .001 percent that year in terms of paying income tax, or because his declared income was so low, he was actually not considered part of that top 5 percent, 1 percent, .1 percent?

Dr. MCBRIDE. Well, I do not know his exact situation, of course, but I could guess that we are talking 2020, perhaps 2021, both years in which the stock market would have been way down——

Senator CASSIDY. But my point is, if somebody borrows against their assets and does not take salary——

Dr. MCBRIDE. Right.

Senator CASSIDY [continuing]. And so their reported income is low, are they considered among this top .001 percent even if they are worth billions of dollars because they are reporting—are we judging that percent by their wealth or by their reported income that year?

Dr. MCBRIDE. Generally, by their reported income. Others try to supplement that with other measures——

Senator CASSIDY. I have limited time, so I just—I did not know that.

So, Mr. Pearl, I have a friend of mine who is always busting my chops on different things. He is a realtor, a real estate developer, and he says because of section 1301—and I understand the importance of incentivizing people to turn that money over and the economic activity that it therefore generates.

What he says is—one of the things he busts my chops on is, he says that he has made a lot of money every year for several decades, and he has not paid income tax for several decades. So, when I read the statistics that the top 1 percent are paying a disproportionate amount of the income tax, which I accept, it seems to me that must be a heterogeneous group though.

There are some who are really paying a lot, and some who are making a lot of money and paying nothing. Is that a fair assessment?

Mr. PEARL. Well, yes. Part of the problem is—I think you are talking about like-kind exchanges.

Senator CASSIDY. Yes.

Mr. PEARL. And yes, part of the issue is that some people—if you are really rich, you do not need any taxable income, either because you borrow against your assets for buy, borrow, die schemes, or because you have like-kind exchanges and a few other things that can reduce your taxable income.

Senator CASSIDY. So, Ms. Huang, if I may, because you seemed to be nodding your head kind of as I was talking. Although some people who are billionaires are paying millions of dollars of taxes, there are others who are millionaires, like my friend, who is kind of like complaining that he is not paying taxes.

I say, "Well, you could give the taxes if you wanted to," but he says that is not the point. So within that, there are those who, although making a lot of money—either because they are borrowing or they are doing like-kind exchanges, et cetera—they are paying nothing.

Ms. HUANG. That is exactly right, yes. And the problem is that when the statistics try to figure out who is in the top 1 percent, those people do not even show up in the top 1 percent because the statistics are based on what shows up on tax returns.

Senator CASSIDY. Now to be clear, this is not their fault. That is the fault of Congress.

Ms. HUANG. Absolutely, absolutely.

Senator CASSIDY. Congress has made these laws, and so we have met the enemy, and he is us. I would like to say it was the Democrats, but that is another issue. They would say to me, you know, that's beside the point. [Laughter.]

So, Dr. Holtz-Eakin, good to see you, man. I could not quite hear what you were saying to Senator Warner, but at the end you said something along the lines that we should not allow people to borrow money and then to——

Dr. HOLTZ-EAKIN. Expense the investments they use that borrowing to purchase.

Senator CASSIDY. Say that one more time. I am a gastroenterologist, not an economist.

Dr. HOLTZ-EAKIN. And so, you have your gastroenterology business, and you need to buy new equipment for it. So the tax code, until recently, allowed you to fully deduct in the year you buy that equipment, the cost of the equipment. That is exactly the right thing to do, from my perspective.

It gives you full cost recovery for your investment—you get it all back right away—and it provides excellent investment incentives. Now that is essentially a zero effective tax rate on the return to that investment, and I am fine with that. If we then give you an extra deduction for the borrowing, you change that zero to a negative number. We are subsidizing that business. I see no reason to do that.

Senator CASSIDY. And current law allows the deduction of that borrowing?

Dr. HOLTZ-EAKIN. Yes, yes.

Senator CASSIDY. Now, reading your testimony, I was not quite clear. Would you repeal capital gains tax and treat all income as ordinary income? Because you said to go to zero on capital gains. Does that mean that there is no taxation on the individual from the sale of a stock, even if it has escalated in value?

Dr. HOLTZ-EAKIN. The easiest way to think about it is, think of IRAs. Take your pick. You can do a traditional IRA, give them the deduction up front but treat everything that comes out and tax it at the same rate. That would tax interest, dividends, capital gains, all at the same rate.

Or do a Roth IRA and do not allow a deduction, but do not even attempt to go after the capital gains. Take your pick. Both are good tax systems—very simple, good investment incentives.

Senator CASSIDY. You are implying that we are taking the worst of both as opposed to one or the other, which would be the best of one.

Dr. HOLTZ-EAKIN. Let me stop implying and say, yes, we are doing the worst.

Senator CASSIDY. We are doing the worst. Okay. If you could send that to me offline, I would appreciate that detail. Thank you.

I have a lot more questions, but I am out of time. But I really appreciate the testimony.

The CHAIRMAN. I thank my colleague and look forward to working with him on these issues.

Senator Casey, you are next.

Senator CASEY. Mr. Chairman, thanks for calling this hearing. I want to thank our witnesses. I want to start with kind of where we have been over the course of 40 years.

Due to the rigging of the tax code over roughly the last 40 years, our tax system over and over again intentionally favors those with very large incomes and often very large lobbying organizations, while the middle class continues to suffer from very limited, if any, tax relief.

Just by way of example, between 2020 and 2022, just those years, corporate profits rose 75 percent, five times—five times—as fast as inflation. I released a report this week called "Greedflation," meaning major corporations taking advantage of customers by jacking up prices and blaming it on inflation, or using inflation as the cover to jack up prices.

The report shows that the average middle-class family in Pennsylvania was forced to pay an extra 3,200 bucks in 2021, and more than $3,500 in 2022, just because of this greedflation. One corporate executive claimed that his company "earned the right" to raise prices. Another executive at a different company bragged that their products are "worth paying a little more for," just seemingly oblivious to what real people are paying at the grocery store and otherwise.

These same companies and their shareholders were given what I would argue were obscene tax breaks in 2017 through that bill, and so now they pay much less in taxes on their profits than they squeeze out of American families.

So, Ms. Huang, what is the best way for Congress to ensure that businesses' high profits are being appropriately taxed, so that we could redirect or reinvest those dollars into the middle class and put money back in the pockets of those families?

Ms. HUANG. So, I have heard my colleagues here say that there is a problem with potential double taxation of both corporate income and at the individual level. But if you look at the data, the actual bigger problem is double non-taxation: corporate profits not going taxed and then the gains also not going taxed at the individual level.

And as you say, the research shows that a large and growing share of those profits—at the very low-end, estimates are about 60 percent of those profits are from windfall rents, monopoly power, pure luck, those sorts of profits, profits that are not sensitive to tax rates or to new investment.

So it is really important to make sure that that income at both levels is subject to tax and subject to tax once.

Senator CASEY. Let me just conclude with one more question. Chairman Wyden recently discovered something troubling about millionaires in this country. Not only do we have a problem when wealthy taxpayers pay too little in taxes; sometimes they do not even bother to file a tax return at all.

From 2017 to 2020, there were almost 1,000 Americans with incomes over a million dollars who did not file their taxes at all. They did not file anything. These taxpayers owed over $34 billion in tax penalties and interest as of May 2023. If we collect those taxes, we could give $450 on average to every child in America.

Mr. Pearl and Ms. Huang, could you talk about how we can make sure that this small group of less than 1,000 millionaires pays their fair share in taxes?

Mr. PEARL. Well, yes. We think that government, whether it is the Department of the Treasury and the IRS or the Justice Department, needs to have the resources to enforce the laws and make sure that these 1,000 people out of the hundreds of millions in our country obey the laws, just like all of your constituents who have tax deducted from their paycheck every week.

Senator CASEY. Mr. Chairman, thanks very much.

The CHAIRMAN. Colleagues—and I will also say to those who are following—Senator Casey is a very modest fellow, and what he was talking about again was trying to ensure that there is fair taxation and smart enforcement of the tax laws, because there are a lot of important things that America needs to do to get ahead.

Senator Casey has led the effort now for years on end to try to build a savings ethic in this country for young people. And I see all your heads nodding, and we've got the political spectrum kind of down there. If I had my way, what we would have in this country—and I think we have a chance to get started on it.

I think we know that it is going to take a substantial amount of money, but you know, if we cap some of these jumbo IRAs beyond the vision of Bill Roth and collect the money from the millionaires who are not even filing returns, we could get started.

I would personally like to see poor kids and poor families, when a child is born, go home with a little bit of a savings account—the kind of thing Senator Casey's been working for—to get them started. And it does not have to be some big government program. It can be some of the approaches Senator Casey is talking about.

So I want to thank the Senator for all his good work, and they are all talking about whatever that retirement name was, SECURE 2.0 and going after SECURE 3.0, SECURE 12.0 and all that, and we may have good ideas for the future. Senator Casey's idea to help those kids with a small savings account—I want everybody to know, as long as I am chairman of this committee, Senator Casey's idea is going to be at the top of the list, and I thank my colleague.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Mr. Chairman. Thanks to everybody for being here.

I just want to flag for this committee that we had a hearing on this subject this week in the Senate Budget Committee, where we looked at the tax gap and learned, first, that the tax gap is known

to undercount the actual tax gap, because there are areas of omitted enforcement that it does not even look at. So it is a way bigger number than we think it is. The second thing that we developed in our testimony was that if you look at the top 10 percent of filers, the amount that the IRS obtains in revenue for a dollar spent in enforcement is $12. So, it is a good deal more than we have been talking about, looking across the board. And because President Biden has promised to focus enforcement on entities and individuals over $400,000 per year, we are starting to move closer to that 12 to 1 return on enforcement, compared to what we have been talking about.

Interestingly, it gets even worse the higher you go up the income level. When you get to the 0.1 percent of wealth, the return on the enforcement dollar can go as high as $35—$35 in revenue for every $1 in enforcement, which signals that there is massive tax dodging and tax cheating going on at the 0.1 percent number. So, not only do Americans face a rigged tax code, they face the double whammy of rigged tax enforcement, even under that rigged tax code. So we have a lot of work to do.

Two of the ideas I like, Mr. Pearl—billionaire Warren Buffet famously highlighted the rigging of the tax code by pointing out that he paid lower tax rates than his secretary. My Pay Your Fair Share Act would codify what is called the Buffet Rule, with a minimum 30-percent tax rate on income over $1 million per year that phases into the $2 million, so there is not an abrupt cliff. Can you say—how would this legislation make our tax system fairer, and from your experience on the investment side, would it cripple the private equity system?

Mr. PEARL. Well, yes. First, I was honored to stand with the President, then-President Obama, when he made that speech about the Buffet Rule. But yes, we think that it needs to be fair. It is exactly the problem that Chairman Wyden was outlining about buy, borrow, die, that results in Warren Buffet paying a far lower tax rate than his assistant does——

Senator WHITEHOUSE. Does it cripple the private equity system?

Mr. PEARL. No. We do not have a shortage of people who are willing to become private equity fund managers. There are tons of people applying for those jobs. As I said in my testimony earlier, I think if we are going to try to use the tax system to incentivize people to join certain careers, I am sure that you can find several careers that are more in need of people than private equity fund managers are.

Senator WHITEHOUSE. Thank you.

Ms. Huang, let me ask you a question about another piece of legislation of mine, the Medicare and Social Security Fair Share Act. You were kind enough to come to the Budget Committee a little while ago and testify about that.

That bill has a provision to support Social Security and Medicare by closing the so-called Gingrich-Edwards loophole that lets wealthy individuals avoid Medicare taxes. Would you mind walking the committee through how this loophole works and through how much revenue-closing it might raise to support Medicare?

Ms. HUANG. Yes. So, the loophole is that some wealthy filers can funnel their income through an S corporation, and if they do so and

they underpay themselves salaries and put more of that return into business income, they can avoid facing any of the Medicare taxes on payroll, on self-employment income, and on investment income. So, they fall right into the gap, and some of that——

Senator WHITEHOUSE. And the money ends up in their pocket either way? It's just a question of which way you route the money that you control into your own pocket?

Ms. HUANG. Absolutely. It's hundreds of billions of dollars that are going through there, and some of that is—people even overstep into evasion, speaking of fund owners. Some fund owners right now are in disputes with the IRS, because the IRS sees that they have gone over the line by trying to push so much of their income into this hole.

Senator WHITEHOUSE. Now the last thing I would mention, Mr. Chairman, is that the other part of the hearing is on the improvement in IRS performance as a result of funding of the IRS, and that there has been massive improvement in how regular taxpayers are treated.

We had a wonderful statement by Senator Romney saying, "You know, if I am a regular taxpayer, I am going to call up, and it is going to really matter to me to be able to get that phone call answered in what is now a 3-minute wait time, and that is really important for the service of regular taxpayers."

But he said, "Once I became very wealthy, I was not calling up that service line any longer. I have accountants and lawyers who intermediate, and for that you really need to have proper audit and enforcement." So, I want to commend Senator Romney's statement to this committee. And with that, I yield back.

The CHAIRMAN. I thank my colleague. It has been great to work with you on all these issues, both here and at the Budget Committee.

Senator Carper?

Senator CARPER. Thanks, Mr. Chairman, for letting me have a second round. Another follow-up, if I could. Ms. Huang, do you believe that the role of noncompliant sole proprietors demands more attention from the IRS, particularly when it comes to wealthy taxpayers? And if so, do you have any recommendations for how the IRS should address this?

Ms. HUANG. Yes, it absolutely does. And in fact, it has received so little attention because of the lack of resources of the IRS to understand what is going on, that we do not have a great idea of what is going on with high-income tax avoidance using sole proprietorships.

But pass-throughs overall, we know are a really big source of tax avoidance and evasion, and part of the reason is just like with sole proprietorship. A lot of the income that flows through them is really just on the honor system, and the IRS does not have any way that they can check what the taxpayer says in terms of the source or the amount of income. And you know, the compliance rate on that income is less than 50 percent, compared to 99 percent for W–2 wage and salary income.

Senator CARPER. All right. More broadly speaking, what steps should Congress, what steps should this committee, and the IRS for that matter, take to improve the tax compliance of pass-through

entities? Does the IRS need additional tools or resources from Congress to support their work in identifying noncompliant wealthy taxpayers?

Ms. HUANG. I think the oversight role that this committee has played in focusing the IRS's attention on partnerships and pass-throughs is really important. But an additional tool that lawmakers could give the IRS is, again, the ability to sort of understand who owns what income when it flows through these spider webs of different types of entities.

And that could include strengthening the bipartisan Corporate Transparency Act, and allow the IRS to be able to trace who actually owns what. That is a really basic question that you need answered to have tax compliance.

Senator CARPER. Thank you, ma'am. And I do not mean to pick on you, but I do have another question, while I let these guys catch their breath. Can you share with us how unequal audit enforcement has historically contributed to wealth and racial inequality?

Ms. HUANG. Yes. Well, as audit rates on the wealthy filers have plummeted, audits on low- and moderate-income filers have increased as a share of all filers. And in addition to that, we now know that, due to research that the IRS itself put forward, Black filers are 2.9 to 4.7 times more likely to be audited by the IRS, even at the same income level.

Part of that has come about because there has been an over-focus on forms of noncompliance from refundable credits, even though they contribute a much, much smaller part of the tax gap than noncompliance by wealthy filers.

The CHAIRMAN. I am going to have to move on, Senator Carper.

Senator CARPER. Yes. Thanks for giving me the time, and thank you all for being here today and for your good work.

The CHAIRMAN. Thank you for your good points.

Senator Cardin?

Senator CARDIN. Well, Mr. Chairman, I came back, first to thank you for holding this hearing. I apologize. I have been busy on some Senate Foreign Relations business, but I just really wanted to underscore the importance of the embarrassment in our tax code on the rate of compliance for high-income people, and the amount of resources that are put into auditing lower-income taxpayers, who in many cases do not have the same degree of help and services to allow them to understand our tax code, which is rather complex.

We find that in so many different areas. I chaired the Small Business Committee, and I found that small business owners, in trying to comply with the requirements we have, do not have the same resources as larger companies. This is a systemic challenge we have in our society.

So my question is—we are giving the IRS a great deal of resources. How can we help middle-income taxpayers, lower-income taxpayers, with the type of information, outreach, and services that can make it easier for them to comply with our tax code, so that the resources of IRS can be really focused on those who are not paying their fair share on higher income? Ms. Huang, do you want to start? I see you are shaking your head the right way, so I will start with you.

Ms. HUANG. Well, you are absolutely right. Low- and moderate-income filers do not have expensive tax advisors, and they count on lawmakers to provide the IRS the resources so that it can answer the phone in 3 minutes instead of 28 minutes, or to have Taxpayer Assistance Centers right there in their community, where they can go and talk to a real person.

And they also count on the IRS—and this comes under the compliance bucket—to put out clear guidance about what their taxes mean. So that is really important.

Senator CARDIN. Well, thank you.

Mr. Chairman, I would hope that we will put a concentration on how we can help middle- and lower-income families get the information they need, so that they can get the benefits they are entitled to, because in many cases, they are losing out on benefits that they are entitled to, and there is no one there to audit their returns to say, "You need more money. You should have gotten more."

It is always that you made a mistake, and therefore we are going after you. And I think, with the resources that were given to the IRS, as we go after the higher-income taxpayers who are not paying their fair share, we need to devote resources to modest-income families to make sure they are being treated fairly in our tax code.

I thank the chairman.

The CHAIRMAN. I thank my colleague. We also ought to pass the Cardin tax preparer bill, in order to beef up work that is done in that area. So I look forward to working with my colleague.

Senator Warren from Massachusetts.

Senator WARREN. Thank you, Mr. Chairman.

So, in 2017, the Republicans in Congress passed one of the biggest tax giveaways to millionaires and giant corporations in recent memory. The Trump tax cut kicked working families to the curb, while it added about $2 trillion to the national debt, all so that Republicans could give a massive handout to their wealthy pals and donors.

But the $2-trillion price tag on this does not actually tell the full story. That is because some of the corporate tax breaks had expiration dates, not because they actually wanted those tax breaks to expire, but expiration dates because that meant they could represent that the total costs of the giveaways would look smaller than they really were.

Corporate lobbyists went along with this, because they knew that when the tax breaks expired, Congress could be counted on to renew them endlessly. Now, three of the biggest giveaways are starting to expire, and the corporate lobbyists around here are working overtime to get them extended.

Ms. Huang, corporate lobbyists claim that these three giant giveaways—known as bonus depreciation, R&D expensing, and the net interest deduction—were really important, because they would spur American investment. So now we have some data on how these corporate tax giveaways worked. Does the data show that companies have used their tax breaks to make new investments?

Ms. HUANG. So, the corporate tax cuts in 2017 were even bigger than what companies asked for, and what we saw is trillions going into buybacks and dividends. Economy-wide investments and jobs did not grow any faster than they had before the law, and careful

economic analysis has failed to find anything near what was promised.

And now as you are saying, there is talk about adding to that retroactive business tax breaks, which would be just a complete wasteful giveaway. You cannot change past investments or wages by giving away tax cuts like that.

Senator WARREN. Right. So take bonus depreciation as an example here. Under normal tax rules, businesses are allowed to deduct expenses from their income so they are not taxed for the losses that they take. Because certain assets lose value over time, like machines or buildings, businesses can typically deduct the cost of that depreciation over the life of the asset.

But bonus depreciation takes this logic and turns it upside down. Instead of taking a chunk of the depreciation each year that the asset has value—say a new set of delivery trucks—bonus depreciation lets businesses deduct the entire cost of those delivery trucks in the year that they buy them.

Ms. Huang, why do businesses benefit so much from bonus depreciation?

Ms. HUANG. So, like a lot of business tax breaks, a company needs to actually be pretty big and highly profitable to take full advantage of it. You hear a lot of rhetoric about small and startup businesses, but they often cannot even access these provisions, because they do not have enough profits to offset them against.

And the research shows that the biggest companies that are getting the bulk of the tax breaks are the least likely to actually increase investment or wages.

Senator WARREN. Okay. So the tax breaks are not used to increase investment, and in fact these tax breaks, business tax breaks, are going to the very richest corporations. And now, like they did in 2017 and like they have done so many times before, corporate lobbyists are asking for a temporary extension of these tax breaks, to make them look cheaper than they actually are. But they have every intention of pushing Congress to extend these tax cuts again and again and again, so their wealthy clients will never actually have to pay the bill.

Ms. Huang, if we look at the true cost of extending these three corporation giveaways that are being championed by lobbyists, and not made-up versions that are being peddled by the corporate lobbyists, what would those figures look like?

Ms. HUANG. Yes. The sticker price here is quite misleading, because the true cost is much larger. The official cost of temporary full expensing would be $3 billion through 2025. But if you would make it permanent, it would be $325 billion.

Senator WARREN. Yes. The difference between $3 billion and—say that second number again.

Ms. HUANG. Three hundred twenty-five.

Senator WARREN. Three hundred twenty-five. So the nominal cost of this, the representative cost of this, is about 1 percent of what you say it would really cost. You know, look. I get it. Extending corporate tax breaks is really good for massive corporations, but it is also really bad for the American people.

We should not be rubber-stamping Trump tax cuts for giant businesses. While Republicans play political games, Democrats should

be doing everything in our power to make sure that millionaires, billionaires, and giant corporations are paying their fair share.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague, and I thank our panelists. We have been at it for a couple of hours here, and I would like to just wrap up this way.

You know, when I am home, people say, "Are we going to have one of these town hall meetings, Ron? Are we going to have another one of these? We like them. We just kind of can come and say our piece." And I have had like 1,065 of them. We have 36 counties, and all of them, again and again and again, 90 minutes, throw open the doors, and no subjects are off limits.

And the percentage of time devoted to taxes is high, and it continues to get higher. It goes something like this. People say, "Ron, what is the deal with the tax deal, because it is so hard to understand? And it sure looks like it just favors a small number of people who can work the system." And I say, "Well, let me offer you a couple of thoughts that I think at least give you an idea of how I see it."

So, when you ask about the tax deal, I always say there are really two tax deals in America. One is for the people who are the firefighters and the nurses, and they pay taxes with every single paycheck. And that really colors everything they do. For example, even if they are going to be audited, the government already has a lot of their information, because they pay taxes every paycheck.

Then there is another system, which is illustrated by the sign up here, that if you are a billionaire—and Ms. Huang told us how it is done—you bring in your accountants and you bring in your lawyers, and you say, I do not want to pay any income taxes this year. Make it possible for me to buy—and I gave examples of that—and borrow, and then when you die, everybody starts all over again.

And Bill Bradley was on the Finance Committee for a number of years. I worked with him. I was a junior member of the House. Doug Holtz-Eakin is smiling. He remembers Bill Bradley, and he was another tall member of the Finance Committee, but he had a better jump shot than I did. [Laughter.]

We always talked about, you know, what do you want in a tax system? And he would say, "Ron, we want a tax system that gives everybody in America the chance to get ahead." And that is what I want to close with, because to get a tax system that gives everybody in America the chance to get ahead means it has got to be built on the idea of being fair to everybody. And it has to be a system that is going to give everyone a chance to be successful, because that is what America is all about. That is America at its best.

So, we appreciate the input that the four of you have given us. I am putting the final details on our proposal that we have been working on for some time, to lay out how we go about fixing this problem of billionaires avoiding taxes through buy, borrow, die, and giving everybody the chance to get ahead.

So, we will look forward to staying in touch with you. Our doors will always be open to you four. We have worked with you in the past.

It has been a very good hearing, a busy week for the Finance Committee. Yesterday, we passed a major piece of health legislation to rein in these PBM middlemen, passed it by the narrow vote of 26 to nothing.

My wife asked me about it. I said, "You cannot get 26 Senators to order a 7-Up right now without a big controversy." So the Finance Committee is serious about these policy issues, and you saw it again today, where you did not see a lot of shouting and hollering. You saw people who are serious about dealing with making the tax system smarter, better, fairer, and one in which we can all enjoy substantial success.

I want to thank our guests. And with that, the Finance Committee is adjourned.

[Whereupon, at 11:58 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Mike Crapo, a U.S. Senator From Idaho

Thank you, Mr. Chairman. I look forward to our discussion today on the effect of the tax code on individuals and families as they work, save, and invest.

The scope of today's hearing provides members the opportunity to cover a broad range of topics, and we will no doubt hear a number of concerns raised about how the code treats high-income taxpayers. We should dispel the notion that there is any support for taxpayers who evade their tax obligations; we all agree taxpayers should pay the tax they legally owe.

For the gray area of taxpayers who aggressively structure their affairs to reduce their tax liability, we should constantly assess how the code can better target certain activity. But framing this issue through the subjective lens of "fairness" often ignores the facts and turns a blind eye to favored incentives.

Rather than focusing on rhetoric, we should examine the data and how the code affects behaviors. That includes examining provisions that primarily benefit a select group of the financially well-off—including tax credits for those who can afford expensive electric vehicles, costly energy-efficient home upgrades, and proposals to repeal the cap or expand the highly regressive deduction for State and local taxes.

As for the data, these are the indisputable facts:

- Most of the Federal tax burden is paid by high earners;
- Federal tax collections have been near all-time highs;
- The voluntary tax compliance rate is high and stable; and
- Higher income taxes serve as disincentives to work, save, and invest.

My Republican colleagues and I remain focused on safeguarding taxpayers and their rights; reducing barriers to work, savings, and investment; and promoting opportunity and wealth to improve the quality of life for all Americans.

In 2017, Republicans lowered individual rates across the board, with middle-income taxpayers getting the largest proportional benefits. Republicans also simplified filing for many, expanded the Child Tax Credit, and limited regressive tax spending like the SALT deduction.

Critics charged that letting Americans keep more of their earnings would stifle the economy, dry up Federal revenue, and favor the wealthy. Instead, it created one of the strongest economies in our Nation's history, including an unemployment rate that reached a generational low; increased Federal tax collections to near all-time highs; grew wages across the income spectrum; and expanded job participation. All Americans benefited.

Notwithstanding claims that high earners pay the least taxes, the reverse is actually true. According to the Biden Treasury Department, in 2023 the top 1 percent of earners paid 42.2 percent of all Federal income taxes—the highest—despite only earning 19 percent of all income. In 2001, the top 1 percent of earners contributed 33.2 percent of income tax revenue, 9 points lower. In other words, the country's income tax burden is more progressive today than it was decades ago.

Expanding the aperture to examine the top 5 percent of taxpayers—those with incomes above $200,000 a year—mirrors this dynamic. These Americans pay 65.3 percent of all Federal income taxes while making only 34 percent of all income.

Meanwhile, Federal tax collections reached an all-time high of $4.9 trillion in FY 2022—with individual income tax collections contributing the most, growing 29 percent year over year. In fact, individual income tax collections reached 10.5 percent of GDP in FY 2022, the highest level on record. All of this is after the impact of Republican-led tax reform.

In arguing for tax code fairness, some have pointed to a recent tax gap projection from the IRS, which shows an increase over the previous estimate. This growth actually shows one of the many effects of inflation.

Despite headlines to the contrary, the tax gap is proportionately flat and historically average relative to the economy's size. According to the Cato Institute's examination of the tax gap as a percentage of GDP, for 2021, that ratio was 2.9 percent, squarely in line with the 20-year average. And the voluntary tax compliance rate—around 85 percent—remains substantially unchanged.

While we should work to find bipartisan measures to narrow the tax gap, any such effort must not reduce economic growth.

I look forward to hearing the perspectives of today's witnesses on how the individual tax system affects taxpayers from all income groups and how increased taxes—in the midst of high and sustained inflation—would impact our economy.

PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, PH.D., PRESIDENT, AMERICAN ACTION FORUM *

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you for the privilege of appearing today to discuss issues related to the tax code, high-income individuals, and tax planning strategies.

I hope to make the following three main points:

- The two most pressing policy problems are the poor pace of economic growth and the unsustainable Federal budget outlook; these interact as deficits are a headwind to growth, but faster growth would improve the fiscal outlook.
- Deficit reduction should be dominated by slowing the growth of mandatory spending, while tax policy should be progrowth with low taxes on saving, investment, and innovation.
- Differential taxation of alternative forms of capital income offers the greatest opportunities for tax avoidance and evasion; a progrowth tax stance reduces risks of these behaviors.

Let me discuss these in turn.

THE TWIN CHALLENGES OF ECONOMIC GROWTH AND THE FEDERAL FISCAL OUTLOOK

The most pressing economic policy issues are interrelated: the need for faster economic growth and a fiscal stance that reduces deficits and controls the Federal debt. The record on growth is striking. From 1960 through 2000, the average pace of growth in real gross domestic product (GDP) per capita was 2.4 percent. At this pace, GDP per capita—a rough measure of the standard of living—would double every 29 years. Thus, in roughly one working career, growth would double the standard of living, giving American families the opportunity to pursue their economic dreams.

Since then, from 2001 to 2022 the average pace of growth has been a full percentage point slower: 1.4 percent. At this pace the standard of living will double only every 56 years. There is the palpable sense that access to the American Dream is disappearing over the horizon.

The implications are enormous. Had the pace of growth been maintained in the 21st century, real GDP (in 2017 dollars) would have been $6.3 trillion higher in 2022, translating into additional real income of nearly $19,000 per capita. There is no government transfer program that can compete with the power of compound economic growth.

The budget consequences would be enormous as well. Assuming Federal revenues are roughly 19 percent of GDP, a faster pace of growth would mean that revenues

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* The views expressed here are my own and not those of the American Action Forum. I thank Gordon Gray, Angela Kuck, and Sarah Smith for their assistance.

would be $1.2 trillion higher than at present. At a time when the Congressional Budget Office (CBO) projects $20 trillion in Federal deficits over the next 10 years, having $12 trillion less in deficits would make the job of controlling the Federal debt much more manageable.

Federal fiscal policy is contributing to the slower pace of economic growth. It is widely recognized that borrowing trillions of dollars when the economy is at full employment competes with private-sector demands for capital. Reduced access to capital diminishes private-sector investment, thereby reducing growth in productivity and the standard of living.

Note, however, that *how* Federal deficits will evolve is especially antigrowth. The CBO baseline anticipates that the unified deficit will rise from 5.8 percent of GDP in 2024 to 7.3 percent of GDP in 2033, a 1.5 percentage point rise. Social Security spending will rise by 0.7 percentage points (from 5.3 percent to 6.0 percent of GDP) and Medicare spending will rise by 1.6 percentage points (from 3.7 percent of GDP to 5.3 percent of GDP). Thus, the combined growth of these two large mandatory spending programs will exceed the increase in the deficit by 0.8 percentage points.

If resources are transferred from private-sector investment to Federal subsidies to consumption, each dollar transferred reduces the growth in productivity, real wages, and the standard of living. Notice that this is true regardless of whether that transfer comes via taxes or deficit finance, but deficit finance is more likely to come at the expense of private investment. Past chronic federal deficits have already been a headwind to growth; the evolution of deficits over the next decade is an even greater threat to growth.

THE ROLE OF TAX POLICY

In the face of the rising debt and fiscal outlook, one might be tempted to focus tax policy on raising revenue, especially from the affluent. But many have observed that there is not enough potential revenue in such an approach and a recent study by Brian Reidl summarizes the evidence.[1] He notes:

> This report models an aggressive tax-the-rich agenda that pushes tax rates for corporations and wealthy families toward revenue-maximizing levels. It shows that such policies could raise, at most, 2% of GDP—and likely far less, when accounting for the macroeconomic losses that would result from layering so many new taxes on top of one another. Consequently, a sustainable economic and tax agenda would limit upper-income-tax increases to 1% of GDP.

A focus on taxing the affluent to "solve" the budget challenge will fail. A strategy more likely to succeed would be to focus tax policy on growth, keeping taxes on the return to saving, investment, and innovation as low and uniform as possible. As noted above, better growth has beneficial impacts on the budget outlook. Moreover, focusing deficit reduction on slowing the growth of mandatory spending programs will have a beneficial impact on growth.

To the extent that raising revenue is necessary, it would be better to focus on consumption-based changes to the tax base. Indeed, a dramatic reform would be to transition the tax code toward a personal consumption tax as the foundation of a progrowth strategy.

THE ROLE OF ANTI-AVOIDANCE AND ANTI-EVASION POLICIES

People should pay their legally owed taxes and the Internal Revenue Service (IRS) should be adequately staffed, funded, and mission-focused to enforce a high level of compliance. Such efforts should be pursued across the income distribution. I am troubled by the notion that recent additional funding to the IRS should be exclusively focused on the tax compliance of the affluent. The President's campaign promise was to not raise taxes on those making under $400,000. He did not promise that those individuals would be allowed to cheat on their taxes, and there is ample evidence of a substantial middle-income tax gap that bears scrutiny.

Tax avoidance, in contrast, is the legal pursuit of tax reduction by taking advantage of features of the tax code. Stripped to the basics, the heart of tax avoidance is to transform one type of income (*e.g.,* interest) to a less heavily taxed form of income (*e.g.,* capital gains). The tax code should be structured to keep the undesired behavioral responses to a minimum by keeping tax rates as low as possible and uni-

[1] *https://manhattan.institute/article/the-limits-of-taxing-the-rich.*

form across sources of income. The tax strategy for growth pairs nicely with reducing the incentives for avoidance, especially among the affluent who have concentration of capital income.

Thank you, and I look forward to your questions.

QUESTIONS SUBMITTED FOR THE RECORD TO DOUGLAS HOLTZ-EAKIN, PH.D.

QUESTIONS SUBMITTED BY HON. MIKE CRAPO

Question. The Biden administration's 2024 budget proposed $4.8 trillion in new taxes targeted at high-income individuals and businesses, making the case for raising taxes on Americans in order to "solve" our fiscal problems.

But you argue that "[a] focus on taxing the affluent to 'solve' the budget challenge will fail." Not just that it is bad policy or based upon flawed premises, but that it simply won't achieve what its proponents intend.

Can you elaborate why taxing the affluent to resolve fiscal challenges will fail?

Answer. A fiscal consolidation of $5 trillion (or larger) is appropriate given the U.S. fiscal outlook. Deficit reduction that averaged $500 billion per year would result an additional $1 trillion in interest savings, for a combined reduction in debt relative to CBO's baseline of about $6 trillion. Unfortunately, the deterioration in the budget outlook is such that these savings would not reverse the accumulation of additional debt and would still result in U.S. debt as a share of GDP topping 100 percent of the economy within 10 years.

The Biden administration, however, has proposed no such plan. Indeed, the Biden administration's budget proposed spending nearly half of its proposed tax hikes, while allowing debt service costs to exceed the cost of any Federal agency. Under the Biden budget, and again, notwithstanding nearly $5 trillion in tax hikes, debt would continue to grow. The scope and scale of the challenge is simply too large to rely on taxing high-income individuals. A recent study [1] by Brian Reidl indicates that such opportunities are quite limited. Noting that "an aggressive tax-the-rich agenda" could yield, at most, 2 percent of GDP, well short of needed deficit reduction.

Question. Some would have you believe the Tax Cuts and Jobs Act (TCJA) is exclusively a benefit for high-income taxpayers. Unfortunately, this is an inaccurate assessment, and more akin to class warfare than objective analysis. The truth is the various tax cuts enacted by the TCJA resulted in a reduction of personal income tax rates across all income brackets.

Could you describe how the TCJA improved incentives and economic growth for all Americans, contributing to record low unemployment and record high Federal tax collections?

Answer. The TCJA can generally be characterized as a major reform to the individual, international, and business tax systems, paired with significant individual tax relief. Prior to the enactment of the TCJA, the U.S. business and international tax system placed U.S. employers at a substantial disadvantage. The TCJA staunched the steady flight of U.S.-headquartered firms and rendered the U.S. corporate income tax somewhat more competitive. The tax literature is clear that these changes would accrue benefits to American workers, indeed the only serious debate is a matter how big the benefits are.

According to the distributional analysis of the TCJA by the Joint Committee on Taxation, the majority of the tax relief delivered by the TCJA in the years immediately following its enactment accrued to taxpayers earning less than $200,000. Indeed, IRS data has since generally borne out the fact that the TCJA delivered tax relief substantially targeted at middle- and lower-income taxpayers.

Question. And how does the TCJA's tax relief across the board contrast with the Biden administration's agenda to increase taxes on the American people?

Answer. The TCJA reflected a growing, bipartisan consensus that the U.S. tax system was outdated and an active drag on economic growth. The U.S. corporate tax rate was the highest among major global economies. The President's budget is instructive on the administration's economic policy priorities—it would substantially

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[1] *https://manhattan.institute/article/the-limits-of-taxing-the-rich.*

increase the tax burden on major U.S. employers and saddle future generations will poor economic performance and unprecedented levels of debt.

QUESTIONS SUBMITTED BY HON. STEVE DAINES

Question. One of the important provisions in the Tax Cuts and Jobs Act (TCJA) was the section 199A deduction for small businesses. For example, EY estimates[2] that with 199A, the typical large pass-through pays a similar effective rate as the typical public company. Without 199A, their rate is significantly higher.

Can you talk about the importance of that provision, especially how it ensured small and family-owned businesses were competitive with public companies and their new 21-percent rate?

Answer. Tax neutrality is a guiding principle in tax reform—that tax policy should not distort the investment decisions of private firms. Prior to the enactment of the TCJA, the U.S. corporation income tax was the highest in the developed world. Theoretical and empirical research reliably found that this tax posture was harmful to U.S. economic performance. A signal achievement of the TCJA was the modernization of U.S. business taxation, after which the steady flight of firms from U.S. shores ceased.

Part and parcel to this modernization was the recognition that taxation should be, to the extent practicable, neutral to a firm's legal form of organization. This is more easily achieved in theory than in practice, but, as affirmed by EY's analysis, TCJA came fairly close. Section 199A was instrumental in this, and more closely harmonized effective tax rates on the return to business investment than would have been achieved through the TCJA's individual income tax changes. Nevertheless, there remains scope for improving the design of this provision as Congress revisits the TCJA in years to come.

Table ES–1. Effective and Marginal Tax Rates Under Pre- and Post-TCJA Law

	Pre-TCJA law	Post-TCJA law (in 2019)	Post-TCJA law (in 2026)
Effective tax rates			
Large S corporation	41.2	33.8	41.2
C corporations:			
Closely held, fully taxable shareholders	43.1	31.2	30.8
Average C corporation	41.3	29.0	28.7
Marginal effective tax rates			
Large S corporations	23.1	16.3	26.2
C corporations	22.6	16.8	22.8

Note: The *effective tax rates* are the average tax rate for hypothetical business earnings received through an S corporation and a C corporation. The *marginal effective tax rates* are for the additional increment of income from a new investment. Figures are rounded.
Source: EY analysis.

Question. Another reason to support 199A is it helped small and family-owned businesses avoid a tax hike under the TCJA. That is because many of the corporate base broadening provisions included in the TCJA, including the new cap on interest deductions, changes to the tax treatment of R&E, and the elimination of the old manufacturing deduction, would have increased taxes on pass-throughs, as did the cap on SALT deductions and the new excess loss limitation rules. Absent 199A, taxes on many of these small and family-owned businesses would have gone up.

Can you address how making 199A permanent would help to offset these revenue raisers?

Answer. Harmonizing the taxation on the return to business investment is critical to minimizing distortions in the investment decisions of private firms. Such distortions lead to misallocation of capital across the economy, ultimately harming long-term growth and wages. Similarly, disparate tax treatment of similar economic ac-

[2] *https://s-corp.org/2019/10/ey-on-tax-parity/.*

tivity can encourage tax avoidance that unduly erodes the tax base. Section 199A is the TCJA's key instrument for minimizing tax distortions depending on business form. This goal should animate Congress's efforts to reform and render more stable the U.S. tax system as it faces the expiration of 199A and other key elements of the TCJA.

Question. Most individual provisions in TCJA expire at the end of 2025, including section 199A. Many estimates, including a Brookings paper authored by Robert Barro and Jason Furman,[3] warn that sunsetting TCJA provisions, including the 199A deduction, would reduce economic output and hurt the labor market.

What do you think would be the consequences for the competitiveness of small businesses compared to large corporations if there is a failure to extend section 199A?

Answer. Among the most progrowth features of the TCJA was making the taxation on the return to business investment substantially more competitive. Among least progrowth features of the TCJA is the budgetary tradeoff that required rendering a significant share of the U.S. tax code impermanent. Among the provisions set to expire is indeed section 199A, which reflects a critical design feature of the TCJA that narrowed certain distortions in the tax code. The expiration of this and other portions of the tax code would introduce new distortions, in particular significantly disparate tax treatment of different legal forms of organization. This would uniquely penalize pass-through entities, including many small and medium-sized firms. Research commissioned by AAF, and performed by EY, found that making permanent the key expiring individual and business provisions of the TCJA, including 199A, would lead to a significant improvement in long-term economic growth, investment, and real wages. Importantly, the magnitude of these economic benefits materially depends on financing. Specifically, financing these tax changes with spending reductions is significantly more efficient than with future tax increases.

Table 1. Summary of the Major Macroeconomic Results for Featured Parameters

(percent change)

	Law as written	Provisions permanent
Long-run Results		
Corporate productivity	2.5%	4.7%
Pass-through productivity	−0.8%	3.1%
GDP per capita	0.9%	3.1%
10-year Results		
Level of output after 10 years	0.4%	1.2%
Change in annual growth rate	0.04 p.p.	0.13 p.p.
Financing Assumptions, 2018–2027		
Cost assuming JCT scoring and our dynamic feedback	$1.2 trillion	$1.7 trillion
Annual lump sum cost per household	$900	$1,400

QUESTIONS SUBMITTED BY HON. MARSHA BLACKBURN

Question. The importance of the 199A Qualified Business Income deduction cannot be understated. It incentives entrepreneurship and small business growth, which is the lifeblood of the U.S. economy and accounts for nearly half of the Nation's private workforce. The continuation of this credit, which was introduced as part of the Tax Cuts and Jobs Act, is the most prominent issue that comes up when I speak to small businesses in Tennessee. That is why I joined Senator Daines and several of my colleagues in introducing the Main Street Tax Certainty Act, which would make the tax deduction permanent and create certainty for small businesses.

What has been the impact of the 199A Qualified Business Income deduction on the growth and development of small business in the United States?

[3] *https://www.brookings.edu/wp-content/uploads/2018/03/BarroFurman_Text.pdf.*

Answer. U.S. economic performance subsequent to the enactment of the TCJA was irreducibly strong, and subsequent research has found a causal link between the TCJA and improved economic growth. The design of the TCJA recognized the need for tax neutrality with respect to business form, with section 199A as the principal instrument for that policy goal. Allowing 199A to expire would reverse that policy design choice, and disproportionately harm small business and lead to reduced investment, productivity, and ultimately, workers' wages.

Question. What would be the impact on the small business community if Congress does not extend this deduction?

Answer. A number of studies, including those published by Brookings as well as AAF, have found that failure to extend key elements of the TCJA, of which 199A is a significant part, would harm U.S. economic performance. Congress will need to revisit the TCJA as it faces substantial expiration in 2025, and should look for approaches that maintain the principle of tax neutrality.

QUESTIONS SUBMITTED BY HON. TODD YOUNG

Question. During your live questioning, you briefly discussed how the burden of the corporate tax falls to individuals. Specifically, you noted the cost of corporate tax often falls to the "shareholders or the customers in higher prices or the workers in lower wages."

Can you please elaborate on the impact of the tie between the corporate tax rate and the economic burden for individuals?

Answer. Corporations are essentially a legal nexus of capital through shareholders, labor through employees, and consumers through their participation in the economy in which the corporation does business. Corporate taxation will ultimately impose a burden on one or all of those channels. This is a simplified narrative, but it illustrates the nature of corporate taxation in a global economy: Everyone but the corporation itself bears the burden, though not equally.

The modern globalized economy is characterized by ever more mobile capital. Increasingly, investment can flow to areas of lower taxation with greater ease. Labor is not nearly so mobile. A worker who lives in the low-tax jurisdiction will generally benefit as more capital flows to firms while workers in high-tax jurisdictions will forgo higher capital and associated productivity and resultant wage gains. There is therefore the potential for labor to bear a high share of the corporate tax burden, and a number of studies have found this burden to be quite high.

Question. Some individuals, including a few of my colleagues, have criticized certain Tax Cuts and Jobs Act (TCJA) provisions that incentivize investment in research and development, among other items, by saying they solely benefit big businesses. However, that narrative fails to acknowledge that these provisions offer tax reductions for workers and businesses across the board, including many small businesses that are now concerned they will have to close their doors if these incentives are not restored.

Can you please discuss the impact TCJA has had on small businesses and their workforce?

Answer. U.S. economic performance materially improved in the wake of the enactment of the TCJA, and there is growing evidence in the research literature on positive contribution of the TCJA to this performance. While the subsequent pandemic has somewhat distorted recent economic history, directionally, TCJA plainly encouraged economic growth. The improved incentives for business investment, including those targeted at small and medium-sized firms, such as 199A and section 179 expensing, are key elements of that improved set of incentives. Reversing this progress would be to the clear detriment of those same firms, as evidenced by research commissioned by AAF as well as other analyses.

Additionally, it is important to note the wide-ranging positive impacts these provisions have had on the economy, the availability of high-paying jobs, and the ability for businesses to invest in new and innovative products important to the long-term growth of the U.S.

Question. Can you please share some of the larger macroeconomic impacts these business investments have provided to companies, both big and small?

Answer. Among the most powerful, progrowth incentives introduced by the TCJA was the 100-percent expensing of investment in equipment and software. This tax provision appropriately treats up front investment as an allowable expense, in contrast to complicated and inefficient amortization schedules that simultaneously inhibited investment and encouraged tax avoidance. A regrettable feature of the TCJA is the expiration of this treatment of capital investment, and the simultaneous erosion in the ability of firms to deduct the cost of research and experimentation. In a modern, global economy, such policies are antithetical to sound tax policy design. Making these and other key design features of the TCJA permanent would forestall a damaging tax increase while providing a more predictable and stable tax code.

Question. In your written testimony, you highlighted concerns with the current Federal budget outlook, noting that the "unsustainable Federal budget outlook" combined with the "poor pace of economic growth" act as a damper to growth, but that "faster growth would improve the fiscal outlook." You also recommended that "tax policy should be progrowth with low taxes on saving, investment, and innovation."

Given these concerns, how would you recommend Congress address the sunset of the Tax Cuts and Jobs Act in 2025?

Answer. While the TCJA substantially improved the U.S. tax system, it should not be viewed as the last word on U.S. policy. The scheduled expiration of a substantially all of the individual tax provisions, as well as some of the most progrowth business tax reforms, should invite an opportunity to revisit these tax policies, and the balance the efficiency gains from these policies against the budgetary cost.

The solution is to neither let the TCJA expire nor extend it permanently. The solution is to take the 2025 deadline as the opportunity to continue the progrowth tax reforms begun in 2017. As a general matter, tax reform is the process of keeping rates as low as possible and the base as broad as feasible. Progrowth tax reform means that the base should be as close to aggregate consumption as possible, while the taxes on the return to saving, investment, and innovation should be as low as possible. Finally, in the interest of efficiency, the tax code should be as neutral as possible between debt- and equity-financed investment; investments in human, physical, and technology capital; and between activity in the corporate and noncorporate sector.

In practice, this means that there should be no contemplation of raising the corporate rate as it is among the most successful parts of the reform. In the decade prior to the TCJA, the United States lost roughly 10 headquarters every year. Since then? None. Could there be improvements in the corporate reforms? Of course, but the basic structure works. Similarly, should there be a way to equalize the tax treatments of corporate-source income and pass-through business income?

Question. In your testimony, you highlighted the pace of economic growth and the fiscal outlook as top policy problems.

Where would you rank tax evasion on your list of policy priorities and why?

Answer. The challenge of weak economic growth prospects combined with high and growing Federal indebtedness poses a serious risk to the prosperity and well-being of every American. Put simply, tax evasion does not. One measure of tax evasion is the "tax gap," which is an estimate of how far short actual tax collections fall from an estimated theoretical ideal. To be sure, there is merit in reducing this gap as is practicable and duly enforcing related U.S. laws. But in general, this gap is relatively stable over time, and is animated by a multitude of factors, none of which invite easy remedy.

PREPARED STATEMENT OF CHYE-CHING HUANG, EXECUTIVE DIRECTOR, TAX LAW CENTER, NEW YORK UNIVERSITY SCHOOL OF LAW

Chairman Wyden, Ranking Member Crapo, and distinguished members of the committee, thank you for the opportunity to testify.[1] I am the executive director of

[1] This testimony draws heavily on my prior work, including: *Strengthening the Tax Base,* Testimony Before the United States Senate Committee on the Budget (September 27, 2023, *https://www.budget.senate.gov/imo/media/doc/huang_testimony_927.pdf*); *Funding Our Nation's Priorities: Reforming the Tax Code's Advantageous Treatment of the Wealthy,* Testimony Before the

the Tax Law Center at NYU Law, a public interest initiative that seeks to improve the integrity of the tax system. The Center is staffed by tax lawyers with expertise in tax administration, private practice, and the tax legislative process, and our work draws on extensive networks of public interest minded tax practitioners and experts.

SUMMARY

The highest-income households get the bulk of their income from their wealth. The Nation spends hundreds of billions of dollars each year to maintain tax preferences that allow income from wealth to face less tax than equivalent income from work.

Tax subsidies for income from wealth add to deficits by narrowing and weakening the Federal tax base. Tax breaks like these are sometimes called "tax expenditures," or "spending through the tax code" because their impact on the budget and the economy is like a spending program designed to subsidize a specific activity.

Tax subsidies for income from wealth are a poor investment. They increase deficits, widen inequality, and spur complex tax avoidance and evasion that locks up capital and talent that could be used for more productive work and innovations. This is a misallocation of both public and private resources. Tax evasion by the very wealthy can often involve the proceeds of other criminal acts such as sanctions evasion and corruption, which undermines the rule of law.

Federal resources can instead be directed towards investments that better meet the Nation's most pressing challenges. That could include investing in workers and families; supporting an innovative and dynamic economy; meeting global challenges; and putting the Federal budget on a stronger long-term Federal trajectory as the baby boomers retire.

THE NATION SPENDS HUNDREDS OF BILLIONS EACH YEAR ON TAX BREAKS ON INCOME FROM WEALTH

Salary earners pay a top Federal tax rate of 40.8 percent on their incomes, in the year they earn it, which is usually withheld in every paycheck. The highest-income filers, however get the bulk of their income not from salaries, but from wealth.[2] Wealth includes financial assets such as stocks and bonds, real estate, personal property such as art, and ownership stakes in non-corporate businesses.[3] About a third of all U.S. wealth is held by the wealthiest 1 percent of households.[4] That wealth generates income, including capital gains from when the assets grow in value, dividends, and business income from ownership of "pass-through" businesses that does not face the corporate tax rate, but is, in theory, taxed at owners' individual tax rates.

The Federal tax system gives income from wealth a series of preferences that allow the very wealthy to effectively choose when—or whether—to pay tax, and at what rate. Large amounts of income from wealth can disappear from the Federal tax base and escape being taxed across decades, lifetimes, and even generations. Federal tax breaks on incomes from wealth include:

Lower rates. The Federal tax code allows income from wealth to face a wide range of rates at a discount to what would be faced on salaries of the same amount—depending on how that income is reported.[5] Long-term capital gains and dividends face a top rate of 23.8 percent, far lower than the top rate of 40.8 percent that would be paid on the same amount of salary. Such preferential rates cost the Federal Government about $177 billion annually.[6] The 2017 tax law's section 199A

House Subcommittee on Select Revenue Matters (May 12, 2021, *https://waysandmeans.house.gov/wp-content/uploads/2021/05/Huang.Testimony.pdf*).

[2] Congressional Budget Office (CBO), *The Distribution of Household Income, 2019* (November 15, 2022, *https://www.cbo.gov/publication/58353#data*). These data do not include unrealized capital gains.

[3] CBO, *Trends in the Distribution of Family Wealth, 1989 to 2019* 1 (September 27, 2022, *https://www.cbo.gov/system/files/2022-09/57598-family-wealth.pdf#page=7*).

[4] Joint Committee on Taxation (JCT), JCX–51–23, *Present Law on the Income Taxation of High Income and High Wealth Taxpayers* 17 (November 7, 2023, *https://www.jct.gov/publications/2023/jcx-51-23/*); *see also id.* at 2.

[5] *See* Lily L. Batchelder and David Kamin, *Taxing the Rich: Issues and Options* (February 1, 2020, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452274*).

[6] The JCT projects that the reduced rate of tax on dividends and long-term capital gains will cost $1.14 trillion from 2022 to 2026, or an average of $227.9 billion each year. JCT, JCX–22–22, *Estimates of Federal Tax Expenditures for Fiscal Years 2022–2026,* at 35 (December 22,

Continued

"pass-through deduction" gives high-income filers a new 11.2 percentage point discount on their top rate on salaries and wages, representing a total tax expenditure of $42 billion in 2019, with over half of that expenditure accruing to the top 1 percent of filers.[7]

Deferred tax. Capital gains, however, are usually invisible to the tax system until they are "realized," usually when the asset has grown in value is sold. If a wealthy person holds stock that grows in value from $100 million to $1 billion, they will not face tax on the $900 million gain until they sell the stock. That allows the very wealthiest filers to choose when to face capital gains income tax—even though they can enjoy the benefit of the gain. The fact that this income is "real" in any practical sense is perhaps most obvious when filers borrow against the gain at low rates—and then, just as with any other type of income, can choose to either consume or invest the proceeds.[8] At the same time as deferring taxes on gains, wealthy filers will often rush to harvest losses. This is the main driver behind estimates that the 400 highest-income households in the country paid effective Federal income tax rates in the range of 8 to 10 percent.[9] Precise estimates are difficult to make: the nature of this preference means that the income does not show up on Federal income tax returns.

Evaporating income [10] ***(stepped-up basis).*** If a wealthy person holds assets that have gained in value until they die, then that untaxed gain disappears from the income tax system entirely. Neither they nor their heirs will ever pay income tax on the gain. This provision is referred to as "stepped up basis," or the "angel of death loophole."[11] It is a Federal tax subsidy for wealthy families making intergenerational transfers because bequests are exempt from capital gains taxes that would normally apply to the sale or transfer of appreciated assets.[12] JCT estimates that this exemption costs some $60 billion annually.[13] Over half of the value of the wealthiest estates is made up of unrealized gain that has never faced tax.[14] A weakened estate tax means that much of that income will never face any type of Federal tax.

A DIZZYING ARRAY OF TAX BREAKS, LOOPHOLES, AND GAMING

Lower rates, tax deferral, and the stepped-up basis are the most obvious tax preferences for the wealthy. In turn, those tax breaks support a dizzying array of additional methods that wealthy filers can use to push yet more income out of the tax base.

Lawmakers have deliberately enacted further preferences that build on or expand the rate, deferral, and step-up provisions. And tax advisors have also created loop-

2022, *https://www.jct.gov/publications/2022/jcx-22-22/*). The surtax on net investment income, estimated at—$254.2 between 2022 to 2026, or an average of $50.8 billion each year—partially offsets the lower rates. *Id.* at 6 n.16, 38.

[7] *See* JCT, *supra* note 4, at 10; *see also* Chuck Marr, Brendan Duke and Chye-Ching Huang, *New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring,* Center on Budget and Policy Priorities (CBPP) (August 14, 2018, *https://www.cbpp.org/research/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring*).

[8] *See, e.g.,* Rachel Louise Ensign and Richard Rubin, *Buy, Borrow, Die: How Rich Americans Live Off Their Paper Wealth,* Wall Street Journal (July 13, 2021, *https://www.wsj.com/articles/buy-borrow-die-how-rich-americans-live-off-their-paper-wealth-11625909583*).

[9] Danny Yagan, *What Is the Average Federal Individual Income Tax Rate on the Wealthiest Americans?,* 39 Oxford Review of Economic Policy 438–50 (Autumn 2023, *https://academic.oup.com/oxrep/article-abstract/39/3/438/7245778?redirectedFrom=PDF*). For an earlier version of this paper based on data through 2018, *see* Greg Leiserson and Danny Yagan, *What is the Average Federal Individual Income Tax Rate on the Wealthiest Americans?,* White House (2021, *https://www.whitehouse.gov/cea/written-materials/2021/09/23/what-is-the-average-federal-individual-income-tax-rate-on-the-wealthiest-americans/*).

[10] *See* Jason S. Oh, *Increasing Progressivity by Reforming the Taxation of Capital Income,* Testimony Before the Subcommittee on Select Revenue Measures 2–3 (May 12, 2021, *https://waysandmeans.house.gov/wp-content/uploads/2021/05/Oh_Testimony.pdf#page=2*).

[11] Michael Kinsley, *The "Angel-of-Death" Loophole,* Washington Post (June 25, 1987, *https://www.washingtonpost.com/archive/opinions/1987/06/25/the-angel-of-death-loophole/5a42296d-982b-4517-a13a-c89ba270f52d/*).

[12] *See* Adam Looney, *Funding Our Nation's Priorities: Reforming the Tax Code's Advantageous Treatment of the Wealthy,* Testimony Before the Subcommittee on Select Revenue Measures (May 12, 2021, *https://docs.house.gov/meetings/WM/WM05/20210512/112604/HHRG-117-WM05-Wstate-LooneyA-20210512.pdf*).

[13] JCT, *supra* note 6, at 37.

[14] Chye-Ching Huang and Chloe Cho, *Ten Facts You Should Know About the Federal Estate Tax,* CBPP (October 30, 2017, *https://www.cbpp.org/research/ten-facts-you-should-know-about-the-federal-estate-tax*).

holes and complex avoidance schemes. Using such methods, wealthy filers can not only seek the lowest possible tax rate on income from their assets, but they can also try to push their *labor* income into the code's preferences for "capital" income, to avoid top income and payroll rates.

Examples include:[15]

- **Carried Interest:** Managers of private investment funds (including hedge funds, venture capital funds, and private equity funds) can be paid in both "management fees" taxed at ordinary income rates and "carried interest" taxed at low capital gains rates. Managers typically choose to receive as much of their income as possible as carried interest.[16]
- **Turning life insurance, investment funds, health savings accounts, and retirement accounts into tax shelters.** Some investments, if made directly by a wealthy household, would generate capital gains and dividends that would be taxed at preferential rates. But planners have found ways to exploit loopholes and deliberate preferences in the code to take that income from wealth entirely out of the tax system by running it through various vehicles recognized by the tax code.

  For example, a loophole enables deferral and even complete avoidance of tax on capital gains made **through Exchange Traded Funds (ETFs),** including extreme forms of tax avoidance such as "heartbeat trades," in which investment banks partner with ETFs to cycle large stock portfolios into funds and then quickly out of them using in-kind redemptions.[17] **Private Placement Life Insurance (PPLI),** a form of life insurance offered privately and only to the wealthiest individuals, enables investment in a wide range of assets and structures (including hedge funds), with tax-deferred growth and tax-free transfer to heirs.[18] **Health Savings Accounts (HSAs),** instead of improving health care, have become a favored vehicle for tax sheltering, in part due to the ability for pretax contributions to be invested and to accrue earnings free of tax.[19] Retirement accounts, particularly **Roth IRAs,** have increasingly become a vehicle into which the wealthy "stuff" undervalued assets like founders' stock and never pay tax on their incredible returns.[20]
- **Tax avoidance using pass-through businesses, including relabeling income from labor.**[21] An array of holes in the taxation of pass-throughs allow

[15] In the past, loss-making jojoba farms (before 1986 tax reform equalized top rates on work and capital income), *see* Department of the Treasury (Treasury), *The Problem of Corporate Tax Shelters* 42 (July 1999, *https://home.treasury.gov/system/files/131/Report-Corporate-Tax-Shelters-1999.pdf*), and "basket options" (after gaps emerged again), *see Wyden Urges Treasury Action Against Basket Options,* Tax Notes (June 16, 2015, *https://www.taxnotes.com/research/federal/legislative-documents/congressional-tax-correspondence/wyden-urges-treasury-action-against-basket-options/fw89?highlight=basket+options+tax*) were other popular techniques, and more recently capital treatment for SPAC founders was one feature of the SPAC craze. *See* Lee A. Sheppard, *SPAC Founders' Shares Are Compensation,* Tax Notes (February 22, 2021, *https://www.taxnotes.com/tax-notes-federal/property-taxation/spac-founders-shares-are-compensation/2021/02/22/2zdyf?highlight=%22SPAC%20founders%22*).

[16] The 2017 tax law made small modifications but left the tax break largely intact. *See* Tax Policy Center (TPC), *What is Carried Interest, and How is It Taxed?* (May 2020, *https://www.taxpolicycenter.org/briefing-book/what-carried-interest-and-how-it-taxed*).

[17] Sam Potter, Katherine Greifeld and Elaine Chen, *ETF Industry Risks Losing Key Tax Edge as Democrat Whets Knife,* Bloomberg (September 14, 2021, *https://www.bloomberg.com/news/articles/2021-09-14/etf-industry-risks-losing-key-tax-edge-as-democrat-whets-knife*).

[18] *See* Press Release, U.S. Senate Committee on Finance, *Wyden Launches Investigation Into Private Placement Life Insurance Schemes* (August 15, 2022, *https://www.finance.senate.gov/chairmans-news/wyden-launches-investigation-into-private-placement-life-insurance-schemes*). *See also* Lauren Loricchio, Sarah Paez, Kiarra M. Strocko and Chandra Wallace, *Offshore Life Insurance: Wrapped in Controversy Amid Senate Probe,* Tax Notes (August 31, 2023, *https://www.taxnotes.com/featured-news/offshore-life-insurance-wrapped-controversy-amid-senate-probe/2023/08/30/7h7vq*).

[19] For discussion of existing tax sheltering using HSAs and House proposals that would exacerbate these problems, *see* Gideon Lukens, *Expanding Health Savings Accounts Would Boost Tax Shelters, Not Access to Care,* CBPP (June 22, 2023, *https://www.cbpp.org/research/health/expanding-health-savings-accounts-would-boost-tax-shelters-not-access-to-care*).

[20] *See* Justin Elliott, Patricia Callahan and James Bandler, *Lord of the Roths: How Tech Mogul Peter Thiel Turned a Retirement Account for the Middle Class Into a $5 Billion Tax-Free Piggy Bank,* ProPublica (June 24, 2021, *https://www.propublica.org/article/lord-of-the-roths-how-tech-mogul-peter-thiel-turned-a-retirement-account-for-the-middle-class-into-a-5-billion-dollar-tax-free-piggy-bank*).

[21] *See* Huang, *Strengthening the Tax Base, supra* note 1, at 1–2, 6, 11–12, 14–15.

high-income filers to pick lower rates on their "business" income.[22] The "Gingrich-Edwards" loophole is an example. Active owners of S corporations, a type of pass-through, can underreport the share of their income from those pass-throughs that is salary for their labor services, overstate the share that is "business profits," and in doing so avoid both the 3.8-percent Medicare payroll taxes on high salaries and the parallel 3.8-percent tax on net investment income. The 2017 "Tax Cuts and Jobs Act" (TCJA) section 199A pass-through deduction supercharges the incentive for filers to reclassify their income from services as "business" income. Its "guard rails" to prevent this are illogical and porous.[23]

Research suggests that about three quarters of "business profits" the very wealthy receive through their pass-throughs may in fact be compensation for their labor.[24]

The taxation of **partnerships**—a form of pass-through controlling more than $40 trillion in assets and vastly outnumbering public firms[25]—is another problem area that currently combines complexity, inconsistency in the system, and optionality.[26]

One role of the **estate tax** is to provide a backstop ensuring that some of the income that escapes the income tax base on its way to heirs is subject to at least some Federal tax. More than half of the value of estates with over $100 million in assets are made up of unrealized capital gains that have never been taxed.[27] But the estate tax has been so weakened that only the largest 1 out of every 1,000 estates in the country faces the tax, and those that do pay an effective rate of 16.5 percent because so much of the value of an estate is exempt.[28]

Only the already wealthy can enjoy outright tax breaks on wealth; they try to expand the coverage of these tax breaks and maneuver through audits and disputes with the IRS to protect those advantages. They have the resources to hire expert tax lawyers and accountants who set up this tax planning and to enlarge and defend their tax breaks through the courts. Such tools are not available to low- and moderate-income workers, who are taxed at ordinary rates, pay taxes as they earn their wages and salary, and overwhelmingly have no professional representation when they are audited.[29]

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[22] *See* Treasury, *Gaps between the Net Investment Income Tax Base and the Employment Tax Base* (April 14, 2016, *https://home.treasury.gov/system/files/131/NIIT-SECA-Coverage.pdf*).

[23] *See* Samantha Jacoby, *Repealing Flawed "Pass-Through" Deduction Should Be Part of Recovery Legislation,* CBPP (June 1, 2021, *https://www.cbpp.org/research/federal-tax/repealing-flawed-pass-through-deduction-should-be-part-of-recovery-legislation*).

[24] Matthew Smith, Danny Yagan, Owen Zidar and Eric Zwick, *Capitalists in the Twenty-First Century,* 134 Quarterly Journal of Economics 1675, 1675–76 (2019, *http://ericzwick.com/capitalists/capitalists.pdf*).

[25] For the size of total assets of all partnerships, *see* IRS, *SOI Tax Stats—Partnership Data by Size of Total Assets* (All Partnerships) (2020, *https://www.irs.gov/statistics/soi-tax-stats-partnership-data-by-size-of-total-assets*). There were over 4 million partnerships in 2020, IRS, *SOI Tax Stats—Partnership Statistics by Entity Type,* Table 9a, compared with about 4,000 to 7,000 public companies. *See also,* IRS, *SOI Tax Stats—Corporation Data by Type of Return (https://www.irs.gov/statistics/soi-tax-stats-corporation-data-by-type-of-return#_1120all)*.

[26] *See* Chye-Ching Huang, *Building Back Better: Raising Revenue to Invest in Shared Prosperity,* Testimony Before the Joint Economic Committee 10 (October 6, 2021, *https://www.jec.senate.gov/public/_cache/files/b2b15aa5-ef93-4fdc-9557-2ddbd569502e/chye-ching-huang-testimony.pdf*); *see also* Press Release, U.S. Senate Committee on Finance, *Wyden Unveils Proposal To Close Loopholes Allowing Wealthy Investors, Mega-Corporations To Use Partnerships To Avoid Paying Tax* (September 10, 2021, *https://www.finance.senate.gov/chairmans-news/wyden-unveils-proposal-to-close-loopholes-allowing-wealthy-investors-mega-corporations-to-use-partnerships-to-avoid-paying-tax*); Michael Cooper et al., *Business in the United States: Who Owns It, and How Much Tax Do They Pay?,* 30 Tax Policy and the Economy 91 (2016, *https://www.journals.uchicago.edu/doi/full/10.1086/685594#.*).

[27] *See* CBPP, *The Federal Estate Tax* (November 7, 2018, *https://www.law.nyu.edu/sites/default/files/Broadening%20the%20US%20Federal%20Tax%20Base%20-%209.26.23.xlsx*).

[28] *Id. See also* Tax Law Center, *Broadening the US Federal Tax Base* (September 27, 2023, *https://www.law.nyu.edu/sites/default/files/Broadening%20the%20US%20Federal%20Tax%20Base%20-%209.26.23.xlsx*).

[29] *See* Nina E. Olson, Hearing Before the House Committee on Oversight and Government Reform (April 17, 2018, *https://www.c-span.org/video/?448991-1/tax-administration-irs-oversight*).

COMPLEXITY AND OPACITY CONCEAL TAX EVASION

The focus of this hearing is the ways in which high-income filers lawfully reduce their taxes, but it is important to know that tax breaks in the law have costs that include unlawful tax evasion.

The top 1 percent (by income) of filers are responsible for some 28 percent of the tax gap of taxes owed but not paid each year that flows from individual income underreporting—amounting to some $80 billion annually, according to Internal Revenue Service (IRS) estimates.[30] Other estimates suggest those figures are even higher.[31] Some of this tax gap is caused by high-income filers attempting to lawfully avoid taxes but overstepping into unlawful evasion. Some of it flows from the most egregious forms of tax evasion associated with the proceeds of other crimes including sanctions, evasion, and corruption.

Both scenarios can be difficult for the IRS to detect and untangle. Wealthy households can have finances far more complex than most typical salary earners. Some of that complexity arises from the slew of tax breaks on income from wealth and the complicated structures developed to take advantage of them.[32] Webs of entities used by high-income filers that own wealth and make income can also make it difficult for the IRS to match income to owners who should pay tax on it. And, unlike income from earnings reported on W–2s (which enjoy 99 percent compliance rates), the IRS often holds little or no "third-party" independent information on income from wealth that they can use to verify the source or amount of reported (or unreported) income.[33]

The returns of wage and salary filers are far easier and cheaper to audit than the complex returns of high-income filers. Before the recent Inflation Reduction Act (IRA) passed, the IRS lost about 40 percent of its auditors, including those experienced enough to review the most complex returns of large businesses and high net worth individuals.[34] Audit rates for the top 1 percent of filers fell by more than 70 percent, becoming a shrinking share of all audits.[35]

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[30] Andrew Johns and Joel Slemrod, *The Distribution of Income Tax Noncompliance,* 63 National Tax Journal *(https://www.journals.uchicago.edu/doi/abs/10.17310/ntj.2010.3.01); The Distribution of Income Tax Noncompliance,* 63 National Tax Journal; *The Distribution of Income Tax Noncompliance,* 63 National Tax Journal 397, 406 (2010); Jason DeBacker et al., *Tax Noncompliance and Measures of Income Inequality,* Tax Notes Federal 7–8 (February 16, 2020, *https://www.taxnotes.com/tax-notes-federal/compliance/tax-noncompliance-and-measures-income-inequality/2020/02/17/2c3y5*). The individual income tax underreporting gap is estimated to have increased from about $348 billion annually between 2014 to 2016 to about $396 billion in 2021. IRS, *Tax Gap Projections for Tax Years 2020 & 2021* 12 (October 12, 2023, *https://www.irs.gov/pub/irs-pdf/p5869.pdf*). *See* Huang, *Funding Our Nation's Priorities, supra* note 1.

[31] *See* John Guyton et al., *Tax Evasion at the Top of the Income Distribution* 35 (National Bureau of Economic Research, Working Paper No. 28542, 2021, *https://www.nber.org/system/files/working_papers/w28542/w28542.pdf#page=29*). Estimates of the total tax gap and the share attributable to the highest-income filers vary and are difficult to make given limited sight lines of the IRS into some major categories of noncompliance (including offshore income, digital assets, and income held through complex layers of entities). *See* Daniel Reck et al., Washington Center for Equitable Growth, *Tax Evasion at the Top of the U.S. Income Distribution and How to Fight It* (March 22, 2021, *https://equitablegrowth.org/tax-evasion-at-the-top-of-the-u-s-income-distribution-and-how-to-fight-it*); *Tax Gap Projections for Tax Years 2020 & 2021, supra* note 30, at 18–21.

[32] Tax system complexity is thought to be a driver of the tax gap generally. *See* CRS, *Federal Tax Gap: Size, Contributing Factors, and the Debate Over Reducing It* 2 (October 30, 2022, *https://crsreports.congress.gov/product/pdf/IF/IF11887#page=2*) ("Tax code complexity also creates opportunities for taxpayers who can afford to hire tax professionals to reduce their tax liability through questionable interpretations of the code.").

[33] IRS, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013* 20 (September 2019, *https://www.irs.gov/pub/irs-pdf/p1415.pdf*).

[34] *See* Chuck Marr et al., *Rebuilding the IRS Would Reduce the Tax Gap, Help Replenish Depleted Revenue Base* (December 16, 2022, *https://www.cbpp.org/research/federal-tax/rebuilding-irs-would-reduce-tax-gap-help-replenish-depleted-revenue-base*).

[35] Calculations use data from: IRS, *IRS Data Book Table 17a: Examination Coverage and Recommended Additional Tax After Examination, by Type and Size of Return, Tax Years 2010–2018* (last updated October 22, 2020, *https://www.irs.gov/statistics/soi-tax-stats-examination-coverage-and-recommended-additional-tax-after-examination-by-type-and-size-of-return-tax-years-2010-2018-irs-data-book-table-17a*). The top 1 percent includes all filers with adjusted gross income of $500,000 and above. Table 17a includes in-process and completed audits, so figures may change as new audits are opened for recent tax years. The figure cited above is for tax year 2015, the most recent year outside the normal statute of limitations for tax returns filed on time.

COSTLY TAX SUBSIDIES FOR INCOME FROM WEALTH ARE A POOR WAY TO INVEST IN THE NATION'S FUTURE

Targeted tax breaks for specific types of income like those for wealth are sometimes called "tax expenditures,"[36] or "spending through the tax code," because their economic and budgetary impact is like a spending program designed to subsidize a particular activity.[37] These preferences carve income out of the Federal tax base.[38] Just like other types of Federal spending, tax expenditures are not inherently sound or unsound policy.[39] But the largest tax breaks on income from wealth have large costs, including the following:

Economic costs of tax avoidance and evasion. The tax avoidance, sheltering, and gaming that these tax subsidies attract pulls capital and talent away from more productive activities.[40]

- **Locking capital into relatively unproductive investments.** The ability to defer taxes on capital gains until they are realized—or wipe them out if held until death—is a major tax incentive for wealthy filers to hold onto old investments that have increased in value. Without this "lock in" effect from taxes, they might instead sell their appreciated assets and use the returns to make other, more productive investments that would deliver a higher pretax return for them and for the real economy.
- **Redirecting resources and talent into tax avoidance.** Talent and innovation go into industries devoted to creating and implementing tax avoidance schemes—which are themselves economically inefficient—rather than where that talent could be more productive.[41]
- **Competitively disadvantaging innovation and work.** Relatedly, innovators and entrepreneurs who wish to focus on productive activity in the real economy can find themselves at a disadvantage relative to those who use tax avoidance and evasion to compete.

Increased inequality. About 90 percent of the benefit of lower rates for capital gains and dividends accrues to the top 20 percent of filers, with more than half going to the top 1 out of every thousand filers, and stepped-up basis is similarly concentrated. These tax benefits for existing wealth increase racial wealthiest disparities that have been produced by historical and current barriers to wealth building.[42]

Failure to deliver promised benefits. Those seeking to maintain tax breaks for income from wealth often argue—contrary to evidence—that they deliver broad-based economic benefits. In fact, there is little evidence that such tax breaks increase private savings rates—while the amounts they add to national deficits and their other economic costs are large and clear.[43]

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[36] TPC, *Briefing Book (Tax Expenditures): What Are Tax Expenditures and How Are They Structured?* (May 2020, *https://www.taxpolicycenter.org/briefing-book/what-are-tax-expenditures-and-how-are-they-structured*).

[37] *See* Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93–344 § 3(a)(3), 88 Stat. 297, 299 (1974).

[38] *See* Treasury, *Tax Expenditures* (last visited September 24, 2023, *https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures*).

[39] For example, the Child Tax Credit is a tax expenditure that is a powerful tool for lifting families out of poverty. *See* CBPP, *Policy Basics: The Child Tax Credit* (December 7, 2022, *https://www.cbpp.org/research/federal-tax/the-child-tax-credit*).

[40] This effect can be described as a reduction in "allocative efficiency." Empirical literature suggests that allocative efficiency effects can be more substantial than supply-side impacts in the context of individual income tax reform; *see* William Gale and Andrew A. Samwick, *Effects of Income Tax Changes on Economic Growth,* Brookings Institution (February 1, 2016, *https://www.brookings.edu/research/effects-of-income-tax-changes-on-economic-growth/*).

[41] Len Burman, *Capital Gains Tax Rates and Economic Growth (or not),* Forbes (March 15, 2012, *https://www.forbes.com/sites/leonardburman/2012/03/15/capital-gains-tax-rates-and-economic-growth-or-not/?sh=65c8e411e2e0*).

[42] *See* Lily Batchelder and Greg Leiserson, *Disparities in the Benefits of Tax Expenditures by Race and Ethnicity,* Treasury (January 20, 2023, *https://home.treasury.gov/news/featured-stories/disparities-in-the-benefits-of-tax-expenditures-by-race-and-ethnicity*).

[43] For reviews of the empirical literature addressing these issues, *see* Congressional Research Service, *Capital Gains Taxes: An Overview of the Issues* (May 24, 2022, *https://sgp.fas.org/crs/misc/R47113.pdf*); Gale and Samwick, *supra* note 40; Chuck Marr and Chye-Ching Huang, *Raising Today's Low Capital Gains Tax Rates Could Promote Economic Efficiency and Fairness, While Helping Reduce Deficits,* CBPP (September 9, 2012, *https://www.cbpp.org/research/raising-todays-low-capital-gains-tax-rates-could-promote-economic-efficiency-and-fairness*).

Fiscal costs—and opportunity costs. The combination of lower rates for long-term capital gains and dividend income and stepped-up basis adds over $200 billion to deficits annually.[44] Taxes owed but not paid by the top 1 percent (by income) of filers is an additional $77 to 143 billion of the annual individual income underreporting gap.[45]

Devoting hundreds of billions in Federal resources annually to support lower (and unpaid) taxes on income from wealth represents a missed opportunity to make investments that could deliver better returns for the Nation.

REALLOCATING TAX BREAKS ON WEALTH TO BETTER INVESTMENTS

Major provisions of the tax law enacted by President Trump are set to expire at the end of 2025. Some lawmakers are proposing to halt this in full without offsetting the cost.[46] That would increase inequality, further lower revenues, and add to deficits, and would represent a tripling-down on a policy mistake already made twice before. Without the two rounds of tax cuts first enacted under President Bush and President Trump, both of which gave a disproportionate share of their benefit to the already wealthy, revenues would be 3 percent higher as a share of GDP today and the ratio of debt to GDP would be declining indefinitely.[47]

Instead, in 2025 lawmakers can take the opportunity to raise revenues to meet our Nation's fiscal and economic challenges, including by redirecting Federal resources away tax breaks for wealth towards better investments.[48]

Federal revenues are currently about 18.4 percent of GDP, and CBO projects this to fall through 2025, and to rise only modestly thereafter. But a large part of that projected rise in revenues will take place only if the parts of the 2017 tax law that are scheduled to expire do in fact sunset. The U.S. raises less revenue at all levels of government, relative to the size of its economy, than most other developed countries.[49]

The projected long-run growth in Federal spending stems primarily from the retirement of the baby boomers and the related rise in health care and retirement security costs.[50] Higher revenues can help address these costs while preventing cuts to programs and investments that would both increase hardship and weaken the economy.[51] Raising revenues can also support the investments needed to raise health and living standards for low- and moderate-income families; secure an innovative, dynamic, and inclusive economy; and address global challenges.

Revenue options. There are many sound options for raising revenue. For instance, in "Broadening the U.S. Federal Tax Base," the Tax Law Center has compiled several dozen options to strengthen the tax base, which we have designed or analyzed. The options span individual, transfer, corporate, and other Federal taxes. This work draws on the deep tax practice, tax administration, and research exper-

[44] JCT, *supra* note 6 at 35.

[45] Estimates suggest that roughly 28 percent to 36 percent of the individual income underreporting gap is attributable to the highest-income 1 percent of filers. Johns and Slemrod, *supra* note 30; DeBacker et al., *supra* note 30; Guyton et al., *supra* note 31. The individual income tax underreporting gap is estimated to have increased from about $348 billion annually between 2014 to 2016 to about $396 billion in 2021. Internal Revenue Service, *Tax Gap Projections for Tax Years 2020 & 2021, supra* note 30 *(https://www.irs.gov/pub/irs-pdf/p5869.pdf)*.

[46] *See, e.g.,* TCJA Permanency Act, H.R. 976, 118th Cong. (2023).

[47] Bobby Kogan, *Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio,* Center for American Progress (March 27, 2023, *https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/*).

[48] Brian Deese and David Kamin, *Principles for the 2025 Tax Debate,* Tax Notes (October 16, 2023, *https://www.taxnotes.com/featured-analysis/principles-2025-tax-debate/2023/10/13/7hdfd*); Bobby Kogan, *The Rich Get Richer, Deficits Get Bigger: How Tax Cuts for the Wealthy and Corporations Drive National Debt,* Testimony Before the Senate Budget Committee n.xxvi (May 17, 2023, *https://www.budget.senate.gov/imo/media/doc/Mr.%20Bobby%20Kogan%20-%20Testimony%20-%20Senate%20Budget%20Committee1.pdf*).

[49] TPC, *How Do US Taxes Compare Internationally?* (May 2020, *https://www.taxpolicycenter.org/briefing-book/how-do-us-taxes-compare-internationally*).

[50] CBO, *The 2023 Long-Term Budget Outlook* 6 (June 2023, *https://www.cbo.gov/system/files/2023-06/59014-LTBO.pdf*).

[51] *See* Paul Van de Water, *Medicare Is Not "Bankrupt,"* CBPP (February 13, 2023, *https://www.cbpp.org/research/health/medicare-is-not-bankrupt*).

tise of our staff, and our networks of public interest minded tax researchers and market actors.[52]

To bring more income from wealth into the tax base in 2025, lawmakers can:

(1) Allow tax breaks for income from wealth to expire. Various provisions of the TCJA expanded tax breaks for income from wealth, increased complexity, encouraged tax avoidance, and delivered no discernible economic benefit.[53] They should be allowed to expire, and include the following:

- **The section 199A "pass through" deduction.** If kept in place, it will cost $700 billion over 2026–2035.[54] More than half of its value goes to the top 1 percent (by income) of filers, and a full quarter goes to the highest-income one out of every 1,000 tax filers.[55] Tax advisors have called section 199A a "gaping hole" in the code.[56] It is, "the very worst kind of tax policy, picking winners and losers haphazardly in a complex tax provision, and then generating significant incentives for people to rearrange their businesses to try to get on the right side of the line."[57] Research suggests that the deduction failed to boost economic activity in the 2 years following its enactment.[58]
- **The doubled exclusion from estate and gift taxes.** The 2017 tax law doubled the amount that a wealthy couple can pass tax-free to their heirs from $11 million to $22 million. Extending this would cost $125 billion between 2026 and 2033.[59] The doubled exclusion potentially *more than* doubles the amount of money wealthy individuals can pass on tax-free. This is because the exemption can be used to make lifetime gifts of assets, and those assets may appreciate over the donee's lifetime. Such gifts can facilitate some of the most complex tax avoidance techniques that push large fortunes out of the transfer tax base.[60]

(2) Ensure the IRS has adequate resources and tools so that more wealthy filers pay what they owe under the law. To rebuild and transform taxpayer services and ensure that high-income filers and large corporations pay more of the taxes they already owe, the IRA provided the IRS an additional $80 billion to be spent through the end of 2031. CBO estimated that this funding would raise a *net* $180.4 billion between 2022 and 2031 by simply collecting more tax revenue

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[52] Many other compilations of potential base broadening options include Treasury's "Green Books," tax reform proposals, and CBO's "Budget Options." Ours focuses on options that the Tax Law Center has developed or analyzed recently in consultation with other experts, and includes links to relevant Tax Law Center publications such as our Priority Guidance Plan submissions and analyses of proposed legislation.

[53] The Tax Law Center and others have written about how the TCJA should be addressed more broadly. *See* Deese and Kamin, *supra* note 48; Huang, *Funding Our Nation's Priorities, supra* note 1; Chuck Marr, *2025 Tax Debate Begins, Offers Opportunity for Course Correction,* CBPP (March 7, 2023, *https://www.cbpp.org/blog/2025-tax-debate-begins-offers-opportunity-for-course-correction*).

[54] Chuck Marr and Samantha Jacoby, *The Pass-Through Deduction is Tilted Heavily to the Wealthy, Is Costly, and Should Expire as Scheduled,* CBPP (June 8, 2023, *https://www.cbpp.org/research/federal-tax/the-pass-through-deduction-is-tilted-heavily-to-the-wealthy-is-costly-and*).

[55] TPC, *Tax Benefit of the Deduction for Qualified Business Income, Baseline: Current Law, Distribution of Federal Tax Changes by Expanded Cash Income Percentile, 2022* (December 29, 2022, *https://www.taxpolicycenter.org/model-estimates/individual-income-tax-expenditures-december-2022/t22-0262-tax-benefit-deduction*).

[56] Emily Horton, *Tax Planner: Drive Wealthy Clients Through "Gaping Hole" in Tax Code,* CBPP (May 31, 2018, *https://www.cbpp.org/blog/tax-planner-drive-wealthy-clients-through-gaping-hole-in-tax-code*).

[57] Jacoby, *supra* note 23 (quoting David Kamin). Similarly, former JCT Chief of Staff Edward Kleinbard called it "Congress's worst idea ever." *Id.*

[58] Lucas Goodman et al., *How Do Business Owners Respond to a Tax Cut? Examining the 199A Deduction for Pass-Through Firms* 1–4 (National Bureau of Economic Research, Working Paper No. 28680, 2022, *https://www.nber.org/system/files/working_papers/w28680/w28680.pdf*).

[59] CBO, *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenue* Table 1 (May 2023, *https://www.cbo.gov/publication/59169*).

[60] *See, e.g.,* Jesse Drucker and Maureen Farrell, *A Lavish Tax Dodge for the Ultrawealthy Is Easily Multiplied,* New York Times (December 28, 2021, *https://www.nytimes.com/2021/12/28/business/tax-break-qualified-small-business-stock.html*); Barbara Bryniarski, *Helping a Client Benefit from an Intentionally Defective Grantor Trust,* Tax Adviser (November 11, 2021, *https://www.thetaxadviser.com/newsletters/2021/nov/helping-client-benefit-intentionally-defective-grantor-trust.html*).

that is already owed under the law.[61] Along with improvements to taxpayer services, the IRS has embarked on several initiatives to improve high-income compliance, including creating a new unit specifically to address large and complex pass-through entities and tripling the size of its global high-wealth group.[62] But by cutting some $21.39 billion from this IRA funding, the debt limit deal, if implemented, will *add* to deficits by a net of some $19 billion over the next 10 years in increased tax noncompliance,[63] and move forward a cliff in IRS funding to FY 2030.[64] Lawmakers can address this cliff in 2025 and before then not worsen the damage from the debt ceiling deal. Doing so will raise net revenue by continuing increased tax compliance among wealthy filer and large businesses.[65]

Additionally, lawmakers can ensure that the IRS and other regulators are able to better understand the opaque structures and transactions that some wealthy filers use to conduct tax evasion, money laundering, sanctions evasion, and other crimes. Options include the following:

- **Improving the bipartisan Corporate Transparency Act (CTA) to identify tax evasion and other criminal activity using pass-throughs.** The Panama Papers highlighted the use of shell companies to hide wealth from tax and law enforcement agencies. Members of this committee helped lead a sound bipartisan step to address this issue with the CTA, which establishes a registry of the ultimate owners of certain entities that is available to the IRS and other regulators. The registry covers many corporations and LLCs but does not currently include most general partnerships, trust arrangements, or other entities with no State filing requirement. The most egregious tax evasion linked with corruption, sanctions evasion and other criminal activities is likely to flow towards the pass-throughs and other entities left in the shadows, unless lawmakers act. The Tax Law Center has proposed paths forward.[66]
- **Extending broker reporting to high-value art and antiquities.** The opaque art and antiquities market facilitates tax and sanctions evasion and money laundering.[67] Currently, brokers must provide information reporting to

[61] Phillip L. Swagel, *Congressional Budget Office, Additional Information About Increased Enforcement by the Internal Revenue Service* 1 (August 25, 2022, *https://www.cbo.gov/system/files/2022-08/58390-IRS.pdf*).

[62] *See* IRS, IR–2023–166, *IRS Announces Sweeping Effort to Restore Fairness to Tax System with Inflation Reduction Act Funding; New Compliance Efforts Focused on Increasing Scrutiny on High-Income, Partnerships, Corporations and Promoters Abusing Tax Rules on the Books,* (September 8, 2023, *https://www.irs.gov/newsroom/irs-announces-sweeping-effort-to-restore-fairness-to-tax-system-with-inflation-reduction-act-funding-new-compliance-efforts*); IRS, IR–2023–176, *IRS to Establish Special Pass-Through Organization to Help with High-Income Compliance Efforts; New Workgroup to Blend Current Employees and New Hires to Focus on Complex Partnerships, Other Key Areas* (September 20, 2023, *https://www.irs.gov/newsroom/irs-to-establish-special-pass-through-organization-to-help-with-high-income-compliance-efforts-new-workgroup-to-blend-current-employees-and-new-hires-to-focus-on-complex-partnerships-other-key-areas*); Wesley Elmore, *IRS Tripling Size of Its Global High-Wealth Group,* Tax Notes (October 30, 2023, *https://www.taxnotes.com/tax-notes-federal/tax-system-administration/irs-tripling-size-its-global-high-wealth-group/2023/10/30/7hhjt*).

[63] Thalia Spinrad and Chye-Ching Huang, *Impact of House and Senate IRS Funding Proposals,* Tax Law Center (July 18, 2023, *https://medium.com/@taxlawcenter/impact-of-house-and-senate-irs-funding-proposals-e8fea900d5e1*).

[64] Chye-Ching Huang, Thalia Spinrad, and Kathleen Bryant, *Debt Ceiling Deal's Cuts to IRS Funding Bring the IRS Funding Cliff Closer: Appropriators Should Not Compound Harm,* Tax Law Center (June 28, 2023, *https://www.law.nyu.edu/sites/default/files/Debt%20Ceiling%20Deal%E2%80%99s%20Cuts%20to%20IRS%20Funding%20Bring%20the%20IRS%20Funding%20Cliff%20Closer-%20Appropriators%20Should%20Not%20Compound%20Harm.pdf*). Moreover, House bills have proposed to rescind all of the remaining IRA funds and thus would, if enacted, move the funding cliff up to FY 2024. *Id.*

[65] Thalia Spinrad and Chye-Ching Huang, *supra* note 63.

[66] Sophia Yan, *How Strengthening the Corporate Transparency Act Can Help the IRS Follow the Money,* Just Security (April 12, 2022, *https://www.justsecurity.org/81008/how-strengthening-the-corporate-transparency-act-can-help-the-irs-follow-the-money/*); Sophia Yan, *Budget Represents a Missed Opportunity to Promote Corporate Transparency Act Reforms,* Tax Law Center (April 19, 2023, *https://medium.com/@taxlawcenter/budget-represents-a-missed-opportunity-to-promote-corporate-transparency-act-reforms-8be5d8bbf438*); Tax Law Center, *Comment Letter on Beneficial Ownership Information Reporting Requirements* (February 7, 2022, *https://www.regulations.gov/comment/FINCEN-2021-0005-0403*).

[67] *See, e.g.,* Graham Bowley, *As Money Launderers Buy Dalís, U.S. Looks at Lifting the Veil on Art Sales,* New York Times (June 19, 2021, *https://www.nytimes.com/2021/06/19/arts/design/money-laundering-art-market.html*); Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *The Art Industry and U.S. Policies that*

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the IRS on the gross proceeds of and gain or loss on dispositions of certain assets, including stocks, securities, and digital assets, but this requirement does not apply to art and antiquities.[68] The Tax Law Center proposes extending broker reporting to art and antiquities to address their role in enabling tax evasion.

- **Improving information reporting on digital assets.** Digital assets pose "a significant detection problem by facilitating illegal activity broadly including tax evasion."[69] In 2019, the Financial Action Task Force (FATF) extended its anti-money laundering and counter-terrorist financing measures to digital assets.[70] But the U.S. is not fully compliant.[71] Congressional action, such as the bipartisan Digital Asset Anti-Money Laundering Act, could help bring the U.S. into compliance and address the significant money laundering and tax evasions risks posed by digital assets by ensuring additional information reporting.[72]

Finally, lawmakers should be ready to respond when taxpayers exploit loopholes in the tax code or undermine provisions that aim to curtail tax avoidance, including by securing interpretations of the code in the courts that undermine legislative intent and tax compliance.[73]

(3) Ensure income from extraordinarily large fortunes faces at least some tax and reduce preferences for income from wealth over work. Lawmakers can address the fundamental issue that much capital gain and dividend income does not face tax or face it at adequate rates. There are many sound options for doing so. Former JCT Chief of Staff Harry L. Gutman noted that in past decades, "both Democratic and Republican Treasury Departments have identified "step-up" as a problem and proposed essentially identical solutions."[74] President Biden's Billionaires Minimum Income Tax would raise $437 billion over 2024–2033,[75] and Chairman Wyden's Billionaires Income Tax would raise an estimated $577 billion over 10 years.[76]

Undermine Sanctions 35–37 (July 27, 2020, *https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf#page=38*).

[68] The Secretary of Treasury has not exercised her authority under section 6045(a) to require brokers to report the gross proceeds of transactions involving art and antiquities.

[69] Treasury, *The American Families Plan Tax Compliance Agenda* 20 (May 2021, *https://home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf#page=21*) (citing Omri Marian, *Are Cryptocurrencies Super Tax Havens?,* 112 Michigan Law Review First Impressions 38 (2013)); *see also* Treasury, *General Explanations of the Administration's Revenue Proposals for Fiscal Year 2024* 200 (March 2023, *https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf#page=207*); David Lawder, *U.S. IRS chief asks Congress for authority to collect cryptocurrency transfer data,* Reuters (June 8, 2021, *https://www.reuters.com/business/us-irs-chief-says-needs-congressional-authority-cryptocurrency-reporting-2021-06-08/*).

[70] FATF, *Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers* 2 (2023, *https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/June2023-Targeted-Update-VA-VASP.pdf.coredownload.inline.pdf#page=4*).

[71] FATF, *United States* (last accessed November 7, 2023, *https://www.fatf-gafi.org/en/countries/detail/United-States.html*).

[72] Digital Asset Anti-Money Laundering Act of 2023, S. 2669, 118th Cong. (2023).

[73] Taxpayer challenges in the courts have put various bipartisan regimes under pressure, including the reportable transactions regime and the conservation easement deduction. *See, e.g., Mann Construction v. United States,* No. 1:20–cv–11307 (6th Cir. March 3, 2022); *CIC Services LLC v. IRS,* No. 3:17–cv–00110 (E.D. Tenn. March 21, 2021). IRS, IR–2022–125, *IRS wraps up 2022 "Dirty Dozen" scams list; agency urges taxpayers to watch out for tax avoidance strategies* (June 10, 2022, *https://www.irs.gov/newsroom/irs-wraps-up-2022-dirty-dozen-scams-list-agency-urges-taxpayers-to-watch-out-for-tax-avoidance-strategies*). Challenges to the economic substance doctrine are also pending.

[74] Harry L. Gutman, *Funding Our Nation's Priorities: Reforming the Tax Code's Advantageous Treatment of the Wealthy,* Testimony before the Select Revenue Measures Subcommittee 3 (May 12, 2021, *https://docs.house.gov/meetings/WM/WM05/20210512/112604/HHRG-117-WM05-Wstate-GutmanH-20210512.pdf#page=3*).

[75] Treasury, *General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals* 82, 214 *(https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf#page=89)*.

[76] JCT estimate for 2022–2031. *See* Press Release, U.S. Senate Committee on Finance, *Wyden Statement on Billionaires Income Tax Score* (November 5, 2021, *https://www.finance.senate.gov/chairmans-news/wyden-statement-on-billionaires-income-tax-score*). Other proposals include: ending step-up basis, *see* Treasury, *General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals* 30, 34 *(https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf)*; "carryover basis," *see* Office of Senator Mitt Romney, *Romney, Bennet Offer Path to Bipartisan Compromise on Refundable Credits, Business Tax Fixes* (December 15,

Lawmakers can also close down or cut back on some of the myriad of other tax breaks and loopholes for income from wealth, such as by closing the **"Gingrich-Edwards"** and related loopholes,[77] ensuring that **partnership taxation** is more rational, clear, and tied to economic reality (including closing the **ETF loophole**);[78] addressing **PPLI,**[79] closing the **carried interest loophole;**[80] and plugging numerous holes in the **transfer tax regime.**[81]

QUESTIONS SUBMITTED FOR THE RECORD TO CHYE-CHING HUANG

QUESTIONS SUBMITTED BY HON. CATHERINE CORTEZ MASTO

Question. Historically, we have seen a significant wealth gap between White families and families of color. Many people of color are also low-income workers and recent studies showed that Black Americans were disproportionately targeted by IRS audits. I applaud the IRS for working to address this issue, yet I am still concerned that we will continue to see the racial wage gap and the overall tax gap widen.

In your testimony, you mention that "tax benefits for existing wealth increase racial wealth disparities that have been produced by historical and current barriers to wealth building."

Can you expand on how lack of action against ultra-wealthy tax cheats disproportionally hurts communities of color?

Answer. Due to cuts to the IRS budget between 2010 and 2021, audit rates on the top 1 percent fell so steeply that they are audited at about the same rate as families claiming the Earned Income Tax Credit ("EITC"), even though the top 1 percent of filers contribute far more to the "tax gap" of taxes owed but not paid.[1] Audits of EITC recipients are easier and cheaper to accomplish than audits of wealthy filers, so these rates fell far less steeply over the same period as a result of budget cuts. Research has now also confirmed that the IRS's audit algorithms have effectively been treating EITC errors as "more important" than other types of tax non-compliance.[2]

Over-auditing of ETIC recipients for both of these reasons compounds existing racial disparities and contributes to the over-auditing of Black filers, in particular. Barriers to full economic participation erected by past and present policy choices and discrimination mean that people of color are disproportionately represented among low-wage workers eligible for tax credits such as the EITC and Child Tax Credit. According to data on audit rates before the recent restoration of IRS funding, the most highly audited areas of the country are rural southern counties that have predominantly Black residents. Restoring and maintaining IRS resources in a way that reduces the disparities in audit rates for wealthy filers compared to EITC recipients is critical for addressing these racial disparities.

2019, *https://www.romney.senate.gov/romney-bennet-offer-path-bipartisan-compromise-refundable-credits-business-tax-fixes/*); targeting consumption out of unrealized gains; and inheritance taxation, *see* Lily L. Batchelder, *Leveling the Playing Field Between Inherited Income and Income from Work through an Inheritance Tax,* in Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue 48–88 (Jay Shambaugh and Ryan Nunn eds., 2020, *https://www.hamiltonproject.org/assets/files/Batchelder_LO_FINAL.pdf*).

[77] *See* Huang, *Strengthening the Tax Base, supra* note 1, at 14.

[78] *Id.* at 14–17.

[79] *See* Press Release, U.S. Senate Committee on Finance, *Wyden Launches Investigation Into Private Placement Life Insurance Schemes* (August 15, 2022, *https://www.finance.senate.gov/chairmans-news/wyden-launches-investigation-into-private-placement-life-insurance-schemes*).

[80] *See* Tax Law Center, *Broadening the US Federal Tax Base* (September 27, 2023, *https://www.law.nyu.edu/sites/default/files/Broadening%20the%20US%20Federal%20Tax%20Base%20-%209.26.23.xlsx*).

[81] For several options related to closing holes in the transfer tax regime, *see id.*

[1] Tax Law Center at NYU Law, *Issue Brief on Rebalancing Reporting on Sources of the Tax Gap* (updated July 11, 2023, *https://www.law.nyu.edu/sites/default/files/Improper%20Payments%20Refundables%20vs.%20Other%20Tax%20Gap%20Sources.pdf*).

[2] Tax Law Center at NYU Law, *IRS Takes Important Step to Increase Accuracy and Reduce Racial Disparities by Addressing Audits by Mail* (September 19, 2023, *https://medium.com/@taxlawcenter/irs-takes-important-step-to-increase-accuracy-and-reduce-racial-disparities-by-addressing-audits-by-f74da8bbea7a*); Kathleen Bryant and Chye-Ching Huang, *New Evidence on Racial Disparities in IRS Audit Selection Calls for Immediate Action,* Tax Law Center at NYU Law (March 2, 2023, *https://www.law.nyu.edu/sites/default/files/New%20Evidence%20on%20Racial%20Disparities%20in%20IRS%20Audit%20Selection%20Calls%20for%20Immediate%20Action_0.pdf*).

Furthermore, working families facing an audit overwhelmingly do not have any professional help navigating that process and can end up losing tax credits that they are eligible for just because they cannot make it through the audit. The experience of being audited may also scare them away from claiming tax credits they are in fact eligible for in the future, research shows.[3]

Question. How can Congress design and monitor Federal policies to promote racial and gender equity?

Answer. **First, the IRS and lawmakers can remove barriers preventing underserved families and communities from accessing tax guidance and reliable tax preparation services.** Instead of subjecting filers who do not have the resources or help to file accurately to unnecessary audits, the IRS can focus on assisting filers to more easily understand and comply with their tax obligations and claim tax credits that they are eligible for. The tax system should not be subjecting filers who are trying to file accurately to unnecessary audits when it could instead provide them the information and support needed to file accurate returns.

The IRS can do some of this by itself with restored funding and better services—an excellent example is its important move to reopen in-person taxpayer assistance centers.[4] And the IRS has also already taken commendable action to reduce reliance on correspondence audits that research shows both feed racial disparities and *increase* inaccuracy by denying credits to families who are eligible but cannot make it through a burdensome audit process.[5]

Congress can help by continuing to support the funding needed to develop better taxpayer services and approaches to compliance, including free and simplified filing tools.[6] Congress can also provide the IRS authority to require unenrolled paid tax preparers, who lack a professional credential indicating their qualification and are a large source of filing error, to meet basic standards of competence.[7]

Second, the IRS can invest in research and transparency. The IRS has not, to my knowledge, publicly committed to regularly reporting on its progress eliminating audit disparities and should do so. Additionally, the IRS has answered some, but not all, of the questions experts have posed about the root causes of the racial disparities in audit. This is also something the IRS should quickly address.[8]

It is notable that IRS data and research by Treasury Department officials, in collaboration with external researchers, confirmed racial disparities in audits that have been long suspected by independent researchers.[9] Lawmakers can ensure that the IRS uses some of its restored funding to continue to invest in the types of research that shone light on these disparities. The divisions of the IRS that perform that research should also be enabled to continue to pursue it even when it puts an uncomfortable spotlight on IRS practices that are not working well or that are inequitable.

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[3] John Guyton, Kara Leibel, Day Manoli, Ankur Patel, Mark Payne, and Brenda Schafer, *The Effects of EITC Correspondence Audits on Low-Income Earners,* IRS SOI Working Paper (December 2019, *https://www.irs.gov/pub/irs-soi/19rpeitccorresponenceaudit.pdf*).

[4] IRS, IR–2023–127, *IRS Continues Reopening Closed Taxpayer Assistance Centers; Begins Special Series of Community Assistance Visits to Help Taxpayers in 8 States to Expand Service for People Who Aren't Near Agency Offices* (July 14, 2023, *https://www.irs.gov/newsroom/irs-continues-reopening-closed-taxpayer-assistance-centers-begins-special-series-of-community-assistance-visits-to-help-taxpayers-in-8-states-to-expand-service-for-people-who-arent-near-agency-offices#:~:text=Help-,IRS%20continues%20reopening%20closed%20Taxpayer%20Assistance%20Centers%3B%20begins%20special%20series,aren't%20near%20agency%20offices*).

[5] Tax Law Center at NYU Law, *IRS Takes Important Step to Increase Accuracy and Reduce Racial Disparities by Addressing Audits by Mail, supra* note 2.

[6] David Kamin and Mike Kaercher, *Finally, Americans Could Soon 'Direct File' Taxes Online Without a Middleman,* Tax Law Center at NYU Law (June 15, 2023, *https://medium.com/@taxlawcenter/finally-americans-could-soon-direct-file-taxes-online-without-a-middleman-a74f11c6ec6b*).

[7] John Wancheck, *IRS Needs Authority to Regulate Tax Return Preparers,* Center on Budget and Policy Priorities (May 5, 2021, *https://www.cbpp.org/blog/irs-needs-authority-to-regulate-tax-return-preparers*).

[8] Kathleen Bryant, *Unanswered Questions Remain on Causes of Racial Disparities in Audit Selection and the IRS's Plans for Further Evaluation,* Tax Law Center at NYU Law (May 26, 2023, *https://medium.com/@taxlawcenter/unanswered-questions-remain-on-causes-of-racial-disparities-in-audit-selection-and-the-irss-plans-1154e19fd09a*).

[9] Hadi Elzayn, Evelyn Smith, Thomas Hertz, Arun Ramesh, Robin Fisher, Daniel Ho, and Jacob Goldin, *Measuring and Mitigating Racial Disparities in Tax Audits,* Stanford Institute for Economic and Policy Research (January 30, 2023, *https://dho.stanford.edu/wp-content/uploads/IRS_Disparities.pdf*).

The IRS Strategic Operating Plan acknowledges that research and evaluation, including on racial disparities, is needed to ensure that the restored funding is used most effectively and efficiently, and this is a good start. Lawmakers can help hold the IRS accountable for following through by ensuring that it makes concrete commitments of resources and staff to research and evaluation on IRS services and compliance efforts. This work is important, but is not likely to generate "quick wins," may lead to uncomfortable but necessary criticism, and can be easily neglected in a major and complex transformation project.

Third, the IRS can make sure it is hearing from all families affected by the tax system. The IRS gets a lot of input from sophisticated, high-income filers who are lobbying for certain regulations, but low- and moderate-income filers do not have the same level of access.[10] In response, the IRS should make certain that the stakeholder engagement practices it relies on to inform its work enables it to get and consider input from all of the people affected by the tax system, not just those with the most resources. For example, the IRS can more actively work to guarantee that the Advisory Committees that it relies on to hear from stakeholders are more representative. There are a wide range of options for improvement in this area, and it is also promising that the IRS and Treasury have started to adopt some innovative approaches to broadening input.[11]

QUESTION SUBMITTED BY HON. ELIZABETH WARREN

Question. Congressional Republicans are working to extend and revive three expiring business provisions from the 2017 Tax Cuts and Jobs Act (TCJA)—100 percent bonus depreciation, R&E expensing, and the net interest deduction—which help giant corporations cut their tax rates to the bone. Just like they did in 2017, congressional Republicans are pushing for a short-term extension to hide just how expensive these provisions really are, despite having every intention of extending them indefinitely.

According to your testimony, extending 100 percent bonus depreciation for 3 years appears to only cost $3 billion over the next decade, but permanently extending the provision would cost a staggering $325 billion over the next decade.

How do the revenue projections differ between a short-term (*e.g.,* 3-year) extension and a permanent extension for all three provisions? What accounting gimmicks have congressional Republicans used to make corporate tax breaks appear drastically less expensive than they actually are?

Answer. The TCJA prioritized making permanent large net cuts to corporate taxes, including cutting the corporate tax rate from 35 percent to 21 percent and slashing the default rate on multinationals' foreign profits even lower. To partially offset the large cost, the law scaled back certain tax breaks for businesses starting in 2023, including requiring businesses to deduct research and experimentation (R&E) expenses more gradually over time and tightening limitations on interest deductions. Furthermore, while the law initially allowed businesses to fully expense their capital investments ("full bonus depreciation"), it set this provision to gradually phase out.

Those three changes allowed proponents to claim $292 billion in "savings" in the last half of the budget window, enough to offset about 40 percent of the cost of cutting the corporate tax rate in those years. Corporate lobbyists now want policymakers to reverse those offsets by reinstating the underlying tax breaks temporarily—but without enacting a corresponding increase in the corporate tax rate or otherwise reversing any of the law's large permanent tax cuts for corporations.

Doing so would be a gimmick upon a gimmick upon a gimmick.

First, undoing "offsets" without also undoing the net tax cuts that they purportedly paid for just richens the already large permanent corporate tax cuts in the TCJA.

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[10] *See* Shun-Yi Oei and Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations,* 69 Emory Law Journal 209 (2019, *https://scholarlycommons.law.emory.edu/elj/vol69/iss2/1/*); Clint Wallace, *Congressional Control of Tax Rulemaking,* 71 Tax Law Review 179 (2017, *https://scholarcommons.sc.edu/cgi/viewcontent.cgi?article=2351&context=law_fac pub*).

[11] Chye-Ching Huang, *Modernizing Tax Regulatory Review,* Yale Journal on Regulation: Notice and Comment (June 29, 2023, *https://www.yalejreg.com/nc/modernizing-tax-regulatory-review-by-chye-ching-huang/*).

Second, doing so in small increments by "temporarily" enacting corporate tax breaks masks the true permanent cost of these tax breaks, which many businesses and lawmakers are seeking to ultimately make permanent.

For example, loosening the limitation on net interest deductions would cost roughly $19 billion over 10 years if enacted "temporarily" for 3 years,[12] while the permanent provision would cost roughly $50 billion over 10 years.[13]

Third, and worse, full bonus depreciation and R&E expensing involve shifts in the timing of when tax breaks are claimed, so the apparent cost of these temporary cuts is even more unrepresentative of the true cost of making these provisions permanent. Official estimates of a temporary restoration of full bonus depreciation and R&E expensing tax breaks show revenue losses for both provisions while the temporary tax break is in effect, but then show revenue increases (above current law levels) after the tax break is assumed to expire. Three-year temporary full bonus depreciation is estimated to cost only $3 billion over 10 years,[14] but the cost of permanent bonus depreciation is $325 billion over 10 years.[15] Three-year R&E expensing is estimated to cost $25 billion over 10 years,[16] while the permanent provision costs more than $150 billion over 10 years.[17]

Because businesses and some lawmakers see "temporary" reinstatement of these three provisions as a way to make the provisions permanent, we should be looking at the permanent cost of provisions like full bonus depreciation and R&E expensing over 10 years. That is also why these provisions may be better addressed as part of a discussion about permanent changes to the tax code in 2025.

PREPARED STATEMENT OF WILLIAM MCBRIDE, PH.D., VICE PRESIDENT OF FEDERAL TAX POLICY AND STEPHEN J. ENTIN FELLOW IN ECONOMICS, TAX FOUNDATION

THE SIZE AND DISTRIBUTION OF THE FEDERAL TAX BURDEN

Chairman Wyden, Ranking Member Crapo, and distinguished members of the Senate Finance 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 in recent years are well above historical averages 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.

RECENT FEDERAL TAX COLLECTIONS ARE ABOVE AVERAGE AND SET TO GO HIGHER

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, 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-

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[12] Joint Committee on Taxation (JCT), JCX–29–23, *Estimated Revenue Effects of H.R. 3938, The "Build It In America Act"* (June 9, 2023, *https://www.jct.gov/publications/2023/jcx-29-23/*).

[13] Committee for a Responsible Federal Budget, *Tax Cut Extensions Cost Over $3.3 Trillion* (August 14, 2023, *https://www.crfb.org/blogs/tax-cut-extensions-cost-over-33-trillion#:~:text=Extending%20the%20TCJA%20in%20full,6.8%20percent%20under%20current%20law*).

[14] JCT, *supra* note 12.

[15] Congressional Budget Office (CBO), *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues* (May, 2023, *https://www.cbo.gov/system/files/2023-05/59154-Budgetary-Outcomes.pdf*).

[16] JCT, *supra* note 12.

[17] Committee for a Responsible Federal Budget, *supra* note 13.

[1] William McBride, "Inflation is Surging, So Are Federal Tax Collections," Tax Foundation, Oct. 13, 2022, *https://taxfoundation.org/federal-tax-collections-inflation-surging/*; Congressional Budget Office, Budget and Economic Data, *https://www.cbo.gov/data/budget-economic-data*.

decade high of about 19.4 percent, up from 17.6 percent in the prior fiscal year and near the last peak of 20.0 percent set during the dot-com bubble in FY 2000.[2]

Only 2 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 20.5 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 2.2 percentage points.

In FY 2022, 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 10.4 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.[5]

As the inflationary boom of 2021 turned into a bust in 2022, and as the Federal Reserve raised interest rates to fight the inflation, Federal tax collections dropped about 9 percent to $4.4 trillion in FY 2023, or about 16.5 percent of GDP.[6] The largest decline was for individual income taxes, which fell $456 billion, or 17 percent, to $2.2 trillion, apparently due in large part to a drop in revenue as the stock and housing markets deflated. CBO's preliminary analysis also points to "higher-than-anticipated claims" of the Employee Retention Credit, a pandemic-era program that spawned a cottage industry until the IRS recently halted new claims due to rampant fraud. Individual income tax refunds were $129 billion higher this year than last, a 52-percent increase. Another factor behind the decline, as noted by the CBO, is that the IRS postponed the filing deadline for taxpayers affected by natural disasters, including most taxpayers in California, until October 16th or later.

In contrast, payroll taxes grew 9 percent to $1.6 trillion in FY 2023, reflecting growth in wages and jobs. Corporate income taxes were roughly flat, falling $5 billion, or 1 percent, to $420 billion, despite the introduction of the new minimum tax on corporate book income and the stock buyback tax, both part of the Inflation Reduction Act (IRA) enacted last year. Other receipts dropped $124 billion, or 35 percent, to $232 billion in FY 2023, primarily reflecting a near-zeroing out of remittances from the Federal Reserve as higher interest rates caused the central bank's interest expense to offset its income.

The extreme volatility in revenue collections over the last 2 years, marked by extraordinary capital gains in 2021 and most likely heavy losses in 2022, reflects a Federal tax system that is heavily reliant on high-income investors (where capital gains and losses are concentrated), as we will see in more detail in the next section.

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[2] Because the Bureau of Economic Analysis recently revised GDP up considerably for several recent years including 2022, tax revenue as a share of GDP has come down relative to earlier estimates.

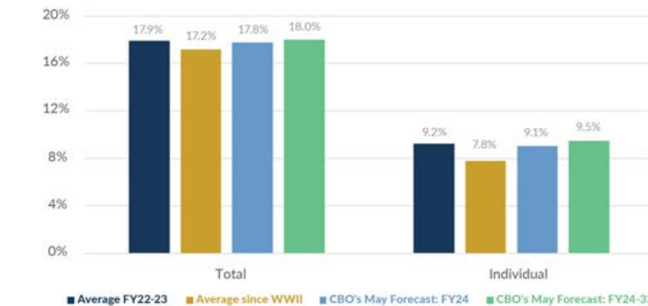
[3] Office of Management and Budget, Historical Tables, Table 2.3—Receipts by Source as Percentages of GDP: 1934–2028, *https://www.whitehouse.gov/omb/budget/historical-tables/;* a similar measure from the Bureau of Economic Analysis (BEA) indicates Federal and State individual income taxes as a share of personal income reached an all-time high of 14.4 percent in calendar year 2022. *See* BEA, National Income and Product Accounts, Table 2.1 Personal Income and Its Disposition, *https://www.bea.gov/itable/national-gdp-and-personal-income.*

[4] William McBride, "Inflation is Surging, So Are Federal Tax Collections," Tax Foundation, Oct. 13, 2022, *https://taxfoundation.org/federal-tax-collections-inflation-surging/.*

[5] Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033," February 15, 2023, *https://www.cbo.gov/publication/58848;* CBO, Budget and Economic Data, Revenue Projections, by Category, *https://www.cbo.gov/data/budget-economic-data#7.*

[6] Congressional Budget Office, "Monthly Budget Review: September 2023," Oct. 10, 2023, *https://www.cbo.gov/publication/59544;* William McBride, "Federal Deficit Grew to $2 Trillion in FY 2023," Oct. 12, 2023, *https://taxfoundation.org/blog/federal-budget-deficit-2023/.*

It also means that future tax collections will depend a great deal on fluctuations in the economy, including the ups and downs of the stock market. As one indicator, the S&P 500 rose about 27 percent in 2021, dropped about 19 percent in 2022, and is up about 14 percent this year. This, and other one-time factors mentioned above, suggests FY 2024 collections may be closer to FY 2022 levels than FY 2023 levels.



Simply averaging FY 2022 and FY 2023 together yields total Federal tax collections of 17.9 percent of GDP, which is 0.7 percentage points above the historical average since WWII. Individual income tax collections average to 9.2 percent of GDP over the last 2 years, which is about 1.4 percentage points above the historical average. In addition, Federal tax collections exhibit an upward trend resulting from many of the provisions of the Tax Cuts and Jobs Act (TCJA), including the phaseout of bonus depreciation that is set to occur over the next 5 years and the expiration of the individual income tax provisions at the end of 2025, as well as the permanent features that boost economic growth, especially the lower corporate tax rate.[7] As such, under a current law baseline, we expect Federal tax collections over the next several years to trend upwards towards 18 percent of GDP or higher, whereas full or partial extension of TCJA's expiring provisions would reduce revenue to a range of about 17 to 18 percent of GDP.[8] Under current law, the CBO projects total collections of 18.0 percent of GDP and individual income tax collections of 9.5 percent of GDP on average from FY 2024 to FY 2033.[9]

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 who 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.[10] The top 1 percent of taxpayers (about 1.6 million filers who earn more than

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[7] Tax Foundation, "Preliminary Details and Analysis of the Tax Cuts and Jobs Act," Dec. 18, 2017, *https://taxfoundation.org/research/all/federal/final-tax-cuts-and-jobs-act-details-analysis/;* William McBride and Alex Durante, "New Study Finds TCJA Strongly Boosted Corporate Investment," Tax Foundation, Oct. 21, 2023, *https://taxfoundation.org/blog/tcja-corporate-tax-economic-effects/*.

[8] Our recent modeling of potential extensions of TCJA expiring provisions indicates full extension of all provisions as they were in 2021, including individual, estate, and business provisions, would reduce revenue to about 17 percent of GDP on average from FY 2024 to FY 2033 (dynamically scored, *i.e.,* accounting for the policy's impacts on economic growth) whereas extension of only the business provisions would reduce revenue to about 17.7 percent of GDP.

[9] CBO, "An Update to the Budget Outlook: 2023 to 2033," May 12, 2023, *https://www.cbo.gov/publication/59096.*

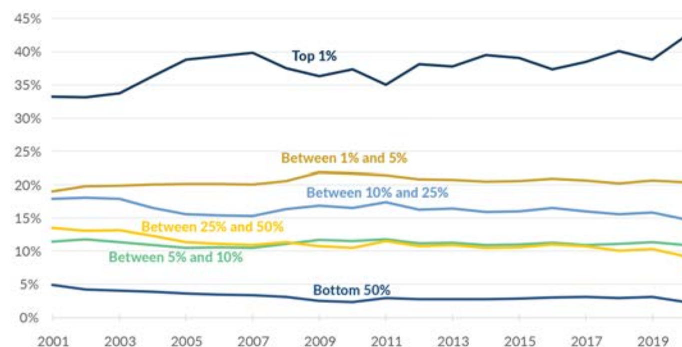
[10] Internal Revenue Service, Statistics of Income, "Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates," Table 1, and "Number of Returns, Shares of AGI and Total Income Tax, and Average Tax Rates," Table 2, *https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-rates-*

$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.[11] 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.

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.[12]



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 redits—corporate income taxes, payroll taxes, estate taxes, and excise taxes, CBO finds that the Federal tax system, as a whole, is pro-

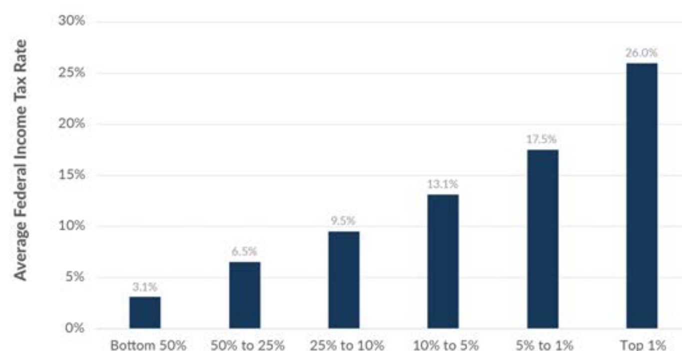
and-tax-shares; Erica York, "Summary of the Latest Federal Income Tax Data, 2023 Update," Tax Foundation, Jan. 26, 2023, *https://taxfoundation.org/publications/latest-federal-income-tax-data/*.

[11] Erica York, "Summary of the Latest Federal Income Tax Data, 2023 Update," Tax Foundation, Jan. 26, 2023, *https://taxfoundation.org/publications/latest-federal-income-tax-data/*.

[12] 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.

gressive.[13] 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.[14] In contrast, the bottom quintile of households paid about 0.1 percent of all Federal taxes.

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.



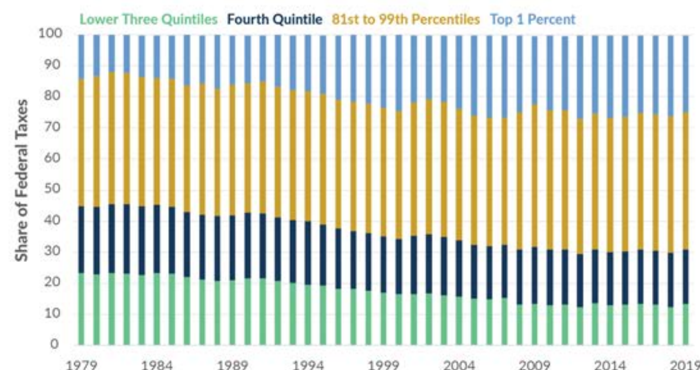
Furthermore, the CBO analysis indicates that average Federal tax rates increase substantially with income. For example, the top quintile of households paid an average Federal tax rate of 24.4 percent in 2019 and the top 1 percent of households paid an average Federal tax rate of 30.0 percent. In contrast, 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.

[13] Congressional Budget Office, "The Distribution of Household Income 2019," Nov. 15, 2022, *https://www.cbo.gov/system/files/2022-11/58353-HouseholdIncome.pdf;* Garrett Watson, "CBO Analysis Finds Income Growth and Progressive Tax Code in 2019," Tax Foundation, Jan. 10, 2023, *https://taxfoundation.org/us-income-growth-progressive-tax-code/*.

[14] 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 $894,400.

The Top 1 Percent Pays About 25 Percent of All Federal Taxes

Shares of Federal Taxes, 1979 to 2019



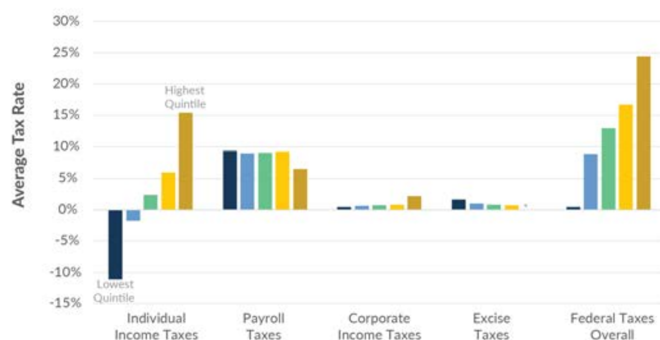
Source: Congressional Budget Office, "The Distribution of Household Income, 2019," Exhibit 16

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.[15] 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.

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 excise tax rate between 0 and 0.5 percent.
Source: Congressional Budget Office, "The Distribution of Household Income, 2019," Exhibit 13

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, com-

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[15] In CBO's analysis, 75 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.

pared 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.

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.[16] 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 3 years alone more than 100 tax expenditures have been created or amended.[17]

While some tax expenditures are important structural elements of the tax code, many are complicated and disproportionately benefit specific industries or types of households.[18] The CBO finds about half of the total income tax benefits of expenditures go to high-income households.[19]

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

[16] Demian Brady, "Tax Complexity 2021: Compliance Burdens Ease for Third Year Since Tax Reform," NTU, April 15, 2021, *https://www.ntu.org/foundation/detail/tax-complexity-2021-compliance-burdens-ease-for-third-year-since-tax-reform.*

[17] The Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2022–2026," Dec. 22, 2022, *https://www.jct.gov/publications/2022/jcx-22-22/;* Treasury Department, "Tax Expenditures," *https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures.*

[18] Alex Muresianu, "JCT Tax Expenditure Report: Not All Expenditures Are Created Equal," Tax Foundation, Feb. 13, 2023, *https://taxfoundation.org/largest-tax-expenditures-saving-investment-tax/;* Erica York and William McBride, "Lawmakers Could Pay for Reconciliation While Improving the Tax Code," Tax Foundation, Oct. 25, 2021, *https://taxfoundation.org/pay-for-reconciliation-tax/.*

[19] Congressional Budget Office, "Distribution of Major Expenditures in 2019," October 2021, *https://www.cbo.gov/system/files/2021-10/57413-TaxExpenditures.pdf.*

at the beginning of this year.[20] 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).[21]

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.[22]

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.[23]

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).[24] Based on wage and benefit 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.[25] 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 billion of 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).[26] 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-

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[20] William McBride, Alex Muresianu, Erica York, and Michael Hartt, "Inflation Reduction Act One Year After Enactment," Tax Foundation, Aug. 16, 2023, https://taxfoundation.org/research/all/federal/inflation-reduction-act-taxes/; Internal Revenue Service, "Latest Updates on the Inflation Reduction Act of 2022," https://www.irs.gov/inflation-reduction-act-of-2022.

[21] William McBride, Alex Muresianu, Erica York, and Michael Hartt, "Inflation Reduction Act One Year After Enactment," Tax Foundation, Aug. 16, 2023, https://taxfoundation.org/research/all/federal/inflation-reduction-act-taxes/.

[22] *Ibid;* John Bistline, Neil Mehrotra, and Catherine Wolfram, "Economic Implications of the Climate Provisions of the Inflation Reduction Act," Brookings Papers on Economic Activity, March 2023, https://www.brookings.edu/wp-content/uploads/2023/03/BPEA_Spring2023_Bistline-et-al_unembargoedUpdated.pdf; Jason Furman, "Comment on 'Economic Implications of the Climate Provisions of the Inflation Reduction Act,'" Mar. 30, 2023, https://www.brookings.edu/wp-content/uploads/2023/02/2b_20230330-BPEA-climate-furman-comment.pdf; Christine McDaniel, "The Cost of Battery Production Tax Credits Provided in the IRA," *Forbes,* Feb. 1, 2023, https://www.forbes.com/sites/christinemcdaniel/2023/02/01/the-cost-of-battery-production-tax-credits-provided-in-the-ira/?sh=362fc62279ef; Christine McDaniel, "The Costs of Wind Production Tax Credits Provided in the IRA," *Forbes,* Mar. 8, 2023, https://www.forbes.com/sites/christinemcdaniel/2023/03/08/the-costs-of-wind-production-tax-credits-provided-in-the-ira/?sh=7cd6f4295ff7; Goldman Sachs, "Carbonomics: The Third American Energy Revolution," Mar. 22, 2023.

[23] Erica York, "Careful What You Wish For: CHIPS Subsidies Require 'Excess Profits' Sharing," Tax Foundation, Mar. 2, 2023, https://taxfoundation.org/biden-semiconductor-chips-act-subsidies/.

[24] White House Office of Information and Regulatory Affairs, Information Collection Review, https://www.reginfo.gov/public/do/PRAMain.

[25] Scott Hodge, "The Tax Compliance Costs of IRS Regulations," Tax Foundation, Aug. 23, 2022, https://taxfoundation.org/tax-compliance-costs-irs-regulations/.

[26] Arthur P. Hall, "House Way & Means Committee Testimony: Compliance Costs of Alternative Tax Systems II," Tax Foundation, March 1996, https://files.taxfoundation.org/legacy/docs/8926e37c5827f958604933276fcb4864.pdf?_gl=1*1bocc81*_ga*MjkzNjU2MTcuMTY4MDg2NjcyOA..*_ga_FP7KWDV08V*MTY4M-TI5MzY4Ni40LjEuMTY4MTI5MzczNy45LjAuMA.

Taxed Income (GILTI), Foreign-Derived Intangible Income (FDII), and Base Erosion and Anti-Abuse Tax (BEAT).[27]

For individual filers, compliance costs generally increase proportionally with income, such that most of the compliance burden is borne by high earners.[28] 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.[29] 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.[30] In recent years, the IRS has found itself literally buried in paperwork, resulting in processing delays, millions of returns backlogged, and poor customer service.[31] 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.[32]

IRS customer service improved considerably this filing season, due partly to reduced demand as many complicated pandemic-era policies expired, such as the 2021 expanded Child Tax Credit, as well as new funding from the IRA and a shift in resources towards phone service.[33] For example, call volume dropped by more than half, returning to "normal" levels seen pre-pandemic in which the IRS received some 30 million to 40 million calls from taxpayers during the filing season. The IRS answered about 34 percent of calls this filing season and substantially reduced wait times. In addition, the IRS was able to significantly reduce its backlog of returns.

However, other performance metrics worsened, including longer processing delays for taxpayer correspondence and amended returns. As well, the number of backlogged identity theft cases increased 46 percent to about 465,000 as of April, requiring about 15 months to resolve on average.[34] Making matters worse, some aspects of the tax code became more complex, consuming more IRS resources and detracting from other core duties. For instance, earlier this year, the IRS requested an additional $3.9 billion in funding to further implement the IRA's green energy tax credits.[35] Clearly, there is room for further improvement, as an overly complex tax code

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[27] Kyle Pomerleau, "A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act," Tax Foundation, May 3, 2018, *https://taxfoundation.org/treatment-foreign-profits-tax-cuts-jobs-act/*.

[28] Daniel Berger, Eric Toder, Victoria Bryant, John Guyton, and Patrick Langetieg, "Estimating the Effects of Tax Reform on Compliance Burdens," Urban Institute, May 19, 2018, *https://www.urban.org/research/publication/estimating-effects-tax-reform-compliance-burdens.*

[29] Alex Muresianu and Garrett Watson, "Chaotic IRS Filing Season Shows the Perils of Running Social Policy Through the Tax Code," Tax Foundation, Apr. 18, 2022, *https://taxfoundation.org/irs-filing-season-2022/*.

[30] Internal Revenue Service, Data Book 2021, May 2022, *https://www.irs.gov/statistics/soi-tax-stats-irs-data-book;* Joseph Bishop-Henchman, "Transforming the Internal Revenue Service," Cato Institute, Apr. 11, 2023, *https://www.cato.org/policy-analysis/transforming-internal-revenue-service/*.

[31] Internal Revenue Service National Taxpayer Advocate, "2022 Annual Report to Congress," Jan. 11, 2023, *https://www.taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-delivers-2022-annual-report-to-congress/;* Joseph Bishop-Henchman, "Transforming the Internal Revenue Service," Cato Institute, Apr. 11, 2023, *https://www.cato.org/policy-analysis/transforming-internal-revenue-service/*.

[32] Internal Revenue Service National Taxpayer Advocate, "2022 Annual Report to Congress," Jan. 11, 2023, *https://www.taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-delivers-2022-annual-report-to-congress/*.

[33] Erin Collins, "Objectives Report to Congress, Fiscal Year 2024," National Taxpayer Advocate, June 2023, *https://www.taxpayeradvocate.irs.gov/reports/2024-objectives-report-to-congress/;* William McBride, Alex Muresianu, Erica York, and Michael Hartt, "Inflation Reduction Act One Year After Enactment," Tax Foundation, Aug. 16, 2023, *https://taxfoundation.org/research/all/federal/inflation-reduction-act-taxes/*.

[34] Erin Collins, "Objectives Report to Congress, Fiscal Year 2024," National Taxpayer Advocate, June 2023, *https://www.taxpayeradvocate.irs.gov/reports/2024-objectives-report-to-congress/*.

[35] Internal Revenue Service, "Inflation Reduction Act Strategic Operating Plan," Apr. 5, 2023, *https://www.irs.gov/pub/irs-pdf/p3744.pdf.*

presents ongoing administrative challenges at the IRS that are also problematic for taxpayers.

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.[36] The report finds that the average number of hours the IRS spends per audit has increased 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, and 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.[37] As the IRS Taxpayer Advocate explains: "Simplifying the code and eliminating complexities in the IRS's procedures would reduce taxpayer compliance burdens by making it easier for taxpayers to understand their filing and payment obligations, and it would also make it easier for the IRS to administer the tax laws. Thus, simplification is essential to the integrity of the U.S. tax system and will enhance voluntary compliance."[38]

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[36] Government Accountability Office, "Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income," May 17, 2022, *https://www.gao.gov/products/gao-22-104960.*

[37] Garrett Watson, "Closing the Tax Gap and Improving the Tax Code Are Complementary Goals," Tax Foundation, Nov. 21, 2019, *https://taxfoundation.org/closing-tax-gap-improving-tax-code/*.

[38] Erin Collins, "Objectives Report to Congress, Fiscal Year 2024," National Taxpayer Advocate, June 2023, *https://www.taxpayeradvocate.irs.gov/reports/2024-objectives-report-to-congress/*.

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.[39] 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.[40]

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 3rd year after the tax change.[41] 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 of 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."[42]

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.[43]

Corporate income taxes are generally more economically damaging than individual income taxes, 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.[44] A study on taxes in the United Kingdom found that taxes on consumption are less economically dam-

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[39] N. Gregory Mankiw, Matthew Weinzierl, and Danny Yagan, "Optimal Taxation in Theory and Practice," *Journal of Economic Perspectives* 2009, volume 23(4), *https://eml.berkeley.edu/~yagan/OptimalTaxation.pdf;* William McBride, "What Is the Evidence on Taxes and Growth," Tax Foundation, Dec. 18, 2012, *https://www.taxfoundation.org/what-evidence-taxes-and-growth/;* Alex Durante, "Reviewing Recent Evidence of the Effect of Taxes on Economic Growth," Tax Foundation, May 21, 2021, *https://taxfoundation.org/reviewing-recent-evidence-effect-taxes-economic-growth/;* Timothy Vermeer, "The Impact of Individual Income Tax Changes on Economic Growth," Tax Foundation, June 14, 2022, *https://taxfoundation.org/income-taxes-affect-economy/*.

[40] Robert Carroll, "The Excess Burden of Taxes and the Economic Cost of High Tax Rates," Tax Foundation, Aug. 2009, *https://files.taxfoundation.org/legacy/docs/sr170.pdf;* Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax," *The Review of Economics and Statistics* 81:4 (Nov. 1999): 674–680, *https://www.jstor.org/stable/2646716.*

[41] Karel Mertens and José Luis Montiel Olea, "Marginal Tax Rates and Income: New Time Series Evidence," *The Quarterly Journal of Economics* 133:4 (Nov. 2018), *https://academic.oup.com/qje/article-abstract/133/4/1803/4880451?redirectedFrom=fulltext.*

[42] Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys, Cyrille Schwellnus, and Laura Vartia, "Taxation and Economic Growth."

[43] Congressional Budget Office, "The Economics of Financing a Large and Permanent Increase in Government Spending: Working Paper 2021–03," Mar. 22, 2021, *https://www.cbo.gov/publication/57021; see also* Garrett Watson, "Congressional Budget Office and Tax Foundation Modeling Show That Some Tax Hikes Are More Damaging Than Others," Tax Foundation, Mar. 26, 2021, *https://www.taxfoundation.org/tax-hikes-are-more-damaging-than-others-analysis/*.

[44] Asa Johansson, Christopher Heady, Jens Matthias Arnold, Bert Brys, and Laura Vartia, "Taxation and Economic Growth," Organisation for Economic Co-Operation and Development Working Paper No. 620, July 3, 2008, *https://www.oecd-ilibrary.org/economics/taxation-and-economic-growth_241216205486.*

aging than taxes on corporate and individual income.[45] 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 1 year, a somewhat larger impact than a similarly sized cut in individual income taxes.[46] 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.[47]

Furthermore, several studies demonstrate that the corporate tax is borne in part by workers.[48] 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.[49]

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.[50]

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.[51]

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.[52] 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.[53]

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 pol-

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[45] Ahn D. M. Nguyen, Luisanna Onnis, and Raffaelle Rossi, "The Macroeconomic Effects of Income and Consumption Tax Changes," *American Economic Journal: Economic Policy* 13:2 (May 2021), *https://www.aeaweb.org/articles?id=10.1257/pol.20170241&&from=f.*

[46] Karel Mertens and Morten O. Ravn, "The Dynamic Effects of Personal and Corporate Income Tax Changes in the Unites States," *American Economic Review* 103:4 (June 2013), *https://www.aeaweb.org/articles?id=10.1257/aer.103.4.1212.*

[47] Alexander Ljungqvist and Michael Smolyansky, "To Cut or Not to Cut? On the Impact of Corporate Taxes on Employment and Income," National Bureau of Economic Research Working Paper No. 20753 (October 2018), *https://www.nber.org/system/files/working_papers/w20753/w20753.pdf.*

[48] Stephen J. Entin, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation, Oct. 24, 2017, *https://www.taxfoundation.org/labor-bears-corporate-tax/;* and Alex Durante, "Who Bears the Burden of Corporate Taxation? A Review of Recent Evidence," June 10, 2021, *https://www.taxfoundation.org/who-bears-burden-corporate-tax/*.

[49] Clemens Fuest, Andreas Peichl, and Sebastian Siegloch, "Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany," *American Economic Review* 108:2 (Feb. 2018): 393–418, *https://www.doi.org/10.1257/aer.20130570.*

[50] Joint Committee on Taxation, "Revenue Estimates and Distributional Analyses," Aug. 3, 2021, *https://www.finance.senate.gov/imo/media/doc/jct_analysis_on_corporate_tax_increase.pdf.*

[51] Cristina Enache, "Corporate Tax Rates around the World, 2022," Tax Foundation, Dec. 13, 2022, *https://taxfoundation.org/corporate-tax-rates-by-country-2022/*.

[52] OECD, Tax Database Table II.4. Overall Statutory Tax Rates on Dividend Income, *https://www.oecd.org/tax/tax-policy/tax-database/;* Elke Asen, "Double Taxation of Corporate Income in the United States and the OECD," Tax Foundation, Jan. 13, 2021, *https://taxfoundation.org/double-taxation-of-corporate-income/*.

[53] Scott Eastman, "Corporate and Pass-through Business Income and Returns Since 1980," Apr. 23, 2019, *https://www.taxfoundation.org/pass-through-business-income-since-1980/*.

icy.[54] 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 10th year in a row that Estonia has the best tax code in the OECD.[55] 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.[56]

Simplicity and neutrality are the hallmarks of the Estonian income tax system.[57] Taxes are so simple in Estonia that they can typically be filed in 5 minutes, and the cost of compliance for businesses is among the lowest of any country.[58] Estonia's tax system is also very pro-growth, increasing small business entrepreneurship, investment, labor productivity and thereby wages.[59] Estonia's income tax system does all of this while generating substantial revenue comparable to other developed countries.[60]

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 401(k)s.[61] 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 re-

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[54] TaxEDU, "Principles of Sound Tax Policy," Tax Foundation, *https://taxfoundation.org/principles/*.

[55] Alex Mengden, "International Tax Competitiveness Index, 2023," Tax Foundation, Oct. 18, 2023, *https://taxfoundation.org/research/all/global/2023-international-tax-competitiveness-index/*.

[56] William McBride, "Biden's New Tax Proposals are Complicated and Rife with Double Taxation," Tax Foundation, Mar. 13, 2023, *https://taxfoundation.org/biden-tax-fairness/*.

[57] Estonia's simple approach to taxing business and individual income has also been implemented in Latvia and Georgia. Daniel Bunn, "Better than the Rest," Tax Foundation, Oct. 9, 2019, *https://taxfoundation.org/estonia-tax-system-latvia-tax-system/;* Gia Jandieri, "Tax Reform in Georgia 2004–2012," Tax Foundation, July 17, 2019, *https://taxfoundation.org/tax-reforms-in-georgia-2004-2012/*.

[58] Kyle Pomerleau, "The Best Part of the Estonian Tax Code Is Not 5 Minute Tax Filing," Tax Foundation, Jul. 21, 2015, *https://taxfoundation.org/best-part-estonian-tax-code-not-5-minute-tax-filing/;* William McBride, Garrett Watson, Erica York, "Taxing Distributed Profits Makes Business Taxation Simple and Efficient," Tax Foundation, Mar. 1, 2023, *https://taxfoundation.org/distributed-profits-tax-us-businesses/*.

[59] Jaan Maaso, Jaanika Meriküll, and Priit Vahter, "Gross Profit Taxation Versus Distributed Profit Taxation and Firm Performance: Effects of Estonia's Corporate Income Tax Reform," The University of Tartu Faculty of Economics and Business Administration Working Paper No. 81–2011, March 23, 2011, *https://ssrn.com/abstract=1793143* or *http://dx.doi.org/10.2139/ssrn.1793143;* Jaan Masso and Jaanika Meriküll, "Macroeconomic Effects of Zero Corporate Income Tax on Retained Earnings," Baltic Journal of Economics, 11:2 (2011): 81–99, *https://www.tandfonline.com/doi/pdf/10.1080/1406099X.2011.10840502;* Aaro Hazak, "Companies' Financial Decisions Under the Distributed Profit Taxation Regime of Estonia," Emerging Markets Finance & Trade 45:4 (2009): 4–12, *https://www.jstor.org/stable/27750676;* Eduardo Davila and Benjamin Hebert, "Optimal Corporate Taxation under Financial Frictions," NBER Working Paper No. 25520, Oct. 2021, *https://www.nber.org/papers/w25520.*

[60] Over the last 10 years, Estonia's central government tax collections from income and profit amount 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/Index.aspx.*

[61] William McBride, Huaqun Li, Garrett Watson, Alex Durante, Erica York, and Alex Muresianu, "Details and Analysis of a Tax Reform Plan for Growth and Opportunity," Tax Foundation, Jun. 29, 2023, *https://taxfoundation.org/growth-opportunity-us-tax-reform-plan/*.

duced 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 2.5 percent in the long run, grow the capital stock by 3.4 percent, add 1.3 million full-time equivalent jobs and raise wages by 1.4 percent. By increasing GDP, we estimate the reform would reduce the debt burden as measured by the debt-to-GDP ratio by 9.2 percentage points over the long run.

Distributionally, we find the reform would increase after-tax income overall by 3.5 percent in the long run, accounting for improved economic growth, with a larger boost of 4.3 percent for the bottom quintile of earners and 4.7 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.[62] 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.[63]

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.[64] 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.[65]

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.[66] 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.[67]

We have recently modeled specific reforms that would shift the U.S. tax system towards taxing consumption rather than income while simplifying the tax code's various antipoverty programs, including an option that combines a cash flow tax with a progressive household compensation tax and per person credit. We find these reforms would lead to higher economic output and higher after-tax income for lower-income households while raising roughly the same amount of tax revenue for the Federal Government.[68]

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[62] Daniel Bunn and Cecilia Perez Weigel, "Sources of Government Revenue in the OECD," Tax Foundation, Feb. 23, 2023, *https://taxfoundation.org/oecd-tax-revenue-by-country-2023/*.

[63] William McBride, "What Is the Evidence on Taxes and Growth," Tax Foundation, Dec. 18, 2012, *https://www.taxfoundation.org/what-evidence-taxes-and-growth/*.

[64] Daniel Bunn, "What the U.S. Can Learn from the Adoption (and Repeal) of Wealth Taxes in the OECD," Tax Foundation, Jan. 18, 2022, *https://taxfoundation.org/wealth-taxes-in-the-oecd/*.

[65] Daniel Bunn and Elke Asen, "Savings and Investment: The Tax Treatment of Stock and Retirement Accounts in the OECD," Tax Foundation, May 26, 2021, *https://taxfoundation.org/savings-and-investment-oecd/#Capital;* Jacob Lundberg and Johannes Nathell, "Taxing Capital—An International Comparison," Tax Foundation, May 11, 2021, *https://taxfoundation.org/tax-burden-on-capital-income/*.

[66] This design is known as the "X Tax," developed by the late economist David Bradford. *See* Robert Carroll and Alan D. Viard, *Progressive Consumption Taxation: The X Tax,* (Washington, D.C.: The Rowman & Littlefield Publishing Group, 2012).

[67] *See* Rita de la Feria and Michael Walpole, "The Impact of Public Perceptions on General Consumption Taxes," British Tax Review 67:5 (Dec. 4, 2020), 637–669, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3723750* 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.

[68] Erica York, Garrett Watson, Alex Durante, and Huaqun Li, "How Taxing Consumption Would Improve Long-Term Opportunity and Well-Being for Families and Children," Tax Foundation, Oct. 12, 2023, *https://taxfoundation.org/research/all/federal/us-consumption-tax-vs-income-tax/*.

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 causes taxpayers to call the IRS millions of times per year asking for help filling tax forms that take them more than 6.5 billion hours to complete.

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."[69] 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 in the current environment of high interest rates and still-too-high inflation reducing living standards and prosperity. The tax code is one of the most effective levers available to lawmakers to strengthen the economy, but it should not be done through preferences that are targeted and complicated. Rather, lawmakers should broadly improve incentives to work, save, and invest by lowering marginal tax rates on individual and corporate income.

We have shown that revenue-neutral tax reform can greatly improve economic growth, increasing GDP by 2.5 percent in the long run, adding 1.3 million jobs, and raising wages by 1.4 percent such that after-tax incomes for the bottom 40 percent of earners increase by more than 4 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.

QUESTIONS SUBMITTED FOR THE RECORD TO WILLIAM MCBRIDE, PH.D.

QUESTIONS SUBMITTED BY HON. MIKE CRAPO

Question. Even as the administration has boasted it will make the wealthy and businesses pay their "fair share," the misnamed Inflation Reduction Act provided hundreds of billions of dollars of tax subsidies to Democrats' favored industries.

In your written testimony, you state that research shows that "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."

Can you discuss how the Inflation Reduction Act, which passed with only Democrat votes, favors high-income earners in the tax code?

Answer. 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 (CBO) and the Joint Committee on Taxation, with the benefits accruing mainly to high earners.[1]

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[69] Internal Revenue Service National Taxpayer Advocate, "2022 Annual Report to Congress," Jan. 11, 2023, *https://www.taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-delivers-2022-annual-report-to-congress/*.

[1] John Bistline, Neil Mehrotra, and Catherine Wolfram, "Economic Implications of the Climate Provisions of the Inflation Reduction Act," Brookings Papers on Economic Activity, March 2023, *https://www.brookings.edu/wp-content/uploads/2023/03/BPEA_Spring2023_Bistline-et-al_unembargoedUpdated.pdf;* Jason Furman, "Comment on 'Economic Implications of the Climate Provisions of the Inflation Reduction Act,'" Mar. 30, 2023, *https://www.brookings.edu/wp-content/uploads/2023/02/2b_20230330-BPEA-climate-furman-comment.pdf;* Christine McDaniel, "The Cost of Battery Production Tax Credits Provided in the IRA," *Forbes,* Feb. 1, 2023, *https://www.forbes.com/sites/christinemcdaniel/2023/02/01/the-cost-of-battery-produc-*

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 of the benefits will accrue to filers earning over $200,000.[2] 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 of the benefits will accrue to filers earning over $100,000.[3]

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 earners.[4] According to TPC, about 5 percent of the benefits of the IRA green energy tax credits for individuals accrue to filers earning more than $1 million and more than 50 percent accrues to filers earning over $200,000.[5]

The benefits of the EV credits are likely further skewed to high earners as a result of 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 *New York Times* article, the share of EV consumers that lease rather than own has grown to 34 percent as of March 2023, compared to 7 percent in September 2022, the month after enacted.[6]

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 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.[7]

Question. There is no shortage of research that demonstrates the significant costs that high marginal income tax rates have on slowing economic growth—which means less investment, fewer jobs, and lower wages. As harmful as higher income tax rates are, some also want to tax "wealth" writ large—once as individual or corporate income, and again as a capital gain or death tax.

How would higher marginal income tax rates, or even a wealth tax, impact Americans' incentives to work, save, and invest?

How have wealth taxes held up in most European countries?

Answer. Because income is generated primarily by working, saving, and investing, raising marginal income tax rates will increase the penalty on those activities, naturally reducing the incentive to do them. As described in my written testimony, this relationship has been documented and measured over and over in dozens of empirical studies, and it is generally well understood among economists that the effect is substantial. This is why the CBO found that a progressive income tax, with mar-

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tion-tax-credits-provided-in-the-ira/?sh=362fc62279ef; Christine McDaniel, "The Costs of Wind Production Tax Credits Provided in the IRA," *Forbes,* Mar. 8, 2023, *https://www.forbes.com/sites/christinemcdaniel/2023/03/08/the-costs-of-wind-production-tax-credits-provided-in-the-ira/?sh=7cd6f4295ff7;* Goldman Sachs, "Carbonomics: The Third American Energy Revolution," Mar. 22, 2023.

[2] Tax Policy Center, Table T23–0049, April 3, 2023, *https://www.taxpolicycenter.org/model-estimates/hr5376-inflation-reduction-act-passed-senate-august-2022/t23-0049-energy-security.*

[3] Tax Policy Center, Table T23–0047, April 3, 2023, *https://www.taxpolicycenter.org/model-estimates/hr5376-inflation-reduction-act-passed-senate-august-2022/t23-0047-energy-security.*

[4] David Roberts, "Clean Energy Tax Credits Mostly Go to the Affluent. Is There a Better Way?," Nov. 24, 2015, *https://www.vox.com/2015/11/24/9792474/energy-tax-credits-inequitable.*

[5] Tax Policy Center, Table T23-0045, April 3, 2023, *https://www.taxpolicycenter.org/model-estimates/hr5376-inflation-reduction-act-passed-senate-august-2022/t23-0045-energy-security.*

[6] Lawrence Ulrich, "Electric Vehicle Tax Credit Rules Create 'Chaos for Consumers,'" *The New York Times,* Apr. 20, 2023, *https://www.nytimes.com/2023/04/20/business/electric-vehicle-tax-credits-consumers.html.*

[7] John Bistline, Neil Mehrotra, and Catherine Wolfram, "Economic Implications of the Climate Provisions of the Inflation Reduction Act," Brookings Papers on Economic Activity, March 2023, *https://www.brookings.edu/wp-content/uploads/2023/03/BPEA_Spring2023_Bistline-et-al_unembargoedUpdated.pdf;* Jason Furman, "Comment on 'Economic Implications of the Climate Provisions of the Inflation Reduction Act,'" Mar. 30, 2023, *https://www.brookings.edu/wp-content/uploads/2023/02/2b_20230330-BPEA-climate-furman-comment.pdf.*

ginal income tax rates that rise with income, is substantially more economically destructive than a flat income tax or a flat labor tax.[8]

Taxing unrealized capital gains or wealth 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 earners (*e.g.,* wealth taxes), as the administrative and economic challenges outweigh any benefits in terms of tax revenue.[9] 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.[10]

QUESTIONS SUBMITTED BY HON. MARSHA BLACKBURN

Question. I find it concerning that the IRS is selectively auditing on factors unrelated to the accuracy of tax returns, particularly when they're scrutinizing a tax base that has historically had no significant issues with compliance. This July, GAO examined IRS audits of large partnerships and found that the agency is starting from a weak position. Between 2010 and 2018, four out of every five of those audits resulted in no change, and of those that changed, the company overpaid taxes and was owed money back by the IRS.

Has the Tax Foundation modeled the fiscal impacts of audit focus at the IRS?

Is approaching audits in this way an effective use of IRS resources?

Answer. No, we have not modeled the fiscal impacts of audit focus at the IRS, nor do we have the capability currently to do so. Our model works with economic aggregates and samples of individual tax return information but does not contain any information on auditing. While we do not model auditing practices, we do think sound tax policy principles—including simplicity, transparency, and neutrality—apply to auditing practices. These principles suggest that taxpayers and administrators would be better served by an audit policy that sticks to simple, understandable rules based on risk assessment, *i.e.,* the risk and likelihood of an audit identifying a substantial underpayment of tax, where taxpayer income becomes a factor only to the extent it is correlated with this risk.

Question. I'd like to ask about the costs to taxpayers to launch the IRS-run, direct electronic filing (e-filing) tax return system. The IRS report to Congress in May 2023 estimated that Direct File may cost American taxpayers $2.5 billion over 10 years. However, TIGTA's report issued in October asserted that the IRS could not provide any documentation to support its cost estimates or how it determined there would be at least 5 million users. As a result, TIGTA had no way to identify the reasonableness of the IRS's cost estimates.

Has the Tax Foundation examined the potential costs to launch the IRS's Direct File program?

If not, is Tax Foundation considering modeling the potential cost of this program versus the cost to revitalize the existing Free File program?

Answer. Yes, we have considered the potential costs of the IRS launching a Direct File program and described our analysis in a July blog post.[11] While some countries, such as Estonia, have proven that Direct File can work, it is important to understand the conditions under which it can work. The main condition is the simplicity

[8] Congressional Budget Office, "The Economics of Financing a Large and Permanent Increase in Government Spending: Working Paper 2021–03," Mar. 22, 2021, *https://www.cbo.gov/publication/57021.*

[9] Daniel Bunn, "What the U.S. Can Learn from the Adoption (and Repeal) of Wealth Taxes in the OECD," Tax Foundation, Jan. 18, 2022, *https://taxfoundation.org/wealth-taxes-in-the-oecd/.*

[10] Daniel Bunn and Elke Asen, "Savings and Investment: The Tax Treatment of Stock and Retirement Accounts in the OECD," Tax Foundation, May 26, 2021, *https://taxfoundation.org/savings-and-investment-oecd/#Capital;* Jacob Lundberg and Johannes Nathell, "Taxing Capital—An International Comparison," Tax Foundation, May 11, 2021, *https://taxfoundation.org/tax-burden-on-capital-income/.*

[11] Taylor Cazy, "The U.S. Tax Code Is Too Complex for Direct eFile to Work," Tax Foundation, Jul. 11, 2023, *https://taxfoundation.org/blog/irs-efile-prefilled-tax-returns/.*

of the tax code: Estonia's tax system is extraordinarily simple, with relatively few special provisions, deductions, credits, et cetera.[12] The U.S. tax code, on the other hand, is complex. It contains more than 200 tax expenditures, including deductions and tax credits for all sorts of activities (*e.g.,* home improvement, child care, medical and educational expenses, et cetera). As such, there is no clear path for the IRS to efficiently and accurately attain such diverse information without intense involvement by the taxpayer. In other words, this is putting the cart before the horse. Direct File should be pursued only after lawmakers substantially simplify the tax code. As mentioned in the prior answer, we do not have the capability to model Direct File, nor do we intend to build out such a model in the near future.

QUESTIONS SUBMITTED BY HON. TODD YOUNG

Question. In your written testimony, you discussed the economic cost of high marginal income tax rates, noting that "high income tax rates come with disproportionately large additional excess burden." This burden is furthered by the double taxation of corporate income, which you noted as "one of the most problematic and economically destructive aspects of the U.S. tax code."

Can you please discuss further the impacts this corporate tax structure has on individuals?

Answer. The integral role corporations play in our economy and the degree to which individuals are affected by corporate taxes are often forgotten in discussions of corporate tax issues. A recent report by McKinsey Global Institute finds, based on OECD data, that across major OECD economies, the business sector contributed 72 percent of value added (that is, GDP).[13] In most countries, the business sector is almost entirely in corporate form, whereas in the U.S., a substantial portion is in pass-through form, only subject to one layer of tax when owners report pass-through earnings on their individual tax returns. Nonetheless, more than half of U.S. GDP is attributable to the corporate sector.

One reason the pass-through sector is so large in the U.S. is the fact that corporations are disadvantaged; they are subject to two layers of tax: corporate income taxes at the entity level (Federal tax rate of 21 percent plus now a minimum tax on book income and a stock buyback tax) as well as shareholder-level taxes on dividends and capital gains (top Federal tax rate of 23.8 percent). That such a large and integral part of the U.S. economy is subject to substantial double taxation makes it particularly problematic and destructive of U.S. economic growth and productivity. The corporate income tax substantially raises the cost of corporate investment, reducing the amount of investment and the number of projects that are pursued. Less investment means a smaller capital stock (fewer factories, equipment, and tools for workers), which means less productive workers and commensurately less pay.

The buyback tax and shareholder taxes punish equity-financed corporate investment, with capital gains and dividends taxes hitting U.S. equity shareholders and disadvantaging U.S. savers, encouraging a larger share of U.S. corporate investment to be financed and owned by foreigners. As it stands, some 58 percent of U.S. households own corporate shares directly or indirectly, such as through mutual funds or retirement accounts, making these taxes a widespread burden on American savers, including tens of millions earning less than $200,000.[14]

Another large share of Americans depend on corporations for employment, with slightly less than half of the private sector workforce employed by traditional C cor-

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[12] William McBride, Huaqun Li, Garrett Watson, Alex Durante, Erica York, and Alex Muresianu, "Details and Analysis of a Tax Reform Plan for Growth and Opportunity," Tax Foundation, Jun. 29, 2023, *https://taxfoundation.org/growth-opportunity-us-tax-reform-plan/.*

[13] McKinsey Global Institute, "A new look at how corporations impact the economy and households," May 31, 2021, *https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/a-new-look-at-how-corporations-impact-the-economy-and-households.*

[14] Hannah Mio, "More Americans Than Ever Own Stocks," *The Wall Street Journal,* Dec. 18, 2023, *https://www.wsj.com/finance/stocks/stocks-americans-own-most-ever-9f6fd963?st=mq1kiym32yeknyp;* Joint Committee on Taxation, "Revenue Estimates and Distributional Analyses," Aug. 3, 2021, *https://www.finance.senate.gov/imo/media/doc/jct_analysis_on_corporate_tax_increase.pdf.*

porations.[15] This fact, and the connection between corporate investment and wages, leads researchers to allocate much of the corporate tax burden to workers in the long run. Accounting for both the portion that falls on shareholders and the remainder that falls on workers, the Joint Committee on Taxation (JCT) assumes that in the long run, the corporate tax burden falls on more than 150 million tax filers earning less than $200,000.[16]

Question. One of the criticisms of the U.S. tax code often highlighted by my Democrat colleagues is the idea that individuals are able to "buy, borrow, die," all while avoiding paying taxes.

Do you agree with this framing of the U.S. tax code? Why or why not?

Answer. The "buy, borrow, die" story presented at the hearing leaves out some important details and in particular fails to mention the role of corporate taxes and estate taxes. As far as we know, the highest net worth individuals in the U.S. (who purportedly rely on this buy, borrow, die strategy) own a large share of their wealth in the form of corporate shares, often founders' shares in companies they have founded. Each year, these companies are subject to the Federal corporate income tax of 21 percent, plus the new 15-percent minimum tax on book income and the new 1-percent buyback tax. The company's market value, and the owner's share of that market value, are reduced each year by these taxes.

Furthermore, these taxes are collected even if the owner of the shares receives no dividends and does not sell the shares during the year, thus avoiding dividend and capital gains taxes (it is unclear how common or economically significant this situation is).

While it is true that the owner of these shares can borrow against the value of the corporate stock, it is costly to do so, particularly now that interest rates for personal loans have increased to a range of roughly 8 to 35 percent depending on circumstances.[17] A portion of the nominal interest rate represents taxes paid by lenders on their interest income, *e.g.,* corporate taxes on banks.

Finally, estate taxes are a final layer of tax triggered by death. The buy, borrow, die story is that step-up in basis for capital gains allows capital gains taxes to be avoided at death, but the Federal estate tax remains and currently applies at a top rate of 40 percent on capital gains and all assets within an estate above a threshold of about $13 million. Step-up in basis exists to avoid double taxing estates.

Question. You have frequently discussed the positive economic impacts the Tax Cuts and Jobs Act (TCJA) has had on the U.S. economy, noting that "[r]eal GDP grew at an annual rate of 2.6 percent from 2017 to 2019, compared to 2.3 percent over the 20 years prior to TCJA", among other measures that point to a strong post-TCJA economy.[18] One of the factors that contributed to this strong economic growth were TCJA provisions that provided incentives for businesses to invest in activities like research and development in order to grow their business and, by extension, the economy.

Can you please share some of the larger macroeconomic impacts the business investments contained in TCJA have provided to companies, both big and small?

Answer. Lowering the corporate tax rate from the highest in the OECD to roughly the middle of the pack improved our economy's competitiveness and attractiveness as a place to locate major economic activities, including U.S. multinational headquarters and R&D operations. The lower corporate tax rate improved the long-run health of the economy by substantially reducing the tax burden on corporate investment, including for the more than 99 percent of C corporations that have fewer than 500 employees.[19] Bonus depreciation reduced the economic harm of both the cor-

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[15] Kyle Pomerleau, "An Overview of Pass-Through Businesses in the United States," Tax Foundation, Jan. 21, 2015, *https://taxfoundation.org/research/all/federal/overview-pass-through-businesses-united-states/.*

[16] Joint Committee on Taxation, "Revenue Estimates and Distributional Analyses," Aug. 3, 2021, *https://www.finance.senate.gov/imo/media/doc/jct_analysis_on_corporate_tax_increase.pdf.*

[17] Bank Rate, "Best personal loan rates for December 2023," Dec. 18, 2023, *https://www.bankrate.com/loans/personal-loans/rates/.*

[18] *https://taxfoundation.org/research/all/federal/tax-cuts-and-jobs-act-biden-tax-policies/#:~:text=Real%20GDP%20grew%20at%20an,20%20years%20prior%20 to%20TCJA.*

[19] U.S. Census, "County Business Patterns," *https://www.census.gov/programs-surveys/cbp.html.*

porate tax and individual income taxes on pass-through business income, boosting business investment incentives broadly, albeit temporarily.

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.[20]

A recent study by economists associated with the National Bureau of Economic Research and the Treasury Department finds the TCJA's corporate reforms substantially raised U.S. capital investment and boosted economic growth. Based on a large sample of 12,000 corporate tax returns covering several years prior to the enactment of the TCJA and 2 years after, the researchers found that, on average, firms impacted by the policy changes increased domestic investment by about 20 percent in the subsequent 2 years relative to firms with no tax change.[21]

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. In your testimony, you highlighted the progressive nature of the tax code and made the point that the share of Federal income taxes paid by the top 1 percent of taxpayers has increased over the last several years. You specifically cited IRS tax data from the 2020 filing season illustrating that over 42 percent of all Federal income taxes were paid by the top 1 percent of earners.

Can you outline how the share of Federal income taxes paid by the highest earners has grown since enactment of the Tax Cuts and Jobs Act and to what degree you anticipate that continuing to be the case should the individual rates be extended beyond 2025?

Answer. As indicated by the IRS data, the share of Federal income taxes paid by the top 1 percent of earners has trended up over the last 20 years, from 33.2 percent in 2001 to 42.3 percent in 2020 (the last year of available data).[22] The trend continued after the enactment of TCJA: the share of Federal income taxes paid by the top 1 percent of earners was 38.5 percent in 2017 and grew to 40.0 percent in 2018 (the first year following enactment), the highest recorded share going back to 1980. The top 1 percent share dropped in 2019 to 38.8 percent before climbing to a new high of 42.3 percent in 2020.

Two factors driving this trend are the growing share of income reported by the top 1 percent of earners and policies that increase the progressivity of the tax code, including higher top tax rates and more generous tax credits for low earners (note that these figures do not include the refundable portion of tax credits, which are counted as outlays). The top 1 percent share of reported adjusted gross income (AGI) grew from 17.4 percent in 2001 to 22.2 percent in 2020, with little variation since the enactment of TCJA. AGI shares fluctuate with the economy and the stock market, and as 2021 represented a rebounding economy and a booming stock market, this points to a further increase in the top 1 percent share of Federal income taxes for that year. As well, certain pandemic-era policies in place during 2021, including the expanded child tax credit, may further increase the share of Federal taxes paid by the top 1 percent of earners.

The extension of TCJA's individual provisions beyond 2025 would likely have little impact on the share of Federal income taxes paid by high earners, since the rate

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[20] Huaqun Li and Kyle Pomerleau, "The Distributional Impact of the Tax Cuts and Jobs Act over the Next Decade," Tax Foundation, Jun. 28, 2018, *https://taxfoundation.org/the-distributional-impact-of-the-tax-cuts-and-jobs-act-over-the-next-decade/*.

[21] William McBride and Alex Durante, "New Study Finds TCJA Strongly Boosted Corporate Investment," Tax Foundation, Oct. 31, 2023, *https://taxfoundation.org/blog/tcja-corporate-tax-economic-effects/*.

[22] Erica York, "Summary of the Latest Federal Income Tax Data, 2023 Update," Tax Foundation, Jan. 26, 2023, *https://taxfoundation.org/data/all/federal/summary-latest-federal-income-tax-data-2023-update/*.

reductions and other measures, including the expanded standard deduction and Child Tax Credit, would provide a broad set of tax cuts across the income scale.[23]

Question. As you know, the Tax Cuts and Jobs Act capped the deduction for State and local taxes at $10,000. And it is no secret that the SALT deduction primarily benefits higher-income earners.

Could you walk through how any revisions of the tax code to either increase the SALT deduction or repeal the cap all together would be a highly regressive policy change and primarily benefit those in higher-income brackets?

Answer. We have recently modeled several options for revising the cap on SALT deductions, finding in general that any lifting of the cap would primarily benefit high-income earners. For example, measured on a conventional basis (static analysis excluding any macroeconomic effects) in 2025, raising the cap to $15,000 for singles and $30,000 for joint filers would have no measurable impact on the bottom 60 percent of filers, but it would boost the after-tax income of the top quintile by 0.4 percent. Fully eliminating the cap would have no measurable impact on the bottom 40 percent of households, but it would boost the after-tax income of the top quintile by 1.3 percent.[24]

PREPARED STATEMENT OF MORRIS PEARL, CHAIR, PATRIOTIC MILLIONAIRES

Chairman Wyden and Ranking Member Crapo, thank you for giving me the opportunity to speak today. I had a long career on Wall Street and currently serve as the chair of Patriotic Millionaires, but most importantly for the purposes of this hearing, I am exactly the kind of very wealthy individual that our tax code is designed to advantage.

The cost of those advantages is:

- A permanent upper hand for the wealthy over working people;
- Economic instability from an extreme concentration of wealth and income at the top;
- An eroding consumer base and tax base; and
- Social instability as more and more people realize that putting in a hard day's work is no longer a path to dignity and a financially stable life.

The original sin of our tax code is the way we value money and wealth over work and wages. Your constituents who work for a living have taxes deducted from their paychecks every single week. I earn money by just watching the numbers on my brokerage statement go up, and I can decide to have that income become taxable if and when I feel like it. We do not tax capital gains until the time of sale, which means for people like me, taxes become essentially optional. We can take out low-interest loans to fund living expenses; never realize the capital gains, so never pay taxes on them; and when we die, thanks to the step up in basis, we're able to pass that wealth on to the next generation completely free of income tax, and the whole "buy, borrow, die" process starts again. People who are rich don't need any "taxable" income. The money made by investors should be subject to taxes just like the money made by your constituents who work for a living. That is the essence of the proposed legislation from Chairman Wyden and from President Biden.

My own family benefited from the step-up basis rule in 2009, inheriting shares of Berkshire Hathaway that had a gain of over 62,000 percent. We enjoyed millions of dollars of gains on which no one had ever paid any income taxes, and on which no one ever will pay any income taxes.

Even when I do choose to realize those gains and pay taxes, the rate is far below the rate paid by people who earn that much from their work. This is supposed to incentivize investment, which fundamentally misunderstands what drives investors like me. My options are to invest my money and get some growth, or stuff it under a mattress. And last time I checked, mattresses don't have great returns. Perhaps even more ridiculously, we give this same benefit to venture capital and private eq-

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[23] Erica York, Garrett Watson, Alex Durante, Huaqun Li, Peter Van Ness, and William McBride, "Details and Analysis of Making the 2017 Tax Reforms Permanent," Tax Foundation, Nov. 8, 2023, *https://taxfoundation.org/research/all/federal/making-2017-tax-reform-permanent/*.

[24] Garrett Watson, "Policymakers Must Weigh the Revenue, Distributional, and Economic Trade-Offs of SALT Deduction Cap Design Options," Tax Foundation, Dec. 7, 2023, *https://taxfoundation.org/blog/salt-deduction-cap-design-options/*.

uity fund managers who are managing other people's investments through the carried interest loophole. If we believe we should be using the tax code to incentivize people to enter certain professions, I would put emergency-room nurses above fund managers.

Even the wealthy people who earn most of their income from work don't experience a truly progressive tax code. Our top tax bracket for a married couple filing jointly starts at a little under $700,000. That's a lot of money every year, but let's not pretend they're in the same income bracket as someone earning $7 million or $70 million. And that couple earning $700,000 in compensation pays Social Security tax on a substantial portion of their income. The burden of Social Security tax for a couple making $7 million or $70 million is negligible (well under 1 percent of income).

Many people, including some of you on this committee, have offered serious solutions that would help reorient the way we tax the ultra-wealthy. Your proposals to tax extreme wealth include Senator Warren's Ultra-Millionaire Tax and the OLIGARCH Act introduced by Rep. Barbara Lee and others in the House.

We also need taxes on unrealized gains of the ultra-rich, like Chairman Wyden's proposal or President Biden's proposal.

To be clear, I am not against being rich. I lead an organization of millionaires. We know that being rich is great, and we recommend that everyone try it. But investors and business people do not want a nation with a few rich people and lots of people just getting by. That is not where we can invest and build businesses. Money doesn't trickle down, it trickles up from every mortgage payment and phone bill payment you make to investors like me who invest in mortgages and phone companies. We need a nation filled with people who have enough money to spend on this. That is what makes the economy work for everyone, including investors. The tax code can, should, and must be used to reduce and constrain inequality, and the status quo is doing the exact opposite.

Thank you, I will be happy to answer any questions you have.

Prepared Statement of Hon. Ron Wyden, a U.S. Senator From Oregon

This Congress, the Senate Finance Committee has investigated a number of tax schemes that the very wealthy—with the help of armies of high-priced tax lawyers and accountants—use to pay virtually no Federal tax for years on end.

Today, we'll examine one strategy—among others—called "buy, borrow, die." Just three little words on the chart behind me, that have a huge impact. Here's how it works.

A corporate raider buys a business, and then borrows against its growing, untaxed value to fund their extravagant lifestyle—everything from superyachts to luxurious vacations, expensive art deals, you name it. It goes up and up in value, all while not paying a dime in tax. And when they die, their assets are passed to their kids—often entirely tax-free—and the cycle continues.

Now let's contrast buy, borrow, die against the tax system mandated for everyone else.

A nurse or a firefighter living in Philomath, OR is required to pay taxes out of each paycheck. Working people don't get to play by the same rules as billionaires. They don't get to call up an accountant every time they don't feel like paying taxes.

Right now, the average billionaire wriggles their way into a measly 8-percent tax rate while a nurse or firefighter making $45,000 is paying a 22 percent tax on their wages. How is that fair?

Americans overwhelmingly believe it's not. So it's time to look to solutions that restore fairness to the tax code while still rewarding success. After all, that's what our country is founded on: the idea that everyone has a chance to get ahead.

Luckily, there's a solution that achieves both fairness and economic growth. It's called mark to market. And here's the kicker: there's already a version of it in the tax code. That means we have the blueprint right in front of us to use as a model for mark-to-market provisions for billionaires. Put simply: mark to market would require billionaires to pay tax every year, just like everyone else.

Buy, borrow, die is the primary mechanism billionaires use to dodge taxes. And if left unchecked, you're inviting more gaming into the system. Ending buy, borrow, die is the best way to ensure billionaires pay their fair share.

Tax laws don't apply to billionaires in the same way they do for everybody else. They're optional, where everybody else's tax rules are mandatory. It's time to close these loopholes and make sure those at the very top are paying taxes on their income as it's earned, just like everybody else.

My team on the Finance Committee and I are fighting tax injustices from every angle. We've investigated crooked Swiss bankers hiding Americans' income; $34 billion in unpaid taxes from millionaires; tax dodging schemes between Leon Black and Jeffrey Epstein; and Supreme Court Justice Clarence Thomas's wealthy buddy secretly forgiving a massive, private loan.

Americans deserve a tax system that can be both fair and encourage success. My hope is that effort could be bipartisan. The invention of Roth IRAs—a Republican idea—has helped working Americans save for the future and get ahead. But now, the ultra-wealthy are abusing them to shield their vast fortunes from Federal tax. It's time to end this exploitation of current tax laws and use the funds to give more families a chance to get ahead by starting child savings accounts, something my colleague, Senator Bob Casey, has been working on for years.

I've laid out just a few of the endless ways the super-wealthy are avoiding paying their fair share, but here's the real gut punch: it's all perfectly legal. If that doesn't make your blood boil, I don't know what will.

The decks are stacked against working families. Wealth continues to build up in the hands of the fortunate few, leaving everyone else behind. Over one-third of families in America don't have the cash on hand to pay for a $400 emergency if they had to. Meanwhile, during the pandemic when families were forced to make tough choices between paying rent and buying groceries, billionaires increased their wealth by over $1 trillion.

Bottom line: it's time to throw out business as usual here.

I'll close with this: there is growing support and demand for solutions that restore fairness to the tax code and level the playing field for working families. You can only have a successful economy if you have a tax code that treats everyone fairly.

It's past time to close the gap between those at the top and everyone else, and I look forward to working with my colleagues on the Committee to make it happen.

COMMUNICATIONS

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Statement of Michael G. Bindner, Principal Consultant

Chairman Wyden and Ranking Member Crapo, thank you for taking my comments on this issue. While you have likely heard some of these before, I offer them anew as a contrast to the testimony of the invited witnesses.

How do the wealthy game the system? Let me count the ways:

- Borrowing from accumulated shares at favorable terms for additional acquisitions or to fund new enterprises and to fund lavish personal spending.
- Using Life Insurance so that heirs avoid taxation of intergenerational wealth.
- Using duty free zones to hide investment assets, such as art for investment.
- Using gifts, inheritance and donations to avoid capital gains taxation.
- The ability to offset financial losses to reduce the taxation of wages and salaries.
- Tax Cuts whenever a Republican is in the White House and controls one or both chambers.
- Leveraging these tax cuts into ownership of the national debt, which is the leverage that allows capitalism to go off the rails into speculation.

For the first four bullets, see our tax reform plan in the first attachment for more detail.

The solution to the first two bullets is to enact a **(credit) invoice value-added tax,** as well as an asset value-added tax. We propose that subsidies to families be paid through an employer-paid **subtraction VAT,** so that they may be distributed with wages or alternatively with other government benefits under the Social Security Act, including Unemployment Insurance.

The invoice VAT will hit every dollar spent, including when goods, services and assets are purchased abroad and brought home. Duty Free zone exemptions on paying such taxes must be abolished above $100. Consumption taxes cannot be avoided by taking funds out of investments or insurance policies, including that portion of the subtraction VAT that is channeled to workers and their families.

The next to bullets are fixed by repealing capital gains taxes entirely and replacing them with an **asset value-added tax.** There should only be one rate for asset VAT, which should be set at the rate for long-term capital gains. This would also be the rate for every short term transaction. This would technically be a tax cut, which will force Republicans to support it or be called out by Mr. Norquist.

At initial public offering, option exercise and the first sale after inheritance, gift or donation, the sale would logically be marked to market. If a family keeps the stock or company, there will be no tax until someone else buys it.

The second tax cut would be to expand the ESOP tax exemption to all sales of public stock, rather than just private stock. Maximizing employee ownership will bring a new level of motivation and excellence to the economy.

There is no hiding from a value-added tax taken at each transaction. Any increased value added would be paid immediately rather than being part of a portfolio which allows offsets from business losses to reduce taxes on wages and salaries.

While requiring the taking of capital gains at death is emotionally satisfying, it has no chance of passage, especially if this breaks up family businesses. While we are in favor of breaking up such fortunes as a general principle, it simply cannot be done until inherited firms or shares in public companies are sold. Zero-rating ESOP sales fulfills the promise of wealth redistribution to workers. Simply forcing the sale of assets keeps them in the capitalist sector, doing nothing for the working class.

Personal income tax filing on wage and dividend income for middle-income households will be replaced with a subtraction value-added tax surtax for income above the ceiling for FICA employee contributions, which will be graduated from a 6.5% rate to a 26% rate for income over $425,000. Again, without capital gains taxation, there is no way to offset dividend and salary income. Using an employer collected surtax with capital gains taxes exported to the asset VAT makes it possible to end filing for all but the top 1% of households.

At $500,000, an individual surtax ranging between 6.5% and 26% would fund net interest payments, debt reduction and paying down the Social Security Trust Fund. For this reason, these payments will be made to the Bureau of the Public Debt. The Asset VAT will be collected by the SEC.

The subtraction VAT, any carbon added tax and the Invoice VAT, which you can call a Fair Tax will be collected by the States (who will also do any auditing on tax collection issues). It is an offer that Republican members cannot refuse.

The 2017 personal income tax changes should not be made permanent or extended, as has been proposed. This will reward savings and speculation, rather than providing an incentive to invest in plant and equipment. The latter responds to greater levels of consumption by households funded by both the public and private sectors, including Social Security recipients. For a more detailed treatment of why this is the case, see the second attachment—which was drafted in 2017 in opposition to the Trump-Ryan-Brady tax cuts. The third attachment explains why any Fiscal Commission should use repeal of these tax cuts as its baseline assumption.

The last attachment, which is an excerpt from my book, *Settling (and Squaring) Accounts: Who Owns the National Debt? Who Owes It?* It shows who really benefits from deficit spending. It is time for the Republicans to wipe their crocodile tears on this issue.

Thank you for the opportunity to address the committee. Please contact us for an in person briefing or to arrange for a public hearing.

Attachment One—Tax Reform, Center for Fiscal Equity, March 24, 2023

Synergy: The President's Budget for 2024 proposes a 25% minimum tax on high incomes. Because most high income households make their money on capital gains, rather than salaries, an asset value-added tax replacing capital gains taxes (both long- and short-term) would be set to that rate. The top rate for a subtraction VAT surtax on high incomes (wages, dividends and interest paid) would be set to 25%, as would the top rate for income surtaxes paid by very high income earners. Surtaxes collected by businesses would begin for any individual payee receiving $75,000 from any source at a 6.25% rate and top out at 25% at all such income over $375,000. At $450,000, individuals would pay an additional 6.25% on the next $75,000 with brackets increasing until a top rate of 25% on income over $750,000. This structure assures that no one games the system by changing how income is earned to lower their tax burden.

Individual payroll taxes. A floor of $20,000 would be instituted for paying these taxes, with a ceiling of $75,000. This lower ceiling reduces the amount of benefits received in retirement for higher-income individuals. The logic of the $20,000 floor reflects full time work at a $10 per hour minimum wage offered by the Republican caucus in response to proposals for a $15 wage. The majority needs to take the deal. Doing so in relation to a floor on contributions makes adopting the minimum wage germane in the Senate for purposes of Reconciliation. The rate would be set at 6.25%.

Employer payroll taxes. Unless taxes are diverted to a personal retirement account holding voting and preferred stock in the employer, the employer levy would be replaced by a goods and receipts tax of 6.25%. Every worker who meets a minimum hour threshold would be credited for having paid into the system, regardless of wage level. All employees would be credited on an equal dollar basis, rather than

as a match to their individual payroll tax. The tax rate would be adjusted to assure adequacy of benefits for all program beneficiaries.

High-income Surtaxes. As above, taxes would be collected on all individual income taxes from salaries, income and dividends, which exclude business taxes filed separately, starting at $400,000 per year. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction.

Asset Value-Added Tax (A–VAT). A replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed. As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax free. These taxes will fund the same spending items as high income and subtraction VAT surtaxes. There will be no requirement to hold assets for a year to use this rate. This also implies that this tax will be levied on all eligible transactions.

The 3.8% ACA–SM tax will be repealed as a separate tax, with health-care funding coming through a subtraction value-added tax levied on all employment and other gross profit. The 25% rate is meant to be a permanent compromise, as above. Any changes to this rate would be used to adjust subtraction VAT surtax and high-income surtax rates accordingly. This rate would be negotiated on a world-wide basis to prevent venue seeking for stock trading.

Subtraction Value-Added Tax (S–VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S–VAT is a vehicle for tax benefits, including:

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer-paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence-level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S–VAT will not be border-adjustable.

As above, S–VAT surtaxes are collected on all income distributed over $75,000, with a beginning rate of 6.25%. replace income tax levies collected on the first surtaxes in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I–VAT). Border adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S–VAT, then they would be funded by the I–VAT to take advantage of border adjustability.

I–VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S–VAT and I–VAT, however net income will be increased by the same percentage as the I–VAT. Inherited assets will be taxed under A–VAT when sold. Any inherited cash, or funds bor-

rowed against the value of shares, will face the I–VAT when sold or the A–VAT if invested.

I–VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I–VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25% to 13%).

Carbon Added Tax (C–AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C–AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

Attachment Two—The Tax and Job Cuts Act

The Tax and Job Cuts Act (not a typo) was a classic piece of Austrian Economics, where booms are encouraged and busts happen with no bailouts. Strong companies and best workers keep jobs and the devil take the hindmost. It is economic Darwinism at its most obvious, but there is a safety valve. When tax cuts pass, Congress loses all fiscal discipline, the Budget Control Act baseline discipline is (as it should be) suspended and deficits grow. Bond purchasers pick up the slack caused by the TCJA, which they will as long as we run trade deficits, unless the President's economic naiveté ruins that for us.

Modern economics has become infected with the idea that higher tax rates and lower public spending hurt the economy. By definition, this is not the case. The exact opposite is true. To refresh our memories of what is in the U.S. Code and most basic economics textbooks, Gross Domestic Product equals equal government purchases, consumption from government employee, contractor, transfer recipient and second order private-sector spending, which leads to private-sector investment, and exports net of imports (which creates a source of funds for debt finance).

Anything that is not part of GDP is considered "savings" or in reality, is asset inflation. If you want to end poverty, give poor people and retirees more money and the economy will grow. Increase government expenditure (even bombers) and the economy will grow, including for the now notorious upper middle class.

Lower tax rates also made money available to chase the same supply of investment instruments, which bid up their price, and caused the invention of a whole range of new products which would be built up and sold by the emerging financial class, who would profit-take and watch what they created go bust and start yet another modern recession, especially the Great Recession just experienced. Only higher tax rates or increased deficit spending control such asset inflation (and the consumption cycles associated with them—which Marx thought was the driver of the boom bust cycle—Marx had a failure of imagination).

A key part of our proposals is to increase income tax revenue from the very wealthy through our income surtax. The higher the marginal tax rate goes, the less likely shareholders and CEOs will go after worker wages in the guise of productivity while pocketing the gains for themselves. Since shareholders usually receive a normal profit through dividends, it is the CEO class that gets rich off of workers unless tax rates are high enough to dissuade them.

Attachment Three—The Proposed Fiscal Commission, October 19, 2023

Job one for any fiscal commission is to allow the Tax Cuts and Jobs Act provisions to expire in 2025. No other baseline is appropriate. Without such a requirement, the Center for Fiscal Equity must oppose any such entity. Fiscal commissions are often an excuse to retain tax cuts that are about to expire.

The 2017 personal income tax cuts reward savings and speculation, rather than providing an incentive to invest in plant & equipment. The latter responds to greater levels of consumption by households funded by both the public and private sectors, including Social Security recipients.

The reality of our fiscal policy is that income tax collected is 1.5% of GDP too low. In other words, they need to be increased by 9%, or more because of how long they have been inadequate. Because the ability to borrow is based on the ability and willingness to tax incomes adequately, AA+ is a gift from ratings agencies. Any other

entity with this revenue to debt ratio with an unwillingness to increase revenue would be rated at junk bond levels.

Oddly, the downgrade is good for bond holders because interest rates will go up. The vast majority of bonds held benefit high income taxpayers. By my calculations, based on observations from the 2019 Survey on Consumer Finance, the top 10% of households own 54% of public debt held by long term asset accounts (insurance policies, savings bonds, retirement accounts) and bank deposits (and therefore assets held by Federal Reserve Banks) and 77% of debt held by mutual fund accounts and direct bond holdings. Applying the same share ratios to the top 1% (which is supported by IRS AGI figures show holdings of 29% of long term debt and Fed held assets and 59% of high yield assets. The top 0.1% hold 45.6% of debt held by high yield assets.

Debt obligation is a function of income tax paid (FICA tax paid to create assets held in trust by the government, not debt obligation). The current factor is 19 dollars of debt owed for every dollar paid in tax.

Ownership of Social Security assets is realized when households are in the bottom quintiles who, at that time (because only 20% have income beside Social Security), own almost all FICA trust fund assets. The bottom quintiles hold more than their obligation.

The next three quintiles owe more than they own until we get to the top 0.1%. Because half of their income is earned through asset ownership taxed at preferred rates and their high share of ownership of debt, they break even. They own what they owe.

In other words, when interest rates go up due to downgrades, their wealth expands in terms of debt owned compared to debt owed. This should guide how the debt should be reduced responsibly.

The Office of Tax Policy and revenue committee staff will hammer out the details as responsible actors. Again, no commission is necessary for the kind of tax reform we need to grow out of our fiscal crisis.

Attachment Four—Debt Ownership as Class Warfare, March 20, 2023

Visibility into how the national debt, held by both the public and the government at the household level, sheds light on why Social Security, rather than payments for interest on the debt, are a concern of so many sponsored advocacy institutions across the political spectrum.

Direct household attribution can be made by calculating direct bond holdings, income provided by Social Security payments and secondary financial instruments backed with debt assets for each income quintile.

Responsibility to repay the debt is attributed based on personal income tax collection. Payroll taxes create an asset for the payer, so they are not included in the calculation of who owes the debt. Using 2019 tax data and the national debt as of COB February 15th, 2022. the ratio is $19 of debt owed for every dollar of income tax paid. Note well that the adjusted gross income of the bottom 80% is just over that garnered by the top 10%.

Percentiles	Millions of Returns	AGI	Income Tax	Debt	Federal Reserve and Bank Debt Assets	Long-Term Investment Debt Assets	Mutual Fund and Bond Debt Assets	Social Security and Medicare Assets
Total with tax	104.01	11,210.1	1,581.4	30,040.3	6,806.6	3,276.5	6,419.1	3,186.5
Top .01%	0.02	659.0	163.2	3,100.2	820.6	378.8	2,519.8	0.0
.01% to 1%	7.26	1,427.9	185.6	3,526.6	1,736.9	844.4	1,652.5	10.2
1% to 10%	7.28	2,086.9	348.8	6,626.8	1,957.5	978.1	1,196.5	177.6
Top 10%	**9.00**	**4,602.44**	**987.23**	**18,754.0**	**4,515.0**	**2,201.4**	**5,368.8**	**187.8**
10% to 20%	13.08	1,788.34	200.3	3,805.1	921.5	644.9	583.2	463.7
Bottom 80%	81.92	4,829.22	393.6	7,476.6	1,370.1	430.3	467.2	2,534.9

The bottom 80% of taxpaying units hold few, if any, public debt assets in the form of Treasury Bonds or Securities or in accounts holding such assets and only take home one-third of adjusted gross income. Their main national debt assets are held on their behalf by the government. They are owed more debt than they owe through taxes. The next 10% (the middle class), hold more in terms of long term investments and mutual fund and bond assets. They hold a bit under a fifth of social insurance assets.

The top 10% pay more than half of income taxes (the dividing line is about 97.5%—and has been for a while). Asset shares within the top 10% are estimated using the same breakdown as the entire population, that is, the top 1% hold 54% of Federal Reserve and Long Term Investment Assets and 77% of mutual funds and bonds as held by the top 10%. A similar fraction is used to estimate holdings by the top 0.01%—which is consistent with how much income they receive (note that I did not say earn).

This illustration shows who benefits the most from having a national debt, therefore who has the most to lose through default. The relative shares of debt ownership, however, are current as reflected in the 2019 Federal Reserve Survey. The 2022 Survey has been released and adjustments will be made accordingly.

STATEMENT SUBMITTED BY ANAND DESAI

Thank you for monitoring the body of tax law and how it is actually applying to look out for individuals and our country's financial well-being.

Please consider whether the following issues along the lines of your hearing are fair and appropriate:

1. Zeroed-out GRATs. Section 7520 of the Internal Revenue Code provides for the Treasury and the IRS to prescribe interest rate based valuation tables regarding interests in for instance trusts. This seemingly innocuous simplification is widely used to transfer assets net of an annuity-like return that would roughly exhaust them if they were placed in stable, low-risk investments, but which leaves a lot over if riskier investments like (for a simple example) a stock portfolio does well. This is commonly repeated until the ups and downs of the market wring out most of the value of a potentially vast fortune to the next generation with allegedly little or no tax cost. See, *e.g.,* "GRAT Strategy Comparison: How Do the Returns Stack Up?", Valur Library.[1]

   Treasury Regulation (26 CFR) 1.7520–3 contains an anti-abuse rule prohibiting the use of a standard actuarial table for an annuity measured by the life of someone who is terminally ill. Why shouldn't the regulations prohibit taking the annuity formula to the zeroed-out GRAT's unreasonable extreme more generally? The fact of a creditor's interest not being worth its face value unless there is additional capital involved to absorb normal ownership risk is obvious to anyone saving for a down payment.

   Whatever one thinks of the estate tax overall, it's hard to see how accommodating that scheme furthers any individual, family, business, or public-policy goal.

2. State and local tax deduction "workarounds". Administrative guidance has been described as providing a "workaround" for the 2017 Tax Cuts and Jobs Act's limit on federal deductions for state and local taxes. See "Federal implications of pass-through entity tax elections", The Tax Adviser.[2]

   Whatever one thinks of the SALT deduction (I think it's a good one, in the interest of federalism, as reflecting a sort of collective charitable donation, and because foreign taxes even by our rivals are generally *creditable*), extra-favorable treatment for taxpayers with enough clout to ask for their income in the form of a business payment seems unfair. Plus benefits for a substitute tax seem at odds with the basic federal income tax judicial principle of substance over form and principles from the foreign tax credit regime to ensure what the federal system defers to are actually taxes, actually on income, and actually on the person for whom claimed.

[1] *https://learn.valur.io/grat-comparison/.*

[2] *https://www.thetaxadviser.com/issues/2022/nov/federal-implications-passthrough-entity-tax-elections.html.*

Moreover, generosity on a recently controversial "revenue raiser" suggests concern about whether Congress (and particularly the House's) role in tax rules is receiving proper weight and whether Congress' internal rules about budget impact of legislation are working as intended.

3. "Carried interest" in tax-favored retirement accounts. Carried interest commonly refers to a manager's profit's interest in an investment fund, which whose receipt is administratively deemed to not be a taxable event under certain circumstances. See Rev. Proc. 93–27. The GAO's October 2014 report to your Committee about "Individual Retirement Accounts"[3] suggests that carried interest is being used to stuff in returns that are disproportionate to invested capital (and thus would seem to have true value far exceeding the contribution limits Congress set to tax-favor only what might correspond to reasonable retirement savings). Shouldn't this be investigated and clearly addressed, at least as a valuation issue or with bright-line rules?
4. Section 7704, with significant exceptions, treats a publicly traded partnership as a corporation. A corporation has an extra layer of tax. But in recent decades many "companies" can elect not to be taxed as "corporations." See Treas. Reg. 301.7701–1 et seq. The result seems to be to systematically increase taxes on those of us who need to join with other investors through the stock markets to finance our companies (or prefer to because they are a very efficient way to allocate capital). Even if more-centralized taxation of business entities with diversified ownership made sense originally, does it still? Consider the recent "centralized partnership audit regime", the Supreme Court's "Wayfair" case recognizing technological advances in tax administration, and tax disadvantages (now perhaps less severe) of having set up as a "U.S. corporation."[4]

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Dear Chairman Wyden and Ranking Member Crapo, the National Women's Law Center ("the Center") commends the Committee for holding this important hearing on the ways the tax code allows the very wealthy to pay less than their fair share of taxes and submits this statement for the record to highlight the ways this unfairness exacerbates gender and racial inequity. Policy changes that would correct the weaknesses in taxation of the wealthy identified by the witnesses at the hearing would both address the gender and racial wealth gap and provide significant revenue that could be invested to help women and families thrive.

I. The gender and racial wealth gap measures inequity in economic security for women and women of color, driven by systemic discrimination

According to data collected in the 2019 Survey of Consumer Finances, for every one dollar of wealth owned by a single white man, single Black women and Latinas own approximately nine cents.[1] Calculated at the median, in 2019, single white men owned $92,300 in wealth, single Black women owned $8,200, and single Latinas owned $7,900.[2] Historic and ongoing systemic discrimination drives these dispari-

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[3] *https://www.gao.gov/assets/gao-15-16.pdf.*

[4] *See* "Nationalities of Convenience," Institutional Investor, February 2002, *https://www.institutionalinvestor.com/article/2btgiowdmfyg7ialal98g/home/nationalities-of-convenience.*

Former Intel Corp. tax chief Robert Perlman got himself into hot water two years ago when he told the Senate Finance Committee: "If I had known at Intel's founding [in 1968] what I know today about the international tax rules, I would have advised that the parent company be established outside the U.S. Our tax code competitively disadvantages multinationals simply because the parent is a U.S. corporation." When Perlman suggested the company could have set up shop in the Cayman Islands, New York's then-senator Daniel Patrick Moynihan, a former ambassador to India and the United Nations, upbraided the Intel executive, asking Perlman if he expected the Marines to show up in the Caymans in case of trouble. Says an unrepentant Perlman, "I should have said 'Ireland.'"

[1] Mariko Chang, Ana Hernández Kent, and Heather McCulloch, "Understanding the Gender Wealth Gap, and Why it Matters," in The Future of Building Wealth: Brief Essays on the Best Ideas to Build Wealth—For Everyone, ed. Ray Boshara and Ida Rademacher. (Aspen Institute, 2021) 53–59, *https://live-future-of-building-wealth.pantheonsite.io/wp-content/uploads/2021/09/Sec1-Ch5-Chang-Kent-McCulloch.pdf.*

[2] *Id.* at 57.

ties. Women, particularly women of color, continue to be underpaid for their work.[3] Women are also overrepresented in the low-paid workforce, making up nearly two-thirds of those in the 40 lowest-paying jobs.[4] Because of a lack of systemic investment in child care, paid family and medical leave, and care for aging and disabled people, women also disproportionately undertake unpaid caregiving responsibilities in the home and predominate in the underpaid child care workforce.[5] Women therefore are less likely to have spare income to set aside in wealth building opportunities such as 401(k) accounts,[6] if they even work in jobs that offer such benefits. Many other factors such as barriers to homeownership,[7] workplace harassment,[8] discrimination in education[9] and more drive wealth disparities. Rather than working to ameliorate such barriers, the tax code instead further entrenches and compounds them.

II. Specific aspects of the tax code lock in wealth disparities, thereby exacerbating rather than mitigating gender and racial inequities

The testimony at the hearing laid out ways the tax code preferences income from wealth compared to income from work, allowing it to be taxed at lower rates or to sometimes go untaxed altogether. Taken together, these preferences for wealth mean those who are already wealthy are positioned to maintain and grow their wealth, locking in wealth disparities by gender and race. Further, specific preferences disproportionately benefit men and white households.

For example, families of color and women are less likely to benefit from tax preferences for capital gains. Taxation of capital gains at a lower rate than wage income disproportionately benefits white households, who are more likely to own investments. One analysis found that while white households comprise 65% of all households, they own almost 90% of corporate stock and private business.[10] Moreover, women are less likely to hold highly-paid jobs that offer investment-based compensation[11] and when surveyed, women have also reported being less likely to invest in the stock market than men.[12]

When wealth is passed down to the next generation, these and other tax preferences further compound largely to the benefit of white households. As detailed in testimony, the step-up in basis wipes out capital gains for tax purposes, and weaknesses in the estate tax do not allow it to serve as an effective backstop. The number of

[3] Brooke LePage and Jasmine Tucker, National Women's Law Center, "A Window Into the Wage Gap: What's Behind It and How to Close It" (January 2023), *https://nwlc.org/wp-content/uploads/2023/01/2022-Wage-Gap-Factsheet-1.10.23v2.pdf.*

[4] Jasmine Tucker and Julie Vogtman, National Women's Law Center, "When Hard Work is Not Enough: Women in Low-Paid Jobs" (April 2020), *https://nwlc.org/wp-content/uploads/2020/04/Women-in-Low-Paid-Jobs-report_pp04-FINAL4.2.pdf.*

[5] Amy Royce and Amy Matsui, "Unsupported: Underinvestment in the Care Economy Drives Gender and Racial Wealth Gaps," Human Rights, January 6, 2023, *https://www.americanbar.org/groups/crsj/publications/human_rights_magazine_home/wealth-disparities-in-civil-rights/unsupported/;* Josephine Kalipeni and Julie Kashen, "Building Our Care Infrastructure for Equity, Economic Recovery and Beyond" (September 2020), *https://caringacross.org/carepaper/;* National Women's Law Center, "Early Educators' Wage Growth Lagged Behind Other Low-Paid Occupations, Jeopardizing the Supply of Child Care as Relief Dollars Expire" (July 2023), *https://nwlc.org/wp-content/uploads/2023/07/ChildCareDollarsFS.pdf.*

[6] Robert Paul Hartley, Ajay Chaudry, Melissa Boteach, Estelle Mitchell, and Kathryn Menefee, National Women's Law Center, Center on Poverty & Social Policy, "A Lifetime's Worth of Benefits: The Effects of Affordable, High-quality Child Care on Family Income, the Gender Earnings Gap, and Women's Retirement Security" (March 2021), *https://nwlc.org/wp-content/uploads/2021/04/A-Lifetimes-Worth-of-Benefits-Compliant.pdf.*

[7] Sarah Javaid and Talia Grossman, "Homeownership—A Pathway to Wealth Building—Is Still Out of Reach for Many Women of Color" (November 2023), *https://nwlc.org/wp-content/uploads/2023/11/2023_NWLC_Homeowner_Brief_Accessible.pdf.*

[8] National Women's Law Center, "Comment on Proposed Enforcement Guidance on Harassment in the Workplace Docket Number EEOC–2023–0005" (November 2023), *https://nwlc.org/wp-content/uploads/2023/11/NWLC-Comment-on-EEOC-Proposed-Enforcement-Guidance-on-Workplace-Harassment.pdf.*

[9] National Coalition on Women and Girls in Education, "Title IX at 50" (June 2022), *https://nwlc.org/wp-content/uploads/2022/06/NCWGE-Title-IX-At-50-6.2.22-vF.pdf.*

[10] Joe Hughes and Emma Sifre, Institution on Taxation and Economic Policy, "Investment Income and Racial Inequality" (October 2021), *https://itep.org/investment-income-and-racial-inequality/.*

[11] Alisha Haridasani Gupta, "Surprise: Women and Minorities are Underrepresented in Corporate Board Rooms," New York Times, October 12, 2021, *https://www.nytimes.com/2021/06/07/us/women-minorities-underrepresented-corporate-boardrooms.html.*

[12] Erin El Issa, "Survey: Less Than Half of Women in U.S. Invest in the Stock Market," Nerdwallet, September 1, 2021, *https://www.nerdwallet.com/article/investing/survey-less-than-half-of-women-in-u-s-invest-in-the-stock-market.*

estates subject to the estate tax has plummeted to less than 2,000 per year, or less than one-tenth of 1 percent of all estates (0.07%), due to continuing increases in the exemption amount, most recently in the 2017 tax law.[13] Well-known loopholes such as the use of trusts further limit the reach of the estate tax.[14] As economist Janelle Jones notes, "White families are twice as likely to receive an inheritance as Black families, and that inheritance is nearly three times as much."[15] Black families are also more likely to have to support parents and older relatives rather than receiving financial support or inheriting wealth from them.[16] Thus, households of color are generally locked out of tax preferences for inherited wealth.[17]

Testimony also highlighted the ways the very wealthy are able to fund extravagant lifestyles while structuring their portfolios to avoid taxation (known as "buy, borrow, die"), making taxation at certain levels of wealth essentially optional.[18] Because wealth itself is outside the tax system, which only reaches gains on wealth, these large fortunes are considered outside the tax base.[19] This generally inures to the benefit of families that are wealthy and white. Because women supporting families on their own and households of color are underrepresented in higher income brackets, it is unsurprising that they are underrepresented among the very wealthiest. One measure of the gender and racial makeup of those at the very top can be seen in the Forbes 400 list, which as of 2021 counted only two Black men and no Black women.[20] Even Black families in the top 10% by income have much less wealth than white families at the same income level: median net worth for white families at this income level is $1,789,300 while only $343,160 for Black families.[21]

Wealthy and white families benefit not only from these, and multiple other preferences in the tax code, but also from underfunded enforcement. Deep cuts to the IRS budget have allowed audit rates to fall dramatically, limiting enforcement on wealthy filers.[22] This underfunding subsidized people who do not follow the law, such as the 1.4 million wealthy people who did not file a tax return at all between 2017 and 2020.[23] Wealthy people can avoid, or even evade, paying what they owe when the IRS is overmatched by the tax lawyers and accountants they employ.[24] While audit rates at the top have plummeted, low-income filers who claim the Earned Income Tax Credit are as likely to be audited as families making up to a million dollars a year in income.[25] Women supporting families on their own and

[13] Tax Policy Center, "Briefing Book: How many people pay the estate tax?" (May 2020), *https://www.taxpolicycenter.org/briefing-book/how-many-people-pay-estate-tax.*

[14] Bob Lord, Americans for Tax Fairness, "Dynasty Trusts: Giant Tax Loopholes that Supercharge Wealth Accumulation" (February 2022), *https://americansfortaxfairness.org/wp-content/uploads/DT-PRINT-2.2.pdf.*

[15] Janelle Jones, Economic Policy Institute, "Receiving an Inheritance Helps White Families More than Black Families," February 17, 2017, *https://www.epi.org/publication/receiving-an-inheritance-helps-white-families-more-than-black-families/.*

[16] Dorothy A. Brown, *The Whiteness of Wealth* (New York: Crown, 2021), 182–185.

[17] Dorothy A. Brown, "Congress is passing up a chance to close a tax loophole—and the racial wealth gap," Washington Post, September 16, 2021, *https://www.washingtonpost.com/outlook/2021/09/16/stepped-up-basis-race/.*

[18] Steve Wamhoff, Institution on Taxation and Economic Policy, "Billionaires Should Pay Taxes on Their Income Every Year Like the Rest of Us" (September 2022), *https://itep.org/billionaires-should-pay-taxes-on-their-income-every-year-like-the-rest-of-us/.*

[19] Lily Batchelder and David Kamin, "Taxing the Rich: Issues and Options" (September 11, 2019), *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452274.*

[20] Nigel Roberts, "Only Two Black People Made Forbes List of the 400 Richest Americans," BET, October 14, 2021, *https://www.bet.com/article/e8q6yp/only-two-black-people-on-forbes-richest-americans-list.*

[21] Kriston McIntosh, Emily Moss, Ryan Nunn, and Jay Shambaugh, Brookings, "Examining the Black-white Wealth Gap," (February 27, 2020), *https://www.brookings.edu/blog/up-front/2020/02/27/examining-the-black-white-wealth-gap/.*

[22] Jeff Ernsthausen, "IRS Strategic Plan Vows to Amp Up Audits of the Rich," ProPublica, April 7, 2023, *https://www.propublica.org/article/irs-strategic-plan-wealth-tax-dodgers;* U.S. Government Accountability Office, "Tax Compliance: Trends of IRS Audit Rates and Results for Individual Taxpayers by Income" (May 17, 2022), *https://www.gao.gov/products/gao-22-104960.*

[23] Senator Ron Wyden, Chairman, Senate Committee on Finance, Letter to Commissioner Danny Werfel, Internal Revenue Service, September 28, 2023, *https://www.washingtonpost.com/documents/df4c32e7-1c29-438d-8395-180649f44f07.pdf?itid=lk_inline_manual_5.*

[24] Natasha Sarin, U.S. Department of the Treasury, "The Case for a Robust Attack on the Tax Gap" (September 7, 2021), *https://home.treasury.gov/news/featured-stories/the-case-for-a-robust-attack-on-the-tax-gap.*

[25] Paul Kiel and Jesse Eisinger, "Who's More Likely to Be Audited: A Person Making $20,000—or $400,000?," ProPublica, December 12, 2018, *https://www.propublica.org/article/earned-income-tax-credit-irs-audit-working-poor.*

households of color are underrepresented among high-income taxpayers who evade taxes, but they are overrepresented in the lower-income brackets.[26] It is no surprise that those at the top have seen their wealth grow, depriving the government and ordinary citizens of needed revenue and further fueling wealth disparities.[27]

III. Tax preferences for wealth deprive us of revenue for needed investments in women and families, which themselves would help women thrive, shrink the wealth gap, and grow the economy

Correcting the tax preferences for wealth outlined above would yield significant federal revenue, which could be used to invest in women and families.[28] Allowing the preferences for wealth to continue instead drives increases in federal deficits, constraining the fiscal space for investments. At the minimum, tax cuts passed in 2017 in the Tax Cuts and Jobs Act that benefited the wealthiest households should not be extended.[29] These tax cuts have contributed significantly to the federal revenue shortfall, growing the debt-to-GDP ratio of primary concern to many lawmakers.[30]

Additional changes to the tax code are needed, however, to further progressivity and support robust public investments that are long overdue. For example, raising the capital gains rate to match the top rate for labor income and closing the stepped-up basis loophole (the primary driver of the "buy, borrow, die" strategy), is estimated to raise $214 billion over 10 years.[31] Similarly, Chairman Wyden's proposed Billionaire's Income Tax, a tax on income from wealth as it is earned (and used to buy real assets in the economy while not being taxed) could yield $557 billion in federal revenue.[32] An annual tax on wealth itself is estimated to raise $1.9–$3.3 trillion over 10 years.[33] Strengthening the estate tax could raise up to $430 billion over 10 years,[34] and even modest reforms, to return to 2009 levels, are estimated to yield $189 billion.[35]

Finally, fully funding IRS enforcement for wealthy filers would drive a tremendous return on investment. Recent research found that every dollar invested in high-income audits translated to more than $12 in revenue,[36] and it is estimated that implementing the Inflation Reduction Act's $80 billion in IRS funding would lead to at least $480 billion in additional taxes collected over 10 years.[37] This funding is already working: As of October 2023, the Internal Revenue Service has collected $160 million in back taxes in 2023 by enforcing against millionaires who haven't

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[26] Married couples are over 4 times more likely than male-headed households and nearly 1.8 times more likely than female-headed households to have income in the top quintile. United States Census Bureau, "2021 Current Population Survey Household Income Table: HINC–05, Percent Distribution of Households, by Selected Characteristics Within Income Quintile and Top 5 Percent in 2020" (2021), *https://www.census.gov/data/tables/2021/demo/cps/hinc-05.html.* In 2019, white-headed households were disproportionately in higher income quintiles (while Black- and Latinx-headed households were disproportionately in the lower income quintiles). Congressional Research Service, "The U.S. Income Distribution: Trends and Issues" (updated January 13, 2021), *https://sgp.fas.org/crs/misc/R44705.pdf.*

[27] Oxfam International, "Inequality and Poverty: The Hidden Costs of Tax Dodging, *https://www.oxfam.org/en/inequality-and-poverty-hidden-costs-tax-dodging.*

[28] Amy Royce and Amy Matsui, National Women's Law Center, "Taxing the Rich Will Make the Tax Code More Equitable and Support Investments in Women and Families," (April 2023), *https://nwlc.org/wp-content/uploads/2023/03/UPDATED-APRIL-2023_nwlc_RevenueRaisers.pdf.*

[29] William G. Gale, Brookings, "A fixable mistake: The Tax Cuts and Jobs Act" (September 25, 2019), *https://www.brookings.edu/articles/a-fixable-mistake-the-tax-cuts-and-jobs-act/.*

[30] Bobby Kogan, Center for American Progress, "Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio" (March 27, 2023), *https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/.*

[31] "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals" (U.S. Department of the Treasury, March 2023), *https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf,* p. 214.

[32] U.S. Senate Committee on Finance, "Wyden Statement on Billionaires Income Tax Score," November 5, 2021, *https://www.finance.senate.gov/chairmans-news/wyden-statement-on-billionaires-income-tax-score.*

[33] Batchelder and Kamin, "Taxing the Rich: Issues and Options," p. 33.

[34] "Revenue estimate of the 'For the 99.5 Percent Act,'" (Joint Committee on Taxation, March 24, 2021), *https://www.sanders.senate.gov/wp-content/uploads/For-the-99.5-Act-JCT-Score.pdf.*

[35] "Recent Changes in the Estate and Gift Tax Provisions" (Congressional Research Service, October 19, 2021) *https://sgp.fas.org/crs/misc/R42959.pdf,* p. 7.

[36] Will Boning, Nathaniel Hendren, Ben Sprung-Keyser, and Ellen Stuart, "A Welfare Analysis of Tax Audits Across the Income Distribution," Policy Impacts (June 14, 2023) *https://policyimpacts.org/research/67/a-welfare-analysis-of-tax-audits-across-the-income-distribution.*

[37] Natasha Sarin and Mark J. Mazur, "The Inflation Reduction Act's Impact on Tax Compliance—and Fiscal Sustainability" (May 21, 2023), *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4449161.*

paid what they owe.[38] Recent rescissions to this funding should be undone, and additional stable funding is needed.[39]

The revenue from more equitably taxing the wealthy and ensuring they pay what they owe could be used for investments that support the health and well-being of women and families, and enable women and people of color to succeed in our economy. In addition to investments in the care economy described above, additional revenues could support robust public investments in policies such as the expanded Child Tax Credit, which raised millions out of poverty in 2021, including 1 million Black women, Latinas, and Asian women,[40] other refundable tax credits for women and families, and affordable and accessible housing. The path to an economy that works for everyone includes raising revenue in a progressive manner. It requires rejecting tax preferences for billionaires and advancing policies that invest in women, families and all of us.

The Center appreciates the opportunity to submit this written statement for the record. Should you have any questions, please do not hesitate to contact Amy Royce, Senior Counsel, at aroyce@nwlc.org.

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Statement of Bob Lord, Senior Advisor, Tax Policy

Chairman Wyden and Ranking Member Crapo, I'm submitting this statement for the record in connection with the hearing held by the Senate Finance Committee on "Examining How the Tax Code Affects High-Income Individuals and Tax Planning Strategies."

I currently serve as Senior Advisor on tax policy for the Patriotic Millionaires and as an Associate Fellow at the Institute for Policy Studies. For the better part of the 4 decades between my graduation from law school and joining the Patriotic Millionaires' staff last year, I practiced tax law. In my practice I advised taxpayers in income and estate tax planning and represented them in tax controversies. I represented the taxpayers in *Sacks v. Commissioner,* 69 F.3d 982 (9th Cir. 1995), a case involving a tax-advantaged transaction, which set the standard in the Ninth Circuit for the determination of economic substance.

From my career as a tax lawyer, and since then as an advocate for fairer federal tax policy, I've come to believe our tax system is fundamentally broken. The consequence of that broken system is an extreme concentration of wealth that has resulted in a democracy-threatening concentration of political power, together with social instability. The problem is existential.

When I say our current tax system is broken, I'm referring to four fundamental flaws, all of which work to the advantage of the ultra-rich: First, our tax system lacks a reliable, working mechanism to constrain the concentration of American wealth in the hands of the ultra-rich. Second, our income tax law favors income from wealth over income from work and further favors the income from work flowing to the wealthy over income from work flowing to average Americans. Third, our income tax law is riddled with loopholes, which not only facilitate legal tax avoid-

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[38] Internal Revenue Service, "IRS launches new initiatives using Inflation Reduction Act funding to ensure large corporations pay taxes owed; continues to improve service and modernize technology with launch of business tax account" (October 20, 2023), *https://www.irs.gov/newsroom/irs-launches-new-initiatives-using-inflation-reduction-act-funding-to-ensure-large-corporations-pay-taxes-owed-continues-to-improve-service-and-modernize-technology-with-launch-of-business-tax-account.*

[39] Chuck Marr, Samantha Jacoby, and Jabari Cook, Center on Budget and Policy Priorities, "Success of the IRS Rebuilding and Tax Gap Reduction Effort Depends on Sufficient Funding Through Annual Appropriations" (December 7, 2022), *https://www.cbpp.org/sites/default/files/12-1-22tax.pdf;* Kimberly A. Clausing and Natasha Sarin, "The coming fiscal cliff: A blueprint for tax reform in 2025," The Hamilton Project and Brookings (September 2023), *https://www.brookings.edu/wp-content/uploads/2023/09/20230927_THP_SarinClausing_FullPaper_Tax.pdf.*

[40] Sarah Hassmer, Amy Matsui, Kat Menefee, and Shengwei Sun, "By the Numbers: Data on Key Programs for the Well-Being of Women & Their Families" (May 2023), *https://nwlc.org/resource/by-the-numbers-data-on-key-programs-for-the-well-being-of-women-lgbtq-people-and-their-families/.*

ance, but also give rise to abusive tax shelters. Fourth, our system of tax enforcement is failing to address systematic tax avoidance by the ultra-rich.

The Lack of a Reliable Working Mechanism to Constrain Wealth Concentration. American wealth is more concentrated in the hands of the ultra-wealthy than at any time since the Gilded Age. We see this play out in the news on virtually a daily basis. For example, while enormous media attention has been devoted over the past week to intense debate over how a country of 330 million people might fund a $14.3 billion foreign aid package, there are over 40 Americans who each have the capacity to fund such an aid package entirely from their personal fortunes.

The extreme concentration of wealth in America is the result of policy failures in multiple areas; antitrust, labor, and intellectual property law to name a few. But the role of tax policy is unique on this front. Our tax system is the last line of defense—the firewall if you will—against undue wealth concentration, and it is obvious why it hasn't provided that defense: it lacks a reliable, working mechanism to do so.

Wealth concentration occurs when the rate at which the rich grow their wealth is greater than the rate at which the country's total household wealth grows. Absent taxation, that situation is bound to be the norm. Besides the obvious advantage of being able to make lucrative investments the rest of us lack the capital to make, the wealthy also are not required to consume the bulk of their income on living expenses.

Consequently, a well-functioning tax system should have a mechanism that reliably reduces the after-tax rate at which the wealth of the richest Americans grows to a rate no greater than the rate at which the country's total household wealth grows. That mechanism would require one or more of three bases for taxation: a tax on true economic income, including unrealized gains, a tax on extreme wealth, or a tax on the intergenerational transfer of extreme wealth.

Currently, our tax system contains one of those three mechanisms: a tax on the intergenerational transfer of wealth, as embodied in our estate, gift, and generation-skipping tax system. But through what has become commonplace planning for the ultra-rich, that tax is entirely avoidable, even by the nation's billionaires. Five or 6 years ago, Chairman Wyden's office published a white paper outlining the various strategies through which the ultra-rich are massively avoiding estate, gift and generation-skipping taxation and bills have been introduced in both chambers to address the systematic avoidance of wealth transfer taxation, but to date, no meaningful action has been taken.

Unfortunately, we've waited too long. Even if our system of wealth transfer taxation were reformed tomorrow, decades would pass before America's dynastic wealth, much of which has been lodged in so-called dynasty trusts, would be subject to meaningful levels of taxation. We can't wait that long. Consequently, although the restoration of a functional, robust wealth transfer tax system would be a welcome development, constraining undue wealth concentration in America within a reasonable timeframe will require us to implement one or both of the other possible mechanisms for doing so: a tax on true economic income or a tax on extreme wealth.

Members of this committee and other members of Congress have made proposals to use each of those other reliable mechanisms to constrain wealth concentration. Chairman Wyden has proposed a system of mark-to-market taxation for the ultra-rich, which, together with the current income tax system, would function to tax the economic income of the ultra-rich. Senator Warren has proposed a wealth tax for the ultra-rich, the Ultra Millionaire tax. Hopefully, one or both of those proposals will receive serious consideration in the near future.

A Tax System That Favors Wealth Over Work (and Income from Work that Flows to the Wealthy). As my Institute for Policy Studies colleague, Sam Pizzigati, and I have written, our income tax code has increasingly favored wealth over work.[1] The most vivid example of this evolution is the complete reversal of the respective treatment of income from work and dividend income. Prior to 1981, income from work, "earned income" under the tax code, was subject to a maximum

[1] *See,* Lord, Bob, and Pizzigati, Sam, Trump Tax Plan Taunts the Dignity of Labor (Dallas Morning News, November 8, 2017), *https://www.dallasnews.com/opinion/commentary/2017/11/08/trump-tax-plan-taunts-the-dignity-of-labor/* (accessed Nov. 1, 2023); Lord, Bob, and Pizzigati, Sam, A tax system that targets workers (Los Angeles Times, June 20, 2013, *https://www.latimes.com/opinion/la-xpm-2013-jun-20-la-oe-pizzigati-tax-system-20130620-story.html* (accessed Nov. 1, 2013)

federal tax rate of 50 percent, while dividend income could be taxed at a rate as high as 70 percent. Today, dividend income is subject to a maximum income tax rate of 20 percent, while income from work can be taxed at a rate as high as 37 percent.

The greatest preference of wealth over work in the tax law is of course the treatment of long-term capital gains. Beyond the preferential rates, capital gains are not taxed until the time of sale, which means for the extremely wealthy, payment of tax becomes flexible. They can take out low-interest loans that aren't available to the average American to fund their living expenses, hold appreciated assets indefinitely, and die with millions or even billions in assets that have never been taxed. Upon their death, the unrealized gains in those assets, often reflecting decades of appreciation, are zeroed out for tax purposes. In the case of the wealthiest Americans, one hundred billion dollars of gains could potentially escape income taxation on their deaths.

Beginning in 2018, an additional preference was added to the tax code: the deduction under Code Section 199A for so-called pass-through income; that is, income received through sole proprietorships, partnerships, limited liability companies and Subchapter S corporations. This new preference allows many wealthy Americans to effectively pay no income tax on 20 percent of their income. As ProPublica has reported, this has conferred enormous windfalls on many of America's billionaires, including Michael Bloomberg and Dick and Liz Uihlein.[2] In some cases, wealthy Americans took enormous cuts in their compensation paid through their businesses, causing a commensurate increase in their pass-through income, along with a deduction of 20 percent of that income.[3]

Corporate income also is income from wealth. It is now taxed at a maximum rate of 21 percent, the lowest maximum corporate tax rate since 1939. The effective rate of tax of many of America's largest corporations, however, is well below ten percent and, in some cases, zero.

Further, income from wealth, whether in the form of interest income, rent, dividends, capital gains, or royalties, largely is exempt from social security taxes. As the portion of wages subject to social security tax has increased over the past 4 decades, the portion of income from wealth that is subject to social security tax has remained at the same level—zero.

Even the wealthy people who earn most of their income from work don't experience a truly progressive tax code. Our top tax bracket for a married couple filing jointly, 37 percent, starts at a little under $700,000. That's a significant income, putting the household near the top 1 percent of all American incomes. But it's a far cry from a $7 million or $70 million income, both of which are subject to the same maximum rate of 37 percent. And that couple earning $700,000 in compensation *does* pay social security tax on a substantial portion of their income. Inversely, the burden of social security tax for a couple making $70 million is negligible (well under one-tenth of 1 percent of income). More significantly, when living expenses are taken into account, the ability of a couple with $70 million in income to accumulate wealth dwarfs that of the couple making $700,000. Under the structure of income tax brackets like those that applied throughout the 3 decades preceding the Economic Recovery Tax Act of 1981, a couple receiving $70 million of income would pay a substantially higher maximum rate of income tax than one earning $700,000. Although many factors impact the concentration of wealth in America, it is worth noting that 1982, the year the Economic Recovery Tax Act of 1981 took effect, is precisely when the concentration of wealth in America began to skyrocket.

A System Rife with Legal and Abusive Tax Avoidance. Our income tax system is riddled with loopholes. Some of them are obvious. One example is how the rules for like-kind exchanges of real estate allow for the systematic avoidance of gain from the sale of real estate as long as the proceeds are reinvested. This enables the "swap till you drop" strategy employed by wealthy real estate investors. If they reinvest the proceeds each time they sell real property, then, eventually, upon their death, the unrecognized gains are excused from taxation. Another example is how the rules

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[2] *See,* Secret IRS Files Reveal How Much the Ultra-Wealthy Gained by Shaping Trump's "Big, Beautiful Tax Cut (ProPublica, August 11, 2021), *https://www.propublica.org/article/secret-irs-files-reveal-how-much-the-ultrawealthy-gained-by-shaping-trumps-big-beautiful-tax-cut* (accessed Nov. 1, 2023)

[3] *See,* How the Trump Tax Law Created a Loophole That Lets Top Executives Net Millions by Slashing Their Own Salaries (ProPublica, August 19, 2021), *https://www.propublica.org/article/how-the-trump-tax-law-created-a-loophole-that-lets-top-executives-net-millions-by-slashing-their-own-salaries* (accessed Nov. 1, 2023)

governing the depreciation of real property allow for deductions from income tax where no economic depreciation has taken place. In the same vein, the rules allowing the amortization of intangible assets for income tax purposes when those assets typically are appreciating in value allow billionaire sports team owners to shelter huge sums of income from taxation. Moreover, the deductions for both amortization of intangible assets and depreciation of real property are not subject to recapture upon death. That allows the inheritor of a sports team or an office building to claim the same amortization or depreciation deductions all over again. The list goes on and on, and often these loopholes compound their effects over time.

The rules that favor income from wealth over income from work often double as tax loopholes. Perhaps the most egregious example is the so-called carried interest loophole, which allows investment managers to pay tax at capital gains rates on the compensation they receive from their investors and to defer payment of tax on that compensation until the underlying assets are sold.

More generally, the line between income from wealth and income from work is often blurry, which allows the capital gains preference and other preferences to serve as loopholes. Take for example real estate professionals. The gain from the sale of raw land is clearly capital gain, while the sale of completed houses by homebuilders is clearly ordinary income from the operation of a business. But those are the endpoints of a vast continuum, which allows for structuring, sometimes aggressive structuring, of real estate activities to maximize the income that is taxed at capital gains rates. For example, the owner of raw land might take the necessary steps to obtain a favorable change in zoning, and then sell the property at a gain to a development entity in which he has an ownership interest. The owner might take it a step further and submit a plat map for approval before selling. Where along the continuum the owner's gains become subject to tax at ordinary rates is far from clear, and tax professionals take advantage of that lack of clarity. Put another way, tax avoidance planners work in the gray areas, and the preferences afforded to income from wealth give rise to an infinite number of gray areas.

Where slight factual differences give rise to disproportionate tax benefits, abusive tax shelters may arise. For example, the 17-percentage-point difference between taxation at ordinary rates and long-term capital gains rates can turn on a holding period of just one additional day. By structuring transactions that create gains and losses in nearly equal amounts, planners can develop strategies to artificially offset short-term gains with losses on assets held for 365 days, while corresponding gains on assets held for 366 days are taxed at capital gains rates. Whether such strategies will be respected for tax purposes is rarely clear, but, as discussed below, there often is little downside to taxpayers and their advisors in taking an aggressive position, even when their interpretation of applicable authority is likely incorrect.

Closing all the loopholes that are based on the long-term capital gains rate and other preferences in the tax code would be difficult and the solutions would be complex. Further, sophisticated tax planners undoubtedly would develop new avoidance strategies using those preferences. Those complex solutions would be unnecessary, however, if Congress took the simple step of eliminating the preferences upon which aggressive avoidance strategies are based. Put another way, if we eliminate the preferences that confer an unfair advantage on the rich and give rise to undesirable legal tax avoidance by the rich, much of the illegal and borderline illegal avoidance will be eliminated as well.

A Failure in Tax Enforcement Against the Rich. In three ways, the system of tax enforcement in America favors the rich. First, the IRS has been critically—and deliberately—underfunded. This precludes the IRS from conducting audits of the rich with a thoroughness which will deter aggressive tax avoidance and result in the collection of tax underpayments. This underfunding has resulted in another sinister effect: because the IRS only has the resources to conduct less labor-intensive audits, the IRS now audits lower-income taxpayers at a higher rate than rich taxpayers, whose accountants and tax attorneys substantially prolong the audit process. The additional funding for enforcement on the ultra-wealthy under the Inflation Reduction Act is crucial to refocusing the IRS's enforcement efforts on the largest and most pernicious component of the tax gap. It must be protected.

Second, our system for reporting tax information to the IRS doesn't apply to the bulk of income that flows to the rich. For the vast majority of Americans, the way the rich are taxed is far removed from their own experience. Most people in this country make money from an hourly or salaried job, have income and payroll taxes withheld from each paycheck, get a W–2 at the end of the year showing the information reported by their employer to the IRS, file their tax returns, and either pay

what they owe or receive a small refund. The rich, by contrast, often have no information related to their tax liability reported to the IRS. The reporting of receipts of their businesses and the proceeds from sales of many assets are entirely voluntary, and not subject to tax withholding. As a result, while wage earners see strong deterrence for tax avoidance due to their income being reported to the IRS, no analogous deterrent exists for rich business owners and investors. Further, in one situation where considerable tax avoidance takes place and where information reporting generally is required—partnerships—the use of tiered structures, where the actual taxpayer may be five or more levels of ownership removed from the entity that produces income, has made the process of connecting reported information to a taxpaying individual so difficult that the information reporting is practically worthless.

Third, audits of the rich are not currently serving one of their core purposes: deterring aggressive and abusive tax avoidance. Egregious tax avoidance occurs because the risk of detection is minimal, and the subsequent penalty for underpayment is negligible compared to the financial reward of tax avoidance going undetected. In most cases, detection on audit simply means the person being audited will pay the tax they owe, plus a modest amount of interest. Penalties typically can be avoided by showing that a taxpayer's reporting position, although incorrect, was supported by substantial authority. That is extremely difficult for average taxpayers. For rich taxpayers, however, who have the assistance of high-powered tax professionals and who can afford lengthy, sometimes concocted, written opinions supporting the reasonableness of their tax reporting position at the time they file their return, the IRS typically is willing to settle for the payment of tax plus interest. The IRS simply does not have the resources to litigate and risk losing many of these cases, including the substantive tax issues involved, for the limited purpose of collecting penalties. To remedy this situation, your committee should consider the expansion of penalties, such as those assessable under Code Section 6707A, based solely on the failure of the taxpayer to disclose their reporting position to the IRS.

Section 6707A, however, as currently structured, substantially favors ultra-rich taxpayers in its operation. The penalty under Section 6707A, 75 percent of the tax sought to be avoided through a listed transaction, is a substantial deterrent in the case of an individual seeking to avoid a modest amount of tax. But because the maximum Section 6707A penalty for failing to disclose a listed translation is $100,000, an ultra-rich taxpayer seeking to avoid, say, $10 million of tax through a listed transaction, is not likely to be deterred, as the penalty for non-disclosure is only 1 percent of the avoided tax. Section 6707A should be amended to eliminate the ceilings on penalties for both individuals and corporations.

Concluding Remarks. In closing, I note that I began my career as a tax attorney in 1983, at the same time extreme wealth in America was beginning to skyrocket. After spending 40 years working on tax matters on a near-daily basis, I can attest that in a healthy and vibrant society, tax law must function to limit economic inequality. All tax policy proposals should be examined through that lens.

To address many of the matters I've outlined above, the Patriotic Millionaires developed a comprehensive proposal, titled Crack the Code. It includes both our recommendations on whether various provisions of the 2017 Tax Cuts and Jobs Act scheduled to expire in 2025 or 2026 should be extended, and our proposals for constraining wealth concentration, narrowing current tax loopholes, and minimizing tax preferences that favor wealth over work. A copy of Crack the Code is available electronically here: *https://static1.squarespace.com/static/643066008ad89d41f9a584c1/t/6439714b698938692be04a39/1681486160147/Crack+The+Code.pdf.*

Thank you.