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Who Wants to Tax a Millionaire?

By Diane Lim Rogers

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In this article, Rogers points out that there are many ways to increase tax burdens on households with annual incomes exceeding $1 million. The various examples among current proposals would have significantly different effects on income distribution, the federal budget, and economic incentives. Those effects should be considered as policymakers contemplate the options.

Who wants to tax a millionaire? Well, almost everyone, it seems. There is a growing consensus that millionaires do not pay their fair share of taxes and that any future tax reform, whatever the levels of revenues produced, should steer more of the tax burden onto those lucky few.

Talk of millionaire tax increases naturally brings proposals for some form of surtax, but there are many other ways we could increase the taxes that millionaires pay. We could let overall income tax rates increase by, for example, letting the Bush tax cuts expire — either all of them, or just the upper-income provisions. We could tax capital gains and dividend income at the same rate as ordinary income instead of under their current preferential tax rates. We could broaden the tax base to reduce tax expenditures that largely benefit higher-income households, such as limiting itemized deductions to a tax rate ceiling (as I discussed in my last column).

Let's consider these options here, as just a few examples of policies that would all raise tax burdens on millionaires — both in absolute and relative terms — but would produce different economic effects in terms of the concentration of the millionaires' higher tax burden, the level of potential revenue raised, and the incentives to work or save.

Table 1 is based on available estimates from the Tax Policy Center (TPC) that correspond to five different policy options to increase taxes paid by millionaires:

1. let all the 2001 and 2003 tax cuts expire;
2. let only the upper-income provisions of the 2001 and 2003 tax cuts expire;
3. tax capital gains and dividend income at the same rate as ordinary income;
4. limit itemized deductions to 28 percent; and
5. impose a millionaire surtax of 5.6 percent as under a recent Senate proposal.

The table summarizes the proposals according to:

1. the effect on marginal tax rates paid on the last dollar of income;
2. the share of the tax burden borne by millionaires;
3. the potential total annual revenue raised; and
4. the implied annual amount of taxes that would be paid by the millionaires.

In most cases, the revenue estimates are implied by the TPC distributional tables, taking average dollar tax burden multiplied by the total number of tax units, rather than official Joint Committee on Taxation or Congressional Budget Office revenue estimates.

Reverting to Old Top Marginal Rates

Option 1 is to let all of the 2001 and 2003 tax cuts expire. Marginal tax rates would rise back to pre-2001 levels. For most millionaires, this would mean an increase in their effective marginal rate from the current 35 to 39.6 percent or from the current 15 to 20 percent. Not only would this option raise enough total revenue relative to the policy extended baseline over 10 years to make the difference between sustainable and unsustainable budget deficits, but it would raise more revenue from millionaires alone than any other proposal discussed here. Although the "millionarity" (the millionaire share of higher tax burdens) is the lowest of the listed proposals, the expiration of all of the Bush tax cuts would still be a highly progressive policy change. According to the TPC, the less than one half of 1 percent of households that are millionaires would bear 22 percent of the burden.

Option 2 is to let only the high-income provisions of the 2001 and 2003 tax cuts expire. This is identical to option 1 in terms of the increases in marginal tax rates on millionaires. This also happens to be the option that President Obama has proposed in each of his budgets. It raises far less revenue relative to the policy extended baseline, but it is far more concentrated on millionaires. Note that because lower-bracket tax rates, which affect the burdens of all taxpayers, would be extended at their lower levels under this proposal, millionaires would not pay as much in taxes as under the full expiration of the full complement of the Bush tax cuts.

Taxing Capital Income as Ordinary Income

Option 3 would raise the marginal tax rates on capital gains and dividend income to be the same as the marginal tax rates on ordinary income, so that millionaires would face the highest effective marginal tax rates even if their income was primarily from capital. Note that under this proposal, Republican presidential candidate Mitt Romney would no longer enjoy an effective tax rate of 15 percent. Even without limiting the tax increase to high-income households, this proposal steers most of the burden (two-thirds) to millionaires simply because the vast majority of capital gains and dividend income goes to the richest households. The proposal raises even more revenue than letting the high-end Bush tax cuts expire, and it does so without raising the highest statutory marginal tax rates. Rather, it levels out marginal tax rates so they are less distortionary across different forms of income, raising effective tax rates on high-income households. (Under this proposal, marginal tax rates on those without any dividend or capital gains income would not be increased no matter how high their income — hence the "maybe" in the table.)

Another example of a proposal that would increase the tax burden on some millionaires by taxing capital income more like labor income would be taxing carried interest like ordinary taxable income. Under the current federal income tax, many forms of capital income are taxed at lower effective rates than income from wages and salaries, and because capital income is a larger share of total income among higher-income households, any proposal that brings the level of capital taxation closer to the level of labor taxation will be naturally progressive.

Broadening the Tax Base

Option 4 would limit itemized deductions to 28 percent and is a proposal I discussed in my last column (*Tax Notes*, Jan. 23, 2012, p. 465, *Doc 2012-910*, *2012 TNT 14-11*). Like any proposal that broadens the definition of taxable income, this proposal has the economic advantage of raising revenue while avoiding higher marginal tax rates that can reduce incentives to work and save. Like the previous option to raise capital gains and dividend income tax rates, it levels out effective marginal tax rates rather than increasing the top marginal tax rates—in this case, treating different uses (rather than sources) of income more similarly.

For distributional goals, such base-broadening strategies are further improved when the higher burdens can be limited to higher-income households. The 28 percent version of this proposal raises a relatively small amount of revenue compared with both the other possibilities considered here and the more aggressive version of the limit on itemized deductions that the CBO presented in its budget options volume. (The amount of revenue raised from the limit varies depending on whether the baseline is the lower marginal tax rates of current policy extended or the higher marginal tax rates under current law.)

Adding a New Top Marginal Tax Rate

Finally, option 5 is to simply add a new tax bracket especially for millionaires. The proposal estimated by the TPC is the Senate version of the American Jobs Act of 2011, which would apply a 5.6 percent surcharge on a taxpayer's modified adjusted gross income in excess of $1 million (or $500,000 for married individuals filing separate returns). Effectively this adds 5.6 percentage points to the top marginal tax rate, be it the current-policy top rate of 35 percent or the top rate of 39.6 percent if the Bush tax cuts expire. This implies a millionaire marginal tax rate bracket of either 40.6 percent or 45.2 percent.

The proposal has what could be considered a distributional advantage of being a true, millionaire-only tax increase. The disadvantage is that in raising the top marginal tax rate quite substantially, it worsens the existing economic distortions of the tax system between fully taxed and more lightly taxed or untaxed activities. The highly targeted nature of the tax (to a small fraction of the population) also severely limits its revenue potential.

Tradeoffs to Consider

To sum up, the more targeted the burden to millionaires, the more limited the total revenue potential, and the more we have to worry about adverse effects on incentives. The more a proposal's tax base is limited to currently taxable income above $1 million, the higher the effective marginal tax rate will be at those millionaire-income levels, for a given level of revenue. The exception to the targeting versus incentives tradeoff is where we can find ways to broaden the tax base that concentrate higher burdens on millionaires by limiting the benefits of tax expenditures (such as the percentage

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Different Options to Increase Taxes on Millionaires

Proposal	Raises Top Marginal Tax Rate?	"Millionarity" (share of burden borne by millionaires)	Total Annual Revenue	(Implied) Annual Taxes Paid by Millionaires
1. All Bush tax cuts expire[a]	Yes	21.8%	$392 billion	$85 billion
2. Upper-income Bush tax cuts expire[b] (Obama's proposal)	Yes	81.2%	$68 billion	$55 billion
3. Tax capital gains and dividends like ordinary income[c]	Maybe	66.9%	$77 billion	$52 billion
4. Limit itemized deductions to 28%[d]	No	68.7%	$20 billion (or $13 billion)	$14 billion (or $9 billion)
5. Millionaire surtax[e] (Senate proposal)	Yes	100%	$43 billion	$43 billion

[a]From Tax Policy Center table T11-0054 for calendar year 2013. Extends all current policy compared with current law; revenue is that implied from TPC distributional table.
[b]From TPC table T10-0233 (*Doc 2010-20317*, *2010 TNT 180-43*) for 2012. Lets high-income provisions expire; implied revenue.
[c]From TPC table T11-0266 (*Doc 2011-17325*, *2011 TNT 155-25*) for 2011. Compares current law to without preferential rates; implied revenue.
[d]From TPC table T11-0042 (*Doc 2011-5830*, *2011 TNT 55-23*) for 2012. Compares against current policy. $20 billion revenue estimate is from CBO relative to current law, while $13 billion is implied revenue from TPC table (relative to current policy).
[e]From TPC table T11-0369 (*Doc 2011-21276*, *2011 TNT 196-77*) for 2013. Senate version of American Jobs Act of 2011; imposes 5.6 percent surtax on modified AGI exceeding $1 million, relative to current law. Implied revenue from TPC table.

applied to itemized deductions) or by phasing out benefits completely at higher-income levels.

Broader proposals to let all of the Bush tax cuts expire may seem contradictory to the "Buffett rule" of raising the tax burden on millionaires, but they would raise the most revenue from millionaires — and not just a lot more revenue overall. It's a reminder that even millionaires benefit from lower-income tax cuts, too. In fact, households who are fully above the lower brackets benefit more in dollar terms from reduced lower-bracket rates than households that fall in the middle of them.

As we continue to seek options to address our society's growing concerns about the fiscal outlook, economic growth, and income inequality, we should remember that there are many ways to tax a millionaire.

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Obama's Tax Proposals Through a Deficit Hawk's Looking Glass

By Diane Lim Rogers

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In this article, Rogers provides an overview of tax proposals in the president's fiscal 2013 budget, noting that (1) the budget raises revenues only relative to the administration's policy-extended baseline and not relative to current law; (2) there are more tax incentives than tax increases; (3) paying for an extension of the Bush tax cuts is still an option; and (4) the administration's way of enforcing the "Buffett rule" is encouraging. She concludes that the quality of the tax proposals in President Obama's budget is higher than expected.

In President Obama's new budget proposal, there's a lot of tax policy going on, most of it the same old proposals we've seen before. The budget expectedly has a more philosophical tone to it, reflecting election-year politics and the president's call for a more balanced approach to deficit reduction. As a largely political document, it isn't always easy to find the numbers that tell the real story.

Does the Budget Really Raise Taxes?

The day after the budget was released, a *Washington Post* front-page story reported that Obama would reduce deficits by raising taxes by nearly $2 trillion over the next decade. But is the president actually doing that?[1]

That depends on the measured starting point, or what budget geeks call the baseline. There is a wide gulf between what tax policy looks like under current law, honoring expirations of temporary tax cuts, and what is expected to occur if policymakers behave as usual, repeatedly extending and deficit-financing these temporary policies. Every year the Congressional Budget Office explains this in its budget outlook, officially projecting deficits under current law but calculating the costs of extended policies as well. And every year the Concord Coalition calculates an implied "plausible baseline" that adjusts the official, current-law calculation for the plausible outcome.

This year, while the CBO current-law baseline shows a 10-year deficit of just $3.1 trillion, the plausible baseline shows deficits of $11.8 trillion.[2] The difference between the two baseline measures has increased, mostly because this year the Bush tax cuts have even less time left on the official clock.

Given how far apart the current-law baseline is from the policy extended one, it shouldn't be that surprising that while Obama's budget proposals reduce the deficit relative to current policy, they actually increase it relative to current law.

Under the Obama budget proposals, revenues as a share of GDP rise from their current 15 to 16 percent of GDP to 19 percent by 2015, and to just over 20 percent by 2022. The CBO said that under current law whereas all of the 2001 and 2003 tax cuts expire at the end of 2012, revenues as a percentage of GDP will reach more than 20 percent by 2015, and 21 percent by 2022. Relative to current law, the president is proposing a net tax cut. Compared with the CBO's projections of the cost of extending all of the Bush tax cuts, however, the president's proposals raise revenue, because Obama proposes to let the high-income Bush tax cuts expire and to add some other tax increases on the rich and some types of corporations, and the new tax cuts he adds are comparatively small in cost.

The Obama budget proposes $1.91 trillion in tax increases and $352 billion in new tax cuts over a 10-year period, for a net tax increase — relative to the policy extended baseline — of $1.56 trillion over 10 years. But this means that relative to current law, Obama proposes to cut taxes by $2.94 trillion.

When the CBO completes its analysis of the budget, it will show the effects of the proposals relative to current law. That presentation will make

[1] Lori Montgomery, "Obama Presents a $3.8 Trillion Spending Plan," *The Washington Post*, Feb. 14, 2012.

[2] *See* http://www.concordcoalition.org/concord-coalition-plausible-baseline.

clear that the single costliest proposal in the president's budget is still the deficit-financed extension of all but the high-end Bush tax cuts, which costs $1.3 trillion. Continuing the associated AMT relief adds another $1.9 trillion. The associated interest costs from the extension of these cuts are likely to be more than $600 billion over 10 years. (This is consistent with the OMB showing in Table S-8 that the debt service costs associated with all its adjustments to get from the current-law baseline to its adjusted baseline are $640 billion.)

Gathering the numbers from all the different places in the Obama budget tables where they appear and adding them up, we find that leaving aside any new tax policies for the moment, the administration is proposing to extend expiring tax cuts at a total cost (including associated interest costs) of almost $4 trillion over the next 10 years. That figure does not include the costs (or revenue gains) of any new tax policies.

Tax Policies as Rewards and Punishments

Let's put aside the baseline issue for now and look at the full set of tax policies, old and new, proposed in the budget. The unifying principles appear to be "cut taxes for good people and things" and "raise taxes on bad people and things." We can sort the tax proposals accordingly:

1. *Continuing tax cuts for middle-income households*: extensions of most of the expiring Bush tax cuts ($1.3 trillion) and alternative tax minimum relief ($1.9 trillion); and extended or expanded new tax cuts "for families and individuals," including the American opportunity tax credit ($179 billion). Total: $3.4 trillion less revenue over 10 years.

2. *Creating new tax cuts for certain job-creating activities and industries*: manufacturing tax incentives for domestic activity ($121 billion); tax cuts for small businesses ($25 billion); and new markets tax credit and growth zones preference ($8 billion). Total: $153 billion less revenue over 10 years.

3. *Allowing tax cuts to expire for the rich*: letting the Bush tax cuts expire for these upper-income households, and in a slightly more aggressive way this year (more below) ($849 billion); and restoring 2009 estate tax rules ($143 billion). Total: $992 billion in new revenue over 10 years.

4. *Implementing new tax increases for the rich and their activities, and for outsourcing and climate-changing industries*: a new, more ambitious base-broadening proposal to reduce tax-rate-dependent, upside-down tax subsidies ($584 billion); taxing carried interest as ordinary income ($13 billion); international tax reform ($147 billion); financial and insurance industry tax reform ($19 billion); and elimination of oil and gas and coal industry tax preferences ($30 billion). Total: $794 billion in new revenue over 10 years.

There are other miscellaneous tax cuts and tax increases that do not fit well into any of the administration's tax policy categories and are relatively small. But this sorting shows that the tax cuts for the good (almost $3.6 trillion) outsize the tax increases for the bad (almost $1.8 trillion) by about 2 to 1.

Could Pay-Go Save the Day?

After all these years of policymakers insisting that the relevant starting point on tax policy is to assume full extension of all of the deficit-financed tax cuts, it's easy for us to forget that the extension and future financing of the tax cuts is a policy choice that has to be legislated by Congress and signed by the president. Budget policy observers have often said that the fiscal outlook would be improved dramatically if lawmakers just stayed home so that they couldn't extend the Bush tax cuts. But the choices to extend and deficit-finance the tax cuts don't have to be an all-or-nothing proposition. Extension of any portion of the Bush tax cuts — or any expiring tax cuts — could be done in a more fiscally responsible way by sticking to strict, no-exceptions, pay-as-you-go rules. If policymakers are not willing or able to offset the cost of extending the tax cuts, they should let them expire. Having to pay for one's policies is a great way to be forced to consider if they're actually worth their cost.

The 'Buffett Rule' as Route to Reform

At this year's State of the Union speech, Warren Buffett's secretary sat next to the first lady, providing a great visual for the point that it doesn't seem fair that the secretary actually pays a higher effective tax rate than multibillionaire Buffett. The "Buffett rule" states that "no household making over $1 million annually should pay a smaller share of its income in taxes than middle-class families pay."[3]

As I wrote in my last *Tax Notes* column,[4] there are many ways to raise tax burdens on millionaires, some economically smarter than others. While a specific surtax on incomes exceeding $1 million seems like the simplest and starkest way to do it, such a policy would increase the distortionary effects of the tax system by raising effective marginal tax rates on income already counted as taxable. Economists would prefer to raise millionaires' taxes by including more of their total income in

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[3]*The Budget for Fiscal Year 2013*, at 39.

[4]*Tax Notes*, Feb. 6, 2012, p. 725, *Doc 2012-1867*, *2012 TNT 24-16*.

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Summary of Budgetary Effects of Tax Proposals in President Obama's Fiscal 2013 Budget	
	Fiscal 2013-2022 (dollars in billions; + is revenue gain)
Overall effects of tax proposals:	
Total effect of all tax proposals, relative to policy extended baseline	+$1,913
Total effect of all tax proposals, relative to current-law baseline	-$2,941
Extended Bush tax cuts and AMT relief:	
Extension of Bush tax cuts other than upper-income provisions	-$1,324
Extension of AMT relief	-$1,898
Total, Bush tax cuts and AMT relief (without debt service)	-$3,222
'Good versus evil' breakdown:	
Continued tax cuts for "good" people (including extended Bush tax cuts)	-$3,401
New tax cuts for "good" things	-$153
Expired tax provisions for "bad" people	+$992
New tax increases on "bad" people and things	+$794
Source: Author's calculations from summary tables of the budget for fiscal 2013.	

what counts as fully taxable income, or by reducing the size of some of the subsidies given to them through various tax expenditures.

One example of a potential base-broadening offset that I've also discussed in a recent column is the limit of itemized deductions to 28 percent, which Obama has now proposed in all four of his budgets. But the president went further in this year's budget to propose reducing a wider array of tax expenditures for higher-income households, including the exclusion of employer-provided health benefits. The proposal sticks to the idea of ensuring upper-bracket taxpayers benefit no more from these tax expenditures than they would if they were only in the 28 percent bracket. Administratively, limiting exclusions isn't as easy as limiting deductions, however, because we would need more information reported on individual tax returns. (I'll discuss how the limit on the tax benefit of exclusions might work in a future column.) But the expanded proposal does improve the bottom line significantly; compared with the limit on itemized deductions only, this version raises about double the amount of revenue — $584 billion over 10 years, according to the administration.

Also new this year is the proposal to not just let the tax rate on dividends go up to a less-preferred rate but to eliminate the preference entirely for high-income households, treating dividends as ordinary income. So even with the administration's consistent push to let the upper-end Bush tax cuts expire, it is expanding the impact of the expiration this year, likely encouraged by its new emphasis on the Buffett rule.

Maybe the Glass Is Half Full

The Obama administration's persistent unwillingness to let go of or offset the cost of the bulk of the Bush tax cuts has made fiscally responsible tax policy elusive. But its embracing of the Buffett rule and smarter, more base-broadening ways of raising taxes on the rich could actually encourage tax reform.

To a tax policy expert, there may be a lot to be cynical about in the president's tax policy proposals, given the politically flashy ideas to "tax the bad" and "reward the good." But to a deficit hawk who happens to hope for good tax policy, there is a lot of promise in Obama's strategy as well. It might be the only way to get policymakers and the American public in general to support economically smart tax reforms and revenue increases that are desperately needed to "go big" enough in deficit reduction.