



*Internal Revenue
Service Building*



Addressing Tax System Failings That Favor Billionaires and Corporations

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Introduction and summary

Recent bombshell reports from ProPublica have confirmed what tax experts have long known and what many Americans have long suspected: Many of the country's wealthiest people pay little or no tax because the U.S. system preferences income from wealth and offers the wealthy and corporations avenues to avoid tax that are not available to working people.¹ These fundamental flaws in the tax code existed many years before the 2017 Tax Cuts and Jobs Act (TCJA) took things from bad to worse by giving massive new tax cuts to the highest-income Americans and largest corporations.² These flaws have helped fuel the dramatic increase in inequality, leading to a less dynamic and less just economy.

For years, many policymakers have decried the tax code as being slanted against working people. They now have a rare opportunity to fix it, with a mandate from and the strong backing of the American people. Recent polls show that raising taxes on the rich and corporations is one of the most popular elements of President Joe Biden's Build Back Better agenda, with the support of roughly 2 in every 3 Americans. Strong majorities believe that raising taxes on the wealthy and corporations helps, not hurts, the economy—and they are more likely to support investments when assured that they are paid for by taxes on the wealthy and corporations.³ It's time for federal policymakers to act.

In doing so, the congressional majority can lay the groundwork for a stronger and more inclusive economy for decades to come. In the upcoming fiscal year 2022 budget reconciliation bill, Congress has a real opportunity to permanently cut child poverty nearly in half; ensure universal preschool and affordable child care; guarantee paid family and medical leave; expand home care and improve the quality of home care jobs; help millions of students afford college tuition and make community college free; lower health care premiums and extend coverage; expand affordable housing; dramatically reduce racial disparities in income and wealth; and forge the transition to a clean energy economy that produces new jobs and a healthier planet.

Given the urgency of these challenges and persistence of negative real interest rates,⁴ Congress need not fully “pay for” all of these priorities. But many members have expressed reservations about deficit financing, and the Senate’s rules prevent reconciliation bills from increasing deficits in the long term.⁵ Therefore, the more revenue Congress raises in the budget reconciliation bill, the more it will be able to invest. By the same token, if Congress falls short in fundamentally fixing the tax code, it will also fall short in making the investments the country needs.

This report explains the extent of income and wealth inequality today and how President Biden’s Build Back Better agenda addresses three fundamental problems with the tax code while raising \$3.6 trillion in revenue to support investments in an inclusive, high-growth economy. These three problems have undermined tax fairness, increased inequality, and reduced revenues:

1. Billionaires paying virtually no taxes
2. Corporations not paying enough taxes, including by shifting profits and investment offshore
3. The rich and corporations not paying the taxes that they already owe

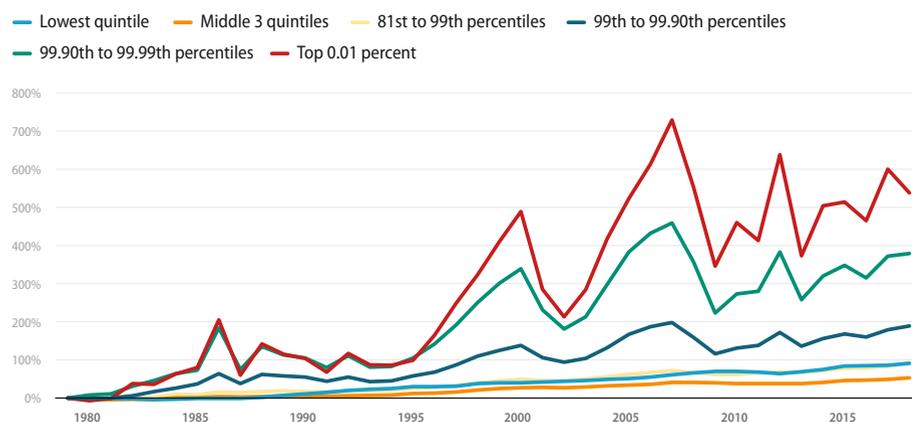
The report then suggests several options not included in the Build Back Better plan that Congress can consider to efficiently raise additional revenue from the wealthy and corporations. Given this surplus of options, there is no excuse for Congress to shortchange vital national investments in the reconciliation bill.

In recent decades, the richest Americans have seen stratospheric gains

The past several decades in the United States have been characterized by increasing income and wealth inequality and slowing productivity and economic growth. The incomes of the richest 1 percent have skyrocketed in relation to those of ordinary Americans—and the very richest 0.1 percent have seen their after-tax incomes shoot upward even faster. (see Figure 1)

FIGURE 1
The richest Americans have seen their after-tax incomes skyrocket

Cumulative growth in average after-tax income, by income group, 1979–2018



Source: Congressional Budget Office, "Distribution of Household Income, 2018" (Washington: 2021), available at <https://www.cbo.gov/publication/57061>.

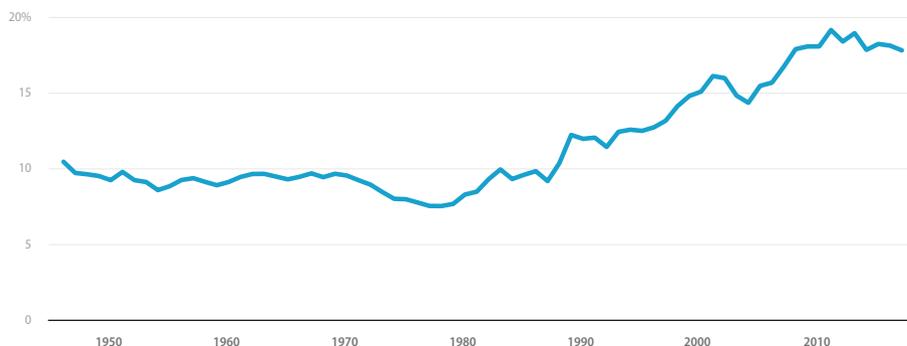
If the after-tax incomes of all Americans had grown together at the same pace since 1979, then by 2018, the total income of households in the richest 1 percent, after taxes, would have been \$850 billion less.

Wealth inequality has also worsened. According to the World Inequality Database, the share of aggregate wealth held by the top 1 percent rose from 22.9 percent in 1979 to 34.9 percent in 2019, while the share held by the middle 40 percent declined from 33.3 percent to 27.8 percent.⁶ As Figure 2 shows, the top one-tenth of the top 1 percent of Americans now hold nearly one-fifth of the nation's wealth—a number that has nearly doubled over the past 40 years.

FIGURE 2

The top 0.1 percent of Americans' share of wealth has nearly doubled over the past 40 years

Wealth share of the top 0.1 percent, 1945–2016



Source: Emmanuel Saez and Gabriel Zucman, "Progressive wealth taxation" (Washington: Brookings Institution, 2019), available at <https://www.brookings.edu/bpea-articles/progressive-wealth-taxation/>.

This inequality has exacerbated the racial wealth gap. For example, depending on the measures used, white Americans are estimated to own at least four times and as much as seven times the wealth that Black Americans own.⁷ The racial wealth gap is the result of centuries of systematic oppression and discrimination, exacerbated by more recent trends in overall wealth inequality.⁸

Many of these trends have grown even worse over the past two years, during which the COVID-19 pandemic has disrupted tens of millions of Americans' livelihoods and caused widespread financial insecurity. Low- and middle-income Americans have lost jobs and sources of income at much higher rates than the affluent. The actions taken by Congress in response to the pandemic have somewhat cushioned the blow, but many millions experienced and are still experiencing hardship.

The richest Americans' fortunes, however, grew to new heights during the pandemic. The biggest driver of growing income and wealth inequality has been the large gains in asset prices, which have soared far above pre-pandemic levels. The wealth of the top 1 percent has grown by more than \$7 trillion since 2019, by \$11 trillion since 2017, and by an astounding \$23 trillion since 2011.⁹

President Biden's Build Back Better agenda proposes raising \$3.6 trillion in revenue from the highest-income Americans and corporations over the next 10 years. The wealth of the richest 1 percent has increased by \$23 trillion over the past 10 years.

3 fundamental failings of the U.S. tax code

Many policy decisions over the course of decades are responsible for this explosion in inequality—including fundamental failings of the U.S. tax system. This report explains how President Biden’s Build Back Better plan would tackle three significant failings:

1. The failure of the tax system to tax income from wealth comparably to income from work—and most fundamentally, the fact that huge amounts of income from wealth escape tax altogether
2. The erosion of corporate taxes during an era of surging corporate profits
3. The weakening of tax enforcement, especially with regard to wealthy individuals and corporations, which has drained hundreds of billions from the U.S. Treasury

1. Billionaires do not pay taxes on trillions of dollars of capital gains

On June 8, the investigative news outlet ProPublica revealed that the 25 richest people in the United States paid a “true” tax rate of just 3.4 percent, on average. Three of the five richest people in the country—multibillionaires Jeff Bezos, Warren Buffett, and Elon Musk—paid even less.¹⁰

How is this possible? The extremely wealthy amass wealth not by earning paychecks, but from gains in the value of assets they own, such as stocks, other types of stakes in businesses, and real estate. Those individuals get richer and are better off because of those capital gains, yet the current tax system does not count these gains as income until they are realized—that is, when an asset is sold. That allows individuals to amass billions of dollars in wealth—and now even hundreds of billions—without reporting it on their tax returns and, thus, without paying a penny of tax on it. By contrast, regular working Americans have taxes withheld from their paychecks in real time.

ProPublica’s “true tax rate” measure includes unrealized capital gains in a person’s income—and therefore, gives a more comprehensive view than tax rate measures that only include income reported on tax returns. Taking unrealized gains into account illustrates just how little the superwealthy are paying in taxes in relation to their actual economic income.

The nontaxation of unrealized capital gains gives the wealthy an extremely valuable deferral benefit: Their wealth, plus the tax savings, compounds over time. And they can enjoy all the benefits of their wealth—including economic power and the ability to live extraordinarily lavish lifestyles—by taking loans that do not trigger capital gains tax.¹¹

Furthermore, if individuals never sell assets, they will never pay income taxes on their gains. Gains on held assets are not taxed as income due to a provision called stepped-up basis. Tax attorney Hank Gutman, the former chief of staff of the bipartisan congressional Joint Committee on Taxation, recently testified to Congress that stepped-up basis “is perhaps the most glaring loophole in the income tax—the complete exemption of the bulk of the wealth accumulation of the super-rich from income tax.”¹²

Economists Gabriel Zucman and Emmanuel Saez estimated in April 2021 that 63 percent of the total \$4.26 trillion of U.S. billionaires’ wealth consists of unrealized capital gains that have never been taxed.¹³ Much of it will never be subject to income tax because of stepped-up basis.

Gains realized through selling assets, meanwhile, are generally considered income and taxed—but at preferential rates. The top capital gains tax rate is currently 20 percent, while the top ordinary income tax rate is 37 percent. When Medicare-related taxes are included, these rates are 23.8 percent and 40.8 percent, respectively. Congress should raise the top capital gains rate—but if policymakers are truly dedicated to ensuring that the tax system does not favor income from wealth over income from work, this step is not enough. The rate only matters if capital gains are taxed in the first place, which the existing system often fails to do.

Fully eliminating the tax advantages that capital gains have over ordinary income would require eliminating the deferral benefit, the stepped-up basis loophole, and special lower tax rates. In 2019, U.S. Senate Finance Committee Chair Ron Wyden (D-OR) proposed achieving this through an anti-deferral system, also known as mark-to-market, that would apply to the wealthiest Americans. Sen. Wyden’s plan would tax capital gains on stocks and other publicly traded assets annually, whether those assets are sold or not.¹⁴

The Build Back Better plan closes the loophole that allows capital gains to escape income tax

President Biden takes a more moderate approach, but one that still fixes the fundamental problems. His plan would repeal stepped-up basis, with protections for the middle class and family businesses, and equalize the capital gains and ordinary tax rates for income of more than \$1 million.¹⁵ Under Biden's plan, capital gains would still enjoy the advantage of deferred taxes until an asset is sold or transferred by gift or bequest—and in the case of family businesses and farms, as long as the business or farm remains owned and operated by the family. But Biden's plan addresses the biggest problem by ensuring that the capital gains of the wealthy are eventually taxed.¹⁶

Biden's plan includes a number of features that focus tax increases on the wealthy, not the middle class. A \$1 million lifetime exemption ensures that only those who have more than \$1 million of untaxed gains on assets, or \$2 million for married couples, would see any tax change. This would come on top of the existing exemption for the appreciation of home values—which exempts the first \$250,000 of gains for single individuals and \$500,000 for couples. Biden's plan also does not affect savings plans such as 401(k)s or individual retirement accounts (IRAs).

Because of these exemptions, only a small fraction of the population would be affected—and only those with very large untaxed gains. The Tax Policy Center estimates that together, all of President Biden's major individual tax proposals would affect only 1.1 percent of taxpayers—those with very high incomes or more than \$1 million in untaxed gains, or \$2 million for couples.¹⁷

The Biden plan also makes a special exception for family businesses and farms, in addition to the \$1 million general exemption and the home sale exemption. When a family business or farm is handed down to heirs, no tax is due. Only when the business is sold or otherwise ceases to be family owned and operated is the tax due on any gain. Despite claims to the contrary, then, no one who wants to keep a business or farm in their family would have to pay capital gains tax upon transferring it from one generation to the next.

The Build Back Better agenda also proposes other reforms that would raise revenue from high-income individuals:

- Restoring the top ordinary income tax rate from 37 percent to 39.6 percent, where it was before the 2017 TCJA

Under Biden's plan, no one who wants to keep a business or farm in their family would have to pay capital gains tax when transferring it from one generation to the next.

- Closing gaps in the law that enable high-income business owners to avoid paying Medicare-related taxes
- Closing the notorious carried interest loophole that enables Wall Street fund managers to convert their income into low-tax capital gains—though Biden’s plan to equalize the tax rates on capital gains and ordinary income of more than \$1 million would almost fully close that loophole¹⁸

See Table 1 for a full list of Biden’s revenue-raising proposals and their estimated effects.

2. Corporations are paying less in taxes despite soaring profits

Corporations are owned overwhelmingly by high-income Americans through stock ownership: More than half of the corporate stock and mutual fund shares that Americans own belong to the richest 1 percent; the wealthiest 10 percent own nearly 90 percent.¹⁹ Foreign investors own roughly 40 percent of U.S. corporate stock.²⁰ These shareholders have been the primary beneficiaries of the gradual erosion of the corporate income tax.

The tax cuts that then-President Donald Trump signed into law in December 2017 slashed the U.S. corporate tax rate from 35 percent to 21 percent, among other changes. Under this rate and other changes, the net reduction in corporate tax revenue that will result over the law’s first decade has been estimated at \$750 billion.²¹ Congress has also enacted additional corporate tax cuts since the TCJA.²²

Since the 2017 tax cut, the United States has collected less revenue from the corporate tax than at any time since the 1930s—averaging just barely more than 1 percent of gross domestic product (GDP) over the past three years.²³ The erosion of the corporate tax has contributed to the decline of overall revenues, which have been historically low and far below levels needed to support current levels of government services and investments, let alone the greater services and investments that are necessary for stronger growth and shared prosperity. In both 2018 and 2019, total federal revenues were 16.3 percent of GDP. By contrast, in 1999 and 2000—also the last two years of a long economic recovery—federal revenues were 19.3 percent and 20 percent of GDP, respectively.²⁴

Still, the U.S. corporate tax was eroding long before the TCJA. A key reason for this erosion has been the global phenomenon known as profit shifting, where large multinational companies artificially report their profits in tax haven countries

rather than in countries where they have real business activity. By 2017, the United States was losing an estimated \$100 billion annually from profit shifting.²⁵ And profit shifting has continued at a massive volume since the passage of the TCJA.²⁶

Corporate profit shifting is a problem faced by countries around the world and the focus of multilateral negotiations toward a coordinated solution. These negotiations are also aimed at preventing the global so-called race to the bottom—in which countries experience pressure to lower their corporate tax rates to match other countries' rate cuts or to poach revenue from other countries by inviting profit shifting into their countries. This summer, 134 of the 140 countries involved in these negotiations signed onto a framework agreement under which countries would adopt a corporate minimum tax rate of at least 15 percent.²⁷ The agreement sets a floor that would substantially raise the corporate tax rates in tax haven countries, which currently are often effectively close to zero.

President Biden's legislative proposals complement and reinforce this effort at international cooperation. Their adoption by Congress would greatly strengthen the United States' hand in finalizing a global agreement. As explained further below, Biden's proposals also advance the country's interests in their own right by raising revenue for investments and addressing the existing tax code's incentives for companies to shift profits and investment overseas. For those two reasons, Congress must act now to reform the U.S. international tax system rather than wait passively until the end of the multilateral process.

The Build Back Better plan makes large corporations pay their fair share. President Biden's plan would raise slightly more than \$2 trillion in corporate tax revenue, with more than half coming from reforming the United States' system for taxing multinational corporations.

Under the Biden plan, U.S. corporate tax revenue would still be relatively low compared with other countries and with revenue levels in past decades. But it would increase substantially to support critical investments in America's competitiveness, including infrastructure, research and science, education, and workforce development. American companies are the most successful in the world because they benefit from these kinds of public investments. Biden's plan makes them pay their fair share in taxes to help fund those benefits. And it levels the playing field between the large multinationals that currently exploit tax havens to reduce their tax bills and their competitors, large and small, that do not.

The three largest components of Biden's corporate tax plan are:

- Raising the corporate rate from 21 percent to 28 percent
- Implementing a strong minimum tax on overseas profits and removing specific provisions that can incentivize investment overseas
- Implementing a mechanism called Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD), which would protect the U.S. tax base, level the playing field for U.S. companies, and influence other countries to stop the corporate tax race to the bottom²⁸

Raising the corporate tax rate

increasing the corporate tax rate from 21 percent to 28 percent would reverse half of the rate cut from the TCJA. The United States' corporate rate had been 35 percent for the 25 years before the 2017 law took effect—years during which U.S. corporations enjoyed surging profits both before and after taxes, gained preeminence in the digital economy, and were highly competitive in global markets.

A 28 percent corporate rate would raise \$300 billion more over the next decade than a 25 percent rate

According to the Treasury, President Biden's proposal to raise the corporate tax rate to 28 percent would increase revenues by \$858 billion over the next decade; the Joint Committee on Taxation estimates that it would raise slightly more than \$700 billion.²⁹ A 28 percent corporate rate would be the United States' lowest rate since 1940, with the exception of the past few years following the TCJA's passage. Raising the corporate rate to only 25 percent, as some members of Congress have suggested, would raise about \$300 billion less in revenue.

To put that amount in perspective, \$300 billion is more than the cost of President Biden's proposal to guarantee paid leave to workers (\$225 billion); his proposal to improve the quality of child care and ensure that no middle-class family pays more than 7 percent of their income for child care (\$225 billion); or his entire suite of investments in higher education, including making community college free for all (\$273 billion). It is about twice the cost of his proposal to ensure universal preschool for 3- and 4-year-olds (\$165 billion).³⁰

Implementing a strong global minimum tax to prevent offshoring of profits and jobs

Biden’s plan would overhaul the United States’ weak corporate overseas minimum tax regime enacted in 2017, known as the tax on global intangible low-taxed income (GILTI). The Biden plan would ensure that U.S. companies pay at least a 21 percent rate on their overseas profits, compared with 10.5 percent under GILTI.³¹ Importantly, the new minimum tax would be calculated on a country-by-country basis rather than on a global average, which would prevent companies from exploiting tax havens to drive their average rate down to the minimum—and eliminate a potential incentive to locate operations in high-tax foreign countries, rather than the United States, if the companies’ average foreign tax rate is below the minimum. GILTI’s exemption for a 10 percent return on physical assets located overseas, known as qualified business asset investment—which can reward companies for locating such assets overseas rather than in the United States—would be eliminated.³² The Biden plan also prevents U.S. companies from claiming deductions against the proposed 28 percent U.S. corporate rate for expenses that generate income that is not taxed or taxed at a lower rate overseas.

Implementing SHIELD as a powerful backstop

One kind of corporate profit shifting is earnings stripping, where multinational corporations move earnings out of the United States by having their U.S. affiliates make tax-deductible payments to affiliates in foreign countries. When those foreign countries are tax havens or have much lower tax rates than the United States, earnings stripping is highly lucrative. This is likely the biggest reason that in past years, U.S. firms sought to invert so that their parent company would be based overseas. Under Biden’s SHIELD proposal, companies would not be able to claim tax deductions in the United States for payments going to affiliates in countries that have a corporate tax rate lower than the internationally agreed-upon minimum, which current negotiations have pegged at “at least 15%.”³³

SHIELD is an extremely powerful mechanism for achieving three goals simultaneously:

- 1. Protecting the U.S. tax base and leveling the playing field by preventing earnings stripping:** By denying U.S. tax deductions for payments to corporate affiliates in tax haven jurisdictions, SHIELD shuts down a major form of corporate tax avoidance. That would stem the loss of revenue and level the playing field for multinational companies that do not engage in aggressive earnings stripping and for small and solely domestic businesses for whom offshore earnings stripping is not even an option.
- 2. Wiping out the financial incentive for U.S. companies to invert to low-tax countries.** In addition to SHIELD, Biden's plan also strengthens rules specifically aimed at preventing inversions.
- 3. Incentivizing low-tax countries to meet international standards.** SHIELD would back up the United States' diplomatic efforts toward multilateral coordination with the power the country derives from its giant consumer market. If the United States adopts SHIELD, low-tax countries will be highly likely to conform with international standards because multinationals based in those countries will pay much higher taxes in the United States if they do not. If other countries make these changes, global corporations will have nowhere to park their profits to escape taxes. And the concerns about the effects of taxes on U.S. multinationals' ability to compete globally—concerns that have always been grossly overstated—will be alleviated.

The growth of pass-through businesses cannot explain the recent collapse of corporate revenue

Many analysts have emphasized that measures of corporate tax revenue as a share of GDP are misleading because they ignore the United States' large pass-through business sector. Pass-through businesses such as S corporations and partnerships do not pay taxes themselves, but their owners are taxed on their share of the profits. These analysts are correct that a large share of business income in the United States is taxed at the individual, not corporate, level; however, corporate revenues have fallen and are well below international standards even when considering the pass-through sector.

Though the pass-through business sector has accounted for a gradually increasing share of total business income, the net income reported by C corporations, not including S corporations, was higher as a share of GDP in the 1990s, 2000s, and this decade than it was in the 1980s, with no downward trend.³⁴ The gradual shift to the pass-through form clearly cannot explain the precipitous drop in corporate revenue since the TCJA was enacted in 2017. In addition, one of the world's other large economies—Germany—has a similarly large pass-through sector but, since the TCJA, raises more than twice as much revenue from its corporate tax, relative to its GDP, as the United States.³⁵

Moreover, the growth of the U.S. pass-through sector is itself one of the policy choices responsible for the decline in corporate revenue. Over decades, the United States gave pass-through business forms nearly all of the advantages of corporate status and allowed many corporations and their owners to shrink their tax bill by converting to pass-through form. Pass-through businesses themselves pay low effective tax rates: In 2011, the average was 19 percent, with a significant amount of pass-through income going untaxed.³⁶ And the 2017 tax law cut taxes on pass-throughs by introducing the new 199A deduction, discussed below.

3. A seriously weakened IRS results in trillions of tax dollars going uncollected

Perhaps the most glaring problem with the current tax system is its failure to collect what is legally owed. Without changes, an estimated \$7 trillion in taxes will go uncollected over the next decade, and honest families and businesses will be left shouldering more of the load.³⁷ The decimation of tax enforcement has benefited high-income and corporate tax dodgers the most. Audit rates of millionaires and the largest corporations plummeted by more than 60 percent and nearly 50

percent, respectively, from 2010 through 2018, while decreasing by much less for other taxpayers.³⁸ The IRS has lost thousands of experienced and skilled enforcement personnel due to severe budget cuts and a nearly decadelong hiring freeze—leaving a dearth of agents able to thoroughly examine the complex returns of wealthy individuals and large corporations. The IRS has instead focused an increasing share of audits on low-wage workers who claim the earned income tax credit (EITC)—who are disproportionately African American and Hispanic—simply because it is relatively cheap to audit them and does not require the highly skilled auditors needed to audit the wealthy and large corporations.³⁹

New research indicates that the United States loses at least \$175 billion per year to tax noncompliance by the richest 1 percent, largely because of offshore evasion and underreported income from pass-through business entities.⁴⁰ IRS Commissioner Charles P. Rettig has also identified the emergence of cryptocurrencies as a growing tax compliance problem.⁴¹ In its most recent analysis, the IRS estimated the net corporate tax gap to have been \$32 billion per year from 2011 to 2013—but it has likely grown since then, and tens of billions more are lost to profit shifting and other aggressive avoidance techniques that are not criminal but often go unchallenged because the IRS is vastly outgunned in audits of and litigation against large corporations.⁴²

When sophisticated high-income and corporate taxpayers are able to evade or aggressively dodge taxes due to nonenforcement, it undermines the fairness and integrity of the tax system—to the disadvantage of the honest businesses and families who pay what they owe. It also worsens inequality along class and racial lines⁴³ and drains enormous amounts of revenue from the Treasury.

The state of tax enforcement in the United States is so bad that many Republicans and conservatives who are generally anti-tax agree that stronger IRS enforcement is needed. Unfortunately, in July, Republican senators negotiating the bipartisan infrastructure legislation backed away from a tentative agreement they had made to increase IRS funding to help raise revenue for infrastructure investment.⁴⁴ It therefore falls to congressional Democrats and President Biden to fix the broken system of tax enforcement through the budget reconciliation process.

The Build Back Better plan includes a comprehensive approach to improving tax enforcement

The Biden tax enforcement plan is focused on rebuilding and modernizing the IRS by giving it additional resources and tools and by directing enforcement resources toward wealthy individuals and corporations. The plan's two main components are:

- 1. Funding the IRS:** President Biden has proposed increasing the IRS budget by \$80 billion over the next 10 years, with the bulk of funding provided on a mandatory basis so that the agency can reliably hire new enforcement personnel, upgrade its computer systems, and provide better service to taxpayers. New audit resources will be focused on high-income taxpayers and corporations, where the IRS can recoup the most revenue. The Biden administration's initiative will reverse the disproportionate focus on low-wage workers claiming the EITC, improve racial equity, and help restore basic fairness for honest taxpayers.⁴⁵
- 2. Improving information reporting:** The tax code requires employers to withhold income and payroll taxes directly from regular workers' paychecks and to report all their wages to the government on W-2 forms. As a result, tax compliance on wage income is nearly 100 percent.⁴⁶ By contrast, business owners and wealthy individuals often receive income in forms that are not reported to the IRS by third parties—making it easier for the unscrupulous to hide or underreport income. To address this problem, President Biden's plan would require banks and financial institutions to provide data on gross inflows and outflows from accounts to help the IRS spot indicia of potential tax evasion. Only gross annual flows, not any information about specific transactions, would be reported. Banks would likely report these flows on forms similar to the 1099-INT forms that they are already required to issue to account holders with \$10 or more of interest income. Taxpayers would not have to do anything, but the information reported by banks would enable the IRS to better target audits, greatly leveraging the additional enforcement resources.

Under Biden's tax enforcement initiative, overall audit rates would not increase for taxpayers earning less than \$400,000 relative to recent years. With audits targeted more effectively because of better information reporting, regular, honest taxpayers would be audited less often—and they would have more confidence that others are not getting away with cheating while they pay full freight.

President Biden's plan also includes several smaller but significant proposals that would help improve tax compliance, including a long-standing bipartisan proposal to clarify the IRS' authority to set basic standards for paid tax preparers.⁴⁷

TABLE 1

Revenue proposals in President Biden's Build Back Better plan

As estimated by the U.S. Department of the Treasury

	fiscal years 2022–2031	
Revenue from corporations	Increase corporate tax rate to 28 percent	\$858 B
	Strengthen global minimum tax regime, limit corporate inversions, and related actions	\$620 B
	Implement the Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) proposal to replace Base Erosion and Anti-Abuse Tax (BEAT)	\$390 B
	Implement 15 percent minimum tax on large corporations based on financial reporting income	\$148 B
	Restrict debt loading	\$19 B
	Total, corporations	\$2 T
Revenue from high-income individuals	Reform capital gains taxes	\$344 B
	Restore top individual tax rate of 39.6 percent	\$132 B
	Close loopholes in Medicare-related taxes	\$237 B
	Extend limit on excess business losses	\$43 B
	Total, high-income individuals	\$755 B
Revenue from better tax compliance and administration	Require more information reporting from financial institutions	\$463 B
	Increase IRS funding (net)	\$245 B
	Other tax compliance and administration proposals	\$10 B
	Total, tax compliance and administration	\$718 B
Revenue from fossil fuel companies and polluters	Eliminate special tax breaks for fossil fuel companies	\$35 B
	Reinstate industry taxes for cleanup of Superfund sites and oil spills	\$25 B
	Total, revenue from fossil fuel companies and polluters	\$60 B
Total revenue	\$3.6 T	

Source: U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (Washington: 2021), available at <https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf>.

Congress has many other progressive revenue options available

TABLE 2
Congress has many other potential revenue options beyond those in Build Back Better

Illustrative, nonexhaustive list of potential actions

	fiscal years 2022–2031	
Revenue from corporations	Repeal the deduction for foreign-derived intangible income (FDII); invest in science and education instead*	\$217 B
	Further limit corporate interest deductions*	\$140 B
	Require amortization of advertising expenses*	\$75 B–\$150 B
	Address tax preferences for stock buybacks through a small excise tax**	About \$50 B per percentage point
Revenue from high-income individuals	Extend \$1 million deduction limit for executive compensation*	\$20 B
	Implement a 10 percent millionaire surtax	\$700 B
	Limit the excess benefit of tax expenditures for top-bracket individuals	\$270 B
	Phase out the Tax Cuts and Jobs Act’s pass-through deduction for those with more than \$400,000 in income	\$143 B
	Restore the "Pease" limitation on itemized deductions above \$400,000 of income	\$51 B
	Revenue from wealthy estates	Return the estate tax to 2009 parameters (\$7 million exemption for couples, 45 percent top rate)
Raise the top estate tax rate for billion-dollar transfers to 65 percent		\$100 B
Restrict vehicles for estate tax avoidance (grantor retained annuity trusts, intentionally defective grantor trusts, and valuation discounts)		\$65 B

*These revenue options assume a 21 percent corporate tax rate. They would likely raise more with a higher rate.

** Rough calculations assuming \$50 billion of stock buybacks per year and disregarding effects on corporations’ behavior.

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Enactment of President Biden's tax proposals would raise a combined \$3.6 trillion in revenue and dramatically advance tax fairness. But they are not the only progressive revenue options available to Congress. Policymakers could adopt many other options in addition to the Biden proposals or as substitutes. All these options, shown in Table 2 and discussed in this section, would raise substantial revenue, and none would raise taxes on families or individuals with incomes of less than \$400,000. This is not an exhaustive list.⁴⁸

Phase out the pass-through deduction for taxpayers earning more than \$400,000 in income

The TCJA added Section 199A to the tax code: a special new tax deduction for most pass-through business income, or income earned through partnerships, S corporations, LLCs, and proprietorships. Since pass-through income is very concentrated among the wealthy, and because the deduction cuts effective tax rates the most for people in the top tax bracket, 199A gives more than 60 percent of its benefits to the richest 1 percent.

Though the pass-through deduction was billed as a Main Street tax cut, its biggest beneficiaries are anything but mom and pop stores or any other kind of small business. A recent ProPublica expose revealed that the deduction's largest benefits have gone to extremely wealthy owners of multibillion-dollar companies such as Uline and Bechtel. Some of these wealthy individuals played a role in lobbying for the provision to be enacted and for them to be included in it.⁴⁹

199A has created new avenues for tax avoidance by the wealthy—including CEOs recharacterizing their income to take advantage of the deduction.⁵⁰ It creates arbitrary disparities between taxpayers who derive their income from earning salaries and many of those who earn it through business entities. The deduction is another significant way in which the tax code favors income from wealth over income from work.

Ideally, the pass-through deduction should be repealed in its entirety. But short of full repeal, Congress could phase the deduction out at more than \$400,000 of income, as President Biden proposed in his campaign plan. That would raise \$143 billion in revenue through 2025, after which the deduction is scheduled to expire.⁵¹ Repealing it for high-income people now would also help ensure that the giveaway is not extended beyond 2025. Senate Finance Committee Chair Wyden has also proposed phasing out the deduction for those with incomes of more than \$400,000 but removing limits on the deduction for some people with incomes below that threshold.⁵²

Implement a surtax on very high-income taxpayers

A relatively straightforward way of raising revenue exclusively from the richest households is to impose a surtax on very high levels of adjusted gross income (AGI). Such a surtax would not allow special deductions and would treat all reported income the same, whether from millionaires' salaries, business profits, or investment income. A bill from Sen. Chris Van Hollen (D-MD), Rep. Don Beyer (D-VA), and others would implement a 10 percent surtax on AGI of more than \$2 million for couples and \$1 million for singles, raising nearly \$700 billion.⁵³ Congressional proposals from several years ago that set the rate in the 5.4 percent to 5.6 percent range but applied to couples' income of more than \$1 million were estimated to raise amounts that were nearly as much if one adjusts for economic growth since then.⁵⁴

Limit tax expenditures for top-bracket taxpayers

Tax benefits that are structured as exemptions, deductions, or deferrals benefit people in higher tax brackets more than people in lower tax brackets. For example, a \$1 deduction saves a high-income individual in the 37 percent bracket \$0.37 in taxes but saves a middle-income person in the 10 percent bracket only \$0.10. The effect is exactly upside-down: People in high tax brackets are least likely to need a deduction for mortgage interest to buy a home, the multiple tax benefits of health savings accounts to afford health care, or the tax deferrals in retirement accounts to save for retirement. Limiting such tax benefits to 28 cents on the dollar, as President Biden proposed during the campaign, is a relatively modest reform.⁵⁵ It would effectively give people in the highest tax brackets the same benefit per dollar of deduction or exemption as if they were in the 28 percent bracket.⁵⁶ It would raise roughly \$270 billion over 10 years.⁵⁷

Congress could also restore the Pease limit on itemized deductions for high-income taxpayers, which was eliminated through 2025 in the TCJA. Because of its structure, the Pease limit was essentially a small addition to the top marginal tax rate.⁵⁸ Congress could also go further than President Biden's proposal and simply raise the top marginal rate above 39.6 percent.

End the tax preference for stock buybacks

In recent years, policymakers in both parties have sought to curb stock buybacks out of concern that corporations are increasingly using them to distribute cash to shareholders and boost executives' pay rather than invest in their business through capital investments or wage increases.⁵⁹ Tax experts have also emphasized that buybacks enjoy several tax preferences, including relative to shareholder dividends, and have proposed eliminating this preferential treatment.⁶⁰ Sen. Sherrod Brown (D-OH) is developing legislation that would level the treatment of stock buybacks through an administratively simple means: requiring corporations to pay a low-rate excise tax on them. Given that the volume of stock buybacks has averaged about \$500 billion per year in recent years, even a low-rate excise tax could raise substantial revenue.⁶¹

Repeal the FDII tax break without replacing it with new benefits for corporations

The 2017 tax law enacted an ill-conceived provision that allows multinational corporations to pay a 13.125 percent tax rate rather than the regular 21 percent rate on foreign-derived intangible income (FDII). This was ostensibly meant to encourage companies to invest in intellectual property that they could use and sell abroad, but its effects are merely to “subsidize monopoly profits and encourage exodus of physical capital,” according to Brookings Institution economist William Gale.⁶² The provision provides a needless windfall for companies that possess very valuable intangible assets rather than incentivizing innovation and research and development on the front end. Worse, under the way FDII is calculated, the more physical assets, such as factories, machines, or buildings, a company has in the United States compared with abroad, the lower its benefit from FDII—creating a perverse incentive to locate such assets overseas. President Biden’s plan repeals the lower tax rate on FDII but repurposes the resulting revenue for new tax incentives for innovation, which the plan leaves for Congress to design. The better way to boost U.S. innovation is to invest directly in research, science, and education, so Congress should simply repeal the lower rate on FDII, raising \$217 billion that can be used for those purposes.

Expand limits on corporate deductions for executive compensation

Currently, corporations cannot deduct their top executives' compensation exceeding \$1 million per year. This limit, however, currently only applies to the top five officers in a company; companies are able to deduct more than \$1 million for other highly paid employees, such as Wall Street traders. Executive compensation is a major driver of inequality, as corporate executives comprise a sizeable share of the top 0.1 percent of earners.⁶³ Deduction limits have not reduced corporate executive pay in the past, potentially because of their limited scope and the large exception for performance-based pay that existed before the 2017 tax law. Broader limits could be more successful in restraining executive pay—and to the extent they are not, they would simply raise revenue from large corporations with many millionaire executives or employees. Expanding the \$1 million deduction limit to cover all executives or employees of public companies would likely raise about \$20 billion.⁶⁴

Limit other corporate deductions

Congress has other avenues to raise revenue by broadening the corporate and business tax base. One option is to reform the tax treatment of advertising. Permanent tax rules allow businesses to fully deduct advertising costs in the year the costs are incurred. But the proper treatment under an income tax for an expense that creates value to a firm over multiple years—as advertising often does—is to treat the expense like an investment and require it to be capitalized with deductions spread over time. Congress has temporarily allowed full, immediate deductions for many other types of investments. But on a permanent basis, the Congressional Budget Office (CBO) estimates that the tax code gives more favorable treatment to brand-building advertising than to any other type of investment—inefficiently favoring advertising over other, potentially more productive investments.⁶⁵ Recent CBO estimates suggest that requiring businesses to capitalize half of their advertising expenses would raise revenue by roughly \$75 billion to 150 billion over the next 10 years, depending on whether deductions would be spread over five or 10 years.⁶⁶

Congress could also further limit corporate interest deductions. The structure of the U.S. corporate tax favors debt financing over equity financing because interest payments to creditors are deductible while dividend payments to shareholders are not. The TCJA partially addressed this bias by strengthening limits on interest deductions. But Congress could raise revenue and further reduce the bias toward debt financing by tightening the interest deduction limits even more. Lowering

the existing limit on interest deductions from 30 percent of adjusted taxable income to 20 percent would raise roughly \$140 billion over 10 years, based on estimates by the Tax Policy Center.⁶⁷

The estimates of the revenue that would be raised from repealing the FDII deduction or limiting deductions for executive compensation, advertising, or interest are based on the existing corporate rate of 21 percent. The higher Congress raises the corporate rate, the more revenue it would raise from limiting these or other corporate deductions.

Strengthen the estate tax

Like the corporate tax, the estate tax has been repeatedly slashed and eroded over the years—to the point where less than 0.1 percent of estates pay any tax.⁶⁸ The first \$11.7 million of an estate’s value, or effectively \$23.4 million for couples, is exempted from the estate tax.

Congress could repeal the TCJA provision that doubled of the estate tax exemption. Better, it could raise about \$250 billion by restoring the estate tax that was in place in 2009, with an exemption of \$3.5 million, or \$7 million for couples, and a top rate of 45 percent. Under those parameters, still far less than 1 percent of estates would pay the estate tax. Congress could raise an additional \$100 billion by raising the rate higher for billion-dollar estates.⁶⁹

Congress must also close the large loopholes in the estate tax that allow the wealthy to avoid it with ease. These loopholes are the reason that former President Donald Trump’s top economic adviser, Gary Cohn, famously said, “Only morons pay the estate tax.”⁷⁰ Vehicles such as grantor retained annuity trusts and intentionally defective grantor trusts, as well as wealthy families’ ability to aggressively claim valuation discounts, enable these families to lowball the value of their estates for tax purposes when transferring them to heirs.⁷¹ Tax experts Daniel Hemel and Bob Lord estimate that shutting down these three vehicles and making some additional changes to protect the estate tax base would raise at least \$65 billion in revenue over the next decade “and potentially much more.”⁷² Congress should also address so-called dynasty trusts, another vehicle for transfer tax avoidance.⁷³

Strengthening the estate tax and ending stepped-up basis are not duplicative. The estate tax is a tax on amounts transferred to heirs—and its purpose is to curb dynastic wealth. Closing the stepped-up basis loophole would ensure that the very wealthy are taxed on their lifetime income, just like everyone else.

Conclusion

This fall, Congress and President Biden have a historic opportunity to lay the groundwork for stronger and more inclusive prosperity for decades to come. That includes fixing the most fundamental problems in the tax code that undermine tax fairness and enable growing income and wealth inequality.

If members of Congress are serious about fulfilling the principle that the tax code should not favor wealth over work and that the wealthy and corporations pay their fair share, they will need to implement fundamental reforms, not tweaks around the edges.

At the same time, substantial tax reforms can offset the long-term cost of the truly transformative and expansive policies that Congress can advance this year: cutting child poverty nearly in half by making the expanded monthly child tax credit permanent; ensuring universal preschool and affordable child care; and guaranteeing paid family and medical leave. More revenue would also allow Congress to expand home care while improving the quality of home care jobs; make community college free and other higher education more affordable; lower health care premiums and extend coverage to millions more people; and recharge America's engines for innovation. And among many other priorities, it would dramatically reduce racial disparities in income and wealth and enable policymakers to forge the transition to a clean energy economy that will produce new jobs and a healthier planet.

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As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

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