WHO PAYS TAXES
AND WHO DOES NOT

Federal Income Tax: Who Pays and Who Does Not

Americans paid over $1.7 trillion in individual and corporate income taxes to the federal government this year.[1] This financial burden, however, is not shared by all citizens. Some corporations and individuals contribute little or nothing in federal income taxes.

The United States has a top federal corporate tax rate of 35 percent, and a combined federal and state top corporate tax rate of 39.1 percent—the highest in the industrialized world.[2] It is certainly in the best interest of our nation's economy to decrease this burden as much as possible. Congress should work strenuously to decrease penalties on innovation and job creation. This process, however, should be carried out in a fair and evenhanded manner. Rather than allowing the biggest tax breaks to go to those with the best lobbyists, lawyers, and accountants, Congress should work to decrease the tax burden consistently throughout the economy.

As it stands, the tax code is littered with provisions that allow businesses to chop away significantly at the 35 percent rate. Studies differ on the effective rates paid by U.S. corporations, but many of the most recent studies put the rate in the mid-to-high twenties, according to a Tax Foundation survey.[3]

This effective tax burden is likely higher than the international average—but it is not shared among all companies. Some companies even received a refund back from the government. Facebook, Inc., for example, brought in over $1 billion in U.S. pretax profits in 2012, yet received a combined $429 million *refund* from federal and state filings. The refund was largely due to the employee stock option deductions the company has claimed over the years.[4]

A recent study found that 111 of 288 Fortune 500 companies surveyed either paid zero taxes or received a refund in at least one year from 2008 to 2012. Notably, the tax benefits were concentrated in a small group. Together, the 288 companies in the Fortune 500 claimed about $364 billion worth of tax breaks from 2008 to 2012—yet just *25* of the companies claimed nearly half of this amount.[5]

For every tax break claimed by one company or industry, other businesses across the country must pay more. They pick up the financial slack created by the favored businesses, and bear a disproportionately high effective rate, because Washington politicians have handed out targeted tax breaks to the well-connected.

There are also nearly 1.6 million tax-exempt entities in the country, including universities, hospitals, labor unions, and religious groups.[6] While tax-exempt organizations must collect and match payroll taxes for their employees,[7] they pay income taxes only in special circumstances.[8] Many nonprofits have little to no net income, and therefore might not owe much in taxes even if they became legally taxable corporations.

This is not always true, however. For example, according to 2012 data, about 3,900 large 501(c)(3) public charities had a combined net income of more than $67 billion, an average of more than $17 million per organization that could be subject to tax were it not for their tax-exempt status.[9] For these organizations, tax exemption is quite lucrative.

On both ends of the economic spectrum there are numerous individual citizens who pay nothing in income taxes. Out of 145 million tax returns in 2011, 54 million (more than a third) had zero tax liability or were owed money back from the government. Most nonpaying filers are from the lower-income tax brackets. Seventy percent of nontaxable returns had an AGI less than $20,000, according to IRS data,[10] while 97 percent had an AGI below $50,000, which was roughly the U.S. median income in 2011.[11]

Overall, the bottom half of tax filers paid 2.9 percent of all federal income taxes in 2011, while the top 10 percent of income earners paid over 68 percent of the income tax burden.[12]

While it is fair to expect those who have more to pay more and for those who have less to pay less, every citizen should contribute in some manner.

Many of those who are not contributing, however, are among the highest earners who use creative accounting to leverage tax breaks and avoid paying taxes. While most high-income earners bear a significant tax burden, a small subgroup pays nothing in federal income taxes. In 2011, nearly 4.8 million tax filers earned $200,000 or more. Of these, 15,000 filers paid no taxes to any national government, despite reporting $5.7 billion in income.[13]It is import-

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ant to note this report focuses on income taxes rather than payroll taxes. Many individuals, corporations, and nonprofits who pay no income taxes do contribute to the payroll taxes that fund Social Security, Medicare, and unemployment insurance; the federal government collected $948 billion in payroll taxes in FY 2014.[14] Payroll taxes, however, fund insurance programs that directly benefit the workers who pay into them.[15] They do not contribute to the shared common goods that must be provided by the federal government, such as defense, the justice system, and other services provided through discretionary programs. The costs for these shared federal services should be shared, to some extent, by all taxpayers.

There may be valid legal reasons for some of the entities and individuals discussed above to have no income tax liability. Yet, for every corporation, individual, or nonprofit entity that contributes nothing to funding the federal government, other taxpayers must pay more.

To avoid creating unfair burdens on the taxpaying public, Congress should ensure there is a legitimate reason these entities are not contributing to the federal income tax base—and where there is no adequate reason, Congress must ensure these entities pay a fair and reasonable amount in federal income taxes.

Millionaires and the Tax Code

Tax filers with $1 million or more in adjusted gross income (AGI) earned about 11 percent of all income, but paid 21 percent of all federal income taxes, according to IRS data from 2011.[16] Yet over 1,600 who filed tax returns with an AGI of $1 million paid no income taxes at all![17]

The reason is simple—Congress has littered the tax code with loopholes and giveaways intended to benefit selected special interests or activities. Wealthier Americans with more resources are better positioned financially to take advantages of these to lower and, in some cases, even eliminate their tax liability. But every tax benefit must be paid for or offset somewhere else through higher taxes on someone or something else, so in effect these tax code provisions are Robin Hood in reverse, taking from those who have less to give to those with more.

Certain tax code giveaways largely benefit big businesses providing a product and service and the well-off who can afford to purchase it, at the expense of smalls businesses and middle class taxpayers who must foot the bill. A family, for example, that relies on public transportation to get to and from work is unlikely to qualify for the credit for buying an upscale electric vehicle they cannot afford. After all, you have to earn enough to purchase a premium car before you can qualify for the payout from the tax code for owning one. This is essentially an upside-down luxury tax that charges the working class for some of the niceties and extravagances enjoyed by the more affluent.

From deductions for yachts and second homes to tax credits for purchasing luxury cars, and write-offs for gambling losses, the tax code is spending billions of dollars subsidizing the upscale lifestyles of the well-off.

Most tax breaks work by allowing the taxpayer to set aside a certain amount of their income, protecting it from taxation. Because the top earners are subject to higher tax rates, these tax breaks are naturally more valuable for them. Most of these provisions are known as deductions.[18]

Many deductions and similar provisions are directed at middle-class Americans, but are quite often leveraged by the wealthy.

Millionaires deducted $5.1 billion from their taxable income using the mortgage interest deduction in 2011. They protected another $7.3 billion from taxation with the investment interest expense deduction. This provision allows the taxpayer to deduct the interest paid on loans that are used to purchase taxable investments, such as stocks.[19] The benefits of this provision are particularly weighted toward wealthy taxpayers who get the majority of their income from investments; over 58 percent worth of the deductions under this provision were claimed by millionaires.

MORE THAN 15,000 MILLIONAIRES CLAIMED OVER $10 MILLION WORTH OF CHILD CARE CREDITS AND 1,300 MILLIONAIRES CLAIMED $9 MILLION WORTH OF QUALIFIED PLUG-IN ELECTRIC VEHICLE CREDITS IN 2012.

Millionaires claimed another $4.8 billion worth of deductions for gambling losses, deducted $67 billion for taxes paid to state and local governments, and deducted another $37 billion for charitable contributions.[20] Millionaires also earned a total of $17.8 billion in tax-exempt interest income from municipal bonds, over 24 percent of such income earned by all tax filers.[21]

Some of these deductions are justifiable and some may not be—but it is important to remember that, dollar-for-dollar, *all* of them are worth significantly more to the wealthy than other taxpayers. A $1,000 deduction for a millionaire could reduce his final tax bill by as much as $396, depending on the individual tax return, while the same $1,000 deduction for a median-income taxpayer may reduce his final liability by only $250.[22]

Millionaires also obtained significant benefits from tax credits. Credits are generally worth the same to all taxpayers, regardless of income. Because they directly reduce tax liabilities, they are also generally worth more than deductions for all taxpayers.

More than 15,000 millionaires claimed over $10 million worth of child care credits and 1,300 millionaires claimed $9 million worth of qualified plug-in electric vehicle credits in 2012. They also claimed $329 million of the "prior-year minimum tax credit," an obscure provision primarily used by options traders.[23] Taxpayers usually use the provision to cancel out an alternative minimum tax caused by exercising an in-the-money stock option.[24]

The $143 million worth of tax subsidies for electric cars[25] has been derided as "limousine liberalism" and "snobby and foolish." One columnist questions "where does the federal government get off spending the average person's tax dollars to help better-off-than-average Americans buy expensive new cars?"[26]

Nearly 9,000 millionaires claimed a total of $67.7 million in residential energy credits in 2012.[27] The federal government offers a credit for energy-efficient home improvements that "covers expensive and somewhat exotic equipment and has no dollar limit," according to MarketWatch, noting "unlike many tax breaks, there are no income limits on this one, so even billionaires are eligible." The credit equals 30 percent of the cost of solar water-heating equipment, solar, wind, or fuel cell power equipment, or geothermal heat pump equipment—no matter how much these improvements cost. The tax credits can even be used to upgrade vacation homes. A smaller credit, limited to no more than $500, is also available for expenses such as insulation, storm doors, and high-efficiency air conditioning units.[28]

The wealthy are also more likely than other taxpayers to live and earn income overseas. Accordingly, millionaires claimed $8.9 billion worth of foreign tax credits in 2011—more than half the value of all foreign tax credits claimed that year.[29, 30] The credit offsets taxes paid to foreign governments. Millionaires also wrote off $28.6 million using the foreign housing deduction, which allows U.S. citizens to deduct a portion of the costs of living overseas.[31, 32]

High-income taxpayers can combine these tax breaks to dramatically lower their tax liability. As discussed in other chapters, for example, some wealthy taxpayers rely on tax-exempt interest and other deductions to cut their tax bill to zero.

It is unfair to take more from those who have less to give more to those who already have more. Whenever Congress creates a deduction, credit, loophole or other distortion, this is exactly what happens. This is the unintended consequence of distorting the tax code to provide preference and favor to certain products, companies and individuals rather than simply being fair to everyone.

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2 "The U.S. Has the Highest Corporate Income Tax Rate in the OECD," The Tax Foundation, January 27, 2014, http://goo.gl/4NYVlw.
3 Phillip Dittmer, "U.S. Corporations Suffer High Effective Tax Rates by International Standards," The Tax Foundation, September 2011, p. 7, http://goo.gl/R7KyRf.
4 "Facebook's Multi-Billion Dollar Tax Break: Executive-Pay Tax Break Slashes Income Taxes on Facebook— and Other Fortune 500 Companies," Citizens for Tax Justice, February 14, 2013, p. 2, http://goo.gl/lxFXOZ.
See also Senator Coburn's "Wastebook 2013," December 2013, p. 26, http://goo.gl/pFozaB.
5 "The Sorry State of Corporate Taxes," Citizens for Tax Justice, February 2014, p. 6; http://goo.gl/yA29WN.
6 "Data Book," IRS, October 1, 2012, Table 25, p. 56; http://goo.gl/U8fwiB.
7 "Exempt Organizations: What Are Employment Taxes?" IRS, July 15, 2014; http://goo.gl/f9Bcsh.
8 Tax-exempt organizations often must pay the Unrelated Business Income Tax (UBIT) on income that is not substantially related to their exempt purpose. "Unrelated Business Income Defined," IRS, Oct. 16, 2014; http://goo.gl/wqsY6A.
9 Includes organizations with more than $100 million in total assets. Table generated from the website of the National Center for Charitable Statistics (NCCS). "NCCS Public Charities Table Wizard," http://goo.gl/jYecX9.
10 Calculations based on Table 1.2. "Individual Income Tax Returns 2011," Publication 1304, revised Aug. 2013, IRS, p. 36-41, http://goo.gl/LT99B8.
11 Noss, Amanda, "Household Income for States: 2010 and 2011," U.S. Census Bureau, September 2012, p. 5; http://goo.gl/Y7c9Lo.
12 "Table 5. All Individual Returns Excluding Dependents: Number of Returns, Shares of Adjusted Gross Income (AGI) and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Expanded Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 2001-2011," Individual Income Tax Rates and Tax Shares, SOI Tax Stats, IRS, http://goo.gl/pAam6a.
13 The IRS concept of "expanded income" is used in this statement instead of AGI because AGI does not include tax-exempt interest and other significant tax preferences on nontaxable returns. Bryan, Justin, "High-Income Tax Returns for 2011," Statistics of Income Bulletin, IRS, Table 6, p. 80, http://goo.gl/eB6gCR.
14 "Monthly Budget Review for September 2014," Congressional Budget Office, p. 2; http://goo.gl/ukRorS.
15 Corporations also pay payroll taxes on behalf of their employees. It may be argued, however, that these taxes are actually borne by employees, since they are part of the corporation's total cost of hiring an employee, and are therefore passed on to the employee through lower wages.
16 For purposes of this section, "millionaires" refers to tax filers with $1 million or more of AGI, unless otherwise noted. "Individual Income Tax Returns 2011," Publication 1304, revised Aug. 2013, IRS, Table 1.2, p. 36-41; http://goo.gl/HvzFFX.
17 Calculations based on Table 1.2. "Individual Income Tax Returns 2011," Publication 1304, revised Aug. 2013, IRS, p. 36-41; http://goo.gl/HvzFFX.
18 Such provisions may also be called exemptions or exclusions. A tax *credit*, by contrast, reduces the taxpayer's final tax bill by the same dollar amount regardless of the tax rate they face. Only a minority of tax breaks are credits, however. Most tax breaks, therefore, are inherently more advantageous to high-income taxpayers that pay high rates.
19 Rande Spiegelman, "Investment Expenses: What's Tax Deductible?" Charles Schwab, March 6, 2014, http://goo.gl/PRbSeD.
20 "Table 3. Returns with Itemized Deductions: Itemized Deductions by Type and by Size of Adjusted Gross Income, Tax Year 2011," SOI Tax Stats, Internal Revenue Service, http://goo.gl/BtIxwL.
21 Tax-exempt bond income is even more valuable to millionaires than the tax deductions discussed above, since it does not trigger Alternative Minimum Tax adjustments. Bryan, Justin, "High-Income Tax Returns for 2009," Statistics of Income Bulletin, 2012, p. 15; http://goo.gl/O8UNc7.
22 Assumes an above-the-line deduction not subject to the Pease limitation. The millionaire is assumed to be in the 39.6 percent bracket and median-income taxpayer in the 25 percent bracket.
23 "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2012," available from "SOI Tax Stats - Individual Statistical Tables by Size of Adjusted Gross Income," IRS, Aug. 22, 2014, http://goo.gl/ZVCo4Q
24 Bill Bischoff, "An upside to the alternative minimum tax," MarketWatch, April 2, 2014, http://goo.gl/y18EBg.
25 Includes qualified electric vehicle credit and qualified plug-in electric vehicle credit. "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2012," available from "SOI Tax Stats - Individual Statistical Tables by Size of Adjusted Gross Income," IRS, Aug. 22, 2014, http://goo.gl/ZVCo4Q
26 Charles Lane, "Unaffordable at Any Speed," Slate, July 30, 2012, http://goo.gl/YU18Se.
27 "Table 3.3 All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2012," available from "SOI Tax Stats - Individual Statistical Tables by Size of Adjusted Gross Income," IRS, Aug. 22, 2014, http://goo.gl/ZVCo4Q
28 Bill Bischoff, "Even billionaires would qualify for these energy-saving tax credits," MarketWatch, Nov. 4, 2014, http://goo.gl/TpypiJ.
29 "Table 2. All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2011," SOI Tax Stats, Internal Revenue Service, http://goo.gl/iZUZxy.
30 "Foreign Tax Credit - How to Figure the Credit," Internal Revenue Service, http://goo.gl/yy1jeb.
31 "Foreign Housing Exclusion or Deduction," Internal Revenue Service, http://goo.gl/bccVF6.
32 "Table 1. All Returns: Sources of Income, Adjustments, Deductions and Exemptions, by Size of Adjus