

# THE OTHER END OF THE STICK:

**REDUCING INEQUALITY BY TAXING LABOR LESS,  
NOT JUST TAXING CAPITAL MORE**

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# CAPITAL

*in the Twenty-First Century*

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THOMAS  
PIKETTY

TRANSLATED BY ARTHUR GOLDHAMMER

<http://phadvisory.com/wp-content/uploads/2014/08/piketty-capital-21st-century.jpg>



# INCREASING INEQUALITY

- ▶ ANTIDOTE: INTERVENTION THROUGH SYSTEMIC SHOCK
- ▶ WARS HAVE PROVIDED THE SYSTEMIC SHOCK IN THE PAST
- ▶ DIFFICULT TO CONTROL
- ▶ COLLATERAL CONSEQUENCES
- ▶ BETTER INTERVENTION: **TAXATION**

WHAT TO TAX FOLLOWS FROM WHAT THE CAUSE OF  
THE PROBLEM IS.

PROBLEM IS CONCENTRATION OF WEALTH

WHAT TO TAX? CONCENTRATION OF WEALTH



**“That’s Where  
the Money is...”**

— *Willie Sutton*

PROBLEM WILL GET WORSE



<http://paxonbothouses.blogspot.com/2013/09/wealth-disparity-cartoon.html>





# WEALTH OVER INCOME FOR TWO REASONS:

- ▶ CONTRIBUTIVE AND INCENTIVE
- ▶ INCENTIVE: IF WEALTH IS TAXED INDIVIDUALS WILL HAVE AN INCENTIVE TO MAXIMIZE THE RETURN TO CAPITAL
- ▶ CONTRIBUTIVE: EVEN A PROGRESIVE INCOME TAX CAN NEVER GO FAR ENOUGH TO REDUCE INEQUALITY SIGNIFICANTLY BECAUSE INCOME IS A VERY SMALL PERCENTAGE OF THE WEALTH OF VERY WEALTHY INDIVIDUALS.

ASSUMES :

THE INCOME TAX AS IT EXISTS

PRACTICAL AND POLICY  
REASONS FOR CONSIDERING A  
DIFFERENTLY DESIGNED INCOME  
TAX

# PRACTICAL AND POLICY REASONS

- ▶ **PRACTICAL:**

- ▶ U.S. CAN'T EVEN SUPPORT A ROBUST ESTATE TAX – A ONCE IN A LIFETIME WEALTH TAX
- ▶ EASIER TO CHANGE AN EXISTING TAX THAN ADOPT A NEW ONE

# PRACTICAL AND POLICY REASONS

## ▶ **POLICY:**

- ▶ TAXING ACCRETION SEEMS FAIRER THAN TAXING STATIC WEALTH – RAWLSIAN VEIL OF IGNORANCE – RELIANCE (?)
- ▶ PREFERENCE FOR COMMISSION OVER OMISSION
- ▶ NOT JUST THE DEVIL WE KNOW – ENTRENCHMENT. IT'S THE DEVIL WE PREFER.

CAMP

PROPOSAL

# CAMP PROPOSAL

1. Phases out the tax benefit of the 10% bracket for high income taxpayers.
2. Limits high income taxpayers' ability to use preferences only against income below the 35% bracket.
3. Repeals the exclusion for gain from the sale of a principal residence.
4. Significantly reduces the deduction for home mortgage interest.

# CAMP PROPOSAL (CONT.)

5. Reduces the deduction for charitable contributions, which would have to exceed 2% of AGI and would be generally limited to basis, except in the case of publicly traded stock and tangible property related to the purpose of the donee EO.



# CAMP PROPOSAL (CONT.)

6. Repeals the deduction for alimony (and the related inclusion in income).
7. Repeals the deduction for medical expenses.
8. Adopts AMT base – broader than regular tax:
9. SALT, 212, 67/MIDS – all non deductible
10. Top rate under proposal (35%) higher than top AMT rate of 28% so that's an increase in the base and the rate.

# CAMP PROPOSAL (CONT.)

9. Repeals the like-kind exchange provisions.
10. Extends from 15 to 20 years the amortization period for goodwill and other intangibles.
11. Does not repeal the section 1411 Net Investment Income tax of 3.8%.
12. Adopts mark-to-market for derivatives.

# BUSINESS TAX BASE BROADENING (INCREASED TAXATION OF CAPITAL)

- ▶ Repeals LIFO
- ▶ Capitalization of 50% of advertising and 100% of R&D (amortization over 10 and 5 years, respectively)
- ▶ Requires straight line depreciation
- ▶ Repeals MACRS recovery periods and methods
- ▶ Repeals tax exemption for sports leagues - NFL

# BUSINESS BASE BROADENING (TAXATION OF CAPITAL)

- ▶ Disallows tax free spin-off of corporate real estate into REITs
- ▶ Repeals 29 credits
- ▶ Ends favorable treatment of carried interests: portion of return taxed as OI
- ▶ Capital gains preference remains about the same, but mechanism differs – return to pre-86 deduction (40%)

# TAX POLICY CENTER ESTIMATE

Camp Proposal:

“would reduce tax burdens on average in **every quintile**, for all tax units, with the **largest reduction** in the **lowest** income quintile and the **smallest** reduction in the **top** quintile.”  
(Emphasis added).

# TOP QUINTILE

“within the top quintile **all** of the reduction would go to the **top 1 percent** (and particularly the top 0.1 per cent); the 80th through 99th percentiles would have increases in tax burden on average.”

A 3D rendered graphic of the text '1%' in a bold, red, sans-serif font. The characters are thick and have a slight shadow beneath them, giving them a three-dimensional appearance. The background is white.

# MODIFICATIONS:

- ▶ Eliminate preferential treatment of capital gains and dividends
- ▶ Mark-to-market for publicly traded securities
- ▶ Mark-to-market for commercial real estate
- ▶ Remove additional restrictions on availability of EITC and CTC
- ▶ Extend eligibility for childless workers, non-custodial parents, and younger workers

# MODIFICATIONS:

- ▶ Eliminate preferential treatment of capital gains **(did it in '86)** and dividends **(didn't even have that until '03)**
- ▶ Mark-to-market for publicly traded securities **(done now for dealers)**
- ▶ Mark-to-market for commercial real estate **(extension of mark-to-market for dealers)**
- ▶ Remove additional restrictions on availability of EITC and CTC **(retain current law)**
- ▶ Extend eligibility for childless workers, non-custodial parents, and younger workers **(endorsed by both Paul Ryan and President Obama)**



# THE OTHER END OF THE STICK

- ▶ Taxing labor less
- ▶ Using a different tax
- ▶ The Social Security (FICA)/Self-Employment (SECA) tax



**SOCIAL  
SECURITY  
TAX CUT**

# ADVANTAGES OVER THE INCOME TAX

- ▶ Actual tax reduction – not a tax expenditure/negative tax
- ▶ Easy to deliver benefit ratably throughout the year
- ▶ Doesn't require filing return and attendant costs – filing by taxpayer and administration and audit by the IRS
- ▶ Significantly reduced risk of error and fraud compared to EITC
- ▶ No marriage penalty (on tax side)
- ▶ Not dependent on age – just labor
- ▶ Lessens burden of worker misclassification
- ▶ Benefits all labor, not just documented workers
- ▶ Taxation of labor income by two federal systems is a significant cause of the over-taxation of labor relative to the taxation of capital (the NII does not bring parity because it is only 3.8%)

# MAJOR DISADVANTAGES EASY TO REMEDY

- ▶ Family size addressed through child tax credit revision
- ▶ Revenue shortfall could be recouped through raising or eliminating the earnings cap



# OPTIONS

- ▶ Reduce employee rate
- ▶ Model: 2010 payroll tax holiday, extended in 2011, but now expired



# OPTIONS

- ▶ Provide a zero bracket (double dipping by individuals with multiple jobs would have to be addressed in payroll but easy for SECA).
- ▶ Rate reduction or zero bracket could apply for EE and EER or just EE, as in 2010.

# SECOND-BEST SOLUTION

- ▶ Reducing the taxation of labor = second best solution only if Piketty's objective is the only objective
- ▶ Reducing taxation of labor  $\neq$  second best if it is a normative goal
- ▶ Reasons:
  - ▶ Labor income taxed multiple times by the federal tax system
  - ▶ Potentially 3 times: income tax, payroll tax and then up to 85% subject to income tax again upon receipt, at progressive rates.
  - ▶ It is a redistributive tax, not social insurance

# MOST ACHIEVABLE OF CHANGES





优酷



*in the land of milk and honey*