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Tax Wealth the Same as Work: The Buffett Rule Makes Tax System More Fair

Most Pennsylvania Families Pay More than Highest Income Communities

Some wealthy households are able to take advantage of tax expenditures and loopholes to pay less of their income in taxes than many middle-class Pennsylvania families. The Buffett Rule is designed to correct for this fundamental unfairness, which has been built into the tax code over the last several decades.

The Pay a Fair Share Act (S. 2230) would require taxpayers with incomes over $1 million (after deducting charitable contributions) to pay a tax rate of 30%.[i] The goal is to reduce the number of millionaires who pay a lower effective tax rate than many middle-class Americans.

Many taxpayers with incomes of $1 million whose income is derived primarily from work — wages and salaries — have an effective tax rate the same, or higher, than middle-class families. The tax code has preferential tax rates for investment income,[ii] which significantly reduces the effective tax rate for taxpayers whose income is largely, or primarily, from investments rather than wages.

Middle Class Pennsylvanians Pay Higher Share of Income in Taxes Than Wealthiest Zip Codes

The highest-income Americans face tax rates today that are among the lowest in 50 years**.** The wealthiest 1-in-1,000 taxpayers pay barely a quarter of their income in federal income and payroll taxes today — half of what they would have contributed in 1960.

The wealthiest Americans are able to reduce their tax rates by hiring lawyers and accountants to exploit loopholes and tax expenditures. As a result, the IRS reports that:

- In 2009, 22,000 millionaires paid less than 15 percent of their income in income taxes.
- Another 1,470 millionaires paid no federal income taxes.[iii]

According to tax data for the richest seven zip codes, including notoriously wealthy destinations like Fisher Island, Fla., Teton Village, Wyo., and 30 Rock, New York City, the very wealthiest taxpayers had average income of over $2 million but only pay a combined average effective tax rate of 17.2 percent.[iv]

Comparing Pennsylvania zip codes to seven of the wealthiest zip codes in America shows that middle-class families are paying more in taxes than many of the richest people in the country and proves that the Buffett Rule is necessary to ensure that the game is not rigged for the wealthiest.

- In Pennsylvania, 99% of taxpayers live in a zip code where the average tax rate is higher than 17.2 percent.
- In Pennsylvania, 74% of taxpayers live in a zip code where the average tax rate is higher than it is in any of these seven ritzy zip codes.

The average low- and middle-income zip codes would expect to see effective tax rates lower than the wealthy zip codes because in general the tax rate on earned income increases as income rises. Still, in Pennsylvania, the majority of lower- and middle-income zip codes had a higher effective tax rate than the wealthiest communities:

- Over half of Pennsylvania taxpayers live in a zip code where the average income is less than $50,000, but the average tax rate is higher than 17.2%.

- And, 61% of Pennsylvania taxpayers live in a zip code where the average income is less than $75,000, but their average tax rate is higher than the ritzy neighborhoods of Santa Barbara, Fisher Island or San Francisco.

Table 1.
Average Income and Effective Tax Rate for Returns Over 200K in Seven High Income but Low Effective Tax U.S. Communities

Zip code	Location	Average Income Per Return over 200k	Effective Tax rate for Returns over 200K
94119	San Francisco, CA	$1,190,944	10.8%
83025	Teton Village, WY	$3,290,089	15.7%
55440	Minneapolis, MN	$2,040,763	16.7%
90071	Los Angeles, CA	$1,881,939	17.6%
33109	Fisher Island, FL	$3,234,469	18.8%
10112	30 Rockefeller Plaza, NY	$3,572,248	19.4%
93150	Santa Barbara, CA	$1,840,652	20.0%

Source. Michael Linden, Center for American Progress based on IRS data for 2008

How Did This Happen?

While the highest income Americans have seen their tax rates plummet, their incomes have exploded**.** The typical CEO in America used to earn about 30 times more than the average worker but today that figure has ballooned to 110 times more.

- In Pennsylvania the top 1% of households captured 57% of all personal income growth between 2000 and 2007.[v]

What Is the Impact of the Buffett Rule?

Pennsylvania has 9,714 millionaires out of 5.99 million taxpayers, according to the Pennsylvania Department of Revenue. Somewhere between 18.8% and 35.5%, or 1,750 to 3,448 millionaires in Pennsylvania could potentially be affected by the Buffett rule, fewer than 1 in every 1000 taxpayers.[vi]

Small businesses are unlikely to be affected by the Buffett rule. According to the Congressional Research Services only 1% of small businesses have adjusted gross income of over $1 million. Most small business job growth is in start-ups and these new firms are unlikely be in the upper income categories, and unlikely to be subject to the Buffett rule.[vii]

Savings rates are unlikely to be affected by an increase in the effective rate on investment income. The top rate on capital gains has fallen from 27% in 1987 to 15% today, and savings rates have also fallen over that time period.

How Much Would the Buffett Rule Raise?

There is some dispute over the revenue generated by imposition of the Buffett rule. The Committee on Joint Taxation estimates revenue of $47 billion over ten years, while the Citizens for Tax Justice estimates revenue at $171 million. Citizens for Tax Justice, citing work by the Congressional Research Services, expects a smaller effect on long-term investment behavior than the Joint Committee, which translates into a higher long-term revenue number[viii].

Closing the Bush tax cuts in total would have a much greater impact on revenue, $533 billion over ten years. The Buffet rule, which is a small, but important step towards ensuring continued funding for public investments or towards debt reduction.

Endnotes

[i] http://www.govtrack.us/congress/bills/112/s2059/text
[ii] Long-term capital gains and stock dividends are taxed at no more than 15% and are exempt from payroll taxes.
[iii] The Buffett Rule: A Basic Principle of Tax Fairness, The National Economic Council, April 201, available online http://goo.gl/snQq1
[iv] Michael Linden, Center for American Progress based on IRS data for 2008. The seven "high income, low tax" zip codes are all among the highest earning zip codes in the country. The tax rates for each zip code are an overall average effective tax rate for both federal income and payroll taxes combined. The income tax data comes directly from the IRS, while the payroll tax calculation was imputed, based on the reported amounts of wage and salary income at the different income levels. The combined effective tax rate was calculated by combining the income tax liability with the imputed payroll tax liability - both employee and employer shares - and dividing it by Adjusted Gross Income plus the employer share of the payroll tax. Most economists agree that the employer-paid portion of the payroll tax is actually paid by the employee, because in the absence of the tax, the employer would increase the wages by the same amount. In other words, the employer portion of the payroll tax is economically equivalent to both added income for the individual and added taxes. The effective tax rates presented in this report, account for this economic principle. The average income in a given zip code is simply total adjusted gross income divided by the number of tax returns.
[v] Keystone Research Center based on Pennsylvania Department of Revenue data
[vi] Keystone Research Center based on estimates from the Tax Policy Center of the impact on the U.S. as a whole http://goo.gl/Ex49N
[vii] Thomas Hungerford, *An Analysis of the Buffett Rule*. Congressional Research Service, October 11, 2011. Accessed at: http://www.fas.org/sgp/crs/misc/R42043.pdf
[viii] http://ctj.org/ctjreports/2012/04/buffett_rule_bill_before_the_senate_is_a_small_step_towards_tax_fairness.php