



Select Committee on Economic Disparity and Fairness in Growth
U.S. House of Representatives

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Memorandum

To: Members, Select Committee on Economic Disparity and Fairness in Growth

From: Select Committee Majority Staff

Subject: June 22, 2022, Select Committee Hearing entitled, **“Tackling the Tax Code: Evaluating Fairness, Efficiency and Potential to Spur Inclusive Economic Growth”**

The Select Committee on Economic Disparity and Fairness in Growth will hold a hybrid hearing entitled "Tackling the Tax Code: Evaluating Fairness, Efficiency and Potential to Spur Inclusive Economic Growth" on Wednesday, June 22, 2022, at 12:00 pm ET in Room 2247 of the Rayburn House Office Building. There will be one panel with the following witnesses:

- **Dr. William Gale**, The Arjay and Frances Fearing Miller Chair and Senior Fellow in Economic Studies, The Brookings Institution; Co-Director of the Urban-Brookings Tax Policy Center
- **Professor Dorothy Brown**, Professor of Law, Georgetown University Law School
- **Mr. Seth Hanlon**, Senior Fellow, Center for American Progress
- **Ms. Amy Matsui**, Director of Income Security and Senior Counsel, National Women’s Law Center
- **Dr. Angela Rachidi**, Senior Fellow and Rowe Scholar, American Enterprise Institute

Overview

This hearing will examine how tax policy affects economic disparity, focusing on how individual and corporate income taxes influence household and business decisions, macroeconomic performance, the distribution of economic well-being across households, and the allocation of resources across different sectors of the economy.

Expert witnesses will explain the history of the federal tax code and how its structural biases developed over time; the distribution of subsidies through the tax system (“tax expenditures”) ranging from refundable tax credits benefitting lower-income families, to deductions, exclusions, and preferential tax rates disproportionately benefitting high-income households; and the need and capacity to raise more revenue in equitable, efficient, and fiscally responsible ways in order to fund public investments essential to support inclusive and sustainable economic growth.

Introduction: The role of tax policy in influencing economic outcomes

Tax policy serves several economic purposes with associated goals for what makes “good” tax policy.¹ The most fundamental reason to have taxes is to raise revenue to pay for government spending on public goods and services and benefit programs. Tax policy also forms part of the tax and transfer system designed to redistribute income—to (on net) tax higher-income households in order to (on net) assist lower-income households. Tax policy is also used to support or promote certain types of economic activities (forms of income, types of consumption) with tax-preferred treatment via exemptions, deductions, credits, or preferential/reduced tax rates. Finally, tax policy can also be used to influence overall macroeconomic activity—to increase demand for goods and services in recessionary (high unemployment) times, and to increase the supply-side productive capacity (potential output) of the economy in periods of low unemployment.²

Whether taxes are levied on households or businesses, tax policy has very direct influences on both economic growth and economic disparity. By taxing income, taxes can discourage productive economic activity such as working and saving by reducing the net-of-tax wage rate or net-of-tax return received, if the incentive effect of the tax rate outweighs the income effect on those behaviors.³ But tax rates that rise with income are necessary to achieve distributional goals (a “progressive” tax system)—so there is often an efficiency-equity tradeoff where lowering taxes at the top of the income distribution could increase overall economic growth yet exacerbate economic inequality (disparity).⁴ The tradeoff between pro-growth and progressive tax policy is not absolute or constant, however, as the influence of tax policy depends on the circumstances of the macroeconomy (is it in recession or at “full” employment), and tax policies can often be both inefficient (high cost for low benefit) *and* inequitable (disproportionately benefitting the rich).⁵

Economists consider tax policy inefficient when household or business economic decisions are distorted to avoid tax liability or to claim tax subsidies rather than based on inherent economic benefit or cost. This causes the economic burden of taxes to exceed revenue collected (sometimes referred to as “deadweight loss” or “excess burden”) or the economic benefit of tax cuts or subsidies to fall short of the revenue loss (cost). As macroeconomic policy, tax cuts are considered inefficient when they have low impact on GDP (either on the demand or supply sides

¹ Reuven S. Avi-Yonah, “The Three Goals of Taxation,” University of Michigan Law School, 2006, <https://repository.law.umich.edu/articles/40>.

² Ben Page, “The Macroeconomic Effects of Taxes,” Urban-Brookings Tax Policy Center, March 8, 2017, <https://www.urban.org/sites/default/files/publication/88811/2001178-the-macroeconomic-effects-of-taxes.pdf>.

³ What economics textbooks call the “substitution effect” is the influence of marginal tax rates on the relative prices or returns on “substitute” economic activities (different goods or services to consume, different investments, different uses of time, etc.). The “income effect” is how tax policy affects economic activities or choices by reducing or increasing the real incomes (purchasing power) of an individual or household. See the introductory section of William G. Gale and Andrew A. Samwick, “Effects of Income Tax Changes on Economic Growth,” Brookings Institution, September 2014, https://www.brookings.edu/wp-content/uploads/2016/06/09_effects_income_tax_changes_economic_growth_gale_samwick.pdf.

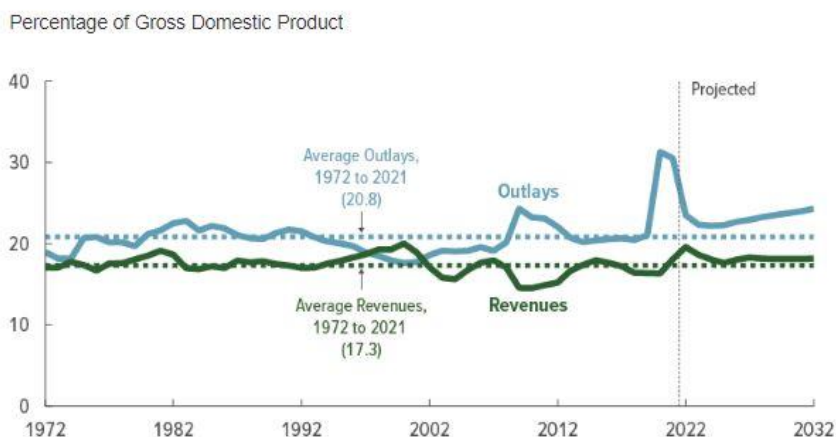
⁴ Torben M Andersen and Jonas Maibomcite, “The trade-off between efficiency and equity,” VoxEU, May 2016, <https://voxeu.org/article/trade-between-efficiency-and-equity>.

⁵ Heather Boushey, “Today’s big U.S. economic trade-off isn’t equality or efficiency,” Washington Center for Equitable Growth, May 2015, <https://equitablegrowth.org/todays-big-u-s-economic-trade-off-isnt-equality-efficiency/>.

of the economy) relative to their revenue cost—low “bang per buck”—or when tax cuts or preferences mainly subsidize activity that would have happened without the tax incentive.

U.S. Tax Policy in (Recent) Historical and International Context

Historical (and budgetary) context. Given that a primary goal of tax policy is to raise revenue to fund government spending, revenue levels would be expected to roughly track (and match) levels of spending (outlays). But because the federal government can run deficits and carry debt, only very rarely have federal revenues exceeded outlays, as shown in the Congressional Budget Office chart below, showing the past 50 years and projections over the next ten years (the budget window) of levels relative to the size of the economy (GDP).⁶ While the gap between spending and revenues tends to close during boom economic times (when real income growth pushes more income into higher tax rate brackets and reduces safety net/income support program spending), the larger and longer-term forces on spending and revenues are: (i) the demographic and health-cost factors that drive increased spending on the major entitlement programs that largely benefit retirees (Social Security and Medicare), and (ii) periodic legislative action to intentionally reduce the level of taxation when revenues/GDP have (automatically) increased as a result of real economic growth.



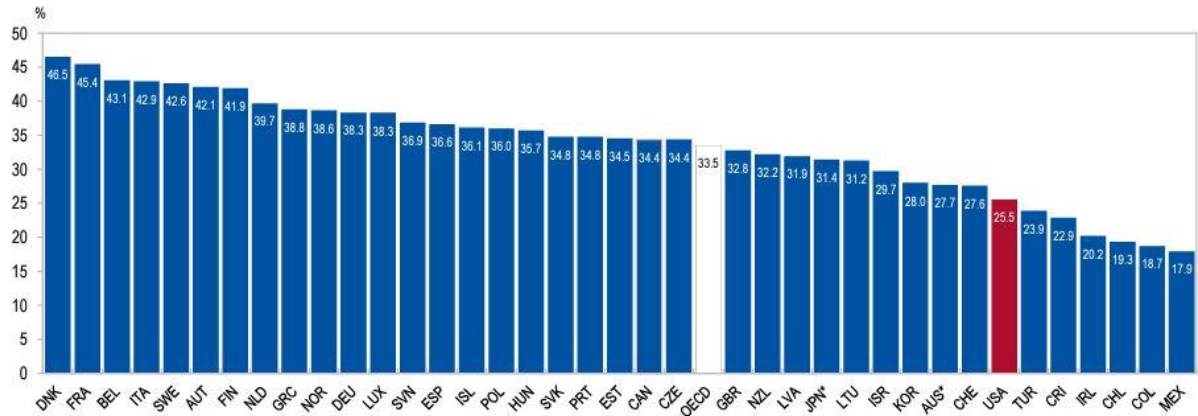
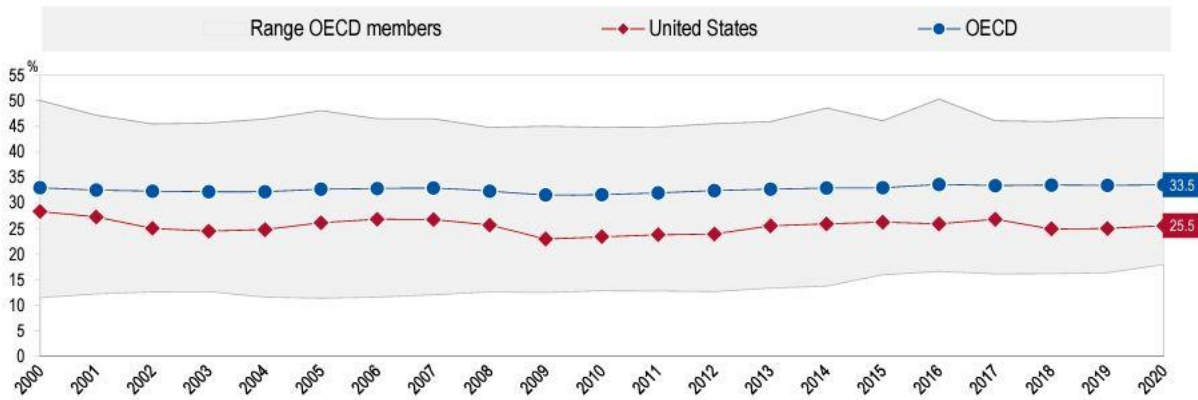
Source: Congressional Budget Office, *The Budget and Economic Outlook: 2022 to 2032*, May 2022, <https://www.cbo.gov/publication/58147>

While the long-standing entitlement programs are the major drivers of the upward trend in federal spending, this is not to say this spending is all the spending we will commit to fund in the future. If the federal government is to dedicate resources to new programs (such as universal pre-K, the caregiving sector, and infrastructure) that would grow the productive capacity of our economy, increases in revenue (additional financial capacity) may be needed.

International context. Accounting for taxes collected at all levels of government (federal, state and local), the U.S. is one of the lowest-taxed countries in the OECD as shown in the charts below⁷:

⁶ Congressional Budget Office, *The Budget and Economic Outlook: 2022 to 2032*, May 2022, <https://www.cbo.gov/publication/58147>

⁷ OECD Centre for Tax Policy and Administration, *OECD Revenue Statistics 2021 – the United States* <https://www.oecd.org/tax/tax-policy/revenue-statistics-united-states.pdf>



* Australia and Japan are unable to provide provisional 2020 data, therefore their latest 2019 data are presented within this country note.

The differences between tax-to-GDP ratios shown may not sum correctly due to rounding

In the OECD classification the term "taxes" is confined to compulsory unrequited payments to general government or to a supranational authority. Taxes are unrequited in the sense that benefits provided by government to taxpayers are not normally in proportion to their payments.

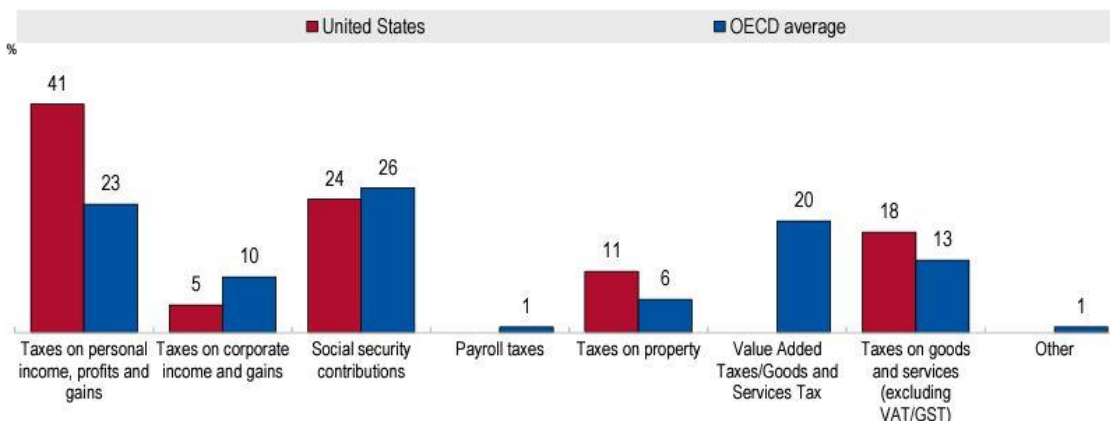
The relatively low level of taxes in the U.S. is (at least partly) related to the smaller role of government (measured in spending as share of GDP) in the U.S. compared with many of the higher-taxed (and richest) OECD countries.⁸

U.S. tax policy is also unique from other OECD countries in relying more on income-based taxes and less on consumption-based taxes, mostly because we have no broad, consumption-based federal-level tax:

⁸ See Economic Policy Institute, *U.S. Tax and Spending Explorer*, charts on the 20 richest countries – government spending and taxes/GDP: <https://www.epi.org/explorer/international>.

Tax structure compared to the OECD average, 2019

The structure of tax receipts in the United States compared with the OECD average is shown in the figure below.



Source (of above OECD charts): *OECD Revenue Statistics 2021 – the United States* <https://www.oecd.org/tax/tax-policy/revenue-statistics-united-states.pdf>

Tax Policy and Man vs. Machine: a playing field that is tilting

In his testimony at our committee’s hearing on automation on November 3, 2021⁹, MIT economics professor Daron Acemoglu explained what he sees as government’s influence on how businesses choose to substitute capital (machines) for labor (humans):

“[G]overnment policy is encouraging automation excessively, especially through the tax code. The US tax system has always treated capital more favorably than labor, encouraging firms to substitute machines for workers, even when workers may be more productive... over the last 40 years, via payroll and federal income taxes, labor pays an effective tax rate of over 25%. Even twenty years ago, capital was taxed more lightly, with equipment and software facing tax rates around 15%. This differential has widened even more with tax cuts on high incomes, the shift of many businesses to S-Corporation status making them exempt from corporate income taxes, and very generous depreciation allowances.”

–[Acemoglu testimony](#), page 8

Acemoglu’s testimony refers to effective *marginal* tax rates on capital vs. labor and is consistent with a World Bank analysis showing effective *average* tax rates on labor have risen while effective tax rates on capital (and corporate profits) have fallen.¹⁰ Globalization and the ability to shift production abroad has exacerbated this trend, especially in high-income countries.

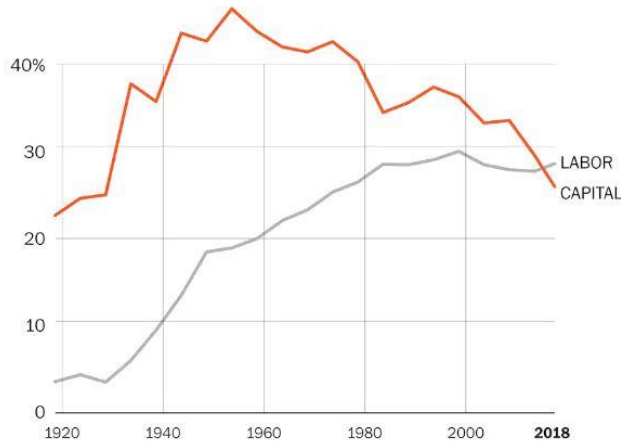
⁹ <https://fairgrowth.house.gov/legislation/hearings/automation>

¹⁰ Pierre Bachas, Matthew Fisher-Post, Anders Jensen, and Gabriel Zucman, “A new dataset to measure the effective taxation of capital and labor globally since the 1960s,” March 24, 2022, World Bank, <https://blogs.worldbank.org/developmenttalk/new-dataset-measure-effective-taxation-capital-and-labor-globally->

An October 2019 Washington Post analysis highlights the research of economists Emmanuel Saez and Gabriel Zucman of the University of California at Berkeley showing that following the passage of the Tax Cuts and Jobs Act in December 2017, “in 2018, labor income was taxed at a higher [average] rate than capital income for the first time in modern U.S. history” (chart below).¹¹

In 2018, capital was taxed less than labor for the first time in modern U.S. history

Average effective tax rates on capital (including taxes on corporate income, property, estates, and capital gains) and labor



Source: Emmanuel Saez and Gabriel Zucman

THE WASHINGTON POST

Tax Policy and Inequality: a tax system that hasn't kept up

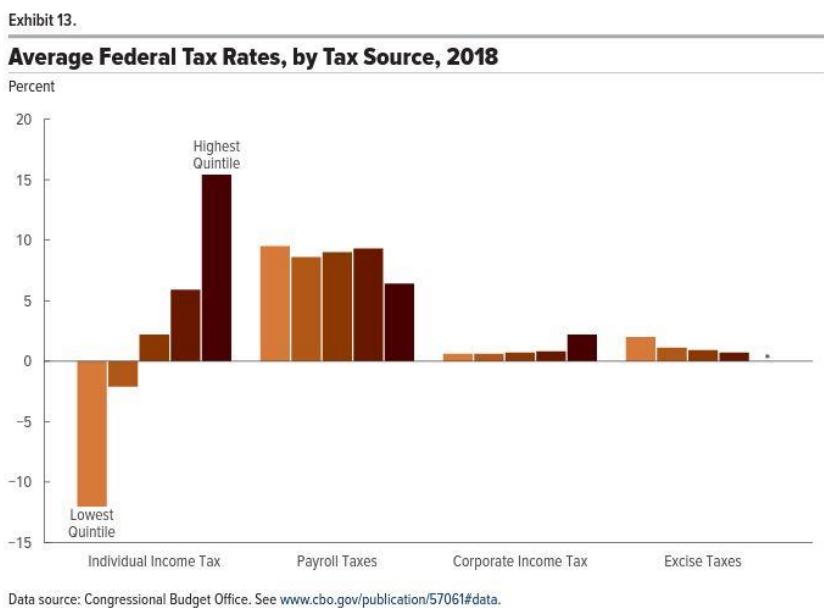
Economists avoid labeling tax policies as “fair, fairer, or fairest”—which would require subjective and personal judgments—but they do try to measure the objective distributional effects of the tax system, or how tax liabilities paid or tax breaks (benefits) received vary across households with different levels of income (at different points in the income distribution). Economists define a “progressive” income tax as one where tax liabilities as a share of income (average tax rates) rise with income, and characterize a policy *change* as “progressive” if it raises average tax rates on high-income households more than on lower-income households. “Regressive” taxes are those where average tax burdens fall as income rises. A tax preference that disproportionately benefits high-income households could be called “regressive” if it would provide bigger tax cuts *as a share of income* (relative to income, not just in absolute value) to

1960s. Marginal tax rates measure the taxes owed on the next dollar of income earned or gained, influenced by a combination of the statutory rate structure and special preferences to various forms of capital income such as accelerated depreciation allowances. Average tax rates are economy-wide aggregate taxes paid on capital or labor income divided by aggregate levels of income.

¹¹ Christopher Ingraham, “For the first time, workers are paying a higher tax rate than investors and owners,” *Washington Post*, October 16, 2019, <https://www.washingtonpost.com/business/2019/10/16/us-now-taxes-wages-higher-rate-than-capital-fueling-income-inequality-study-finds/>.

higher-income households. (A tax system that is exactly “proportional” in incidence has average tax rates that are the same across all income levels.)¹²

As illustrated below (chart from Congressional Budget Office (CBO)¹³), the overall federal tax system accounting for all the major tax bases (individual income, corporate income, payroll, and excise) is a progressive system, in general imposing higher average tax rates on high-income households than on lower-income households, largely because the largest tax in revenue terms is the individual income tax which is intentionally designed to be progressive via both the exemption level and increasing marginal tax rates (tax liability on next dollar earned) as taxable income rises. (The payroll tax system is mostly proportional and even regressive over higher income levels because of a maximum level of labor income above which no additional payroll taxes are collected.)



But because the tax system does not tax all forms of income at the same marginal or average rates, there are distributional consequences reflecting the fact that highest-income households tend to have more sources of income than only labor income, and capital income faces lower marginal tax rates as well as benefits from explicit tax subsidies (“tax expenditures”) like preferential tax rates and exclusions or deductions.¹⁴

While the current federal tax system overall is progressive and *reduces* income inequality, recent changes to tax policy—especially the [Tax Cuts and Jobs Act of 2017](#) (TCJA)—have further

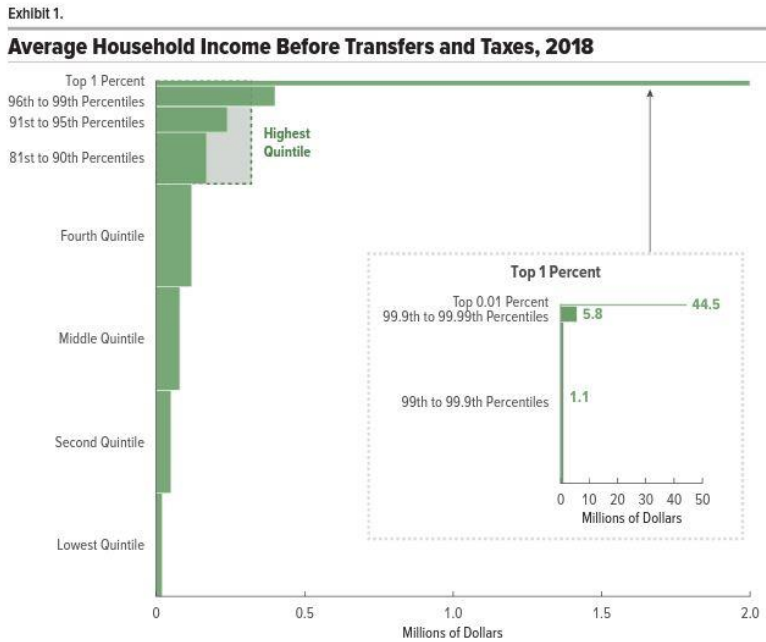
¹² See [Tax Policy Center](#) and [Tax Foundation](#) explainers.

¹³ Congressional Budget Office, *The Distribution of Household Income, 2018*, August 2021, <https://www.cbo.gov/system/files/2021-08/57061-Distribution-Household-Income.pdf>.

¹⁴ See Greg Leiserson and Danny Yagan, CEA/White House blog “What Is the Average Federal Individual Income Tax Rate on the Wealthiest Americans?” (September 2021) on how preferential tax rates on capital gains keep the effective tax rate (tax burdens/income) on the very wealthiest Americans low: <https://www.whitehouse.gov/cea/written-materials/2021/09/23/what-is-the-average-federal-individual-income-tax-rate-on-the-wealthiest-americans/>.

reduced effective tax rates on capital and provided bigger tax cuts for the rich (as a share of income and not just in absolute dollars). This implies recent tax *reforms* have exacerbated (not reduced) income inequality at the top—particularly the very top—of the income distribution.¹⁵

The CBO regularly analyzes the trends in household income inequality and the role of the tax (and transfer) system in reducing inequality.¹⁶ Their report highlights the extreme skewness of inequality at the very top of the income distribution, before the influence of government spending (transfers) and taxes:



Data source: Congressional Budget Office. See www.cbo.gov/publication/57061#data.
 All dollar amounts are in 2018 dollars.
 Income groups are created by ranking households by income before transfers and taxes, adjusted for household size. Each quintile (fifth) contains approximately the same number of people. The lowest quintile does not include households with negative income.
 For information about the methods underlying this analysis, see Appendix A. For detailed definitions of income measures, see Appendix C.

The CBO report also shows (chart below) that the primary source of income for the vast majority of households—across all income categories but the top 1 percent—comes from work (wage and salary income). Only within the *top one-tenth of the top 1 percent* do households make most of their income from capital income, implying that it is the extreme skewness in the distribution of wealth (asset ownership) and income generated from wealth—before any influence of government spending or taxes—that drives extreme inequality at the very top of the U.S. income distribution:

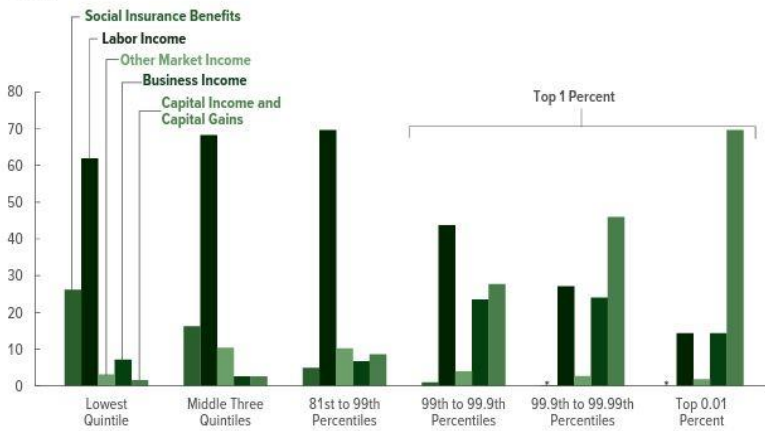
¹⁵ Congressional Budget Office, *The Distribution of Household Income, 2018* <https://www.cbo.gov/system/files/2021-08/57061-Distribution-Household-Income.pdf>. (See pages 24-29 on the Tax Cuts and Jobs Act.)

¹⁶ *Ibid.*

Exhibit 2.

Composition of Income Before Transfers and Taxes, 2018

Percent



Data source: Congressional Budget Office. See www.cbo.gov/publication/57061#data.

Other market income includes income received in retirement for past services and other nongovernmental sources of income.

For information about the methods underlying this analysis, see Appendix A. For detailed definitions of income measures, see Appendix C.

* = between zero and 0.5 percent.

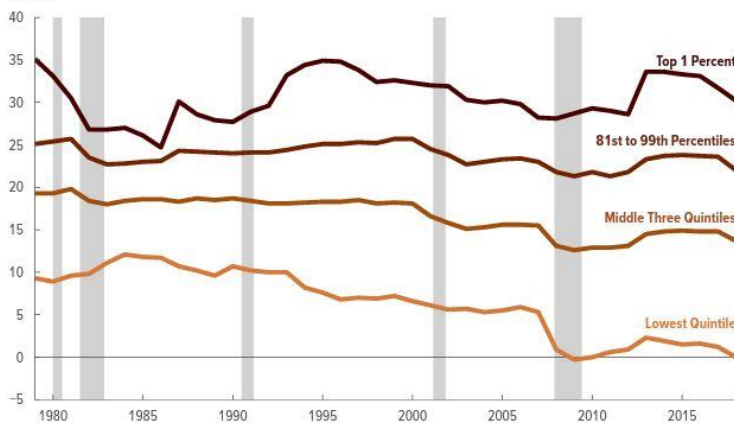
This concentration of capital income at the very top of the income distribution explains why differences in tax treatment of capital income compared with labor income dramatically influence the distribution of tax burdens and benefits by income.

The progressivity of overall federal taxes (mostly through the income tax) has generally increased since the mid-1980s, at least looking across quintiles (one-fifths) of the household population ranked by income. This is shown in the CBO chart below as the gap between the quintiles having widened significantly since the mid-1980s:

Exhibit 11.

Average Federal Tax Rates, by Income Group, 1979 to 2018

Percent



Data source: Congressional Budget Office. See www.cbo.gov/publication/57061#data.

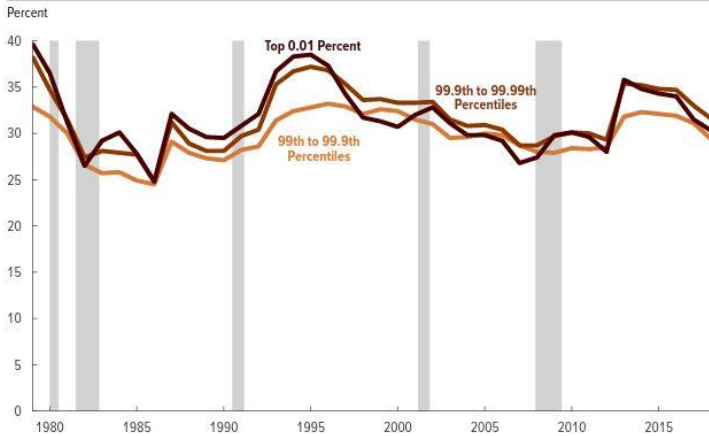
Shaded vertical bars indicate the duration of recessions. (A recession extends from the peak of a business cycle to its trough.)

For information about the methods underlying this analysis, see Appendix A. For detailed definitions of income measures, see Appendix C.

But looking *within the top 1 percent*, progressivity has decreased over the past two decades. CBO explains, “in most years since the mid-1990s, households in the top 0.01 percent paid a lower average federal tax rate than did households in the 99.9th to 99.99th percentiles because a larger portion of the former group’s income consisted of capital income, which is generally taxed at lower rates under the individual income tax. That group’s average federal tax rate tended to fall in periods with large capital gains, such as the late 1990s, mid-2000s, and 2017.”

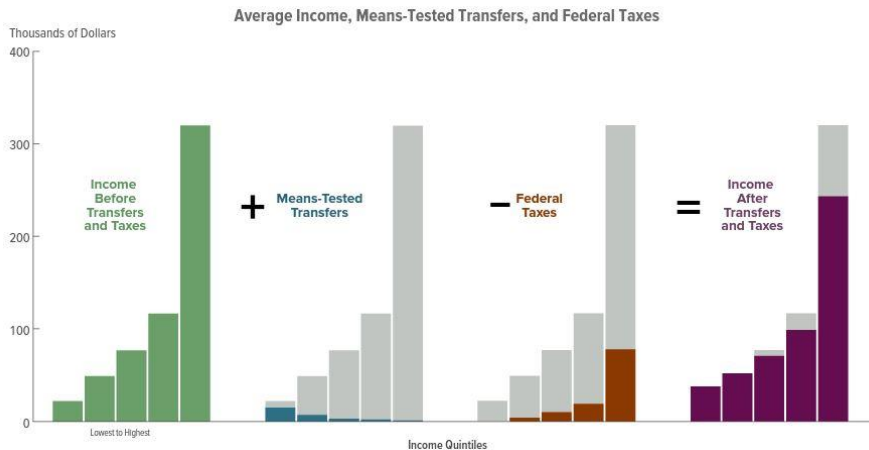
Exhibit 12.

Average Federal Tax Rates Among Households in the Top 1 Percent, 1979 to 2018



Data source: Congressional Budget Office. See www.cbo.gov/publication/57061#data.
 Shaded vertical bars indicate the duration of recessions. (A recession extends from the peak of a business cycle to its trough.)
 For information about the methods underlying this analysis, see Appendix A. For detailed definitions of income measures, see Appendix C.

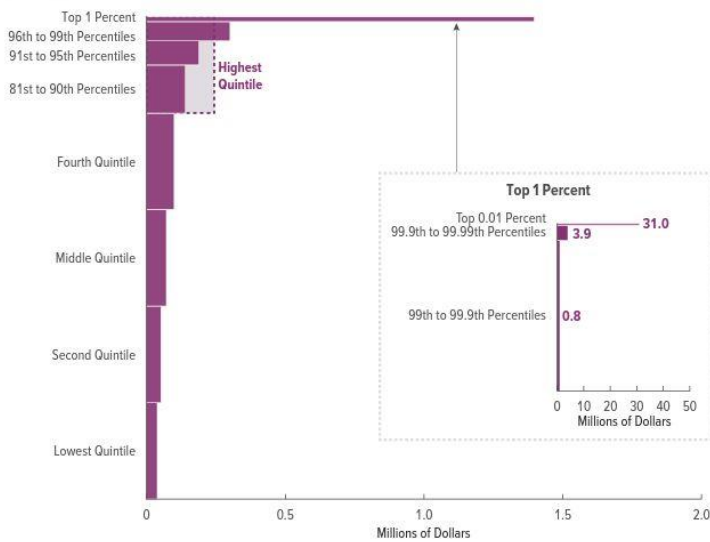
The CBO analysis shows the tax *and transfer* system is “progressive” overall (disproportionately taxing the rich and disproportionately benefitting the poor) and hence reduces inequality, but not by much:



If one compares the after-government inequality chart (below) with the before-government chart; the difference in skewness is hard to notice:

Exhibit 21.

Average Household Income After Transfers and Taxes, 2018



Data source: Congressional Budget Office. See www.cbo.gov/publication/57061#data.
 All dollar amounts are in 2018 dollars.
 Income groups are created by ranking households by income before transfers and taxes, adjusted for household size. Each quintile (fifth) contains approximately the same number of people. The lowest quintile does not include households with negative income.
 For information about the methods underlying this analysis, see Appendix A. For detailed definitions of income measures, see Appendix C.

For example, the “before” vs. “after” charts show the average *after-tax-and-transfer* income of households in top 0.01 percent (one-hundredth of the top 1 percent) is \$31 million, compared with an average *before-tax-and-transfer* income level of \$44.5 million—implying an average tax rate of 30.3 percent, which is lower than the average tax rate faced by households in the *rest* of the top tenth of the top 1 percent ($(\$5.8 \text{ mil} - \$3.9 \text{ mil})/\$5.8 \text{ mil} = 32.8 \text{ percent}$).

Tax policy was originally designed to serve traditional household structures (married, single-earner families) and employment relationships (full-time with benefits rather than part-time or contract work). Because households rather than individuals are the tax-filing unit, the tax system treats households with the same total income differently depending on marital status (single vs. married) or the division of labor income between a married couple. Since the joint tax return was established in 1948, the income tax system has imposed marriage penalties on two-earner couples with more similar earnings, and marriage bonuses for single or primary breadwinner couples.¹⁷ Penalties on similar-earning couples were reduced by TCJA, and bonuses to unequal-earning couples were expanded.¹⁸ The tax system favors those in full-time, conventional employment as well. Because the largest tax preferences/subsidies (or “tax expenditures”) in the federal tax system are the exclusions of employer-provided health insurance and employer-provided retirement savings plans, only individuals that receive such benefits through their

¹⁷ Taxing households at the same income level differently is sometimes referred to as “horizontal inequity” to distinguish from evaluations of “vertical equity” (or inequity) which compare tax burdens by income level. The disparate income tax treatment of households at similar levels of income results in disparities in tax burdens or benefits by race and gender. See Dorothy A. Brown testimony and her book, *The Whiteness of Wealth*, (Crown, 2022), and explainer on marriage penalties and bonuses in Tax Policy Center’s briefing book: <https://www.taxpolicycenter.org/briefing-book/what-are-marriage-penalties-and-bonuses>.

¹⁸ Ibid.

(standard) employment—and only those who have high enough earnings to be paying individual income taxes—benefit from these subsidies.

Tax Policy and the Macroeconomy: how do tax cuts create jobs?

Collecting revenue through an income tax where both marginal (statutory) and average (effective) tax rates tend to rise with income can in theory present a tradeoff between the distributional and macroeconomic goals of taxation. Taxing higher-income households at higher rates might discourage people from earning higher income, if the tax share taken out of their marginal dollars earned is too high. Taxing corporations via the corporate income tax does not absolve us from this tradeoff, as the economic burden of taxes remitted by a corporation ultimately falls on real people, in their roles as workers, consumers, executives or investors. The theoretical concern about higher tax rates on the rich or on corporations is that they might discourage work, saving, investment, or innovation—in a way that reduces overall macroeconomic growth (GDP) and economic activity for everyone. On the flip side, the so-called “supply side” theory of tax policy, popularized by Arthur Laffer in the early 1980s, suggests that lower tax rates (even if focused on the rich and corporations) can boost the economy’s supply-side productive capacity by so much that tax cuts can ultimately benefit *everyone* in the economy and even raise, rather than reduce, the government’s revenue yield.¹⁹ But there has never been empirical evidence to support the notion of the U.S. being on the “wrong side” of the Laffer Curve (with tax rates so high that the economy and revenue would shrink), and there is little empirical evidence that marginal tax rate reductions on high-income households or large corporations increase broadly-experienced, supply-side economic growth.²⁰

Recent research focused on the performance of broad-based tax cuts in terms of creating jobs and boosting wages shows mixed results, suggesting that tax policies more specifically targeted toward businesses that *demonstrably* create new jobs or retain workers or increase wages would be more effective.²¹ Another recent analysis of the effect of the influence of (broad-based) corporate tax cuts on employee wages finds that the workers most likely to see tax cuts passed along to them in higher wages are the most highly compensated employees, not the rank and file.²²

The influence of tax cuts on overall macroeconomic growth depends on the starting condition of the economy. During times of low unemployment, the goal is to use fiscal policy (whether it is tax or spending policy) to grow the supply side or productive capacity of the economy—reducing tax rates or increasing tax subsidies that encourage greater labor-force participation, saving, and

¹⁹ The theoretical possibility that a decrease in tax rates could raise revenue or an increase in tax rates could reduce revenue is behind the so-called “Laffer Curve.” https://en.wikipedia.org/wiki/Laffer_curve

²⁰ See William G. Gale and Claire Haldeman, “Searching for supply-side effects of the Tax Cuts and Jobs Act,” Brookings Institution, July 2021, <https://www.brookings.edu/research/searching-for-supply-side-effects-of-the-tax-cuts-and-jobs-act/>; William G. Gale and Andrew A. Samwick, “Effects of Income Tax Changes on Economic Growth,” Brookings Institution, February 2016, <https://www.brookings.edu/research/effects-of-income-tax-changes-on-economic-growth/>; and Gale’s testimony for this hearing.

²¹ Juan Carlos Suarez Serrato, “Targeting business tax incentives to realize U.S. wage growth,” Washington Center for Equitable Growth, January 2021, <https://equitablegrowth.org/targeting-business-tax-incentives-to-realize-u-s-wage-growth/>.

²² William G. Gale and Samuel I. Thorpe, “Rethinking the incidence of the corporate income tax,” Brookings Institution, May 2022, <https://www.brookings.edu/research/rethinking-the-incidence-of-the-corporate-income-tax/>.

investments in capital. During recessionary times of high unemployment (with much idle productive capacity), however, the most reliable way for fiscal policy to increase GDP is through policies that will increase the *demand* for goods and services (and thereby create jobs). Because lower-income households consume larger shares of their income than do higher-income households, fiscal policies that are most effective at stimulating consumption (have the highest “multipliers”) are those that immediately and directly put cash in the hands of lower-income households. This tends to handicap the effectiveness of tax policy relative to government spending programs, as only rebate checks or refundable tax credits are able to reach lower-income households.²³

Tax Policy As Government Spending: subsidies that disproportionately benefit the rich

An October 2021 Congressional Budget Office report defines “tax expenditures” as the “exclusions, deductions, credits, and net preferential rates in the federal tax system that cause government revenues to be lower than they would otherwise be for any given structure of tax rates.”²⁴ CBO’s analysis of 2019 tax data shows both the large aggregate cost of tax expenditures (\$1.2 trillion in reduced income and payroll tax revenue for 2019) and a pronounced skewness of benefits (in both absolute and relative-to-income terms) to the richest of households, as the figure below summarizes.

At 7.8 percent of GDP, the total cost of tax expenditures well exceeds all discretionary spending—defense plus non-defense spending—combined (6.3 percent of GDP).²⁵ The most expensive tax expenditures—exclusions for employment-based health insurance and for pensions and retirement savings accounts—account for nearly half of the total value of tax expenditures or about 2.6 percent of GDP and by definition cannot benefit people who do not owe federal income taxes. Moreover, the refundable tax credits that do benefit qualified families even at lower incomes—the term “refundable” referring to the benefit being paid even if the household does not have positive tax liability to subtract the credit from—are only a small share of the overall cost of tax expenditures.

²³ Ben Page, “The Macroeconomic Effects of Taxes,” Urban-Brookings Tax Policy Center, March 8, 2017, <https://www.urban.org/sites/default/files/publication/88811/2001178-the-macroeconomic-effects-of-taxes.pdf>; Committee for a Responsible Federal Budget, “Comparing Fiscal Multipliers,” October 2020, <https://www.crfb.org/sites/default/files/managed/media-documents/2022-02/CRFB%20Comparing%20Fiscal%20Multipliers.pdf>.

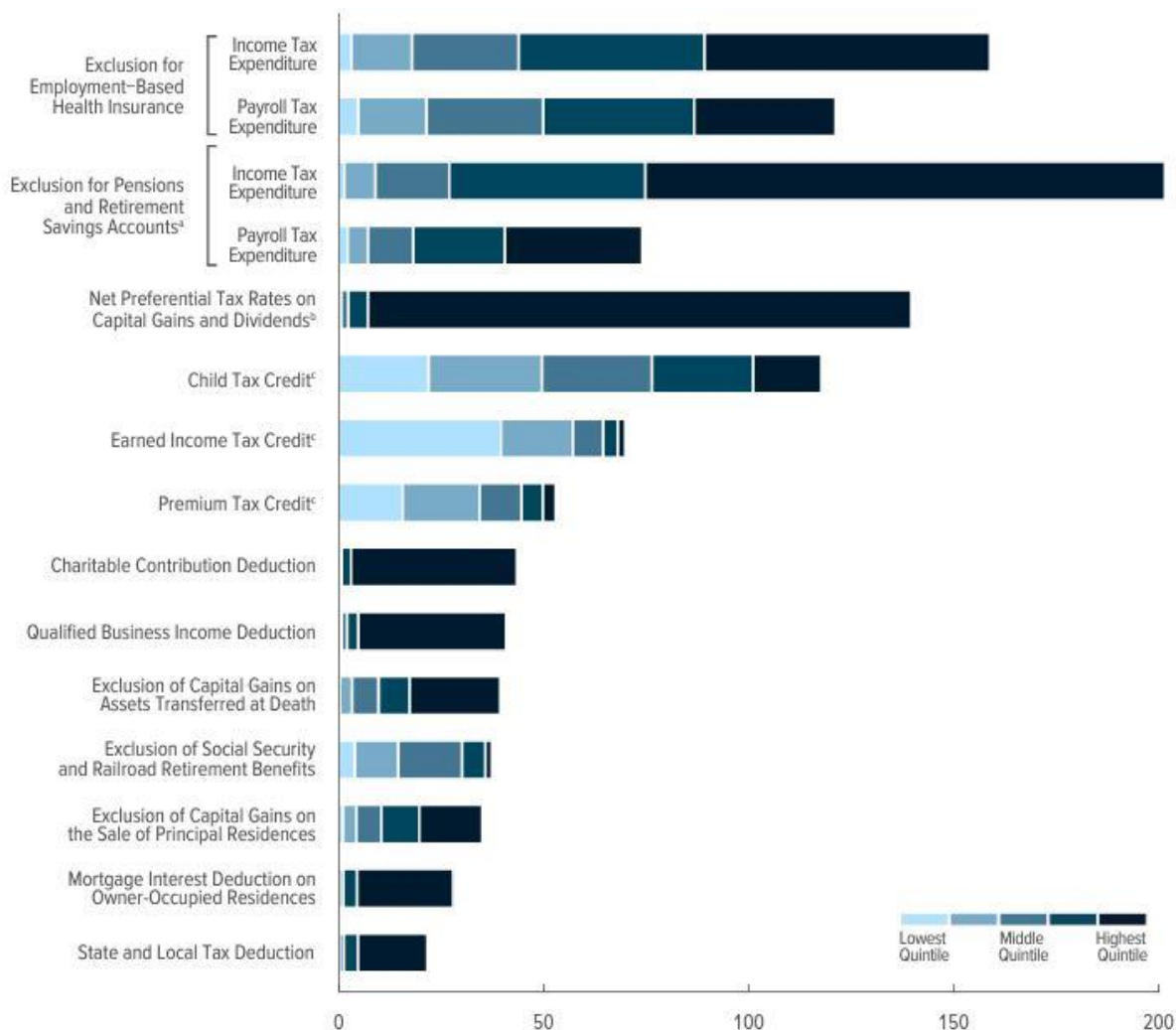
²⁴ Congressional Budget Office, *The Distribution of Major Tax Expenditures in 2019*, October 2021, <https://www.cbo.gov/system/files/2021-10/57413-TaxExpenditures.pdf>. Exclusions are forms of income that are simply not counted/included in any definition of income on the tax form. Deductions are components of income or expenditures that are subtracted from gross income in the calculation of taxable income. After an initial tax liability is determined by applying the tax rate schedule to taxable income, credits are subtracted from tax liability. Preferential tax rates are the tax rates applied to particular components of income which are lower than normally applied to “ordinary income” via the tax rate schedule.

²⁵ *Ibid.*, see Figure 1 on page 11.

Figure 2.

Shares of Major Tax Expenditures, 2019

Billions of 2019 Dollars



Data source: Congressional Budget Office, using estimates from the staff of the Joint Committee on Taxation. See www.cbo.gov/publication/57413#data.

A couple comparisons derived from the CBO analysis underscore the skewness of benefits toward highest-income households:

- The *entire* cost of child tax credit (\$118 billion in 2019) is just slightly higher than the value of the capital gains preferential rate to the *top 1% alone* (who receive 75 percent of the aggregate benefit, or \$105 billion in 2019).
- The top 1% of households receive a larger aggregate benefit from tax expenditures (\$188 billion in 2019) as the *middle 20%* of households do (\$173 billion in 2019).²⁶

²⁶ Select Committee Majority staff calculations based on CBO report and underlying data tables.

These tax expenditures are government subsidies that do not show up on the spending side of the budget and yet are economically equivalent to direct spending programs and increase the size and scope of government.²⁷ They also complicate the tax code and increase the inefficiency (distortionary effects) of the tax system, as people make decisions or rearrange their activities on basis of tax treatment rather than on inherent economic merits.²⁸

Recent and Pending Tax Reforms: leveling the tax policy playing field

The Tax Cuts and Jobs Act of 2017. In December 2017, Congress passed the Tax Cuts and Jobs Act (TCJA) into law which made several temporary and permanent tax policy changes. For individual income taxes, almost all marginal statutory tax rates were reduced, shifting the top marginal tax rate from 39.6% to 37%, and the remaining rates changed to 10, 12, 22, 24, 32, and 35%. TCJA also increased the pre-2017 Child Tax Credit from \$1000 per qualifying child to \$2000 and increased the refundable Additional CTC to “15% of household earnings above \$2,500, and up to \$1,400 per child in 2018”; created a new tax provision, the Family Credit, to deliver benefits for non-child-credit eligible dependents equal to about \$500 per non-child credit-eligible dependent with phaseout parameters identical to the CTC; and doubled the standard deduction for married couples, single filers, and heads of households to \$24,000, \$12,000, and \$18,000, respectively.²⁹ Each of these provisions listed expire after 2025.

TCJA also permanently modified the corporate tax structure. The biggest change was to the graduated rate structure of the corporate income tax. Before TCJA, the top corporate rate was 35% on taxable income above \$10 million, 34% on taxable income above \$75,000 and not over \$10 million, 25% on taxable income above \$50,000 and not over \$75,000, and 15% on taxable income not over \$50,000.³⁰ The TCJA changed this structure to a flat tax rate of 21% on corporate taxable income, lower than the OECD average. The Corporate Alternative Minimum Tax was repealed as part of the TCJA.³¹

The Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO) estimated that the TCJA would reduce federal revenues by about \$1.456 trillion between FY2018 – FY2027.³² This figure consists of a loss of \$1.126 trillion attributed to the individual income tax reforms, a loss of \$653.8 billion attributed to corporate tax reform, and a gain in international tax revenues of \$324.4 billion. Proponents of the TCJA argued these changes had the potential to

²⁷ Donald B. Marron and Eric J. Toder, “Tax Policy and the Size of Government,” Urban Institute and Urban-Brookings Tax Policy Center, June 2013, Available at SSRN: <https://ssrn.com/abstract=2671540> or <http://dx.doi.org/10.2139/ssrn.2671540>

²⁸ Leonard E. Burman and Marvin Phaup, “Tax Expenditures, the Size and Efficiency of Government, and Implications for Budget Reform,” *Tax Policy and the Economy* 26(1), 2012, National Bureau of Economic Research <https://www.journals.uchicago.edu/doi/full/10.1086/665504>

²⁹ William G. Gale, Hilary Gelfond, Aaron Krupkin, Mark J. Mazur, and Eric Toder, “Effects of the Tax Cuts and Jobs Act: A Preliminary Analysis,” Tax Policy Center, June 2018, https://www.brookings.edu/wp-content/uploads/2018/06/es_20180608_tcja_summary_paper_final.pdf; and Congressional Research Service report, “The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law,” February 6, 2018 ([R45092](https://www.congress.gov/legislation/115/97/2018-02-06/RS45092)) by Molly F. Sherlock and Donald J. Marples.

³⁰ Gale et al. (2018), op. cit.

³¹ CRS (2018), op. cit.

³² Ibid.

increase GDP in the short run by increasing aggregate demand. The JCT estimated a 0.7 percent increase in economic output (GDP) “relative to the baseline over the 10-year budget window.”

Shortly after the passage of TCJA, JCT (which uses after-tax income as a proxy for taxpayers well-being) found “the groups predicted to have the largest increases [in after-tax income] being those who earn between \$500,000 and \$1 million.”³³ Further, low- to moderate-income taxpayers (\$40,000 or less) would see after-tax incomes *fall* in years 2023 and after.³⁴ One reason for this disparity is that the deduction for pass-through business income tends to benefit higher-income households. Together with the corporate tax rate cuts, these TCJA tax policy changes disproportionately benefit highest-income households.³⁵ The Tax Policy Center analysis shows the individual income tax provisions will “raise after tax income by 0.3% for households in the lowest income quintiles, 2.2% for those in the top quintile, 3.4% for those in the 95th-99th percentile, and 2.2% for taxpayers in the top 1 percent.”³⁶

The American Rescue Plan and pandemic-era tax policy. The COVID-19 Pandemic-induced recession incurred severe costs on Americans’ economic well-being. The federal government responded with major stimulus programs to mitigate the economic downturn, which included the most significant tax policy changes since TCJA. The American Rescue Plan Act (ARPA) of 2021 made expansions to key tax provisions primarily benefiting low-income families. The White House outlined that for individuals without children, ARPA “increased the Earned-Income Tax Credit (EITC) from \$543 to \$1502”; for those with children, “ARPA increased the Child Tax Credit (CTC) from \$2,000 per child (previously set by the TCJA) to \$3,000 per child for children over the age of six, and \$3,600 for children under the age of six – and raised the age limit from 16 to 17”; and finally ARPA “increased and expanded the Child and Dependent Care Tax Credit (CDCTC), increasing eligibility and the total credit to \$4,000 for one qualifying individual and \$8,000 for two or more,” while making the CDCTC fully refundable.³⁷

As a result of ARPA, the expanded and refundable CTC reached nearly 40 million families and 65 million children, driving child poverty to record lows in 2021 with 67 percent of households benefiting from the expansion making less than \$99,000 a year.³⁸ The EITC expansion helped millions of front line workers – many of which are people of color – and benefited over 25 million working families and individuals who received around \$2,400.³⁹ Lastly, the CDCTC has

³³ Ibid.

³⁴ Ibid.

³⁵ Ibid.

³⁶ Gale et al. (2018), op. cit.

³⁷ White House description of American Rescue Plan, <https://www.whitehouse.gov/american-rescue-plan/>.

³⁸ Christian E. Weller, “Expanded Child Tax Credits Have Been a Lifeline for Many,” Center for American Progress, February 2022, <https://www.americanprogress.org/article/expanded-child-tax-credits-have-been-a-lifeline-for-many/>; and White House fact sheet, “State-by-State Analysis of American Rescue Plan Tax Credits for Families and Workers,” March 2022, <https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/08/fact-sheet-state-by-state-analysis-of-american-rescue-plan-tax-credits-for-families-and-workers/>.

³⁹ White House fact sheet, op. cit.; and Teon Dolby, Ashley Burnside, and Whitney Bunts, “EITC for Childless Workers: What’s at Stake for Young Workers,” The Center for Law and Social Policy (CLASP), June 2022, <https://www.clasp.org/publications/report/brief/eitc-childless-workers-2022/>.

benefitted millions of families across the country, with more than 7 million families benefitting nationally (3 times larger than years before).⁴⁰

The expansions of these three tax credits expired at the end of 2021, and both the Biden Administration and Members of Congress have introduced proposals and legislation to further extend, expand, and make permanent these credits that have benefitted millions of low- and moderate-income Americans. It is likely when Congress next takes up major tax reform, these credits will be discussed as will TCJA's expiring individual income tax provisions.

The Biden Budget, Build Back Better, and future tax policy considerations. The Biden Administration's Build Back Better (BBB) plan, which passed the House in November 2021 ([H.R. 5376](#)) but did not come up for Senate vote, was intended to extend ARPA's expansions to the CTC, EITC, CDCTC, and other family tax provisions. Currently, many of the Build Back Better's tax provisions are included as revenue proposals in the American Families Plan section of the President's FY2022 budget proposal to Congress.⁴¹ The President's FY2022 budget advocates for continued support of families by extending and making permanent the CTC, EITC, CDCTC. Additionally, the President's Budget includes many proposals for increasing federal revenue, including raising the corporate income tax rate to 28 percent, increasing the top marginal income tax rate for high earners, and reforming the taxation of capital income. The Biden Administration's FY2023 Budget, however, does not include expansions and extensions of the CTC, EITC, or CDCTC.⁴²

Expanding the accessibility of the tax system. The IRS estimates that Americans spend 13 hours and \$240 dollars on average preparing and filing their tax returns.⁴³ One practical way of leveling the playing field within the tax system involves expanding access to free electronic filing of taxes for individuals. Through the IRS' existing Free File program, a public-private partnership, about 70 percent of taxpayers should be able to file their taxes online for free, but only 3 to 4 percent of eligible taxpayers have benefitted from this program so far on an annual basis.⁴⁴ The IRS's Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) provide free tax return preparation services for the elderly and other underserved communities. While highly acclaimed for its filing accuracy, the VITA program serves only around three million tax filers annually of the 19 million eligible individuals and families.⁴⁵ The proposed "Tax Filing Simplification Act" aims for the IRS to develop its own free online tax preparation and filing service to allow all taxpayers to prepare and file their taxes directly with the federal government.⁴⁶

⁴⁰ White House fact sheet, op. cit.

⁴¹ U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, <https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf>.

⁴² Treasury "General Explanations" of FY2023 proposals, <https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf>.

⁴³ Internal Revenue Service. "[1040 \(and 1040-SR\) Instructions](#)." 2021. Accessed on June 13, 2022.

⁴⁴ Treasury Secretary Yellen at [Senate Finance hearing](#), June 2022.

⁴⁵ "[Free Tax Return Preparation for Qualifying Taxpayers | Internal Revenue Service](#)." *Internal Revenue Service*. Accessed 17 June 2022; "[At 45, the VITA Program Offers So Much More Than Just Tax Assistance](#)." *Prosperity Now*, 19 Aug. 2015.

⁴⁶ First introduced in 2016 by Senator Elizabeth Warren; 2019 version: <https://www.congress.gov/bill/116th-congress/senate-bill/1194>.