# The Tax System
## A Matter of Faith, Fairness, and Flourishing Communities

Many serious problems plague the country today: the large number of poor and near-poor families who fail to receive the financial support they need and the opportunities they deserve; the severe shortage of good jobs; the unaffordable cost of higher education; the millions of people who lack health insurance; the roads and bridges that are crumbling; and the high level of income inequality.

While multiple factors contribute to these problems, our flawed tax system plays an important role.

Religious and community organizations struggle to meet the needs of the many people who lack food, shelter, health care, jobs, and other essentials. But these faithful efforts inevitably fall short. The needs are just too great. In a nation of 310 million people and a world of over six billion, only government – of, for, and by the people – has the potential to raise sufficient resources and put in place the structures and institutions that can fill our unmet needs and provide for the common good. Taxes pay for a social safety net that supports us when we cannot support ourselves. Taxes fund avenues of opportunity by paying for education, health care, training programs, childcare, and early childhood education. Taxes strategically assessed can encourage desirable behaviors and discourage undesirable ones. Taxes pay for goods and services that promote the common good. A good tax system is essential for an equitable and well-functioning society.

For the government to do its work successfully it needs adequate resources. But during the last few years, federal revenues, measured as a share of national income, were lower than at any time since 1950.[1] More revenue is needed; taxes must be raised. The tax system must also be fair. For many people of faith this means a "progressive" tax system that places tax obligations on taxpayers in accordance with their ability to pay. Individuals with higher incomes are taxed at higher rates than those with lower incomes. A good tax system raises sufficient revenue for society's needs, is progressive, and eliminates loopholes and other possibilities for tax avoidance.

## Theological and biblical foundations

The Great Commandment calls Christians to love God and love our neighbors as we love ourselves (Matthew 22:36-39). We are called to care for the hungry, the thirsty, and the sick, and for orphans, widows and others who cannot care for themselves (Matthew 25: 31-46; James 1:27). In a modern society caring and sharing occur in many ways including, very importantly, through a system of progressive taxation that pays for a social safety net, the universal provision of public services, and opportunities for all.

We are called to generosity and we need not fear scarcity. God provides abundantly for all people (Exodus 16: 14-21, Mark 6: 30-44). We do not need to worry whether there will be enough. If our communities first seek God's reign, if we first seek to live out God's vision for God's people and God's earth, then all we need will be given to us (Matthew 6: 25-34). There is enough for all if we share.

In Paul's second letter to the Corinthians, he asks them to donate money to help poor Christians in Jerusalem. He writes, "I do not mean that there should be relief for others and pressure on you, but it is a question of a fair balance between your present abundance and their need, so that their abundance may be for your need, in order that there may be a fair balance. As it is written, 'the one who had much did not have too much, and the one who had little did not have too little'" (2 Corinthians 8:13-15).

A fair balance is needed. One person's abundance is for another person's need. There is plenty for all if we share. We are called to work for a world where there is a "fair balance" between abundance for a few and the needs of many.

## Fairness Demands Tax Reform in the United States

An equitable tax system is:

- progressive, requiring higher-income households and corporations to pay a greater share of income in taxes than lower-income ones;
- fair and without loopholes, havens and other arrangements that can be used to shield income from taxation;
- neutral, that is, does not create incentives for particular behaviors except when those behaviors are explicitly intended as a goal of public policy;
- adequate to raise sufficient funds to meet social needs and promote the welfare of all; and
- redistributive, shifting income from rich to poor to reduce income inequality and enhance the common good.

The following reforms could strengthen the U.S. tax system.

**Capital Gains Taxes**. Under current law, taxes are assessed on the gains from the sale of stocks, bonds, businesses, mutual funds, property, and other investments. The tax rate on capital gains is lower than the rate on wages and salaries. Households with income above $400,000 (single people) or $450,000 (couples) pay a tax of 20% instead of 39.6%, the rate they pay on earnings. Those with incomes below this level but above $36,250 (single) or $72,500 (married) pay 15%, not 25%, 33%, or 38%.

The benefits of a low tax rate on capital gains accrue disproportionately to the wealthy. In 2013, an estimated 94% of the benefits from the low rate on capital gains will go to taxpayers with cash incomes over $200,000, and three-fourths of the benefits will accrue to millionaires.[2] Because many wealthy people receive much of their income from investments, the low tax on capital gains is the primary reason that millionaires pay lower taxes, as a share of income, than their secretaries.[3]

**Carried Interest.** In a private investment fund like a hedge fund, a lead manager (general partner) typically receives a sizable share of the fund's profits each year. This "carried interest" can be one-third of the general partner's annual pay[4] of $1 billion or more.[5] Carried interest is taxed at the low capital gains rate of 20%, not the rate of 39.6% applied to high levels of earnings. It would be fairer and more efficient for carried interest to be taxed like other wage and salary income.

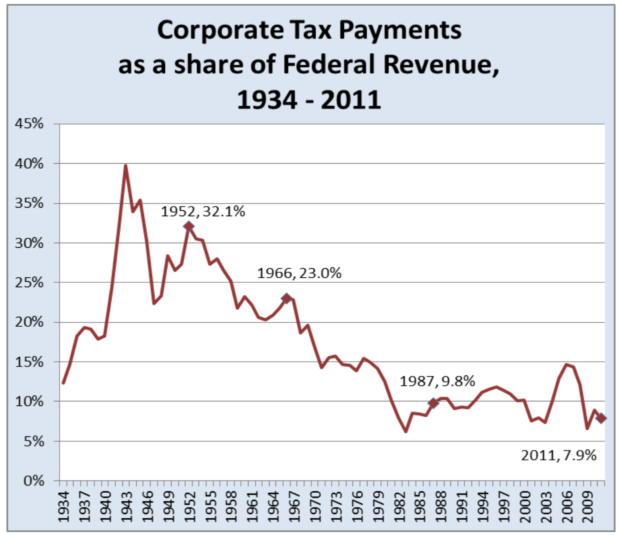
**Estate Tax.** The estate tax is the most progressive federal tax. After changes made in January, 2013, a tax of 40% is now assessed on estates of $5.25 million or more and this amount will rise each year with inflation. In 2011, just 3,270 estates exceeded $5 million and owed estate tax. Over half of all estate taxes were paid by people who were, before death, in the top 1/10th of 1% of the income distribution.[6] The estate tax helps narrow income inequality by reducing the size of massive inheritances and limits the corrosive power and influence that accompanies wealth. The tax also encourages donations to nonprofit organizations because contributions to charity made from estates are tax-free.

**Corporate Taxes**. The total amount of taxes paid by corporations has been declining for decades. In 1952, nearly one-third (32.1%) of federal revenue came from corporate tax payments. This amount fell to 23.0% in 1966, 9.8% in 1987, and 7.9% in 2011. (See the chart below.) But while firms' contributions to federal revenue have declined, their needs for the things that tax money buys are unchanged. Corporations need healthy, educated, talented, and innovative employees; they need reliable infrastructure that allows them to communicate and move products to market; and they need the courts and a regulatory system to make the market function.

Corporate tax *rates* in the U.S. are higher than in many other industrialized countries. But because of tax loopholes and many other legal and illegal measures, U.S. firms *pay less* in taxes than do firms in other nations.[7] A three-year study of 280 Fortune 500 corporations found that they paid just 18.5% of their profits in taxes, on average, roughly half the official corporate tax rate of 35%. Thirty corporations, including GE, Boeing, Verizon, and Pepco, paid no taxes during the three years.[8]

There are many loopholes and preferences in the corporate tax code that allow firms to reduce their tax liabilities. Initial reforms could focus on the treatment of stock options, depreciation allowances, and industry-specific tax breaks.

Firms evade taxation by shifting income to low-tax foreign jurisdictions (so-called tax havens) where they maintain an office or at least a post office box. U.S. multinational firms appear to book a disproportionate share of profits in low-tax locations.[9] A recent report from the authoritative Government Accountability Office found that 83 of the 100 largest publicly-traded U.S. corporations have subsidiaries in tax havens.[10] Some large firms have many such subsidiaries: Abbott Laboratories, a giant drug company, reported 36; ExxonMobil has 32 and Citigroup reports 427. Estimates of the taxes lost through these practices range from $10 to $60 billion a year.[11]




Another flaw in the tax code not only reduces firms' tax liabilities but also encourages them to move jobs offshore. Because the U.S. does not tax corporations on the profits they earn abroad until they bring those profits back to the U.S., firms have a financial incentive to build plants and create jobs in other countries, or to make their business appear to take place abroad in order to reduce their taxes. This flaw in the tax code also encourages a host of other book-keeping irregularities designed to boost reported profits earned abroad and reduce profits earned in the United States. Fundamental reform of the corporate tax code is sorely needed.

**Financial Transaction Tax.** A financial transaction tax would slightly raise the cost of buying and selling financial instruments such as stocks, bonds, mutual funds, currency, derivatives, and credit default swaps. Although the tax – a very small amount in the range of ½ of 1% of the purchase price – would be nearly unnoticed by typical investors, it would reduce unproductive and potentially destabilizing financial speculation while encouraging investments in the long-term health and growth of a company.

***Tax Expenditures.*** Tax expenditures are tax provisions that resemble government spending because they provide financial assistance to specific activities, businesses, or groups of people. Tax expenditures typically allow qualifying tax payers to forego paying certain taxes. For example, homeowners can deduct from their income the amount they spend on mortgage interest and reduce the income tax they owe. Firms can deduct particular items, reducing their profits and the tax they owe. Once a tax expenditure has been established by law, it continues indefinitely until the law is changed. It does not need to be reauthorized each year like many other types of spending.

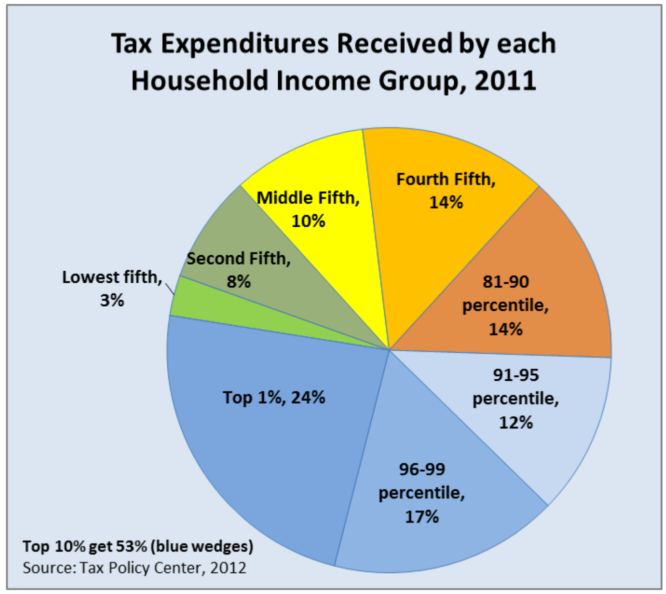
Tax expenditures are the cause of large revenue losses each year. In 2011, tax expenditures reduced federal revenues and raised outlays by an estimated $1.1 trillion.[12] This is more than was collected in personal income taxes. Federal tax expenditures equal nearly one-third of the total expenditures made through the budget. In many states, tax expenditures equal nearly half the amount of expenditures made through the budget. These are very large costs that continue largely unexamined from year to year.

Some of the largest tax expenditures, and their estimated cost in 2013, include the following.[13]

- Exclusions from income of employer contributions for health insurance premiums, $180 billion
- Exclusion from income of contributions to retirement plans, $125.1 billion
- Mortgage interest deductions from income, $101 billion
- Reduced tax rate on realized capital gains, $62 billion
- Deductions from income of charitable contributions, $48.9 billion
- Deductions from income of state and local taxes, $46 billion
- Corporations' deductions of accelerated depreciation for machinery and equipment, $33 billion

The largest beneficiaries of tax expenditures are upper income households. (See the chart.) The top 1% of households received 24% of all federal tax expenditure dollars.[14] The top 10% of households receive 53% of the benefits. Just 11% of all tax expenditure dollars accrue to the lowest 40% of households.

The Earned Income Tax Credit and Child Tax Credit are refundable tax expenditures, that is, they are paid to households even if they owe no personal income tax. Refundable tax credits (primarily the EITC and CTC) comprise 18% of all tax expenditures.[15] But even though these two tax expenditures are particularly beneficial to lower-income people, overall, most of the benefits from tax expenditures flow to wealthier households.




## Moving Forward

Our faith calls us to work and pray for a society where all God's people enjoy the fullness of life that is God's vision for each one of us. In today's world, a just and faithful society depends upon a fair tax system. Our federal tax code has many beneficial features but it also stands in need of reform. Let us be about this ministry.

The UCC General Synod, meeting in July, 2013, approved a Resolution on taxes that endorsed many of these reforms. See http://www.uccfiles.com/pdf/Tax-Res-background.pdf

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**ENDNOTES**

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