

Tax Equity and the Nonprofit Sector

by Chuck Collins

Over the last thirty years, ideas of “waste, fraud, and abuse”
have loomed large in the debate over taxes,
while lawmakers have made our tax system more regressive.
Is there hope for reform? The author identifies
seven tax policies that nonprofits should back.

CYNTHIA CARRANZA IS THE DIRECTOR OF A FOOD pantry in Niles, Illinois. For a decade she has watched the growing number of hungry people at her food pantry door, even as government support for her program is slashed. When she hears politicians talking about how our nation is broke, she has a pithy response: “Our country is not really broke, but our priorities are twisted. We’re an incredibly rich and prosperous nation. But our wealth is skewed to a very few fortunate at the top. We’re not broken, just twisted.”

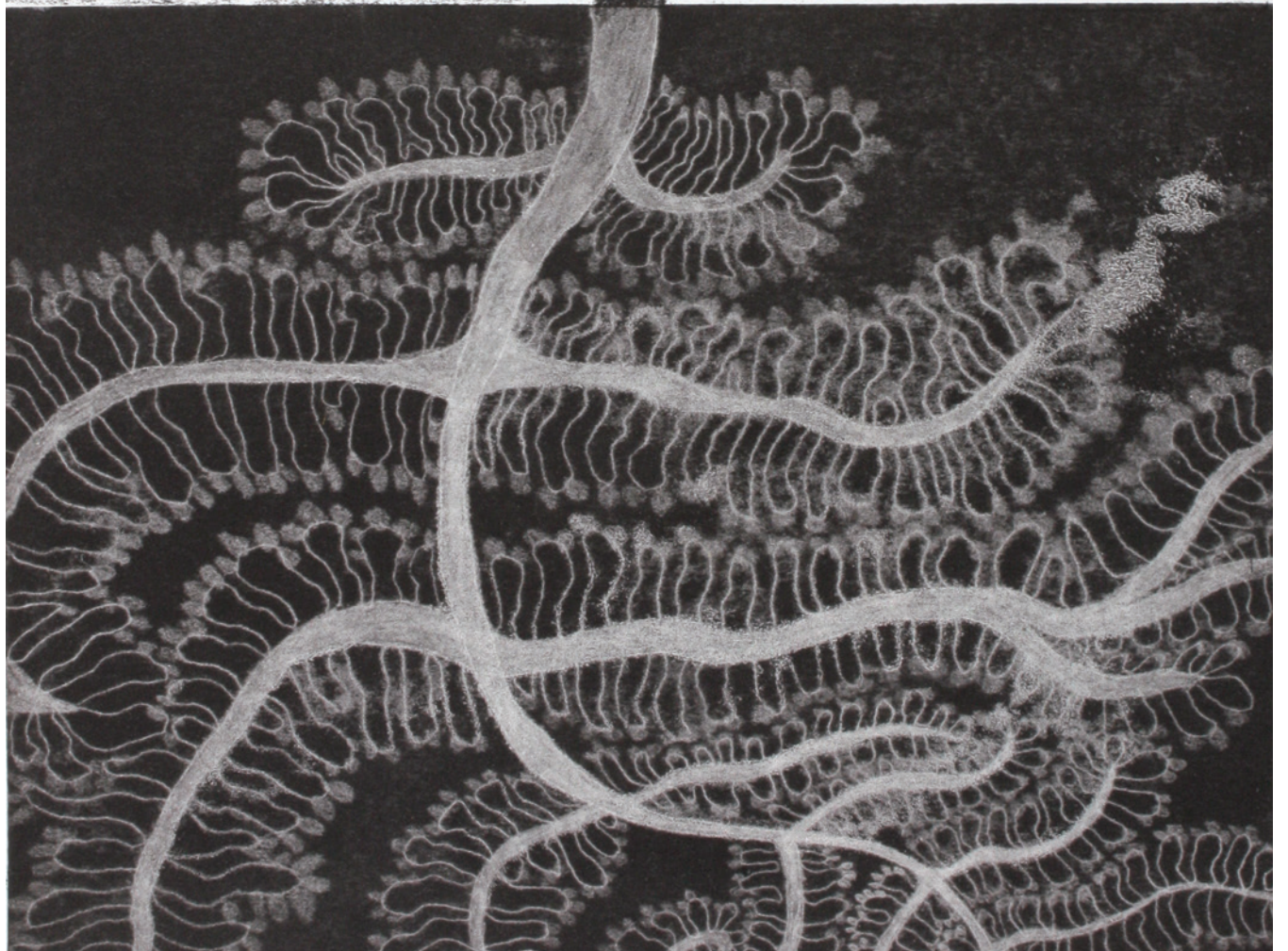
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We Are Not Broke, Just Twisted

You may have heard the news—our communities are financially insolvent and the federal government is so mired in debt that we must tighten our belts. Politicians and governors are calling for deep cuts in education, community services, and other investments that cut close to the heart of the nonprofit sector. Around the country, states and localities are making decisions based on this austerity framework, gutting their budgets and undermining the quality of our lives.

There are two important points of engagement for the nonprofit sector to connect to beyond advocating for specific spending initiatives.

Tell our stories of effective government. Underlying the debate over taxes are public attitudes about government and the nonprofit sector. There is an infrastructure of anti-government, tax-cut-advocacy organizations whose



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primary agenda is to beat the drum about public and community sector “waste, fraud, and abuse.” Their goal is to undermine confidence in the work that the third sector and government do. To counter this, we need to broadcast the success stories of effective government and community organizations that transform lives or provide lifeline services.

Advocate for new sources of tax revenue. For decades, federal lawmakers have been cutting taxes on high-income households and allowing huge corporate loopholes to be established. We need to raise our voices in support of specific revenue proposals that will raise hundreds of billions of dollars a year and obviate the need for extreme cuts.

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How Our Federal Tax System Became More Regressive

For three decades, lawmakers have gradually been shifting the design of our tax and revenue system. They have reduced “progressive taxes”—those primarily paid by the wealthy. These include taxes on higher incomes, dividends and capital gains, and inherited wealth. More of our federal and state revenue now comes from “regressive taxes”—those paid disproportionately by lower-income households. These include taxes on wage income and sales taxes.

In 1915, Congress passed laws instituting federal income taxes and inheritance taxes (estate taxes). Over the subsequent decades, these helped to reduce the concentration of income and wealth, and even encouraged Gilded Age mansions to be turned over to civic groups and charities.¹ Today, the higher up the income ladder people are, the lower the percentage of income they pay in taxes. This is why Warren Buffett’s disclosure about his own low taxes was so important. Buffett revealed that in 2010 he paid only 14 percent of his income

in federal taxes—lower than the 25 or 30 percent rate that more than twenty of his co-workers paid. Buffett wrote:

While the poor and middle class fight for us in Afghanistan, and while most Americans struggle to make ends meet, we mega-rich continue to get our extraordinary tax breaks. Some of us are investment managers who earn billions from our daily labors but are allowed to classify our income as “carried interest,” thereby getting a bargain 15 percent tax rate. Others own stock index futures for ten minutes and have 60 percent of their gain taxed at 15 percent, as if they’d been long-term investors. These and other blessings are showered upon us by legislators in Washington who feel compelled to protect us, much as if we were spotted owls or some other endangered species. It’s nice to have friends in high places.²

The richest four hundred taxpayers saw their effective tax rate decline to 19.9 percent in 2009.³ In 2009, the most recent year for which data are available, fifteen hundred millionaires paid no income taxes, largely because they dodged taxes through offshore tax schemes, according to the IRS.⁴

The 2001 and 2003 tax cuts passed under President George W. Bush were highly targeted to the top 1 and 2 percent of taxpayers. Between 2001 and 2010, the United States borrowed almost \$1 trillion to pay for the higher-income tax cuts. These included reducing the top income tax rate, cutting capital gains and dividend taxes, and phasing out the estate tax, our nation’s only levy on inherited wealth.

Toward a New Tax and Revenue Policy

In the next two years there may be actual reforms of the federal tax system, motivated in part by embarrassing corporate tax loopholes. Anti-tax forces will continue to advocate for regressive taxes and reduced or eliminated corporate income taxes.

You may have heard the expression “sin taxes” (or “tax the bads”), referring to taxes levied on socially destructive activities such as cigarettes, some of which allocate funds to healthcare and

smoking-cessation education. Governors and state legislatures are now looking to address the obesity crisis by instituting taxes on candy and soda. These taxes tend to be regressive, disproportionately falling on lower-income households. Are there progressive “sin taxes?” What are the new “bads,” those destructive forces that are undermining the health and well-being of our society?

There are four modern-day “bads” that should be the focus of our taxes: *concentrated wealth*, *financial speculation*, *short-term financial horizons*, and *environmental destruction*. Taxing these bads will not only generate revenue but also address several of our most pressing societal problems.

Concentrated wealth. A decade of research in a variety of disciplines now shows how the extreme inequalities of income and wealth are destructive to almost every dimension of our society. Too much concentrated wealth undermines our democratic system, thwarts social mobility, reduces competition in the business sector, threatens our physical and mental well-being, and tears communities apart. Too much inequality destabilizes the economy, as the affluent shift more wealth into the speculative investments and working families take on more precarious debt to cover for stagnant or falling wages.⁵ These extreme wealth disparities have nothing to do with individual deservedness; rather, they are a cancer on an otherwise healthy society and vibrant private sector. We have to directly reduce wealth concentration through progressive income taxes, estate or inheritance taxes, and taxes on luxury consumption.

Financial speculation. The economic meltdown of 2008 was fueled by extreme inequalities of wealth and the corporate capture of our regulatory system, leaving the Wall Street foxes in charge of our economic henhouse. The healthy “built to last” sectors of the economy that produce real goods and services are being wrecked by the parasitical “built to loot” antics of several thousand transnational corporations whose business model is to squeeze out short-term gains and undermine long-term economic health.

Short-term financial horizons. The incentive system in large global corporations encourages

CEOs to adopt a destructive, short-term, “take the money and run” outlook. An earlier generation of CEOs operated within different rules and values—and they had a longer-term orientation.⁶ There are a wide range of policies and rule changes that would alter this warped incentive system that results in reckless corporate behavior and excessive executive pay.

Environmental destruction. We are consuming the earth’s bounty at a dizzying pace and dumping carbon and other toxins into the environment in ways that are unsustainable. To slow global warming, we have to raise the cost of burning fossil fuels. Progressive consumption taxes and a tax on carbon would raise substantial revenue and reorient investment toward green energy and conservation.

Seven Tax Policies that Nonprofits Should Back

1. **Restore income tax progressivity.** Taxes on the wealthy have steadily declined over the last fifty years. If the 1 percent paid income taxes at the same actual effective rate as they did in 1961, the U.S. Treasury would receive an additional \$231 billion a year.⁷ Taxes on higher income and wealth reached their zenith in the mid-1950s. At the time, the incomes of millionaires were taxed at rates over 91 percent. Creating additional tax brackets for people earning \$1 million or more per year could generate at least \$79 billion annually.⁸
2. **Eliminate tax preference on income from wealth.** One simple proposal would be to tax income from wealth the same as income from work. Current law subjects most dividend and capital gains income—the investment income that flows overwhelmingly to wealthier Americans—to a 20 percent tax rate, after a decade at 15 percent. The tax on wage and salary income, by contrast, can now run up to 39 percent. This yawning gap is what inspired Warren Buffett to call on Congress to “stop coddling the super-rich” and institute higher rates on income from wealth.⁹ With carefully structured rate reform, we can end this preferential treatment and at the same time encourage average families to engage in long-term investing.

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One distortion of the two-tier system is the so-called “carried interest loophole,” which permits gazillionaires to pay only a capital gains tax rate (just raised from 15 to 20 percent) on the profit share (the carried interest) that they get paid to manage hedge and private equity funds. Ray Dalio of Bridgewater Associates raked in \$3 billion in 2011, making him the highest-paid hedge fund manager in 2011. If his income were taxed like a doctor’s wages, and not investment income, he would have paid an extra \$450 million in taxes.

3. **Eliminate taxpayer subsidies for excessive executive pay.** One way to discourage “short-termism” among leading corporations would be to deny all firms tax deductions on any executive pay that runs over twenty-five times the pay of the firm’s lowest-paid employee or \$500,000—whichever is higher. Companies can pay executives whatever they want, but over a certain amount ordinary taxpayers should not have to foot the bill for what becomes excessive executive compensation. Such deductibility caps were applied to financial bailout recipient firms and will be applied to health insurance companies under the healthcare reform legislation. Eliminating perverse loopholes that encourage short-term “take the money and run” financial decision making adds up to more than \$20 billion per year in otherwise lost revenue.¹⁰
4. **Institute a Wall Street financial transaction tax.** A modest financial transaction tax on the sale of stocks, bonds, and other financial instruments such as derivatives would generate substantial revenue, estimated between \$150 billion and \$200 billion a year.¹¹ At least eleven European countries are on track to adopt a financial transaction tax that could soon raise a total of nearly \$72 billion U.S. per year if enacted throughout the European Union.¹²

A financial transaction tax would have the positive economic impact of discouraging the controversial high-speed trading that destabilizes the investment markets. New technologies and increased competition between brokers

have lowered the cost of trading, which has benefited all investors. But lower trading costs have also opened the door to widespread speculative activity that erodes confidence in the stability of markets. High-frequency trading now comprises about 55 percent of equity trades in the United States.¹³ This is a threat to the interests of responsible investors.

5. **Levy a progressive estate tax on large fortunes.** Since 2001, Congress has weakened the federal estate tax, our nation’s only levy on inherited wealth transfers. A progressive estate tax could include graduated rates starting on estates over \$5 million and getting more steeply progressive on large estates. One estate tax proposal includes a 10 percent surtax on individual estates valued over \$500 million—or \$1 billion for a married couple.¹⁴ This would raise \$35 billion a year and put a significant brake on the buildup of concentrated wealth over generations, a virtual “plutocracy prevention act.”
6. **Close offshore tax haven loopholes for transnational corporations and wealthy individuals.** In the mid-1950s, corporations contributed a third of the nation’s revenue; today, corporations contribute less than one-tenth. By current statute, corporations are supposed to pay a 35 percent tax on their profits. According to Citizens for Tax Justice, between 2008 and 2010, the top U.S. corporations actually paid only 18.5 percent of their profits to Uncle Sam.¹⁵

One of the main ways that large corporations dodge their fair share of taxes is by playing global shell games using subsidiaries in countries with low or no taxation. The use of offshore tax havens and “secrecy jurisdictions” enables hundreds of multinational companies like Apple, Verizon, Boeing, Pfizer, and General Electric to shift their responsibility for paying taxes onto responsible businesses that operate within our borders. A common gimmick of the corporate 1 percent is to shift profits to subsidiaries in low-tax or no-tax countries such as the Cayman Islands. They pretend corporate profits pile up offshore while their losses accrue in the United States,

reducing or eliminating their company's obligation to Uncle Sam.

These same companies, however, use our public infrastructure—they hire workers trained in our schools, they depend on the U.S. court system to protect their property, and our military defends their assets around the world—yet they're not paying their share of the bill.

Corporate tax dodging also hurts Main Street businesses that are forced to compete on an unlevel playing field. "Small businesses are the lifeblood of local economies," said Frank Knapp, Jr., president and CEO of the South Carolina Small Business Chamber of Commerce. "We pay our fair share of taxes, shop locally, support our schools, and actually generate most of the new jobs. So why do we have to subsidize the U.S. multinationals that use offshore tax havens to avoid paying taxes?"¹⁶

Several pieces of federal legislation, including the Corporate Tax Dodging Prevention Act (S. 250, introduced and referred to committee on February 7, 2013) and the CUT Loopholes Act (S. 2075, introduced and referred to committee on February 7, 2012), would close numerous loopholes that facilitate tax dodging via tax havens. For example, they would treat foreign subsidiaries of U.S. corporations whose management and control occur primarily in the United States as U.S. domestic corporations, for tax purposes.¹⁷ Both of these acts would each generate an estimated \$100 billion in revenues a year—or \$1 trillion over the next decade.

7. **Tax carbon and pollution.** In order to slow the pace of climate change, we must raise the cost of carbon. A number of proposals levy a tax on carbon and increase it gradually each year to encourage new investments in energy efficiency. The revenue from a carbon tax could be \$90 to \$150 billion a year, and could be partially rebated back to consumers on a per capita basis to offset its regressivity.

Conclusion

Taxing the wealthy and closing corporate tax loopholes won't entirely solve our nation's short-term

deficit problems nor dramatically reduce inequality in the short run, but it will have a meaningful impact on both problems over time. Thirty years of tax cuts for transnational corporations and the wealthiest 1 percent has shifted taxes onto middle-income taxpayers and added to the national debt. The non-profit sector can play a critical role in educating our communities and advocating for progressive tax reforms. We're not broke by any means.

NOTES

1. See William H. Gates, Sr., and Chuck Collins, *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes* (Boston: Beacon Press, 2003).
2. Warren E. Buffett, "Stop Coddling the Super-Rich," *The New York Times*, August 14, 2011, www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html.
3. Internal Revenue Service, Statistics of Income Division, *The 400 Individual Tax Returns Reporting the Largest Adjusted Gross Incomes Each Year, 1992–2009* (Washington, DC: Internal Revenue Service), "Table 1," www.irs.gov/pub/irs-soi/09intop400.pdf.
4. Amy Bingham, "Almost 1,500 Millionaires Do Not Pay Income Tax," ABC News, August 6, 2011, abcnews.go.com/Politics/1500-millionaires-pay-income-tax/story?id=14242254.
5. See Collins, *99 to 1: How Wealth Inequality Is Wrecking the World and What We Can Do about It* (San Francisco: Berrett-Koehler Publishers, 2012).
6. See David Callahan, *Kindred Spirits: Harvard Business School's Extraordinary Class of 1949 and How They Transformed American Business* (Hoboken, NJ: John Wiley & Sons, Inc., 2002).
7. Collins, Alison Goldberg, Scott Klinger, and Sam Pizzigati, *Unnecessary Austerity, Unnecessary Shutdown* (Washington, DC: Institute for Policy Studies, 2011), 6, www.ips-dc.org/reports/unnecessary_austerity_unnecessary_government_shutdown.
8. Citizens for Tax Justice, "Congresswoman Schakowsky Proposes Millionaires Tax as Alternative to Cutting Education, Health and Other Programs," *Tax Justice Blog*, March 18, 2011, www.ctj.org/taxjusticedigest/archive/2011/03/congresswoman_schakowsky_propo.php.
9. Buffett, "Stop Coddling the Super-Rich."
10. Sarah Anderson, John Cavanagh, Collins, Pizzigati, and Mike Lapham, *Executive Excess 2008: How*

"Small businesses are the lifeblood of local economies . . . We pay our fair share of taxes, shop locally, support our schools, and actually generate most of the new jobs. So why do we have to subsidize the U.S. multinationals that use offshore tax havens to avoid paying taxes?"

Average Taxpayers Subsidize Runaway Pay; 15th Annual CEO Compensation Survey (Washington, DC: Institute for Policy Studies, 2008), www.ips-dc.org/reports/executive_excess_2008_how_average_taxpayers_subsidize_runaway_pay.

11. Dean Baker, *The Deficit-Reducing Potential of a Financial Speculation Tax* (Washington, DC: Center for Economic and Policy Research, 2011), 2, www.cepr.net/index.php/publications/reports/the-deficit-reducing-potential-of-a-financial-speculation-tax. Note that this estimate falls in the middle of various revenue estimates, which differ significantly depending on tax rates, the types of financial instruments covered, and assumptions about how traders will respond to the tax. On the higher end, Professor Robert Pollin of the University of Massachusetts Amherst has estimated that a U.S. financial transaction tax could generate as much as \$350 billion per year (Robert Pollin, *A U.S. Financial Transaction Tax: How Wall Street Can Pay for Its Mess* [Amherst, MA: Political Economy Research Institute, 2012], 98, www.peri.umass.edu/236/hash/d31f8df4477017ad670dd86a8e73bc6f/publication/508/). On the lower end, the Joint Committee on Taxation has estimated that a bill introduced in November 2011 by Representative Peter DeFazio (D-OR) and Senator Tom Harkin (D-IA) would generate \$352 billion from January 2013 through 2021. This bill would apply a lower tax rate—0.03 percent on each transaction—than that considered by Pollin and Baker (“Joint Tax Committee Finds Harkin, DeFazio Wall Street Trading and Speculators Tax Generates More than \$350 Billion,” press release from Kate Cyrul for Senator Tom Harkin [D-IA] and Jen Gilbreath for Congressman Peter DeFazio [D-OR], November 07, 2011, www.defazio.house.gov/index.php?option=com_content&view=article&id=736:memo-joint-tax-committee-finds-harkin-defazio-wall-street-trading-and-speculators-tax-generates-more-than-350-billion&catid=63:2011-news).

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13. Jeremy Grant and Telis Demos, “Ultra-Fast Traders Braced for Tough Curbs in Europe,” *Financial Times*, October 14, 2011, www.ft.com/intl/cms/s/0/c51fce68-f5b1-11e0-be8c-00144feab49a.html#axzz1di76p6gx.

14. The figures represent an annualized average of the cuts recommended over a five-year time period in Andrew Fieldhouse, “The People’s Budget: A Technical Analysis,” EPI Working Paper (Washington, DC: Economic Policy Institute, 2011), www.epi.org/publication/the_peoples_budget_a_technical_analysis/.

15. Robert S. McIntyre, Matthew Gardner, Rebecca J. Wilkins, and Richard Phillips, *Corporate Taxpayers & Corporate Tax Dodgers, 2008–10* (Washington, DC: Citizens for Tax Justice/The Institute on Taxation and Economic Policy, 2011), 3, www.ctj.org/corporatetaxdodgers/CorporateTaxDodgersReport.pdf.

16. Frank Knapp, “Statement at Press Conference,” Business and Investors against Tax Haven Abuse, October 11, 2011, businessagainsttaxhavens.org/press-release-small-businesses-agree-with-new-senate-study-don%E2%80%99t-reward-job-destroyers-with-another-tax-holiday (accessed January 3, 2012; site discontinued). See also “U.S. Small Businesses Call for End to Tax Haven Abuse,” Cayman News Service, April 15, 2011, www.caymannewsservice.com/business/2011/04/15/us-small-businesses-call-end-tax-haven-abuse.

17. “Summary of the Stop Tax Haven Abuse Act of 2011,” July 12, 2011, press release from the office of Senator Carl Levin (D-MI), levin.senate.gov/newsroom/press/release/summary-of-the-stop-tax-haven-abuse-act-of-2011.

RESOURCES

For more information, see:

Citizens for Tax Justice

www.ctj.org

Center on Budget and Policy Priorities

www.cbpp.org

Program on Inequality and the Common Good

www.inequality.org

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