The Tax Law Center NYU LAW

Oral Testimony (As Prepared) for Hearing, "Examining How the Tax Code Affects High-Income Individuals and Tax Planning Strategies"

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United States Senate Committee on Finance
November 9, 2023

Chairman Wyden, Ranking Member Crapo, and distinguished members of the Committee,

I'm honored to join you today.

The highest income filers receive tax breaks on income from wealth to the tune of hundreds of billions of dollars each year. Largely unknown to most Americans, these tax breaks increase deficits and deepen inequality, and the outright tax breaks inevitably spur tax avoidance and evasion. This harms the economy by locking up capital in old investments where the tax breaks are the most lucrative, rather than it flowing to new, more productive ventures. Talent goes to waste dreaming up new tax shelters for the ultra-wealthy instead of driving business or scientific innovation. Those who want to focus on work and entrepreneurship face competition from tax avoiders and evaders.

Here's how this system works.

Tax breaks for wealth allow the highest-income filers to choose when to pay income tax, at what rate, and even whether to pay it at all. Most Americans make the bulk of their income from work, but the highest income filers make the bulk of their income from their wealth.

Wealth is stocks and bonds, real estate, personal property like art, and ownership stakes in non-corporate "passthrough" businesses. These assets throw off income, including dividends, and the capital gains from when they grow in value.

But while the top tax rate on salaries is 40.8%, the top rate on long-term capital gains and dividends is dramatically lower—at 23.8 percent. Most Americans pay taxes on salaries in the year the income is earned – often withheld in each paycheck. But capital gains are mostly invisible to the tax system until they are "realized," usually when the asset that increased in value is sold.

So, the wealthiest filers can choose when capital gains show up on tax returns and faces tax. Meanwhile they can see that income in their bank statements and borrow and spend against it. And if they hold the assets that have gained in value until they die, then neither they nor their heirs will ever pay income tax on that gain. Billions of dollars of income gets an income tax rate of zero.

These are large outright tax subsidies for wealth. JCT estimates that the zero and low rates for capital gains and dividends cost the federal government more than $200 billion last year. That's more than the CHIPs and Science Act's investments in innovation over a whole decade.

It's also just the start of how wealthy filers can benefit from low rates on income from wealth. Their tax planning techniques can be complex, but they have a simple aim: to shift income from assets and work into the lowest possible rates of tax for wealth. Carried interest is used by fund managers to get a low capital gains tax rate on income from their services. Pass-through businesses help the wealthy avoid income and payroll taxes. There's an alphabet soup of other vehicles that are being co-opted to shelter capital income from tax. Private Placement Life Insurance, the ETF loophole, HSAs, mega-Roths, and more.

The wealthiest filers have well-paid tax lawyers and accountants to set up "spiderwebs" of entities and transactions.

And then, sometimes, egregious but lawful tax planning oversteps into unlawful tax evasion. The complex and opaque tax system for the wealthy can also give cover to money launderers, sanctions evaders, and corrupt officials looking to hide assets and income.

All income underreporting by the top 1 percent adds about $80 billion per year to the "tax gap" of taxes owed but not paid –more than the annual budget of the Small Business Administration.

Lawmakers can move federal and private resources away from tax breaks on wealth to make better investments in the nation's future.

Various tax cuts for wealthy filers should expire as scheduled in 2025. These include the pass-through deduction and the doubled estate tax exemption.

The IRS should have the resources and tools it needs to ensure wealthy filers pay more of the taxes they owe, and various tax breaks on income from wealth can be repealed or scaled back, so that the wealthy pay effective tax rates closer to the tax rates on salaries.

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And various tax breaks on income from wealth can be repealed or scaled back, so that the wealthy pay effective tax rates closer to the tax rates on salaries. My testimony lays out a menu of options, and I would be happy to take your questions.