Analysis: Ryan takes aim at tax favors for rich - save a key break

Kim Dixon | August 23, 2012

Paul Ryan, the Republican candidate for vice president, says he wants to scuttle the tax breaks of America's rich, but he also proposes expanding one of the biggest breaks enjoyed by the wealthiest - the low tax rate on investment income.

Ryan, Mitt Romney's running mate, last week hinted at how their ticket would revamp the tax code starting in 2013. He vowed to unveil details only after the November 6 elections so Washington lawmakers could hash out the issues in public.

"What we're saying is get rid of special interest loopholes and deductions that are uniquely enjoyed by the wealthy," Ryan told Fox News.

Ryan has not defined the wealthy, but in some cases Romney - like President Barack Obama, the man he hopes to unseat - has used the threshold of taxpayer income above $200,000.

Wealthier Americans generally trim their taxes in two big ways. One is through tax deductions such as those for charitable donations. The other, a lower tax rate on investment income than on wages, favors the rich because they have more investment income than taxpayers further down the income ladder whose salaries make up the bulk of their income.

The wealthier also reap a bigger benefit because their steeper marginal income tax rates mean that a lower rate on investment income translates into a bigger discount.

Federal tax rates on wage income range from 10 percent to a high of 35 percent, while investment income such as capital gains and dividends is taxed at a 15 percent rate. The lower taxes on investments were the biggest factor in helping Romney keep his own effective tax rate near 15 percent for the past two years.

Ryan wants to eliminate investment taxes like those on capital gains and dividend taxes altogether. Romney has pitched keeping the current 15 percent rate for those making more than $200,000 and to zero out the taxes altogether for those making less than that.

"When I look for tax advantages enjoyed by very high-income people, everything else pales in comparison to the favorable treatment of their capital gains and dividends," said Clint Stretch, former counsel at the congressional Joint Committee on Taxation.

The top 1 percent of taxpayers derive 35 percent of their income from investments, while the poorest 20 percent derive about 2 percent of their total income from capital investments, according to the nonpartisan Tax Policy Center.

Conservatives favor low or no taxes on investment income, arguing that such taxes impede economic growth by driving capital and potentially jobs overseas.

"Capital gains and dividends are mainly owned by higher income households, but there are offsetting effects," said Jeff Miron, a fellow at the conservative Cato Institute and a lecturer at Harvard.

"Starting from scratch if they had their druthers, I think they'd say there should be zero taxation of capital income," Miron said.

"CARRIED INTEREST"

One controversial tax advantage that might be considered a subset of capital taxation - enjoyed exclusively by the rich - is the lower rate on what is known as carried interest.

That's the share of profits earned by executives of private equity firms, some hedge funds and real estate partnerships and which is treated as capital gains when it comes to taxes. These executives typically earn a 20 percent slice of profits, while earning a 2 percent management fee that is taxed as ordinary income.

Democrats have been trying for years to kill this tax advantage. Critics say the private equity managers are simply performing services and should pay the individual income tax rate, not the lower capital gains rate.

Romney benefits because he still earns income from his time at Bain Capital, the private equity firm he co-founded. About $13 million of his Bain income over the last two years was subject to the preferential 15 percent rate, according to his campaign.

Ryan is easier to pin down on this topic. Although he has not talked about it widely, he did vote against efforts in the House to kill the tax preference several times.

Romney has not taken an official stance on that topic.

"This is much messier than the pure capital taxation argument," said Miron, a conservative economist who confessed to being torn on the issue.

Greg Mankiw, an economics professor at Harvard and a Romney adviser, wrote in a New York Times opinion piece in March that there are "shades of gray" with carried interest, and he described the difficulty in separating labor and investment in some cases.

Of the criticism that money managers unfairly pay lower rates while individuals like doctors and lawyers pay the much higher rates, Mankiw said: "It is a reasonable point and some reform may well be appropriate."

TAX BREAKS SHARED WITH MIDDLE CLASS

Ryan said "yes" in the Fox interview when asked whether enough revenue could be raised without slashing such breaks as the deduction for home mortgages.

The campaign did not respond to a request to expand on his comments.

Romney has pledged to preserve the biggest tax deductions for the middle class, including those for mortgages, charitable contributions and healthcare costs. He also has said the rich should go on paying the "same share of the tax burden" that they pay today.

U.S. tax data offers a snapshot of the tax deductions the wealthiest take most - and they show the rich use the same write-offs as those who earn less.

The wealthy don't take the lion's share of itemized deductions either. Just 8.4 percent of all itemized deductions are taken by those earning more than $1 million, while the biggest group itemizing are individuals earning from $100,000 to $500,000.

The IRS provides data for income bands that differ from proposals made by the candidates.

Nearly half of all itemized deductions taken by those earning more than $1 million are for state and local taxes, while about a third are for charitable giving, according to an analysis of IRS Statistics of Income for 2009 prepared by Stretch.

These are among the largest tax breaks also taken by those earning under $1 million, and along with other popular tax breaks such as interest payments on mortgages, cost more than $1.1 trillion a year. They are well known parts of the law prized by many taxpayers.

"They didn't sneak into the code when no one was looking," said Ken Kies, a lobbyist and former tax counsel for House Republicans.

Ryan also said the campaign would crack down on the abuse of "tax shelters" by the wealthy to trim rates for all Americans.

Tax experts, though, say the era of big tax shelters is over, after a 1986 tax law and recent government legal wins.

"There really aren't that many tax shelters anymore," said Kies, who also worked as chief of staff at the Joint Committee on Taxation. "The amount of money involved is nothing."