Robert W. Wood
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Tax Gap Grows Between Haves And Have-Nots

President Obama's call for tax reform may have sparked an unpleasant debate about who should pay more and what kind of system we have. Unfortunately, a minimum tax is something we tried in the 1960s. It spread into the out-of-control (and often quite inequitable) AMT. Will Everyone Pay AMT Next Year? Plainly, an AMT model is flawed.

Yet with all the rhetoric about tax rates and reform, some statistics are disturbing. The Congressional Research Service (CRS) has charted Changes in the Distribution of Income Among Tax Filers Between 1996 and 2006: The Role of Labor Income, Capital Income, and Tax Policy (R42131).

Adam Smith discussed income inequality issues as early as 1776. Since then, especially over the last century, academics have been worrying over this issue. Policy makers have long been interested in income inequality issues, so it isn't just the Occupy generation. For example, the issue came up in the Senate in 1898.

Congress will be debating the anticipated 2012 expiration of the Bush tax cuts. They are a common target of income inequality. In anticipation of that and many other tax policy issues impacting this issue, the CRS looked at the numbers for tax filers in the 10 year period between 1996 and 2006.

What happened between 1996 and 2006? It's hard to figure exactly why many of these things occurred, and some are surely interrelated. But here's a sampling:

- Inflation-adjusted average after-tax income grew by 25%.
- The poorest 20% of tax filers experienced a 6% reduction in income.
- The top 0.1% of tax filers saw their income almost double.
- Tax filers in the middle experienced about a 10% increase in income.
- The proportion of income from capital increased for the top 0.1% from 64% to 70%.
- Before tax and after tax, income inequality increased between 1996 and 2006.
- Before tax, income inequality increased from 0.532 to 0.582 between 1996 and 2006—a 9% increase.
- After tax income inequality increased by 11% between 1996 and 2006.

If you are focusing on the comparative income inequality before vs. after tax, you'll note these last two figures. Some will say this means our tax system gives more benefits to the wealthy and is making whatever income inequality tendencies already exist in our society and economy even worse.

Yet the study says total taxes (the individual income tax, the payroll tax, and the corporate income tax) reduced income inequality in both 1996 and 2006. In 1996, taxes reduced income inequality by 5%. In 2006, however, taxes reduced income inequality by less than 4%. Taxes were more progressive and had a greater equalizing effect in 1996 than in 2006.

Taxes were less progressive in 2006 than in 1996, says the study. Capital gains and dividends were a larger share of total income in 2006 than in 1996 (especially for high-income taxpayers). They were more unequally distributed in 2006 than in 1996. In fact, the report says that changes in capital gains and dividends were the largest contributor to the increase in the overall income inequality.

For more, see:

A Response To: "Don't Tax The Rich, Tax The Inequality Itself."

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Economic Inequality Of Various Shapes And Sizes

The biggest driver of income inequality: capital gains

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New Capital Gain Tax Reporting For 2011 Tax Returns

Bush Tax Cuts–Better By Another Name?

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.