Tax Fairness and the Buffett Rule

Middle-class Ohioans now paying higher effective tax rates than some of the nation's richest people

Executive Summary

The Buffett Rule is a tax reform measure designed to restore fairness to the federal tax code. It is named for legendary investor and famed billionaire Warren Buffett, who has spoken out against the unfairness of his paying a lower tax rate than his secretary.

Championed by President Obama and legislatively incorporated into Senate Bill 2230 (the "Paying a Fair Share Act"), the Buffett Rule would ensure that all taxpayers pay their fair share, and apply a 30% tax rate to the richest Americans.

SB 2230 is scheduled for a vote in the U.S. Senate on Monday, April 16.

Innovation Ohio, in collaboration with the Center for American Progress, has done an analysis of federal tax data[1]. Among the highlights of our findings are:

- In seven of the wealthiest zip codes in America—a list that includes such exclusive destinations as Fisher Island in Florida and Wyoming's Teton Village, 27% of taxpayers earn 94% of the income—$2.2 million annually, on average—and pay a combined effective federal income and payroll tax rate of just 17.2 percent.
- 99 percent of Ohioans live in zip codes where the average tax rate is higher than 17.2 percent.
- The average Ohio taxpayer, earning an average of $49,043, pays a total effective tax rate of 21.5 percent.
- Two-thirds of Ohio taxpayers live in zip codes where average income is below $50,000, but tax rates are above 17.2 percent.
- 63 percent of Ohio taxpayers live in zip codes where the average tax rate is higher than it is in any of the seven "ritzy" zip codes that are among America's wealthiest.

[1] Analysis was conducted using 2008 tax return data from the Internal Revenue Service.

Background

Tax rates alone, however, don't tell the entire story. They must be put into context alongside America's growing wealth and income gap in order to get a true picture of the deepening gulf between the rich and the rest.

According to the Center for Budget and Policy Priorities, between 1979 and 2007, the gap in after-tax income between the top 1% and the bottom 40% of America's earners more than tripled.[i] By 2007, two-thirds of this nation's total wealth was concentrated in the hands of the richest 10%[ii] and just 400 people now control more wealth than the poorest 100 million Americans *combined.*[iii] According to the CIA, income inequality in the United States is now greater than in countries like Yemen, Uganda and Mongolia. [iv]

Nor are things getting better as we emerge from the Great Recession. According to an April 5 Bloomberg Brief as cited in the *Washington Post*, a full 70% of all job gains in the past six months came in low-wage sectors of the economy.[v] Wages have even been falling in manufacturing, long a bastion of high-paying work opportunities. Midwest auto factories now pay $15 per hour for jobs that once paid $28 per hour[vi] and the *Wall Street Journal* reports that heavy equipment superpower Caterpillar is offering workers just $12 per hour—or $24,000 a year—to assemble extremely sophisticated machinery at its new locomotive plant in Muncie, Indiana.[vii]

Meanwhile, corporate profits, dividends, and executive compensation have risen so fast that *all* income growth in 2010 went to the wealthiest 10% of households—and 93 percent of *that* was snapped up by the richest 1 percent.[viii]

Thanks to an array of loopholes, exemptions, deductions and preferential rates for certain kinds of income, however, many of these wealthiest Americans are paying lower tax rates than middle class workers whose wages are stagnating.

According to a new White House report, the richest 400 taxpayers, each earning in excess of $110 million, were subject to an average income tax rate of just 18 percent in 2008.[ix] In 2009, over 20,000 households—each with income of over $1 million—paid less than 15 percent.[x]

Through an analysis of federal tax data, Innovation Ohio, in collaboration with the Center for American Progress in Washington, D.C., has found that this unfairness is especially pronounced here in Ohio.

Ohio communities that pay a higher tax rates than the wealthiest Americans

Our analysis of taxpayer data finds that 99 percent of Ohioans live in zip codes where the average combined effective rate of federal income and payroll taxation is higher than that paid by the richest members of the some of the wealthiest communities in the country.

Table 1 lists the seven zip codes identified as "high income, low tax" according to our research. These include affluent zip codes in San Francisco, Los Angeles and New York. Taxpayers with incomes greater than $200,000 living in these rarified communities paid, on average, less than 20 percent of their income in federal taxes.

Table 1 – America's high income, low tax zip codes							
Community			All Tax Returns		Tax Returns – income over $200K		
Zip	Location	State	Avg. Income[2]	Effective Tax Rate[3]	% of total zip code income	Avg. Income	Effective Tax Rate
94119	San Francisco	CA	$324,726	13.5%	84%	$1,190,944	10.8%
83025	Teton Village	WY	$604,305	16.0%	94%	$3,290,089	15.7%
55440	Minneapolis	MN	$525,563	16.7%	94%	$2,040,763	16.7%
90071	Los Angeles	CA	$570,274	18.1%	93%	$1,881,939	17.6%
33109	Fisher Island	FL	$1,530,593	18.8%	98%	$3,234,469	18.8%
10112	30 Rockefeller Plaza	NY	$1,920,134	19.4%	99%	$3,572,248	19.4%
93150	Santa Barbara	CA	$373,567	19.7%	90%	$1,840,652	20.0%
		AVERAGES	***$631,242***			***$2,240,316***	***17.20%***

Digging deeper into the situation of residents of these "high income, low tax" zip codes, CAP researchers found that the average effective tax rate paid by their richest residents was 17.2 percent, among individuals boasting average incomes of $2.2 million.

In stark contrast to these privileged few residing in some of America's most glamorous addresses paying 17.2 percent of their income in taxes, the vast majority of Ohioans live in communities where the effective tax rate is higher, as identified in Table 2.

Table 2 – Ohio zip codes with average effective tax rates greater than 17.2%		
Average Income	Zip codes paying 17.2% or greater effective tax rate	% of all Ohio taxpayers
All Income Levels	1006	99%
Less than $75,000	949	90%
Less than $50,000	802	66%

Our research shows that **99 percent of all Ohioans live in zip codes where the average effective tax rate is greater than 17.2 percent**. The average Ohio taxpayer, who earned an average of $49,043 in 2008, is subject to a total effective tax rate of 21.5 percent, substantially greater than the 17.2 percent

[2] "Average Income," as referred to throughout the report and in tables represents adjusted gross income divided by the number of tax returns in a given zip code.

[3] "Tax Rate", as referred to in all tables represents the average combined effective income and payroll tax rate, which was calculated by combining income tax liability with imputed payroll tax liability–both employee and employer shares–divided by Adjusted Gross Income plus employer share of payroll tax

paid by the richest taxpayers in America's wealthiest communities. In fact, fully two-thirds of Ohio taxpayers reside in zip codes where the average income is less than $50,000 but the tax rate is greater than 17.2 percent.

Table 3 lists the Ohio zip codes with average incomes below $50,000 that pay the highest combined effective tax rates in the state.

Table 3 – Top Ohio communities with average income < $50K, by tax rate			
Zip Code	**Income**	**Rate**	**City (Neighborhood)**
44113	$43,778	24.6%	Cleveland (Ohio City)
45220	$48,933	23.8%	Cincinnati (Clifton)
43201	$30,881	23.2%	Columbus (Weinland Park)
43206	$41,357	23.1%	Columbus (South Parsons)
45227	$48,952	22.5%	Cincinnati (Fairfax)
44120	$48,392	22.5%	Shaker Heights
44107	$43,336	22.3%	Lakewood
45356	$47,679	22.2%	Piqua
43606	$49,840	22.2%	Toledo (Ottawa Hills, Westgate)
43202	$34,539	22.1%	Columbus (OSU area)

Conclusion

Comparing Ohio zip codes to seven of the wealthiest zip codes in America shows that middle class families are paying more in taxes than many of the richest people in the country, and proves that the Buffett Rule is necessary to ensure that the game is not rigged for the wealthiest.

Methodology

Using data from the Internal Revenue Service, Statistics of Income Division[xi], researchers at the Center for American Progress calculated average effective income and payroll tax rates by zip code for Ohio and nationwide.

Average income in a given zip code is simply total adjusted gross income divided by the number of tax returns. The combined effective tax rate was calculated by combining the income tax liability with the imputed payroll tax liability – both employee and employer shares – and dividing it by Adjusted Gross Income plus the employer share of the payroll tax[xii]. The income tax data comes directly from the IRS, while the payroll tax calculation was imputed, based on the reported amounts of wage and salary income at the different income levels.

Researchers isolated the seven most "high income, low tax" zip codes in the country, by sorting first by total income and again by average effective tax rate, selecting those that were in the top of both categories. Five of the seven zip codes are in the richest 50 zip codes in the country, and the richest taxpayers in all seven have an average income of over $1 million.

A similar analysis was conducted for Ohio tax returns, allowing for the calculation of the average income and effective tax rate paid by taxpayers in each zip code in Ohio.

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[i] Sherman, A. and Stone, C. "Income gaps between very rich and everyone else more than tripled in last three decades, new data shows," Center on Budget and Policy Priorities, June 25, 2010

[ii] Gilson, D. and Perot, C. "It's the Inequality, Stupid," *Mother Jones*, March/April 2011

[iii] PolitiFact, "Michael Moore says 400 Americans have more wealth than half of all Americans combined" *Wisconsin Journal-Sentinel*, March 10, 2011

[iv] Central Intelligence Agency, World Factbook: Distribution of Family Income-GINI Index, Country Comparison, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2172rank.html

[v] Meyerson, Harold "An Economic Recovery that Leaves Workers Further Behind", *Washington Post*, 4/10/2012

[vi] Ibid

[vii] Hagerty, J.R. and MacDonald, A. "As unions lose their grip, Indiana lures manufacturing jobs," *Wall Street Journal*, March 18, 2012.

[viii] Saez, E. "Striking it Richer: The Evolution of Top Incomes in the United States," UC Berkeley Center for Equitable Growth, March 2012.

[ix] "The Buffett Rule: A Basic Principle of Tax Fairness," National Economic Council, April 12, 2012.

[x] Ibid.

[xi] Individual Income Tax Zip Code Data, Internal Revenue Service Statistics of Income Division, June 2011, http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96947,00.html.

[xii] A note on the payroll tax calculation: most economists agree that the employer-paid portion of the payroll tax is actually paid by the employee, because in the absence of the tax, the employer would increase the wages by the same amount. In other words, the employer portion of the payroll tax is economically equivalent to both added income for the individual and added taxes. The effective tax rates presented in this report, account for this economic principle.