WALL STREET BANKS AND FINANCIERS MUST PAY THEIR FAIR SHARE

After driving our economy off a cliff with their recklessness and greed, the biggest banks benefited from taxpayer-funded bailouts and returned to profitability. Instead of cutting rates on corporations and the wealthy in this time of record income inequality and corporate profits, we need to comprehensively reexamine the adequacy and fairness of our current tax system. The following specific reforms would generate approximately $1 trillion in revenue over 10 years while reducing incentives for risky and unfair financial behaviors that endanger the economy.

Close the Carried Interest Loophole: Private equity funds and hedge fund executives slash their tax bills by classifying income as capital gains rather than ordinary income. Thus, they pay only 23.8% (20% capital gains rate plus a 3.8% investment surtax) on much of their income, rather than the 39.6% they would normally owe. This means some of the wealthiest Americans pay a lower tax rate than millions of middle-income workers, including many teachers, firefighters, and nurses. After numerous promises by both political parties to address this tax loophole, it is past time to close it once and for all.

Wall Street Speculation Tax: Working families pay sales tax when they buy anything from a car to a pair of shoes. But when Wall Street traders buy millions of dollars in derivatives they don't pay any tax at all. According to the Joint Committee on Taxation, a fee of just ten cents per $100 of trading on stocks, bonds, and derivatives would raise more than $700 billion over 10 years.[i] Such a fee would also discourage destabilizing short-term speculation.

End the CEO Bonus Loophole: Current law allows banks and other corporations to deduct unlimited amounts of executive compensation from their taxable income — if the pay is "performance based." This gives banks an incentive to perpetuate the reckless Wall Street bonus culture that was a key factor in the 2008 financial crisis. According to the Institute for Policy Studies, the top 20 U.S. banks paid out more than $2 billion in fully deductible performance bonuses to their top five executives between 2012 and 2015, for a taxpayer subsidy of $725 million. Ending the CEO bonus loophole would also discourage the ballooning levels of equity-based pay at non-financial companies. In the form of stock options, such pay packages encourage excessive short-termism in corporate management.

Leverage Fee on Large Financial Firms: Before the financial crisis, the largest Wall Street banks borrowed excessively. When these and other "too big to fail" financial institutions could not repay their debts, the financial system collapsed, doing enormous economic damage, and taxpayers were on the hook for huge bailouts. A 2016 Treasury Department proposal estimated that a small tax on wholesale non-deposit liabilities funded through debt at the largest banks, which is the riskiest form of big bank borrowing, could raise $111 billion over 10 years.[ii] It would also encourage banks to fund more of their liabilities through equity investment, discouraging future bailouts.

Limit Tax Benefits for Excessive Leverage at Non-Financial Firms: Wall Street financial institutions, particularly private equity firms, also benefit from current tax rules that provide an implicit subsidy to debt-financed acquisitions. In recent years, there have been bipartisan proposals that have proposed limiting or eliminating the interest deduction. For example, the 2011 Wyden-Coats tax plan would have cut back the interest deduction sharply by basing it on the real interest rate.

Excessive leverage for non-financial corporations, often created by leveraged acquisition strategies driven by private equity firms, increases the danger of bankruptcy for non-financial firms, with accompanying job loss and economic disruption.[iii] Indeed, the most recent IMF Global Financial Stability Report identified excessive leverage in the non-financial corporate sector as a major threat to employment and economic growth should interest rates increase from their current low level.[iv]

For non-financial companies, the interest deduction could be disallowed for companies that exceeded a certain ratio of debt to earnings before interest and taxes (EBITDA). For example, debt ratios of leveraged buy-out targets have typically averaged five to six times EBITDA, a level that poses significant risk. If EBITDA is considered too cyclical to use as a base for such a tax, the ratio of debt to a balance sheet metric of leverage such as debt to assets or equity could be used as a leverage metric. A cap on interest deductions for borrowings exceeding a metric of excessive debt could raise more than $100 billion over ten years.[v]

Close other Wall Street Loopholes and Tax Avoidance Schemes: Other measures that would make Wall Street pay its fair share include closing the reinsurance loophole that allows hedge funds and certain insurers to transport money to untaxed foreign “reinsurance” subsidiaries, requiring private equity firms to report bogus "monitoring fees" as taxable income, and taxing derivatives contracts on a standardized, mark-to-market basis in order to ensure that complex derivatives are not used to avoid taxes.[vi]

These tax changes could raise significant sums over a ten-year period while improving economic efficiency. The chart below shows how the tax package proposed above could raise $1 trillion over the next decade, while at the same time discouraging dysfunctional financial behaviors such as excessive leverage, predatory high-frequency trading, and stock option pay packages that create excessive focus on short-term profits. The package would also improve the fairness and equity of the tax code.

Reform	Revenue over 10 years
Wall Street Speculation Tax Of Ten Basis Points	$717 Billion
Leverage Fee on Large Financial Institutions	$111 Billion
Limit Tax Benefits For Excess Leverage at Non-Financial Firms	$100 Billion
End the CEO Bonus Loophole	$50 Billion
Mark to Market for Derivatives Contracts for Tax Purposes	$21 Billion
Close Carried Interest Loophole	$19 Billion
Crack Down on Bogus Private Equity Monitoring Fees	$10 Billion
Close the Reinsurance Loophole	$8 Billion
Total	**$1 Trillion +**

Sources: U.S. Treasury and Joint Committee on Taxation; AFR estimate

[i] See Congressional Budget Office, "Option 41: Impose a Tax on Financial Transactions", in *Options For Reducing the Deficit: 2017 to 2026*, citing to Joint Committee on Taxation. Available at https://www.cbo.gov/budget-options/2016/52287

[ii] United States Treasury, *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, Department of the Treasury, February, 2016.

[iii] Appelbaum, Eileen and Rosemary Batt, *Private Equity at Work: When Wall Street Manages Main Street*, Russell Sage Foundation, March, 2014.

[iv] International Monetary Fund, *2017 Global Financial Stability Report*: *Getting the Policy Mix Right*, April, 2017, available at https://www.imf.org/en/Publications/GFSR/Issues/2017/03/30/global-financial-stability-report-april-2017

[v] Estimate by Americans for Financial Reform, should be considered highly approximate. Estimate assumes a five percent reduction in non-financial sector interest deductions, taxed at 35 percent, calculated from 2013 IRS data and projected over ten years with inflation adjustments.

[vi] For explanations of these provisions, see United States Treasury, *General Explanations Of The Administration's Fiscal Year 2017 Revenue Proposals*, Department of the Treasury, February, 2016; Appelbaum, Eileen and Rosemary Batt, *Fees, Fees, and More Fees: How Private Equity Abuses Its Limited Partners and U.S. Taxpayers*, Center for Economic and Policy Research, May, 2016.