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TAX FAIRNESS: PRESIDENT DONALD TRUMP, A CASE STUDY

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*The views expressed are my own and should not be attributed to the Urban Institute, the Brookings Institution, the Tax Policy Center, their trustees, or their funders.

Chairman Pascrell, Ranking Member Kelly, distinguished Members of the Subcommittee, and other Members of the Ways and Means Committee:

Thank you for inviting me to share my views on tax fairness, a topic that has been in the news recently, after the New York Times (the "NYT") shined a spotlight on the income taxes of President Trump.[1]

My testimony will examine tax fairness from three perspectives: (1) the fairness of the amount of taxes the President reportedly paid, (2) the fairness of the President's reported business losses, and (3) the fairness of the Internal Revenue Service ("IRS") audit of President Trump's income taxes.

In 1974, President Richard M. Nixon voluntarily released his tax returns to quiet the public clamor over his reportedly low tax payments. He also invited the Congressional Joint Committee on Taxation to review his tax returns after the IRS reportedly let them pass. In the years since, every President until Donald J. Trump voluntarily released his returns to the public.[2] Also, since President Nixon, the IRS automatically audits every President's returns.[3]

In 2019, Chairman Neal asked the IRS for information on President Trump's tax returns and his audit.[4] The Chairman sought to determine whether the President's audit was being conducted fairly and impartially. But the IRS refused to release the requested information—and forced the Chairman to pursue his request in court.[5]

Last month, the NYT published details from more than 20 years of the President's tax returns. The NYT had previously published tax information on Trump going back to 1985.[6]

Because President Trump has not released his tax returns, I base my testimony on details published by the NYT and other media sources.

I. Are Mr. Trump's Taxes "Fair"?

No, if we look to horizontal and vertical equity to evaluate "tax fairness." Horizontal equity means taxpayers with the same income or the same economic situation pay the same amount in taxes. Vertical equity means those that can afford to pay more, do so.

President Trump's tax payments, as reported by the NYT, are low by both standards.

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[1] Buettner, Craig, and McIntire, "Long-concealed Records Show Trump's Chronic Losses and Years of Tax Avoidance," NYT, Sept. 27, 2020.

[2] President Gerald Ford opted to release a summary of his returns rather than the returns themselves. See "Presidential Tax Returns," Tax Analysts, available at https://www.taxnotes.com/presidential-tax-returns.

[3] IRS, Internal Revenue Manual, Section 4.8.4, available at https://www.irs.gov/irm/part4/irm_04-008-004.

[4] Letter by Richard E. Neal, dated April 3, 2019, available at https://int.nyt.com/data/documenthelper/740-congress-request-trump-tax-returns/8fca455b44e383714434/optimized/full.pdf.

[5] Letter by Richard E. Neal, dated May 10, 2019, available at https://int.nyt.com/data/documenthelper/876-subpoena-irs-treasury/0b7a5ac978ab60960b53/optimized/full.pdf#page=1

[6] Buettner and Craig, "Trump Tax Figures Show a Decade of Huge Losses," NYT, May 8, 2019; Barstow, et al., Trump Took Part in Suspect Schemes to Evade Tax Bills, NYT, Oct. 3, 2018; Barstow et al., "Donald Trump Used Legally Dubious Method to Avoid Paying Taxes," NYT, Nov. 1, 2016.

Average income tax liability by income, 2017

AGI	Number of Returns	Average Tax Liability
None (includes deficits)	3,445	$57,698
$1-$40,000	33,525,246	$1,398
$40,000-$100,000	42,724,906	$5,903
$100,000-$500,000	25,989,999	$26,201
$500,000-$1,000,000	1,009,082	$171,421
$1,000,000-$2,000,000	312,813	$378,625
$2,000,000-$10,000,000	161,343	$1,066,082
$10,000,000+	20,209	$7,997,099
All taxable returns	103,747,043	$15,473

Source: IRS, SOI Tax Stats, Publication 1304, Table 1.1, year 2017, available at https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report.

According to the NYT, for 2017, President Trump paid only $750 of taxes, but the NYT did not report the President's adjusted gross income ("AGI"). The President regularly compares himself to the highest-income and richest Americans. However, his taxes are not comparable: $750 is a small fraction of the $8 million average paid in 2017 by the top category of taxpayers, those with an AGI of more than $10 million.

$750 is also less than the average tax bill at every income level, including the average paid by those reporting AGI between $1 and $40,000 for the year. President Trump even paid less than the average of the few thousand taxpayers reporting zero or negative AGI.

Perhaps President Trump's 2017 tax return just represents a businessman who had a bad year (and there may be other businessmen at the bottom two categories). But Mr. Trump paid little or no taxes repeatedly. According to the NYT, Mr. Trump also paid $750 for 2016. He reportedly paid nothing for ten of the prior 15 years. The NYT reported that Mr. Trump paid the alternative minimum tax ("AMT") for several years, but the NYT did not report the amount.[7]

II. Are Mr. Trump's reported business losses fair?

Yes, if they are reported accurately, and no, if they are not. According to the NYT, Mr. Trump deducted large operating expenses and losses for his businesses, resulting in zero or negative AGI for many years.[8] As a result, Mr. Trump reportedly paid little or no tax in those years.

[7] The AMT applies to taxpayers with high economic income by setting a limit on certain tax benefits that can significantly reduce a taxpayer's regular tax amounts. The AMT helps to ensure that those taxpayers pay at least a minimum amount of tax by adjusting items that can reduce ordinary income tax liability. For example, the deduction for net operating losses is limited to 90 percent of AMT income, and the limit on losses could trigger an AMT liability.

[8] The figure below reflects Mr. Trump's income, as reported by the NYT. Mr. Trump's income was not reported by the NYT after 2009.

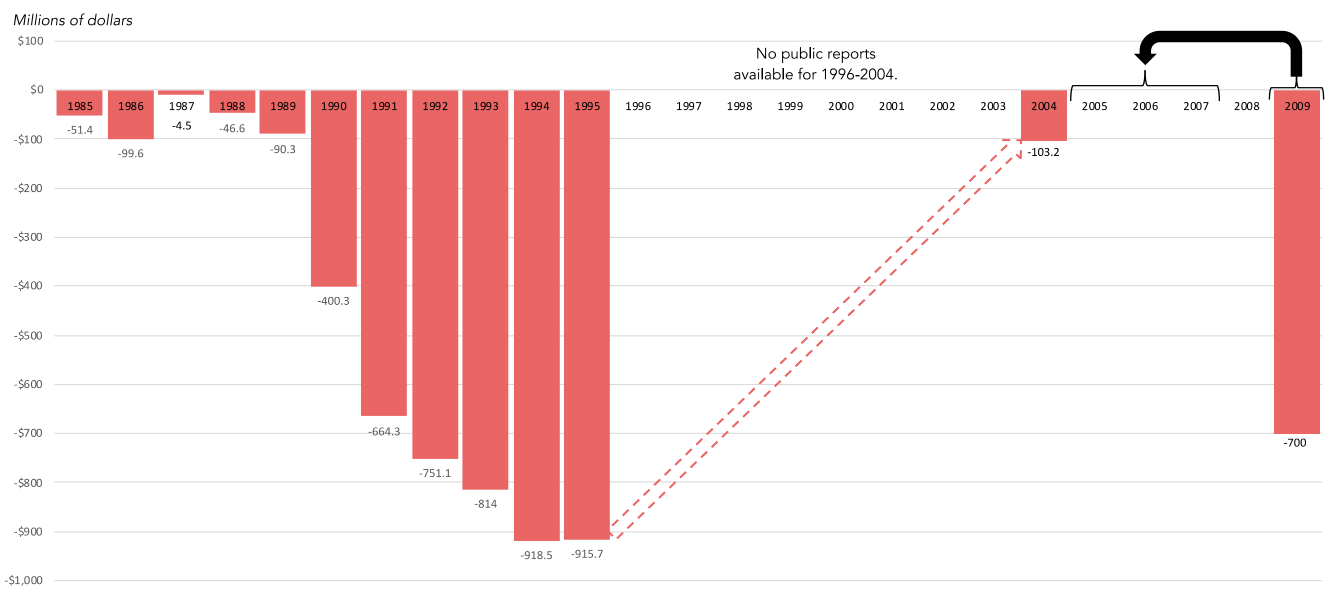
Deductions for business expenses and for losses are critical to determine taxable income. If accurate, the deductions help reflect the economic situation of taxpayers and their ability to pay income taxes. However, if the amounts deducted are inflated, artificial, or omit offsets, they distort income.

Businesses that have deductible expenses that exceed their gross income generate net operating losses. These losses may be deducted in other years to help smooth out large fluctuations in income that might occur over time.[9]

Individuals, like Mr. Trump, who own pass-through businesses, such as partnerships or limited liability companies, may deduct their businesses' losses on their personal return. Prior to 2018, these losses could be carried back two years or carried forward 20 years to reduce income on earlier or later returns.[10]

The solid red columns in the chart--for 1988 through 1995--show Mr. Trump's negative AGI after mounting losses at his businesses, as reported by the NYT. Each year during this period, Mr. Trump's losses accumulated, reaching $916 million by 1995. For example, on his 1989 return, Mr. Trump reported about $90 million of losses that he carried to 1990, and in 1990 he had about $310 million of new losses, resulting in a carryforward of $400 million of losses to 1991. By 1995, Mr. Trump had $916 million of losses to carry forward.

Mr. Trump's Adjusted Gross Income, 1985-2009



Sources: Buettner, R and Craig, S. (2019, May 8). Decades in the Red: Trump Tax Figures Show Over $1 Billion in Business Losses. *New York Times*.
Buettner, R, Craig, S, and McIntire M. (2020, Sep 27). Long-Concealed Records Show Trumps Chronic Losses and Years of Tax Avoidance, *New York Times*.
Note: Totals approximated with data from New York Times reports.

After 1995, Mr. Trump reportedly began making money—and his accumulated losses declined through 2004. In other words, Mr. Trump reportedly used portions of these accumulated losses to erase income (i.e., he carried forward those prior losses to deduct against current income). By 2005, Mr. Trump "burned through" his last $103 million of losses

[9] Congressional Research Service, "The Tax Treatment and Economics of Net Operating Losses," May 29, 2020.

[10] For 2018, the Tax Cuts and Jobs Act permitted taxpayers to carry business losses forward, but not back. Temporary relief enacted in 2009 and, later, in 2020, allowed taxpayers to carry business losses back 5 years.

and started reporting positive income—and paying income tax. But, in 2009, Mr. Trump reportedly replenished his stockpile of losses with more than $700 million of new business losses, which he then carried back to deduct against the income he had reported in 2005 through 2007.

Based on NYT reports, Mr. Trump generated the vast amount of red ink by borrowing, spending, and losing a large amount of money in a series of failed ventures, mainly casinos. Mr. Trump later defaulted on his loans, which left his creditors bearing the loss economically.

Taxpayers, like Mr. Trump, do not recognize income when they borrow funds. The logic is that taking on debt increases their assets but also increases their liabilities, in the form of an obligation to repay the debt. However, when their creditors relieve them from part or all of their obligation to repay, they generally must report the difference as income subject to tax. Mr. Trump apparently sidestepped that responsibility.

We have no evidence that Mr. Trump violated the law but he stretched it beyond recognition to omit income (and to preserve his large stockpile of business losses through the 1990s).[11] He did not report taxable income when hundreds of millions of dollars of his loans were forgiven by his creditors, which would have caused him to forego about half of his $916 million of accumulated losses (and thus reduced his ability to use those losses to erase income).[12]

Similarly, we cannot tell whether Mr. Trump violated any laws by replenishing his losses with a $700 million dollar deduction in 2009, which he carried back to 2005, 2006, and 2007 to recover the $70 million of taxes that he had paid for those years.[13] President Trump and the IRS continue to disagree on the appropriateness of this large loss, according to the NYT.

III. Is the IRS Audit of President Trump Fair?

We can’t say, without more information.

Mr. Trump’s lawyers, in 2016, stated that Mr. Trump’s “personal tax returns had been under continuous examination by the IRS since 2002, consistent with the IRS’s practice for large and complex businesses.”[14] As of 2016, the IRS closed its examinations of Mr. Trump’s tax returns for the years 2002 through 2008, but continued to examine his returns for the 2009 year and forward.

According to the NYT, the IRS audit for Mr. Trump’s 2009 year still is open, after another four years. An audit for an individual that is still open after 12 years is unusual. But, without more information, we cannot determine whether any part of the delay is attributable to Mr. Trump’s status as President.

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[11] Rosenthal, “Protecting Trump’s $916 Million of NOLs,” Tax Notes (Nov. 7, 2016).

[12] Letter by Sheri Dillon and Will Nelson, Morgan Lewis, dated March 7, 2016, available at . https://assets.donaldjtrump.com/Tax_Doc.pdf.

[13] Trump filed a “quickie refund” request in January 2010, under the special carryback rules enacted in 2009, similar to the special carryback rules enacted in the CARES Act for 2018-2020. The IRS must pay a “quickie refund” within 90 days and may audit the refund later. IRC §6411(a).

[14] Letter by Sheri Dillon and Will Nelson, Morgan Lewis, dated March 7, 2016

Some of the delay is almost certainly attributable to the sprawling nature of Mr. Trump's businesses empire. As his lawyers explained, because Mr. Trump "operates his businesses almost exclusively through sole proprietorships and/or closely held partnerships, [his] personal federal income tax returns are inordinately large and complex for an individual."[15]

Importantly, our tax system is "voluntary," it's based on self-assessment. That is, we depend on taxpayers to calculate, declare, and pay their taxes accurately. But a voluntary system requires goodwill, which requires a fair and thorough auditing system. And the system breaks down, if taxpayers don't cooperate.

The IRS often struggles to ensure compliance by taxpayers that earn their income through complicated financial arrangements or through passthrough entities.[16] Enforcement for ordinary wage and salary workers is easy, because of information matching. The IRS gets the same information from the W-2 form that a wage earner receives from their employer. But for sole proprietors and other business owners, it's much harder, because there is little or no third-party reporting of income and expense items—which leads to a sizable tax gap.[17]

And the IRS is losing the compliance race. Over the last two decades, the IRS' funding has been cut and its administrative capacity suffered. In FY 2020 the appropriation for the IRS was $11.5 billion, slightly down from $12.1 billion in 2010 in nominal dollars, but down more than 20 percent in real dollars, even as the economy has grown and the IRS' responsibilities have increased. The effects of these budget cuts are apparent in many areas. For example, the audit rate for all individual taxpayers fell from 0.9 percent in 2010 to 0.4 percent in 2019. For taxpayers with over $1 million in positive income, the audit rate fell from 8.4 percent to 2.4 percent over the same period.

More resources for the IRS are clearly needed. At a minimum, the IRS must have enough enforcement tools to maintain a credible threat to taxpayers who would avoid or evade the law.

Mr. Trump is one of the relatively few individuals who has been audited. However, without more information, we cannot say whether his audit has been adequate—or fair. And we can't assess the outcome.

I am happy to take questions, thank you.

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15 Id.

16 Hanlon, "Unrigging the Economy Will Require Enforcing the Tax Laws," Center for American Progress (March 12, 2020), available at https://www.americanprogress.org/press/release/2020/03/12/481568/release-weakened-tax-enforcement-rigs-economy-workers-honest-taxpayers/.

17 See, e.g., "Individual Returns with Large Business Losses and No Income Pose Significant Compliance Risk, " (auditing the IRS review of Schedule C filings, profit or loss from business by sole proprietorships) available at https://www.treasury.gov/tigta/auditreports/2020reports/202030056fr.pdf.

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