

Taxation to End Stagnation

by David Wayne Hancock Jr.

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In this article, Hancock examines current proposals to end wage stagnation, and he suggests that the best solution may be a new tax deduction for business entities that increase employee wages.

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I. Introduction

In 2017 the wealthiest 1 percent of individuals captured 82 percent of newly created wealth.¹ On its face, this fact is not problematic; but in context it illustrates a larger problem in the American economy: wage stagnation, which is the slow growth of income derived from employment for low- and middle-income employees when their incomes are adjusted for inflation. The United States had an inflation-adjusted GDP of \$1.076 trillion in 1970, and a GDP of \$18.624 trillion in 2016.² That correlates to an average approximate growth rate of 2.7 percent annually. Over this period, inflation-adjusted wages have stagnated, with a growth rate of only 0.2 percent per year.³

Traditional macroeconomics postulates that “wages grow with productivity,”⁴ while the statistics suggest this has not been true over the last 47 years. Between 1973 and 2013, productivity rose by 74.4 percent, while hourly compensation grew by 9.2 percent.⁵ This stagnant wage growth

was not experienced by all income levels: Between 1979 and 2013, wages for the top 1 percent of earners grew by 138 percent, while wages for the bottom 90 percent of earners grew by 15 percent. Wage growth was not experienced by the entire bottom 90 percent of earners over this time, with the lowest-wage workers experiencing their inflation-adjusted wages decrease by 5 percent.⁶

Several key factors have created the problem of wage stagnation.⁷ The first is the abandonment of the goal of full employment in the economy by macroeconomic policymakers over the last 35 years, who cite concerns about inflation. An important consequence of this policy shift is that low-wage employment is in higher demand, which has allowed low-wage employers to depress the wages for those positions. Another factor contributing to wage stagnation is the decline of union membership. Thus, more corporate revenue has been shifted to high-wage earners and corporate profits.⁸

The third factor contributing to wage stagnation is financial deregulation, the change of tax law around executive compensation, and reduction of the top marginal tax rates. The result is that wealth has accumulated in the top tranches of the economy, and the holders of that wealth have been able to wield increasing amounts of political power to favor policies that further improve their position. The last factor in wage stagnation is the globalized economy. The consequence is that traditional low-wage jobs in the United States have been shifted to countries that allow businesses to pay even lower wages,

¹Katie Hope, “World’s Richest 1% Get 82% of the Wealth,” Says Oxfam,” *BBC News* (Jan. 22, 2018).

²The World Bank, “GDP (current US\$).”

³Jay Shambaugh and Ryan Nunn, “Why Wages Aren’t Growing in America,” *Harv. Bus. Rev.* (2017).

⁴Michael Burda and Charles Wyplosz, *Macroeconomics: A European Text* 115 (6th ed. 2013).

⁵Lawrence Mishel, Elise Gould, and Josh Bivens, “Wage Stagnation in Nine Charts,” Economic Policy Institute (2015).

⁶*Id.*

⁷Lawrence Mishel, “Causes of Wage Stagnation,” Economic Policy Institute (2015).

⁸*Id.*

which has led to the boosting of wages for the top earners and an increase in corporate profits.⁹

The solution to ameliorate wage stagnation will be multifaceted and likely include a combination of several current proposals. This article focuses on proposals for a universal basic income (UBI) and tax policy changes. After an analysis of the proposals, the article then proposes a solution to wage stagnation that would establish a new tax deduction for business entities that increase employee wages. Finally, after explaining the proposal, the article analyzes the anticipated results of the new proposal.

II. Universal Basic Income

UBI is a theoretical construct that has been discussed by economic theorists for centuries. In basic terms, UBI can be thought of as a giving a Social Security payment to every American. UBI minimally addresses the causes of wage stagnation; however, it does address the issues created by wage stagnation by providing a monetary payment to everyone, including low-wage earners.

A. UBI: A Brief History

The modern theoretical basis for UBI can be traced to Thomas More's 1516 publication *Utopia*, in which he advocated that wealth generated from shifting public lands to private ownership should be shared.¹⁰ This idea was further developed by famed American pamphleteer Thomas Paine in his 1797 publication *Agrarian Justice*, in which he stated that government should create a "national fund [to pay] . . . every person . . . as a compensation in part, for the loss of his or her natural inheritance, by the introduction of the system of landed property."¹¹ More recently, economists, thinkers, and leaders like Milton Friedman,¹² Richard Nixon,¹³ and Martin Luther King Jr.¹⁴ have supported UBI in some form.

⁹ *Id.*

¹⁰ See generally More, *Utopia* (3d ed. 2016).

¹¹ Paine, *Agrarian Justice*, Social Security Administration Social Insurance History.

¹² Friedman, "The Case for the Negative Income Tax," *Nat'l Rev.* 239-241 (Mar. 7, 1967).

¹³ Nixon, "324 — Address to the Nation on Domestic Programs," U.C. Santa Barbara The American Presidency Project (Aug. 8, 1969).

¹⁴ King, *Where Do We Go From Here: Chaos or Community* 171 (2010).

Building on the theoretical foundation established over the last five centuries, a group of leaders are making proposals for UBI to be enacted today.

B. UBI: A Modern Proposal

The leader of the modern UBI movement is Philippe Van Parijs, a professor at Université catholique de Louvain in Louvain-la-Neuve, Belgium. Van Parijs has proposed that an income be paid "by a political community to all its members on an individual basis, without a means test or work requirement."¹⁵ The mechanics and intent of this proposal are witnessed the way Van Parijs describes each part of the proposal individually.

The income would be paid in cash, regularly.¹⁶ The purpose of this is twofold. First, the cash payment supplements in-kind transfers of free education or basic health insurance; and second, by providing the income on a regular basis, purchasing power is continually provided to the income's recipients, which allows for planning.¹⁷

While most UBI proposals call for a nation-state to pay for the income out of a redistributive tax, that is not the only method to implement an effective UBI. While the nation-state is the traditional target of UBI proposals, UBI can be implemented at the state or local levels in the United States, or at supranational political levels like the European Union or United Nations. While UBI may be funded through a specific, earmarked fund, it may also be funded through a tax on land, natural resources, or a VAT.¹⁸

While most proposals for UBI limit the income payments to citizens of the political community, this is not the only possible method. Advocates of UBI who view the income as a tool of inclusion in a society take the position that all legal residents of a political community should receive UBI in order to prevent the further dualization of the labor market. Citizenship status joins age and criminal status among issues facing UBI

¹⁵ Bruce Ackerman, Anne Alsott, and Van Parijs, *The Real Utopias Project: Redesigning Distribution: Basic Income and Stakeholder Grants as Alternative Cornerstones for a More Egalitarian Capitalism*, vol. V, at 4 (May 2003).

¹⁶ *Id.* at 5.

¹⁷ *Id.*

¹⁸ *Id.*

eligibility. Van Parijs proposes a UBI that begins at adulthood and extends into retirement age; however, an individual loses the income upon incarceration.¹⁹

Unlike traditional welfare programs in the United States,²⁰ and unlike other wealth redistributive programs like the earned income tax credit,²¹ UBI would be paid to each individual in the community, regardless of household composition.²² Also unlike the EITC, UBI would not be subject to a means test, thus allowing every member of the community to benefit from the income. Giving the income to the rich as well as poor would not make the rich richer, because a progressive tax system would ensure that wealthy individuals not only pay for their own UBI income but also the UBI income for poor individuals.²³

Income from UBI would be given to its recipients without a work requirement, which necessarily means that the amount of income granted would not be contingent on the amount of money contributed to the overall system. Further, UBI would be paid by right, irrespective of willingness to work. However, because it would not be subject to the income tax, individuals in low-income tranches would always be better off working under a system with UBI than under a traditional means-tested welfare state, which has the consequence of disincentivizing work.²⁴

C. UBI: A Critical View

While the supporters of UBI believe that it would create a future of economic freedom and boundless opportunity, UBI's opponents submit that its fundamental premise is flawed. One argument against UBI is that it would reallocate

resources to higher economic tranches by spending additional trillions on UBI or by limiting resources available to the poor.²⁵ Also, substituting a UBI for a means-tested welfare system would make reducing or eliminating benefits in the face of budget pressures easier.²⁶

Pursuing full employment, raising the minimum wage, expanding the EITC, supporting trade unions, and paying caregivers would be more effective at providing a basic standard of living than a UBI.²⁷ A UBI would also require an eligibility determination, which would have the same overhead costs associated with verification that burden means-tested welfare programs.²⁸

Opponents of UBI also point to the negative consequences that it could have on its recipients' quality of life.²⁹ They argue that misery is experienced by many people already receiving welfare benefits, and UBI is a benefit program that risks spreading this misery to many more. Also, many people find joy and meaning in life through work; opponents say improving quality of life requires transforming the way we think about and conduct work, not by providing a government benefit.³⁰

D. UBI: An Economic Analysis

It is undeniable that UBI would have a substantial effect on any economy in which it is implemented. Fortunately, a model is available to predict the macroeconomic effects of UBI on a society.³¹ The model examines two UBI amounts — \$1,000 per month and \$500 per month — financed by either a fully tax-funded system or deficit spending over an eight-year period. The model also takes the distributional effect of the income into account. The distributional effect

²⁵ IMF, "IMF Fiscal Monitor: Tackling Inequality, October 2017," ch. 1, at 21 (Oct. 2017).

²⁶ Isabel V. Sawhill, "Money for Nothing: Why a Universal Basic Income Is a Step Too Far," The Brookings Institution (June 15, 2016).

²⁷ Mike Konczal, "Guest Post: Max Sawicky on the Liberal Case Against a Universal Basic Income," The Roosevelt Institute (Dec. 17, 2013).

²⁸ *Id.*

²⁹ George Zarkadakis, "The Case Against Universal Basic Income," *The Huffington Post*, Feb. 27, 2017.

³⁰ *Id.*

³¹ Michalis Nikiforos, Marshall Steinbaum, and Gennaro Zezza, "Modeling the Macroeconomic Effects of a Universal Basic Income," The Roosevelt Institute (Aug. 2017).

¹⁹ *Id.*

²⁰ Ron Haskins, "Means-Tested Programs, Work Incentives, and Block Grants," The Brookings Institution (Apr. 17, 2012).

²¹ Publication 596, "Earned Income Credit (EIC): For Use in Preparing 2017 Returns," at 30 (2018).

²² Ackerman, Alsott, and Van Parijs, *supra* note 15, at 8.

²³ *Id.* at 9.

²⁴ *Id.* at 10.

considers that additional income in the hands of low-income households leads to higher spending, leading to higher levels of consumption in the economy, while high-income households are more likely to save additional income.

Funding UBI through deficit spending would create the largest measurable growth for the economy. For the \$1,000-per-month payment, when the distributional effects are not accounted for, GDP is projected to increase by 12.56 percent above baseline, price levels are projected to increase by 3.68 percent, and nominal wages are projected to increase by 5.16 percent. When distributional effects are taken into account, GDP is projected to increase by 13.1 percent, price levels are projected to increase by 3.77 percent, and nominal wages are projected to increase by 5.23 percent. For the \$500-per-month payment, when the distributional effects are not accounted for, GDP is projected to increase by 6.5 percent above baseline, price levels are projected to increase by 1.96 percent, and nominal wages are projected to increase by 2.75 percent. When distributional effects are taken into account, GDP is projected to increase by 6.79 percent above baseline, price levels are projected to increase by 2.02 percent, and nominal wages are projected to increase by 2.8 percent.³²

In the fully tax-funded system, no effect on the economy is witnessed relative to the baseline for either payment amount when distributional effects are not taken into account. This is because money is simply being redistributed from high-wage individuals to low-wage earners. When distributional effects of the payment are taken into account, the UBI has a positive effect on the overall economy: For the \$1,000 monthly payment, GDP is projected to increase by 2.62 percent over the baseline, price levels are projected to increase by 0.56 percent, and nominal wages are projected to increase by 0.51 percent; and for the \$500 monthly payment, GDP is projected to increase by 1.65 percent, price levels are projected to increase by 0.37 percent, and nominal wages are projected to increase by 0.37 percent.³³

³²*Id.*

³³*Id.*

The cost of a UBI program in the United States would be immense. As a percentage of the 2013 U.S. tax base, the \$500-per-month proposal would account for 60 percent of the tax base, while the \$1,000-per-month proposal would account for 120 percent of the tax base. To account for this increase in cost, tax rates would have to be adjusted. While low-wage earners would not experience a tax increase under either plan, under the \$500-per-month proposal, taxes would have to increase by 5 percent for the fourth quintile of earners and up to 26 percent for the top 1 percent of earners in order to fully fund the proposal. For the \$1,000-per-month proposal, the middle quintile of earners would experience a tax increase of 11 percent, while the top 1 percent of earners would have an increase of 35 percent in order to fully fund the proposal.³⁴

Even with the scale of a UBI program, there are potential savings in other areas of government spending. Many supporters of UBI center their proposals around it as a substitute for traditional, means-tested welfare programs. The United States spends around \$881 billion on its means-tested welfare programs annually.³⁵ Critics of UBI often argue that it will disincentivize work; however, the model projects the employment rate will increase after UBI is implemented.³⁶ The current welfare system creates “welfare cliffs,” which limits programs to specific income levels and essentially taxes low-income individuals whose incomes rise even one dollar too high.³⁷ In addition to welfare cliffs giving incentives to benefit recipients to limit their income, these programs have high costs associated with their bureaucratic administration. The adoption of a UBI proposal as a substitute for the current welfare system would eliminate both of those issues.³⁸

In a debt-conscious political environment, it is important to note the effects that a UBI would have on the accumulated debt of the federal government. While a UBI funded by deficit

³⁴*Id.*

³⁵ Andrew Flowers, “What Would Happen if We Just Gave People Money?” *FiveThirtyEight*, Apr. 25, 2016.

³⁶ Nikiforos, Steinbaum, and Zezza, *supra* note 31.

³⁷ Flowers, *supra* note 35.

³⁸*Id.*

spending could cause logarithmic growth in the federal debt, a UBI that is fully tax funded could actually reduce the federal debt when the rate adjustments discussed above are implemented. For the \$500 monthly payment, a deficit-funded UBI is projected to increase the federal debt by 4.73 percent over eight years, while the fully tax-funded UBI could reduce the federal debt by 0.78 percent over eight years, when distributional effects are taken into account.³⁹ For the \$1,000 monthly payment, a deficit-funded UBI is projected to increase the federal debt by 9.33 percent over eight years, while the fully tax-funded UBI could reduce the federal debt by 1.39 percent over eight years, when distributional effects are taken into account.⁴⁰

III. Refundable Tax Credits as a Wage Subsidy

For purposes of the IRC, income is a clearly realized and undeniable ascension to wealth over which the taxpayer has complete control.⁴¹ After this income determination, it must then be determined if the gain is taxable, and if so, when the gain is taxable. Refundable tax credits are realized by taxpayers when their tax returns are filed, improve the financial position of the taxpayer, and the proceeds are given to the taxpayer for use at their discretion. This shows that refundable tax credits are nontaxable income, and therefore subsidize the wages of low- and middle-income taxpayers.

A hallmark of many proposals to assist low-income individuals is a plan to tie a benefit to some sort of production, typically employment. A simple way to administer this kind of benefit would be to do so through the tax system. The United States provides the EITC, a benefit for low- and middle-income individuals, through the tax system. A proposal exists that would replace the EITC with a fully refundable tax credit for 100 percent of the individual's first \$10,000 of earnings.

A. The EITC

While the EITC is administered through the code, it is, in effect, a social welfare program.⁴² It was designed to confer a benefit upon low-income individuals, while at the same time encouraging them to work rather than receive assistance from a traditional, means-tested welfare program.⁴³ In addition to giving incentives low-income individuals to increase their income through labor, the EITC is an economic stimulus because it shifts funds from high-income individuals who are more likely to save their money to low-income individuals who are more likely to spend the money immediately.⁴⁴ It also combats the effects of inflation and wage stagnation by providing additional funds to low-income individuals suffering from rising food and energy prices.⁴⁵

As discussed above, the EITC is a fully refundable tax credit for low- and moderate-income individuals who file a tax return and meet specific requirements.⁴⁶ To qualify for the EITC, a taxpayer must (1) have earned income; (2) be a U.S. citizen or resident alien for the entire year; and (3) have a valid Social Security number for themselves, their spouse if filing jointly, and for any qualifying children.⁴⁷ A qualifying child is (1) a child of the taxpayer, descendant of the taxpayer's child, the taxpayer's sibling, or a descendant of the taxpayer's sibling, who (2) has the same principal place of abode for more than half of the tax year, (3) is under the age of 19 or is a student under the age of 24, (4) has had more than half of their support provided by the taxpayer, and (5) has not filed a joint return with another taxpayer.⁴⁸ Unfortunately, a taxpayer fails to qualify for the EITC if their filing status is married filing separately.⁴⁹ As the charts in the statute that authorizes the EITC make clear, the EITC is gradually phased out as income increases, and a

⁴² *In re Searles*, 445 F. Supp. 749, 753 (D. Conn. 1978).

⁴³ See S. Rep. No. 94-36, 94th Cong., 1st Sess. 11 (1975), reprinted in 1975 U.S. Code Cong. & Ad. News 54, 63-64.

⁴⁴ *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 864 (1986).

⁴⁵ *Id.*

⁴⁶ IRS, "Earned Income Tax Credit (EITC)."

⁴⁷ Section 32.

⁴⁸ Section 152(c).

⁴⁹ Section 32.

³⁹ Nikiforos, Steinbaum, and Zezza, *supra* note 31.

⁴⁰ *Id.*

⁴¹ *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

taxpayer who is single and doesn't claim a qualifying child will receive fewer benefits than taxpayers who are married and filing jointly and have three or more qualifying children.⁵⁰

The EITC's implementation has increased work among the target low-income group, lifting millions of Americans out of poverty.⁵¹ Since 1975 the EITC has grown, providing increasingly large benefits to more taxpayers. In 1975 around 6.2 million families received the EITC, at an average amount of \$201 per family.⁵² That equates to a total cost of \$1.25 billion for the year, of which \$900 million represented a refund of the credit. In 2015 about 28 million families received the EITC, at an average amount of \$2,440 per family. The total cost was more than \$68.52 billion, of which about \$58.79 billion represented a refund of the credit.⁵³

The elements listed above that test a taxpayer's eligibility for the EITC are simplified points that are subject to a litany of additional rules and regulations. Thus, the EITC occasionally falls victim to overpayments, primarily from taxpayer error, but occasionally because of fraud.⁵⁴ Nina Olson, the national taxpayer advocate, has testified before Congress that overpayments occur so infrequently, regardless of the cause, that about 20 percent of all EITC expenditures are made in an effort to verify eligibility.⁵⁵ In addition to issues of administrability, the EITC gives employers an incentive to pay lower wages to its recipients.⁵⁶ Another motivation for this behavior from employers is that reducing the wages of EITC-eligible employees can reduce incidence of turnover among EITC-ineligible employees

because the post-tax wages of both groups would then be similar.⁵⁷

B. The Rising Tide Wage Credit

In a coming article, Leonard E. Burman, an expert with the Tax Policy Center, writes about a proposal for a fully refundable universal wage credit that would be supported by the implementation of a VAT, which he submits would solve issues surrounding wage stagnation.⁵⁸ Under the proposal, a universal, fully refundable wage credit of 100 percent of the first \$10,000 earned would be made available to all individual taxpayers. The credit would be financed through the implementation of a broad-based VAT at an estimated 8 percent. There would also be an increase in the child tax credit — in addition to making that credit fully refundable — and a full repeal of the EITC. The pecuniary gain received from the credit would be treated as income for purposes of determining eligibility for federal means-tested welfare programs.

In the plan, there would be a phase-in for the credit and VAT and a phaseout for the EITC over a four-year period. The four-year period is intended to minimize market disruption, give the IRS and businesses time to adopt the VAT to comply with the law, and create time to calibrate the program for it to be revenue neutral over a 10-year budget window. The first thing that separates the credit from other proposals is that it would be available to all taxpayers and would not phase out based on income. In contrast, the EITC phases out and is unavailable to taxpayers whose income has reached a minimal threshold. The second thing that separates the credit from other proposals is that the credit could be advanced by employers to employees, with the limitation that only one employer may advance the credit for employees that have multiple employers.⁵⁹

Any innovative proposition of tax reform presents several issues that have to be resolved,

⁵⁰ *Id.*

⁵¹ Hilary Hoynes, "The Earned Income Tax Credit: A Key Policy to Support Families Facing Wage Stagnation," U.C. Berkeley Institute for Research on Labor and Employment (Jan. 10, 2017).

⁵² Urban-Brookings Tax Policy Center, "EITC Recipients 1975-2015" (Oct. 4, 2017).

⁵³ *Id.*

⁵⁴ Robert Greenstein, John Wancheck, and Chuck Marr, "Reducing Overpayments in the Earned Income Tax Credit," Center on Budget and Policy Priorities (Feb. 20, 2018).

⁵⁵ Testimony of Olson, "IRS National Taxpayer Advocate Before House Appropriations Subcommittee on Financial Services and General Government," at 31 (Feb. 26, 2014).

⁵⁶ Jesse Rothstein, "Is the EITC as Good as an NIT? Conditional Cash Transfers and Tax Incidence," Princeton University (Jan. 2009).

⁵⁷ Andrew Leigh, "Who Benefits From the Earned Income Tax Credit? Incidence Among Recipients, Coworkers and Firms," Australian National University — Economics Program, Research School of Social Sciences, at 12 (May 2010).

⁵⁸ Email from Burman, "The Rising Tide Wage Credit," TPC (Mar. 19, 2018) (on file with author) (cited with permission).

⁵⁹ *Id.* at 8.

and the same is true for this credit. First, as with the EITC, the incentive for individuals to work presented by the credit would enable employers to lower wages. The increased supply of low-wage labor, coupled with the availability of money from the government, would likely cause the price point for low-wage labor to fall.⁶⁰ Second, that the credit could be advanced by employers invites the possibility for fraud by both employer and employee. The potential for fraud arises on the part of the employee in that an employee with multiple employers may ask each employer to advance the credit to him. The potential for fraud arises on the part of the employer in that the employer may assert to the IRS that the credit was advanced to the employee. Third, the universality of the credit would reduce its ability to combat wage stagnation relative to high-income individuals. A universal credit, by definition, improves every worker's financial position, regardless of income. This would hamper the credit's ability to resolve the issues surrounding wage stagnation because the increased financial position of high-wage individuals relative to low- and middle-wage earners is likely to maintain the status quo among income levels, also potentially introducing higher levels of inflation, which would worsen the effects of wage stagnation.

IV. The American Wage Improvement Deduction

Wage stagnation has been a problem for low- and middle-income earners in the economy for many years. Many solutions have been proposed, and several have been attempted. In the face of those proposals and enacted policies, wage stagnation is still an issue today, with most evidence suggesting that it will continue. Given the theoretical nature of UBI, issues surrounding other proposals, and problems with current law, the time has come for a simple and practical proposal regarding solutions to wage stagnation.

A. The Proposal

This proposal is intended to solve the issue of wage stagnation by offering incentives to business entities to increase the wages of employees who

are in a salary range that has suffered from wage stagnation over recent decades. The proposal is a tax deduction for business entities that increase the wages of an employee that makes less than \$100,000 annually, absent a promotion or legal requirement for the wage increase, as long as the business entity does not reduce the average hours worked by the employee following the wage increase. The deduction amount for the business entity would match the amount of the raise given to the employee pro rata, could only be deducted in the tax year in which the raise was given, and would be subject to rules regarding carryforward losses. The deduction would also be given to business entities that give raises to employees that satisfy the requirements regardless of the employee's filing status with the IRS or household income. If a business gave an employee a wage increase above a government-mandated increase in minimum wage, the amount of the increase to meet the minimum wage would not be deductible, but the amount exceeding the increase to minimum wage would be deductible, as long as the business entity met all other requirements of the deduction.

The deduction would be limited to employees who make less than \$100,000 because this is the group that has experienced the highest incidence of wage stagnation over recent decades. Employees receiving promotions would be excluded from eligibility in the deduction because they would receive an increase in pay in exchange for an increase in station inside of the business entity. Employees receiving increases in salary because of a legal requirement — an increase in the minimum wage, for example — would be ineligible for the deduction because they would be receiving an increase in wages that didn't result from actions taken by the employer, but by unilateral action taken by a governing body that required the raise. Employers may not reduce the average number of hours the employee works because it is possible that employers would finance the increase in pay through a reduction of hours and then use the deduction, which undercuts the reasoning that supports the deduction.

⁶⁰ Dylan Matthews, "A Bold New Plan Promises to Fix Middle-Class Wage Stagnation," *Vox*, Aug. 23, 2017.

B. Illustrative Examples

Several examples are provided below for clarity. The numbers in the examples are larger than what would likely be seen if the proposal were enacted into law, and are provided for the sake of simplicity.

Example 1: Business has decided to give Office Assistant a raise. Office Assistant makes \$9 per hour and works 40 hours per week over the course of 52 weeks. This results in a gross yearly income for Office Assistant of \$18,720. Business has decided to increase Office Assistant's pay to \$10 per hour while maintaining their average hours per week and number of weeks of employment, resulting in a gross yearly income for Office Assistant of \$20,800 — a gross raise of \$2,080 over the course of a year. Under the proposal, Business would be eligible to deduct \$2,080 from its taxes during the fiscal year of the raise because Office Assistant made less than \$100,000 per year, Business was not under a legal obligation to give Office Assistant a raise, and Office Assistant's schedule did not change as a result of the increased compensation.

Example 2: Business has decided to give Executive a raise. Executive is contracted to make \$1 million over the course of a year and Business wants to raise Executive's salary to \$1.5 million. Under the proposal, Business would not be eligible to deduct the increase in Executive's compensation from its taxes because Executive previously earned a salary above the \$100,000 ceiling for the deduction.

Example 3: Business has decided to give Office Assistant a raise in salary from \$9 per hour to a contracted salary of \$75,000 per year because of a promotion to management. That is an raise of \$56,280 per year for Office Assistant. Under the proposal, Business would not be eligible to deduct the increase because the wage increase for Office Assistant resulted from a promotion, not a raise.

Example 4: Business gives Office Assistant a raise from \$7 per hour to \$12 per hour. Office Assistant works 40 hours per week for 52 weeks a year, and that schedule will not change because of the wage increase. The raise was mandated by the government of the state in which Business operates increasing the minimum wage from \$7 per hour to \$12 per hour. Under the proposal, Business would not be eligible to take a deduction

because the increase in Office Assistant's salary resulted from a legal requirement.

Example 5: Business has given Office Assistant a raise from \$10 per hour to \$15 per hour. Office Assistant works 40 hours per week for 52 weeks a year, and that schedule will not change because of the wage increase. Before Business made this decision, the government of the state in which Business operates increased the minimum wage from \$7 per hour to \$12 per hour. The total raise for Office Assistant in gross pay is \$10,400, of which \$4,160 is from an increase in the minimum wage, and the remaining \$6,240 is given as a raise to Office Assistant from Business. Under the proposal, Business would not be able to deduct the first \$4,160 of the raise because it was from the increase in minimum wage, but Business would be able to deduct the remaining \$6,240 because that portion of the raise was not prompted by a mandatory increase.

Example 6: Business gives Executive a raise from \$95,000 per year to \$105,000 per year. Executive works 40 hours per week for 52 weeks a year, and that schedule will not change because of the wage increase. Because of the wage increase, Executive is now making more than \$100,000 per year. Under the proposal, Business would be able to deduct the first \$5,000 of the raise because that portion of the raise brought Executive's salary to \$100,000, which means the entirety of the first \$5,000 was below the \$100,000 ceiling for the deduction, but Business wouldn't be able to deduct the remaining \$5,000 because that portion of the raise exceeded the \$100,000 ceiling for the deduction.

Example 7: Business gives Office Assistant a raise from \$9 per hour to \$10 per hour. Before the raise, Office Assistant worked 40 hours per week for 52 weeks a year, but now Office Assistant works 36 hours per week. Under both schedules and both pay rates, Office Assistant receives a gross annual income of \$18,720. Under the proposal, Business would be ineligible to use the deduction because the wage increase for Office Assistant was financed through a reduction in Office Assistant's scheduled hours of labor.

C. Anticipated Results

It has been shown that business entities — specifically corporations — will respond to tax

incentives and change their behavior to achieve preferential tax results.⁶¹ This leads to the first anticipated result, which is that business entities would begin to increase the wages of employees who are eligible for the deduction. The deduction would motivate businesses to implement wage increases for their low- and middle-wage employees because it would maximize their tax outcomes, and thus likely increase their profitability. Because of the increase in wages for eligible employees, the effects of wage stagnation would begin to decrease.

A recent study conducted under the previous corporate tax regime showed that many of the largest corporations in the United States pay little to no federal tax at the corporate level.⁶² In fact, many of the corporations studied had a negative effective tax rate.⁶³ Following the reduction in corporate tax rates in 2017,⁶⁴ it's expected that federal corporate tax receipts will also decline. This leads to the second anticipated result, which is that federal income tax receipts would increase because of the deduction. The deduction would reduce the liability of the business entity that gives wages to eligible employees. Following the first anticipated result, business entities would raise wages of eligible employees in an effort to seek improved tax results. In the case of corporations, this reduction in tax liability would likely be negligible because of the low effective rates they pay. The increase in receipts would be attributable to the shifting of tax liability from business entities to individuals. Individual taxpayers who are eligible for the deduction are rarely able to use tax avoidance mechanisms, thus leaving the entirety of their income subject to taxation. While taxing individuals making less than \$100,000 annually would be suboptimal, the increase in wages and relatively low marginal tax rates would still leave the individuals with an increase in net salary. Because of the increase in individual income, there would be a larger

amount of money subject to taxation. With a larger amount of income subject to taxation, and the individuals holding that income having less ability to avoid taxation, the federal government should see an increase in revenue, above what is available under the current tax regime.

D. Comparison With Other Proposals

In comparison with UBI, this article's proposal isn't focused on the economic position of all members of the economy, but instead specifically targets the individuals struggling to increase their financial well-being in a global economy. Most proposals for UBI, including the one analyzed above, suggest that an amount be paid to all individuals of the community, regardless of the individual's employment status.⁶⁵ The intent of UBI is to safeguard members of the community from the harm that could come from the changes taking place in the economy, and while the models discussed above show that the problem of wage stagnation would lessen with a UBI, these outcomes would be collateral benefits to individuals in the community. By definition, this article's proposal benefits only those individuals that are working in the economy and making less than \$100,000 per year.

While the intent and target group of each proposal differ, these proposals would work well if implemented together. One criticism of UBI that this article's proposal would help to alleviate is that a UBI would reallocate resources to wealthier individuals or limit resources available to the poor.⁶⁶ If a UBI was implemented in conjunction with this article's proposal, the two proposals would likely solve all of the economic issues facing low- and middle-income Americans while avoiding the problem surrounding allocation of resources. This would be attributable to the UBI solving issues surrounding loss of low- and middle-wage jobs, like in the manufacturing sector, and this article's proposal to solve the allocation issues by giving incentives to businesses to allocate further economic resources down the wage scale.

⁶¹ Annette Alstadsaeter and Knut Reidar Wangen, "Corporations' Choice of Tax Regime When Transition Costs Are Small and Income Shifting Potential Is Large," University of Oslo (Aug. 17, 2008).

⁶² Institute on Taxation and Economic Policy, "The 35 Percent Corporate Tax Myth" (Mar. 9, 2017).

⁶³ *Id.*

⁶⁴ Alistair M. Nevius, "How Tax Overhaul Would Change Business Taxes," *J. of Acct.* (Dec. 20, 2017).

⁶⁵ Ackerman, Alsott, and Van Parijs, *supra* note 15, at 4.

⁶⁶ IMF, *supra* note 25.

In comparison with Burman's Rising Tide Credit, the intent to reduce the effects of wage stagnation is shared; however, this article's proposal is narrowly tailored to benefit only those suffering from wage stagnation, while Burman's proposal would grant an entitlement to everyone. Burman's proposal would grant every taxpayer a fully-refundable tax credit for 100 percent of the first \$10,000 earned.⁶⁷ In conjunction with this, Burman proposes an increase of the child tax credit, repeal of the EITC, and imposition of a VAT.⁶⁸ Under this article's proposal, in contrast, none of the current credits or deductions in the code would be repealed, and, as discussed below, the proposal would work well when paired with the EITC.

With the shared intent of Burman's Rising Tide Credit and this article's proposal, the two ideas could be jointly implemented as a solution to criticism when each proposal stands alone. One criticism of Burman's proposal is that the availability of the credit would allow employers to lower wages. Pairing this article's proposal with Burman's proposal would alleviate this issue because, while Burman's proposal may have the economic incentive to lower wages, this article's proposal would create the economic incentive to increase wages on the same group that would likely experience wage reduction under Burman's proposal. The net effect of buttressing Burman's proposal with this article's proposal would likely be an increase of \$10,000 to low-wage earners from Burman's credit, because employers would reduce wages under Burman's proposal, but then increase the wages by the same amount under this article's proposal. Another criticism of Burman's Rising Tide Credit is that the availability of the credit to high-income individuals would reduce the proposal's effect on wage stagnation. This article's proposal would alleviate some of that concern because it would increase any positive effects that Burman's proposal has toward solving the issue of wage stagnation.

Another criticism of Burman's proposal is that it would be susceptible to fraud. While this article's proposal isn't able to assist Burman's

proposal with this criticism, it is important to note that this article's proposal would not be as susceptible to fraud because of the competing tax motives of employers and employees. These opposing tax incentives would make the business entity and the employee a monitor against fraud by the other party. Also, the required filings by the employee and business entity would readily provide the IRS with access to the verifiable financial information of each party, which would ease the process of a fraud investigation.

E. Interaction With Current Law

The code provides low-income individuals with the EITC, a refundable tax credit that is intended to increase the income of the target group while encouraging them to work. The intent of the EITC and this article's proposal are shared, and it is anticipated that this article's proposal would increase the positive effects of the EITC because of the increase in the shifting of funds from high-income tranches to low-income individuals.

This article's proposal would also benefit the EITC's target group by reducing the effects of the criticisms against it. The first criticism of the EITC is that it motivates employers to lower wages for the target group because it can be viewed as a wage substitute.⁶⁹ This article's proposal would assist the intent of the EITC by increasing wages for its target group while reducing the effect of wage reduction by employers, because this proposal provides employers with the economic incentive to increase rather than reduce wages. A second criticism of the EITC is that it can cause an increase in turnover rates among employees that are not in the EITC's target group because those employees do not see the increase in income through the EITC's wage subsidy. This proposal could assist the EITC by curtailing the turnover rates, because it would expand the number of employees eligible for a wage increase. This article's proposal would not completely resolve the turnover rate issue, but it would likely elevate the level at which a wage increase would be supported by a tax incentive, which would reduce incidence of turnover.

⁶⁷ Burman, *supra* note 58, at 6.

⁶⁸ *Id.* at 6-7.

⁶⁹ Rothstein, *supra* note 56.

The code also allows businesses to deduct salaries and other compensation paid to employees through the trade or business expense deduction.⁷⁰ That code section would not be changed upon adoption of this article's proposal. The proposed deduction could be used only in the year in which the wage increase is given. While this would allow a portion of the employees' wages to be deducted twice, this would only happen in the year in which the raise is given. The purpose of the proposed deduction is to reduce the effects of wage stagnation; allowing the deductions to be taken simultaneously would give further incentive for business entities to raise wages for those in the target group. Keeping the trade or business expense deduction would give further incentives to business entities to give raises to eligible employees, because the businesses would be able to deduct the increased wages in subsequent tax years, thereby avoiding increased net expenses following a wage increase.

When a business entity has tax deductions that exceed taxable income, it has a net operating loss.⁷¹ A NOL will carry over to every subsequent tax year until the business entity's taxable income is greater than its tax deductions, at which point the accumulated NOLs will have been completely used.⁷² This article's proposal provides business entities with a tax deduction for increasing the wages of eligible employees. Should a business take advantage of the deduction in a tax year in which it has a NOL, the deduction would be added to accumulated NOLs and would then carry over to subsequent tax years.

F. Anticipated Counterargument and Rebuttal

The first anticipated counterargument to this article's proposal is that it would distort the labor market by providing a tax incentive to increase wages. The basis for this counterargument is that the proposed deduction would encourage business entities to give raises to employees that it otherwise would not.

The rebuttal is that there are copious amounts of these types of economic distortions throughout

the code. As discussed above, the EITC distorts the economy in two areas. First, it artificially increases wages by providing low-income individuals with a refundable tax credit that is essentially a wage subsidy. Second, it gives incentives to employers to reduce wages for EITC-eligible individuals by the amount of the EITC. Another way in which the code distorts the economy is through the Tax Cuts and Jobs Act (P.L. 115-97), which allows for the immediate expensing of specific assets purchased by businesses.⁷³ Immediate expensing of assets gives businesses the economic incentive to increase automation, which will reduce the amount of human work required and lead to higher rates of unemployment.⁷⁴ While the code provides various economic incentives that create distortions in the economy, this article's proposal provides incentives to businesses to hire people and give wage increases rather than replace human labor with machines.

The second anticipated counterargument is that the TCJA has reversed the trend of wage stagnation. The basis for this counterargument is that several companies have given pay raises, bonuses, and other pecuniary benefits to employees following its passage.⁷⁵ President Trump even praised the success of the bill as a solution to wage stagnation.⁷⁶

The rebuttal to this anticipated counterargument is that most companies giving benefits to employees are giving bonuses rather than raises.⁷⁷ Bonuses are fundamentally different than wage increases because bonuses are one-time payments to employees while a wage increase is a permanent investment in the production of the employee. Bonuses have no effect on wages, and therefore no effect on wage stagnation. Businesses giving wage increases is anecdotal evidence that the TCJA has had a

⁷³ Carrie Christensen, "Tax Reform — Expensing and Depreciation," Ketel Thorstenson LLP (Jan. 3, 2018).

⁷⁴ Nicole Goodkind, "Trump Tax Plan Gives Jobs Away to Robots and Will Increase Unemployment," *Newsweek*, Nov. 15, 2017.

⁷⁵ John Kartch, "List of Tax Reform Good News," Americans for Tax Reform (Mar. 15, 2018).

⁷⁶ White House, "President Donald J. Trump's State of the Union Address" (Jan. 30, 2018).

⁷⁷ Jena McGregor, "Why Many Companies Are Giving Bonuses — Not Raises — After the New Tax Cuts," *The Washington Post*, Jan. 18, 2018.

⁷⁰ Section 162.

⁷¹ Section 172.

⁷² *Id.*

positive effect on wage stagnation, but it is not dispositive and demands further study. Further, to have a large effect on overall wage stagnation, more businesses must begin to increase wages.

V. Conclusion

Low- and middle-wage earners have been suffering from the effects of wage stagnation for nearly 50 years. There are many solutions available that would supposedly either solve or positively affect wage stagnation. This article has proposed a tax deduction that would both increase the wages of individuals suffering from wage stagnation and protect businesses from any potential harmful effects of wage increases. This proposal is also versatile, in that it can be added to the code as currently constituted or paired with another proposal. However wage stagnation is solved, ending it will be positive for individual Americans and for the United States both economically and politically. ■

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