



How rich people avoid paying taxes

TAXES, MONEY, NAKEDLAW, OPINION

Apr 26, 2016

By [Brette Sember](#)

Tax season may be over, but the fairness of taxes and what we should and should not have to pay will inevitably arise again. Furthermore, the [Panama Papers leak](#) has put a spotlight on how the rich shelter wealth from taxation, and is sure to be an issue as the presidential election approaches later this year.

The whole concept of the [tax structure in America](#) is that the more you earn, the more you pay. The majority (though certainly not everybody) believe that richer people should pay more in taxes, because they have a higher income. According to a report from the IRS though, this is not what is actually happening.

The tax rate cliff

When Americans' income is studied, tax paid does tend to increase with income—up to a point. The [statistics](#) show that the top 50% of earners pay an average of 14.33% of their income in tax, and as income increases, taxes increase up to 22.83% for those whose income hits the top 1% mark. That's the peak, however, and people who earn *more* than the top 1% actually pay a smaller percentage in taxes as their incomes go up.

Here's how it plays out. Those in the top 0.1% pay 21.67% and those in the top 0.01% pay 19.53%. Meanwhile, those lucky few in the top 0.001%—who enjoy an adjusted gross income of at least \$62 million—pay an average of only 17.6% in taxes, roughly the same percent in taxes as people who earn just \$85,000.

What's going on?

Tax deductions pay off for the wealthy

Rich people get to take lots of [tax deductions](#) on their income tax, lowering what they owe. They own big houses and get to deduct the massive interest on their mortgages. Oh, and they can deduct that mortgage interest on their [second homes](#), too. (To be fair, they are subject to a phase-out of the mortgage interest deduction, which limits but does not completely eliminate its tax advantage.) The wealthy also get to deduct the interest for the loans on their yachts. They can deduct any losses they take on gambling, up to the amount of their winnings. Many wealthy people also claim large amounts of [charitable deductions](#), reducing their taxable income.

Income free of Social Security taxation

No one pays Social Security taxes on income above a specified amount, which is currently \$118,500. This means that someone earning \$1 million (or \$100 million, for that matter) pays the same Social Security tax as a person who makes \$118,500. (Anybody want to take a stab at coming up with a way to save Social Security?)

The capital gains bonanza

But the biggest reason wealthy people aren't taxed equally is due to the way the IRS treats [capital gains](#). People who get most of their income from their investments—and that includes most of the super-rich—pay an average of about 24% in tax on that type of income. Meanwhile, everyone who earns money through hard work pays up to 39.6% in tax.

Loopholes for the rich

Huge loopholes are available to the mega-rich: There's something called the [payroll tax loophole](#) that allows self-employed people to [set up an S corporation](#) and declare most of their earnings as profits of the corporation, thereby avoiding Social Security and Medicare taxes on much of their self-employment income.

Another brilliant loophole applies to private equity funds, whose [managers](#) receive part of the net gains of the fund as their compensation. This compensation is classified as [carried interest](#), which allows it to be taxed as a capital gain, not as income (resulting in a lower tax rate).

As the Panama Papers leak starkly demonstrated, some wealthy people park their money [offshore](#) to avoid paying tax on it. In fact, a study by the Tax Justice Network showed that \$21 trillion is being sheltered in tax havens like the Cayman Islands. Many wealthy people also [circumvent the estate tax](#) by setting up special trust funds that pass their assets without any taxation.

The truth is, once you get to be really, really rich, you have the resources to find lots of ways to reduce your taxes. It's a steep slope up the tax rate mountain, but once you make it to the top, there's a big payoff.

The views and opinions expressed here are those of the author and do not necessarily represent those of Avvo.

Tagged [elections](#), [real estate](#), [small business](#)