



Taxing Employers for Excess Compensation

Washington State has two inter-related public policy dilemmas. The first is that our tax system fails to generate the revenues needed to fund public services. This is in large part due to our overdependence on sales taxes and property taxes and the lack of a progressive income tax. The second is that this very regressive tax system encourages the polarization of income to the top group of already privileged employees, while reinforcing wage stagnation for typical workers.

Middle-class and working-class workers find their economic circumstances precarious, with average wages less than \$47,000¹, while the public services on which they have depended, such as health coverage and higher education, come with higher and higher private price tags.

We could consider an excise tax on employers to progressively fund public services and rein in the acceleration of employer-based compensation to top of employees.

Here is how this could work: All employers compensating employees in excess of a compensation threshold of, for example, \$250,000, would be taxed for this excess compensation. All employers includes corporations, all other for-profit businesses, non-profit organizations, universities and colleges, foundations, and public institutions.

This tax would be paid **by these employers** on compensation for their employees in excess of this threshold. If they don't compensate above this threshold, they are exempt from this tax. If they choose to compensation above this threshold, they will have to contribute excess compensation taxes to help fund public services. The tax itself may encourage a deceleration of income to the top, as well as create an incentive to increase the compensation for middle class workers whose compensation has stagnated over the past ten years.

One version of this tax has been introduced in the Washington State Senate. Senate Bill 6017² would establish a progressive tax rate for compensation in excess of \$1 million. Employers would pay a 5% tax on compensation for their employees exceeding \$1 million and less than \$5 million, a 7.5% tax on compensation for their employees exceeding \$5 million and less than \$10 million, and a 10% tax on compensation exceeding \$10 million. If this tax had been in place in 2018, it would have raised \$226 million in that year.

¹ Author's calculation from 2016 data on employee compensation by the Employment Security Department.

² <https://app.leg.wa.gov/billssummary?BillNumber=6017&Year=2019>

The Washington State Employment Security Department (ESD) has the database of employees in Washington, so that adherence to this tax would be relatively easy to track and implement.

The tax would cover fewer than 3,300 employees, the top one tenth of one percent of employees in our state. The average compensation for these employees is over \$2 million. The average compensation for the 56 employees compensated over \$10 million is \$18.5 million.³

Compensation from Employer	Number of Employees in Cohort	Total Compensation of Cohort	Revenue from Tax on Excess Compensation	Marginal Tax Rate	Average Compensation Per Employee
\$1,000,000 - \$4,999,999	3,087	\$5,109,018,600	\$101,100,930	5.0%	\$1,655,011
\$5,000,000 - \$9,999,999	138	\$924,562,345	\$45,192,176	7.5%	\$6,699,727
\$10,000,000 +	56	\$1,037,449,515	\$79,944,952	10.0%	\$18,525,884
Total	3,281	\$7,071,030,460	\$226,238,057		\$2,155,145

What could \$226 million annually finance for public services? We could:

- Reduce tuition by \$1,000 a year for every student in public higher education, including community colleges and our four-year institutes.
- Fully fund an expanded ECEAP program for all three and four year olds for families with incomes up to 200% of the federal poverty level (\$41,000 for a family of three).
- Reduce premiums on the Health Benefit Exchange by \$150 a month for all participants up to 500% of the federal poverty level (130% of the median income in our state).

Or, we could do nothing and endorse the acceleration of compensation to the privileged and affluent.

³ Author’s calculation from 2018 data on employee compensation by the Employment Security Department.

Other possible iterations for excess compensation:

- A tax of 1% on employers on employee compensation in excess of \$250,000 would have raised **\$136 million** in 2018, according to Employment Security Department estimates. This tax would have covered 58,000 or 1% of all employees in the state, because only 1% receive compensation from a sole employer in excess of \$250,000.
- A progressive tax rate (1% above \$250,000, 2% above \$500,000, 4% above \$1 million, 10% in excess of \$5 million, 20% in excess of \$10 million) would raise roughly **\$400 million** a year.
- A third approach is to consider that the Social Security wage cap for 2019 is \$132,900. Employers are excused from any contribution of 6.2% for FICA for Social Security and 0.148% for Washington State’s paid family and medical leave program for compensation in excess of \$132,900. This totals a 6.35% payroll windfall for the employer.

If we had a 6.35% excess compensation tax starting at \$133,000 and up, we would realize \$1.8 billion annually. That currently is the windfall which employers gain from the cap on payroll taxes.

If we taxed excess compensation above \$250,000 at 6.35%, we would realize over \$850 million a year in new revenues for public services.

If the threshold was set at \$500,000, the state would realize almost \$450 million a year.⁴

Recouping the FICA Windfall for Public Services	Employees	Total Wages	Total Public Revenue
Total for Compensation >\$133K	262,874	\$ 63,416,516,156	Tax of 6.35% over \$133,000 \$1,806,846,408.91
Total for Compensation >\$250K	58,328	\$ 28,241,692,136	Tax of 6.35% over \$250,000 \$867,390,450.64
Total for Compensation >\$500K	12,562	\$ 13,260,585,564	Tax of 6.35% over \$500,000 \$443,203,683.31

⁴ Ibid.