3 Pro-Union Reforms To Improve Tax Fairness for American Workers

By David Madland and Malkie Wall September 2, 2020

The balance of power in the United States' economy and democracy is wildly off. Soaring inequality, stagnant wages, scant worker protections, and huge divides across race and gender are symptoms of a system where corporate interests dominate the American economy and political system. The COVID-19 pandemic and the protest movement against systemic racism have thrown this imbalance into stark relief. Now more than ever, workers need a greater voice and policymakers need to support them by passing pro-union legislation.

Unions and collective bargaining can help address many of the socioeconomic issues facing the United States by raising workers' wages, closing pay gaps, reducing economic inequality, promoting safe workplaces, and increasing workers' democratic voice.[1] Yet the broken labor law system too often impedes the ability of workers to form unions and engage in collective bargaining and needs to be reformed.[2]

Legal barriers against workers extend well beyond labor policy. For a country that prides itself on the tenacity of its workforce, the U.S. legal code is steeped in rules that hinder workers' ability to prosper. To see how this is woven into the fabric of the economy, one need look no further than the Internal Revenue Code, which contains several provisions that further tilt power away from unions and toward corporations. For instance, tax law allows businesses to deduct the costs of fighting unions, prevents workers from deducting the costs of joining a union, and facilitates companies that misclassify employees as independent contractors, which denies workers their right to unionize.

Policymakers should reverse the anti-union biases in the tax code and take steps to build power for workers by:

1. Imposing limits on corporate deductions of business expenses that are anti-labor
2. Creating a new above-the-line deduction for union dues
3. Changing tax law to reduce misclassification of employees as independent contractors

These policies are by no means all that is required to strengthen unions and collective bargaining, improve conditions for workers, and make American democracy more responsive to the will of the people—or to even make the tax code fair. Legislation such as the Protecting the Right to Organize (PRO) Act and the Public Service Freedom to Negotiate Act are essential to strengthening worker power, as are reforms that promote sectoral and/or multiemployer bargaining and provide incentives for union membership.[3] Similarly, a host of reforms, from raising the minimum wage to implementing automatic voter registration, are also sorely needed to raise standards for workers and encourage democratic participation. Other tax policies that harm workers and indirectly weaken unions, such as those that encourage outsourcing and offshoring, need to be reformed.[4] In addition, policymakers must reverse the generally pro-corporate tilt of the Trump administration's 2017 tax overhaul—known as the Tax Cuts and Jobs Act (TJCA)—which provided massive tax cuts for corporations and created new deductions for pass-through businesses, mostly to the benefit of wealthy owners rather than workers.[5] Future tax legislation must also take steps to address income inequality, restore greater tax progressivity, and generate needed revenues to pay for public services.

Still, these pro-union tax reforms would be an important step forward in increasing the number of workers with access to unions and collective bargaining and should be part of any effort to create a more progressive tax framework. Unions and collective bargaining are vital to addressing many of America's core problems. Unions raise wages, reduce the racial wealth gap, close gender pay gaps, shrink economic inequality, and make workplaces safer.[6] Just as importantly, they help balance political power so that democracy can function properly by increasing voter turnout from people of modest means and advocating for policies that the public supports.[7] Finally, unions help ensure that other policies are effectively implemented and enforced.[8] Other types of pro-worker or pro-democracy reforms cannot substitute for all that unions do. Thus, pro-union tax policy is critical to addressing some of the most fundamental problems the country faces and should be part of future tax reform efforts.

Recommendations for pro-labor tax reforms

1. Prevent employers from claiming tax deductions for anti-labor expenses

Employers use a range of tactics to prevent workers from organizing a union and collectively bargaining.[9] Some of these tactics—such as firing or discriminating against employees because of union activity—are illegal under federal labor law.[10] However, the National Labor Relations Act (NLRA), which grants workers the right to form or join a union, leaves workers vulnerable to several other types of coercive conduct. For example, many employers require workers to attend "captive audience meetings"—workplace gatherings used by management to communicate anti-union views—and to prevent union organizers from communicating with workers at their worksites. In addition, the Economic Policy Institute (EPI) recently found that employers spend roughly $340 million a year on union avoidance consultants whose purpose is to fend off union organizing campaigns.[11]

Current tax law allows companies to deduct ordinary and necessary business expenses, which includes money spent on anti-union campaigns. In effect, the tax code rewards companies for thwarting workers' labor rights. Although companies may have the legal authority to engage in anti-union campaigns, there is no public policy justification for having taxpayers subsidize such conduct, especially when you consider that the express purpose of the NLRA is to encourage collective bargaining.[12]

Lawmakers should rectify the imbalance by ensuring that money spent on opposing union organizing is not deductible as an ordinary business expense.[13] For example, lawmakers could prohibit deductions for spending on anti-union consultants as well as money for in-house lawyers that do work similar to that of anti-union consultants. They also could potentially prohibit the deduction of expenses incurred in recruiting and retaining permanent strike replacements; certain expenses related to office email systems, unless the employer allows workers to use their email system for union and protected concerted activity; or expenses incurred in defending unfair labor practices that are found to have violated the NLRA or in negotiating a first contract, unless the employer has agreed to submit to binding arbitration in the event that the parties are unable to promptly reach agreement.

The authors estimate that a pared-down policy prohibiting deductions for expenditures on anti-union consultants would increase revenues by roughly $71 million per year—and potentially significantly more. As mentioned above, the EPI estimates that companies spend roughly $340 million on anti-union consultants every year.[14] U.S. corporations have a marginal tax rate of 21 percent.[15] Multiplying $340 million by the marginal tax rate suggests that the maximum corporate tax savings for hiring anti-union consultants today are slightly more than $71 million. With a higher corporate rate, savings would be even higher. This proposal could also prohibit deducting the costs of other anti-union activities outlined above and therefore lead to an even larger increase in tax revenues.

2. Create an above-the-line deduction for union dues

Lawmakers could also create an above-the-line deduction for union dues.[16] Such a deduction would increase tax fairness while also lowering the cost of joining a union, according to Alexandra Thornton, senior director of Tax Policy at the Center for American Progress.

In tax policy, there is a well-understood principle that taxpayers should be able to deduct the costs of earning that income. For example, tax laws allow companies to deduct ordinary and necessary business expenses. Similarly, the pre-TCJA tax code allowed workers to deduct unreimbursed business expenses, such as union dues and business travel costs, subject to certain limits explained below. However, the TCJA eliminated the deduction for unreimbursed employee expenses.[17] As a result, workers and their unions are now entirely excluded from standard tax benefits, even as those benefits are still being extended to corporations.

Prior to the TCJA, union dues were deductible, but only some workers actually deducted them because individuals could only deduct the portion of such expenses exceeding 2 percent of their income—and only if they did not claim the standard deduction. In other words, it was a below-the-line, itemized deduction. In comparison, an above-the-line deduction would improve on the pre-TCJA framework by allowing taxpayers to deduct all union dues regardless of whether they chose the standard deduction or itemized deductions. This type of deduction would allow union members to deduct the costs of earning their income and result in the tax code more accurately measuring individuals' ability to pay. Policymakers have recognized this need for greater tax fairness: For instance, Sen. Bob Casey (D-PA) and Rep. Conor Lamb (D-PA) have put forward legislation that would make union deductions above-the-line.[18] CAP estimates that in 2018, an above-the-line federal tax deduction for union dues would have reduced revenues by roughly $1 billion—a relatively modest sum compared to many existing tax expenditures for business, which can range from tens to hundreds of billions of dollars per year.[19]

3. Reduce misclassification of employees as independent contractors

When employers misclassify their employees as independent contractors, workers and taxpayers lose out. Misclassification robs workers of their right to collectively bargain and denies them access to overtime pay, unemployment insurance, and workers' compensation.[20] It also costs local, state, and federal governments billions in unpaid tax revenues.[21] Unfortunately, employee misclassification is a persistent issue in today's economy, especially in some of the fastest-growing industries—such as home care, hospitality, and trucking, to name just a few.[22]

Many different strategies are required to fully address the problem,[23] some of which can be undertaken through tax reforms. One important step to help address misclassification and therefore ensure that more workers can legally join unions would be to repeal Section 530 of the Revenue Act of 1978—known as the "safe harbor" rule. The provision allows companies to continue misclassifying workers as independent contractors even if the IRS determines they are employees; and it also prevents the IRS from assessing back taxes on those employers.[24] Repealing Section 530 would allow the IRS to require prospective reclassification of workers who are currently misclassified and would allow the U.S. Department of the Treasury and the IRS to issue generally applicable guidance on the proper classification of workers.[25] In 2016, the Joint Committee on Taxation estimated that a related proposal would raise nearly $11 billion in revenue over 10 years.[26] Several policymakers, including Sen. Sherrod Brown (D-OH), have attempted to close this loophole on numerous occasions in the past, and there continues to be interest in doing so.[27]

A related option for addressing misclassification in the tax code would be to amend the definition of "employee" under Section 3121 of the Internal Revenue Code of 1986. The revised definition of employee could, for example, resemble the "ABC test" established by A.B. 5 in the state of California. Under the ABC test, a worker is considered an employee—rather than an independent contractor—unless the individual is a) free from the control and direction of the hiring entity; b) performs services that are outside the usual course of business; and c) is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the services performed.[28]

Conclusion

Workers need access to the collective bargaining process in order to build power in the United States economy and democracy, so that wages and benefits can rise and politicians will be more responsive to the desires of regular citizens. This country's current tax policy creates unnecessary roadblocks for hardworking Americans, but straight-forward pro-worker tax reforms can move the needle in the right direction. Tax reforms that make it easier for workers to unionize and harder for employers to stymy their rights would be a step toward a more equitable tax system for both workers and the public.

David Madland is a senior fellow and the senior adviser to the American Worker Project at the Center for American Progress Action Fund. Malkie Wall is a research associate for Economic Policy at the Action Fund.

Endnotes

1 Karla Walter and David Madland, "American Workers Need Unions: 3 Steps to Strengthen the Federal Labor Law System" (Washington: Center for American Progress Action Fund, 2019), available at https://www.americanprogressaction.org/issues/economy/reports/2019/04/02/173622/american-workers-need-unions/.

2 Clean Slate for Worker Power, "The Clean Slate Agenda," available at https://www.cleanslateworkerpower.org/clean-slate-agenda (last accessed April 2020).

3 David Madland, "How to Promote Sectoral Bargaining in the United States" (Washington: Center for American Progress Action Fund, 2019), available at https://www.americanprogressaction.org/issues/economy/reports/2019/07/10/174385/promote-sectoral-bargaining-united-states/.

4 Under the TCJA, U.S. multinational corporations enjoy a tax exemption on the first 10 percent return on their tangible offshore assets—such as factories and equipment. This gives U.S. companies a financial incentive to move production offshore in order to lower their tax bills. Moreover, foreign income above that 10 percent return is considered global intangible low-taxed income and is only taxed at a low 10.5 percent tax rate, or half the domestic corporate tax rate of 21 percent. The TCJA also introduced a deduction for foreign-derived intangible income that is similarly structured in a way that incentivizes offshoring. See Kimberly Clausing, "Options for International Tax Policy After the TCJA" (Washington: Center for American Progress, 2020), available at https://www.americanprogress.org/issues/economy/reports/2020/01/30/479956/options-international-tax-policy-tcja/; Amy Hanauer, "Trade Deals Aren't Enough: Fixing the Tax Code To Bring American Jobs Back" (Washington: Institute on Taxation and Economic Policy, 2020), available at https://itep.org/trade-deals-arent-enough-fixing-the-tax-code-to-bring-americans-jobs-back/.

5 Alexandra Thornton, "Why All Workers Should Be Able To Deduct Union Dues" (Washington: Center for American Progress, 2019), available at https://www.americanprogress.org/issues/economy/reports/2019/12/19/478894/workers-able-deduct-union-dues/.

6 David Madland and Malkie Wall, "The Middle Class Continues to Struggle as Union Density Remains Low," September 10, 2019, available at https://www.americanprogressaction.org/issues/economy/news/2019/09/10/175024/middle-class-continues-struggle-union-density-remains-low/.

7 Walter and Madland, "American Workers Need Unions."

8 For a discussion on co-enforcement, see David Madland and Malkie Wall, "American Ghent: Designing Programs to Strengthen Unions and Improve Government Services" (Washington: Center for American Progress, 2019), available at https://www.americanprogress.org/issues/economy/reports/2019/09/18/474690/american-ghent/.

9 Celine McNicholas and others, "Unlawful: U.S. employers are charged with violating federal law in 41.5% of all union election campaigns" (Washington: Economic Policy Institute, 2019), available at https://www.epi.org/publication/unlawful-employer-opposition-to-union-election-campaigns/.

10 Section 8(a) of the NLRA defines a number of unfair labor practices. The Economic Policy Institute found that employers are charged with violating federal law violations in more than 40 percent of all union election campaigns. See Ibid.

11 McNicholas and others, "Unlawful."

12 The NLRA states that it is the "policy" of the United States to eliminate obstructions to the free flow of commerce "by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization, and designation of representatives of their own choosing, for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection." See Legal Information Institute, "U.S. Code §§ 151–169," available at https://www.law.cornell.edu/uscode/text/29/chapter-7/subchapter-II (last accessed August 2020).

13 This recommendation was suggested to the authors by Sarah Fox, a former member of the National Labor Relations Board.

14 McNicholas and others, "Unlawful."

15 Tax Policy Center, "Key Elements of the U.S. Tax System," available at https://www.taxpolicycenter.org/briefing-book/how-does-corporate-income-tax-work (last accessed August 2020).

16 Thornton, "Why All Workers Should Be Able To Deduct Union Dues."

17 The TCJA also made a number of other modifications to allowable deductions. See Tax Policy Center, "Key Elements of the U.S. Tax System."

18 Office of Sen. Bob Casey, "Casey, Lamb Push For Tax Fairness For Workers," Press release, April 5, 2019, available at https://www.casey.senate.gov/newsroom/releases/casey-lamb-push-for-tax-fairness-for-workers. See also, the original amendment put forward by Sen. Casey during consideration of the 2017 tax bill: U.S. Senate Committee on Finance, "Amendments to the Tax Cuts and Jobs Act," available at https://www.finance.senate.gov/imo/media/doc/Master%20Tax%20Amendments.pdf (last accessed August 2020).

19 Thornton, "Why All Workers Should Be Able To Deduct Union Dues"; Frank Sammartino and Eric Toder, "What are the Largest Business Tax Expenditures?" (Washington: Tax Policy Center, 2019), available at https://www.taxpolicycenter.org/publications/what-are-largest-business-tax-expenditures/full.

20 Note that, thanks to the Coronavirus Aid, Relief, and Economic Security (CARES) Act, there is a temporary exception in 2020 where, for a period, misclassified workers have been able to access unemployment insurance. See Françoise Carré, "(In)dependent Contractor Misclassification" (Washington: Economic Policy Institute, 2015), available at https://www.epi.org/publication/independent-contractor-misclassification/; Catherine Ruckelshaus and Ceilidh Gao, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries" (Washington: National Employment Law Project, 2017), available at https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries-update-2017/.

21 Ruckelshaus and Gao, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries."

22 Ibid.

23 Such strategies should include passage of the Protecting the Right to Organize (PRO) Act, which would tighten the definition of independent contractors. See Protecting the Right to Organize Act of 2019, H.R. 2474, 116th Congress, 1st sess. (June 2, 2019), available at https://www.congress.gov/bill/116th-congress/house-bill/2474/text.

24 Businesses that misclassify workers as independent contractors instead of employees may face back taxes and penalties. However, Section 530 provides employers who acted in good faith relief from federal employment tax obligations. In order to be eligible for safe harbor, employers have to meet three statutory requirements: 1) reporting consistency, i.e. "the taxpayer must have timely filed the requisite information returns consistent with its treatment of the worker as a non-employee"; 2) substantive consistency, i.e. "if the taxpayer or predecessor treated the worker, or any worker holding a substantially similar position, as an employee at any time after December 31, 1977, the taxpayer will not be eligible for relief"; and 3) reasonable basis, i.e. "the taxpayer must have relied on one of the following for purposes of treating the worker as a non-employee: 1) prior audit; 2) judicial precedent; 3) industry practice; or 4) other reasonable basis." See Internal Revenue Service, "Work Reclassification – Section 530 Relief," available at https://www.irs.gov/government-entities/worker-reclassification-section-530-relief (last accessed June 2020).

25 U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals" (Washington: 2016), p. 207, available at https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf.

26 For more on the provision to "increase certainty with respect to worker classification," see Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2017 Budget Proposal" (Washington: 2016), available https://www.jct.gov/publications.html?func=startdown&id=4902; U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals."

27 Both the Fair Playing Field Act of 2015 and the Taxpayer Responsibility, Accountability, and Consistency Act of 2009 would have terminated Section 530. See Fair Playing Field Act of 2015, S. 2252, 114th Cong., 1st sess. (November 5, 2015), available at https://www.congress.gov/bill/114th-congress/senate-bill/2252/text; Taxpayer Responsibility, Accountability, and Consistency Act of 2009, S. 2882, 111th Cong., 1st sess. (December 15, 2009), available at https://www.congress.gov/bill/111th-congress/senate-bill/2882/text. President Barack Obama also proposed the change in his 2012, 2013, 2014, 2015, and 2016 budget proposals. See Carré, "(In)dependent Contractor Misclassification"; U.S. Office of Management and Budget, "Budget of the U.S. Government: Fiscal Year 2017" (Washington: 2017), available at https://www.govinfo.gov/content/pkg/BUDGET-2017-BUD/pdf/BUDGET-2017-BUD.pdf. Trump's fiscal year 2017 budget proposal also included provisions to address the issue of misclassification. See U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals," p. 207. A 2018 report by the Treasury Inspector General for Tax Administration recommended a legislative change to Section 530 allowing the IRS to, at minimum, "take prospective action to enforce the law on employers who incorrectly treat workers as independent contractors." See U.S. Treasury Inspector General for Tax Administration, "Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance" (Washington: 2018), available at https://www.treasury.gov/tigta/auditreports/2018reports/201830077fr.pdf.

28 California Labor and Workforce Development Agency, "ABC Test," available at https://www.labor.ca.gov/employment-status/abctest/ (last accessed July 2020).