The Campaign to Fix the Debt

The Case for Fundamental Tax Reform

The Need for Tax Reform

- The tax code is littered with **$1.3 trillion** of deductions, credits, and other tax preferences.
- Many of these preferences are expensive, regressive, and economically distorting; they increase complexity, reduce fairness, and let the government pick winners and losers.
- The higher than necessary rates, narrow base, and sheer complexity in the tax code hurt economic growth by driving up compliance costs and reducing incentives to work, save, and invest.
- Comprehensive tax reform should cut spending in the tax code in order to lower tax rates, improve simplicity and fairness, encourage economic growth, *and* help reduce the deficit.

The Benefits of a "Blank Slate" / "Zero Plan" Approach

- Tax reform should begin by eliminating *all* tax preferences and lowering tax rates, and *then* requiring policymakers to add back preferences at the cost of higher rates.
- Eliminating *all* tax preferences would allow for a top individual rate as low as 23 percent and a corporate rate of about 27 percent without increasing the deficit.
- Starting from zero will require advocates of tax preferences to justify the existence of their favored preference rather than requiring policymakers to justify each reform.
- Starting from zero will force policymakers to come to terms with the fact that tax preferences have a cost: more tax expenditures mean higher rates, larger deficits, or both.

Acting Responsibly in Adding Back Tax Preferences

- Under the blank slate / zero plan approach, lawmakers must justify which tax preferences, if any, to add back in; any add-backs will result in higher tax rates.
- Senate Finance Committee Chairman Max Baucus and Ranking Member Orrin Hatch have outlined that in order to be re-included in the Committee's draft legislation, a tax preference must: (1) help grow the economy; (2) make the tax code fairer; and/or (3) effectively promote other important policy objectives.
- Many tax preferences work against those objectives: hurting economic growth, reducing fairness, and making the attainment of other policy goals more difficult.
- Preferences that are worthwhile can almost always be added back in a more efficient and better targeted way – for example, by turning various deductions into credits.

The Fix the Debt Campaign's Principles for Tax Reform

- Tax reform should promote economic growth and help reduce future deficits.
- Tax reform should begin with a "blank slate" by eliminating all corporate and individual tax preferences that do not pass a cost-benefit analysis, recognizing that each restoration must be accompanied by a tax rate increase.
- Tax preferences that are restored should be made more efficient and cost-effective to maximize return on investment for the American taxpayer.
- Tax reform should lower tax rates for individuals, corporations, and small businesses.
- Tax reform should promote fairness and protect the most vulnerable in society.
- Tax reform is a complement, not a substitute, for entitlement reforms. Policymakers must continue to pursue structural reforms to slow the rate of growth of Medicare, Medicaid, and Social Security in order to fix the debt and make those programs sustainable.

For more information on tax reform and the blank slate approach, click here.

Considerations for Select Tax Preferences

Tax expenditures that do not pass a cost-benefit test should not be reintroduced into the tax code, unless redesigned to more efficiently and effectively achieve their intended goals. Below are examples of some more prominent tax preferences currently in the code.

Mortgage Interest Deduction

- The mortgage interest deduction will cost more than **$1 trillion** over the next decade.
- Only one-fourth of taxpayers take the mortgage interest deduction, and three-quarters of the benefit accrues to those in the top fifth of the income spectrum.
- Rather than increasing homeownership, most economists believe the mortgage interest deduction encourages more borrowing for larger homes.
- Options to modify the mortgage deduction include eliminating it for vacation homes, limiting it for million-dollar houses, capping its value, replacing it with a credit, or phasing it out entirely.
- Analysis by the Tax Policy Center suggests that relative to a deduction, a mortgage interest credit could raise substantial revenue, reduce the average tax burden for all income groups below $100,000, and have little effect on housing prices.

Charitable Giving Deduction

- The charitable deduction will cost nearly **$600 billion** over the next decade.
- Although nearly nine in ten households give to charity, only a quarter take advantage of the charitable deduction and 85 percent of the benefit accrues to the top fifth of earners.
- Options to modify the charitable deduction include limiting its value, converting it into a credit, allowing it only above a floor, or changing contribution rules and regulations.
- According to the Congressional Budget Office, a 15 percent credit with a floor of 2 percent of AGI would reduce the cost of the deduction by 60 percent and only reduce giving by 5 percent.
- A 25 percent credit with a $500 floor would cut the cost of the deduction and *increase* giving.

The Employer Health Insurance Exclusion

- The exclusion of health insurance from taxable income will cost nearly **$2 trillion** in income tax revenue over the next decade and nearly **$3.4 trillion** when including payroll tax revenue.
- 34 percent of the health care tax exclusion goes to the top fifth of earners.
- Economists believe the health exclusion drives up economy-wide health care costs and limiting it would help to "bend the health care cost curve."
- Options include limiting the value of the exclusion by income, capping it for high-cost insurance plans, replacing the exclusion with a deduction or credit, or phasing it out altogether.

Higher Education Tax Provisions

- The tax code includes over a dozen different provisions to subsidize higher education, with a ten-year cost of about **$400 billion**.
- Many higher education tax preferences have overlapping purposes and complicated rules that make them difficult to navigate and lead to costly mistakes.
- Higher education tax preferences are as large as Pell Grants, but weighted much more heavily toward higher-earning families.
- Options exist to consolidate and better target higher education preferences or phase them out in favor of direct spending, lower tax rates, or deficit reduction.

Corporate Tax Breaks

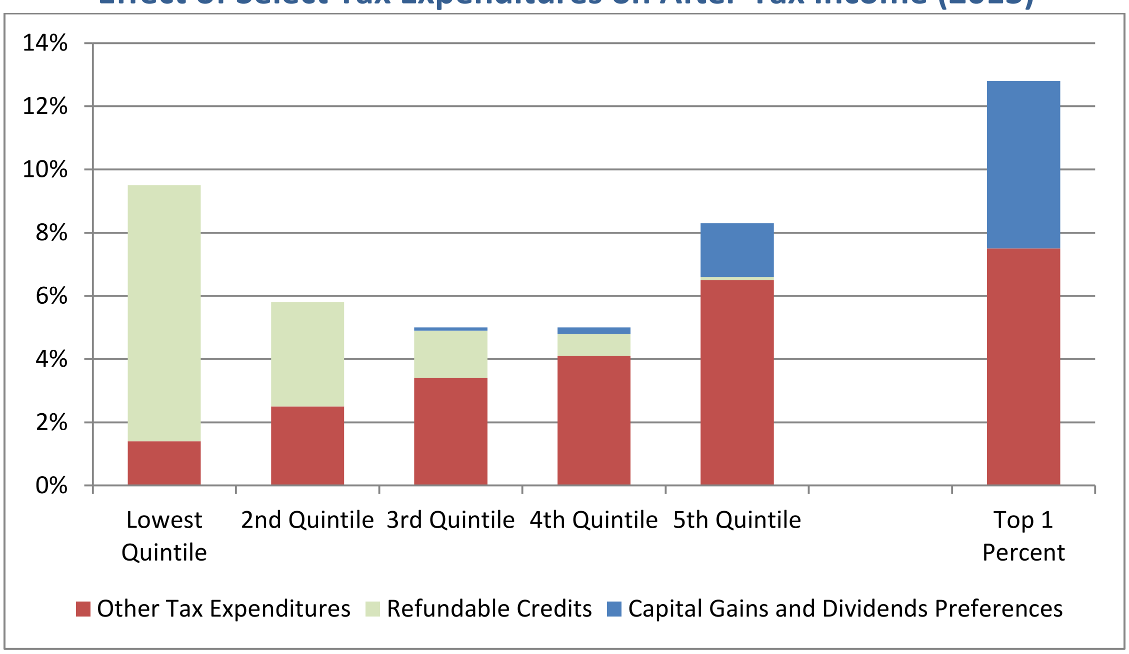
- There are roughly 80 breaks available to corporations, totaling about **$2 trillion** over ten years.
- These breaks include credits, deductions, special accounting rules, and accelerated depreciation.
- In part because of these tax breaks, the United States has the highest statutory corporate tax rate in the industrialized world at 35 percent, despite low revenue collection.
- Eliminating *all* domestic corporate tax breaks would allow for a corporate rate of about 27 percent, suggesting few add-backs will be possible if substantial rate reduction is desired.

Select Major Tax Expenditures

	Average Cost (2013-2017)
Employer Health Insurance Exclusion	$152 billion^
Capital Gains and Dividends Rates	$123 billion
401(k)s and IRAs	$88 billion
Mortgage Interest Deduction	$76 billion
Earned Income Tax Credit	$67 billion
Child Tax Credit	$58 billion
State and Local Tax Deduction	$56 billion
Deferral of Foreign-Source Income	$53 billion
Step-up Basis for Capital Gains at Death	$52 billion
Charitable Deduction	$40 billion
Total, Major Tax Expenditures	**$765 billion**
Memorandum: Total Tax Expenditures	***$1.379 trillion***
Memorandum: Individual Income Tax Revenue	***$1.558 trillion***

Source: Committee for a Responsible Federal Budget, Joint Committee on Taxation and Congressional Budget Office
^Revenue loss would total about $270 billion including the payroll tax exclusion

Effect of Select Tax Expenditures on After-Tax Income (2013)



Source: Committee for a Responsible Federal Budget, Congressional Budget Office
Note: Graph represents select income tax expenditures as identified by CBO which make up two-thirds of total tax expenditures

Comparison of Bipartisan Tax Reform Plans

Area	Simpson-Bowles Illustrative Plan	Domenici-Rivlin	2005 Tax Panel Growth and Investment Plan	Wyden-Coats
Individual Income Tax				
Tax Rates	12%|22%|28%	15%|28%	15%|25%|30%	15%|25%|35%
Standard Deduction	Increased 10%	Replaced with work and family credits	Replaced with work and family credits	Roughly Tripled
Personal Exemptions	Retained			Retained
Child Tax Credit & EITC	Retained			Retained
AMT	Repealed	Repealed	Repealed	Repealed
Mortgage Interest Deduction	Converted to 12% credit; capped at $500K mortgage	Converted to 15% credit; limited to $25K of interest	Converted to 15% credit; limited to average price of housing	No change
Charitable Deduction	Converted to 12% credit; 2% of AGI floor	Converted to 15% credit	Retained with 1% of income floor	No change
Employer Sponsored Insurance Exclusion	Capped, phased out from 2018 to 2038	Capped, phased out from 2015 to 2025	Capped at average premium	Cafeteria Plans Preference Eliminated
State & Local Tax Deduction	Eliminated	Eliminated	Eliminated	No change
Misc. Itemized Deductions	Eliminated	Floor increased to 5% of AGI	Unspecified	Eliminated
Muni Bond Exclusion	Phased out for new bonds	Private Activity bonds repealed	Retained	Replaced with a credit
Retirement Savings	Consolidated and capped at $20K or 20% of AGI	Consolidated, replaced with 15% credit up to $20K or 20% of AGI	Replaced with "Save for Retirement" accounts with $10K limit	Consolidated into new Retirement Savings Accounts and Lifetime Savings Accounts
Capital Gains and Dividends	Taxed as ordinary income (top rate 28%)	Taxed as ordinary income (top rate 28%)	Taxed at 15% top rate	Taxed as ordinary income with 35% exclusion (top rate 22.75%)
Step-up Basis for Capital Gains	Eliminated	Eliminated	Retained	No change
Other Tax Expenditures	Most other tax expenditures eliminated.	Most other tax expenditures eliminated.	Most other tax expenditures modified or repealed	Several dozen tax expenditures eliminated, including various exclusions for employee benefit
Corporate Income Tax				
Rates	28%	28%	30% (consumption base)	24%
Depreciation	Economic depreciation	No change	Full expensing	Alternative Depreciation Schedule
Domestic Production Deduction	Eliminated	Eliminated	Unspecified	Eliminated
Inventory Accounting	LIFO eliminated	No change	All purchases immediately deductible	LIFO and LCM eliminated
Other Tax Expenditures	Eliminated	Mostly eliminated	Mostly eliminated	Mostly eliminated
Interest Deduction	No change	No change	Disallowed; interest income is not taxed	Deduction in excess of inflation disallowed
International Tax	Territorial	No change	Destination-based	Worldwide

Source: Committee for a Responsible Federal Budget