

What Next if Not Simplification?

C. Eugene Steuerle

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Around the town of Washington, the passing of a tax act never leads to a decline in requests for new tax breaks, for reform, or for deform. Nor does it remove all legitimate sore points regarding taxation—unnecessary complications, different rates of taxation on those similarly situated, and distorting incentives to engage in tax avoidance rather than productive economic activity. Each new act, moreover, creates a number of new issues that were not completely resolved in the rush to legislation set by a political timetable.

Therefore, it is not surprising that a number of elected and appointed officials have already begun to lay out potential agendas for the next tax bill. The Secretary of the Treasury has expressed his interest in a more integrated system of corporate and individual taxation, giving recognition to the view that businesses don't pay tax, individuals do.

Members of Congress have already stated some of their preferences, with some Republicans seeking to speed up the phase-in periods for provisions just enacted and some Democrats seeking to slow them down or remove some of the cuts just enacted but not effective for close to a decade down the road.

A number of items got left off the table this time, including some provisions normally extended from one period to the next, such as the research tax credit. Many in Congress have also expressed their interest in eliminating the telephone excise tax, a rather inefficient and inequitable tax on one particular type of service. The alternative minimum tax keeps rearing its head. Every member of Congress and the Bush administration knows the AMT issue cannot be avoided forever. The president's own agenda of changes in the tax treatment of charities and subsidies for health care insurance got short shrift in the recent tax bill.

Now, many of these proposed changes have merit, but that is not the point. There is not a great deal of hope for a process that starts out with a hodgepodge of ideas, but no central theme, and then through bargaining works out some solution in which everybody gets a little bit of what they want. That kind of a process has not proven to be the way to achieve good tax policy. Half-baked reforms, even in pursuit of worthwhile goals, are often worse than nothing at all. The best chance for obtaining good tax policy is to articulate a clearly defined and rational goal, one that proceeds generally from some principle or another.

My own favorite principle to emphasize at this point in time, and with this tax code, is simplification. The problems with the AMT must be addressed, but a bill to eliminate or somehow reform the AMT is unlikely to get anywhere by itself. The main constraint is that it would provide simplification mostly for those with incomes in the upper-middle class and higher.

Most true reformers would be willing to pay for a simpler and fairer code by putting tax rates directly in the rate schedules in exchange for eliminating problems like the AMT. But that doesn't seem to be on the table just after a bill was enacted that emphasized the reduction in tax rates to the exclusion of real AMT reform.

If AMT reform must involve some tax cutting, then the problem of the distribution of the tax cut will come up. Admittedly, the AMT's reach keeps stretching down to the middle class, especially in the cases that are beginning to produce public relations horror stories—families getting nailed by the AMT because they have a lot of personal exemptions or live in a high-tax state. But however much sympathy is generated for those who are paying the AMT without justification, low-income and middle-income taxpayers are also hit by an enormously complex tax code. So why should they want their relative tax burdens to rise simply to provide simplification for those who are more capable of paying tax than they are?

The solution that one is inevitably drawn toward—whether on political or tax policy grounds—is that broader simplification is probably required to sell an AMT simplification that has to be undertaken. Simplification, in effect, should dominate considerations in the next major round of tax reform. The Joint Committee on

Taxation has already issued a list of potential simplification proposals, and there's no shortage of ideas from a number of reliable sources, including some legal and accounting associations that are willing to approach the issue without ideological bias.

For the president to take on simplification seems to me to be a slam dunk. It would give him control over an agenda that is otherwise going to be rather wide-ranging. In some ways it offers him a major hook just as rate reduction did in the recent tax bill. By setting out a timetable for a simplification report from his own Treasury, he could also gain some control over alternative tax agendas developing on the Hill. Once work proceeded on the report, he could choose to advance the agenda at whatever pace he desired—if necessary, putting it forward quickly or asking Congress to hold it in abeyance while some other reform effort, such as social security, education, or whatever, proceeded toward completion.

A model already exists. The tax cuts of 1981, largely centered on rate reduction, were followed by a tax reform effort that proceeded from a Treasury study issued in 1984. While the timing is not exactly the same—I do not believe a three-year delay is possible this time—the tax reform debate of 1984-1986 allowed President Reagan to maintain control over much of the tax agenda, while preserving his primary concern for keeping tax rates low.

I am not suggesting there are no other worthwhile agendas. Nor am I suggesting that simplification is always and everywhere a more important principle to be pursued than others. But none has the potential momentum that simplification has at this very point in time. All others are likely to lead to a much more anarchic congressional process and take legislators' minds off of the economic efficiency goal the president so emphasizes.

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