

## A Bipartisan Simplification Package?

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It receives almost no media attention. No one knows how it will even get on the tax agenda. It's not big enough to attract even a glance from the radical reformers, but not small enough to simply get attached to some other bill. What is it? Nothing less or more than a bipartisan movement to provide a moderate amount of simplification in the current tax code.

Its early movers include several members of the House Ways and Means Oversight Subcommittee and is reflected in the "Individual Tax Simplification Act of 1999," introduced by Rep. Richard E. Neal, D- Mass., on April 14, 1999, and the "Tax Simplification and Burden Reduction Act," a legislative drafting effort being led by the Chair of the Oversight Subcommittee, Rep. Amo Houghton, R-N.Y. And an even earlier legislative effort by William J. Coyne, D-Pa., proposed significant simplification of capital gains taxation.

Both efforts deal with rules considered flawed by most tax policy experts because they are needlessly complex or represent hidden taxes. The provisions in Neal's bill include simplification of nonrefundable credits, simplification of the capital gains tax, and repeal of certain marginal rate increases caused by phase-outs of itemized deductions and personal exemptions (the so-called Pease and PEP rules). Houghton's legislation, among other items, would also provide simplification of nonrefundable credits and simplification of capital gains taxation, as well as a higher exclusion for group-term life insurance provided by an employer, a simplified safe harbor for payment of estimated taxes, and expensing of personal property purchased in connection with residential rentals. It would also treat the postmark date as the filing date on all returns.

The bills, however, differ in important respects. Neal would completely repeal the alternative minimum tax and replace it mainly with direct and explicit tax rates of an additional 1 percent for adjusted gross income in excess of \$120,000 on a joint return and 2.08 percent for AGI in excess of \$150,000. Houghton's bill would reduce the application of the AMT for many middle-income taxpayers by establishing a new, higher, exemption level and with a few other changes. Although the two might have some disagreement over whether or not to pay for AMT changes through explicit tax rates, it is nonetheless quite important at this stage that they agree something must be done about the AMT.

Houghton's bill would establish a simple capital gains exclusion of 50 percent; Neal's exclusion would be 38 percent. But, once again, reflect on what the two have in common. Both would replace a complex series of rates and exclusions with one simple exclusion.

Although individual tax rates and capital gains rates may appear higher in Neal's bill, his bill attempts to achieve its goal by maintaining revenue neutrality. Houghton's bill is still being developed. The extent to which it involves revenue raisers may depend on how far the Ways and Means Committee gets this year in trying to draft a larger tax bill, whether it puts any money aside for simplification, and who gets to "spend" that money. Comparisons between the two efforts at this stage, therefore, must be made with caution, as it is unclear whether the Neal bill could be amended to provide fewer rate increases or whether Houghton would be willing to accept some explicit rate increases in exchange for getting rid of some of the implicit rates in the current tax system. Keep in mind, however, that the Neal bill, as it currently stands, essentially provides relief to the upper-middle class by raising tax rates on those with the highest incomes.

There are also elements in each bill that, while not fatal flaws, raise questions. For example, Neal would increase the floor for miscellaneous itemized deductions from 2 percent of adjusted gross income to 4 percent. When I first suggested a percent floor under itemized deductions as part of Treasury's proposals leading to the Tax Reform Act of 1986, I was mainly concerned with the very high error and noncompliance rate associated with small miscellaneous deductions, and I was also seeking to provide simplification by combining various lines on which such deductions are taken. Congress bumped that 1 percent floor to 2 percent mainly as a revenue measure. That raise had the effect of denying (beyond some de minimis amount)

legitimate deductions in measuring net income. A 4 percent floor could be harsh on workers who really do face significant work-related costs. It would also hit investors with significant expenses in handling their portfolios, but they are also likely to be the beneficiaries of some other changes in the bill.

Another example: Houghton would allow a deduction for all points paid in refinancing mortgages for personal residences. While this might provide some simplification, one has to be careful. Lenders can easily convert normal interest costs into up-front refinancing points, so one has to be wary of encouraging them to play games with mortgage points. Some limit on immediate deductibility is still required. Exactly what is a "refinancing point" could be strictly defined, but for all intents and purposes such a definition would operate pretty much like a limit.

A final concern is whether simplification efforts such as Neal's and Houghton's would be overridden by special interests once they begin to attract attention. Certainly those special interests are capable of packaging many of their wants as "simplifications." If equity and efficiency concerns became ignored altogether, then simplification would not be worth the price. So far, however, these simplification efforts have not been overtaken by special interests, and the members involved have appealed to outside sources such as the New York State Bar Association, which has long been known for putting together nonpartisan analyses even when they go against the interests of clients of members of that bar.

It is refreshing to see basic tax reform legislation being developed this way. In our media era, it is often hard to get attention for the basic art of governing and to those more nitty-gritty policy changes that simply help government function more efficiently and openly. Hope springs eternal. Maybe tax simplification is not dead after all.

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