# AN ANALYSIS OF GOVERNOR BUSH'S TAX PLAN

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ABSTRACT

This paper analyzes presidential candidate Jeb Bush's tax proposal. It would reduce individual and business marginal tax rates, curtail tax expenditures, and convert the corporate income tax into a cash-flow consumption tax. The proposal would cut taxes at all income levels, reducing federal revenues by $6.8 trillion over its first decade before considering macro feedbacks. The plan would improve incentives to work, save, and invest, but unless accompanied by very large spending cuts, it could increase the national debt by as much as 50 percent of GDP by 2036, which would tend to put a drag on the economy.

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## EXECUTIVE SUMMARY AND INTRODUCTION

As part of his presidential campaign, Jeb Bush has proposed the "Reform and Growth Act of 2017," which would reduce marginal tax rates for both individuals and corporations; curtail some tax preferences; repeal the alternative minimum tax and estate and gift taxes; allow business to expense capital investments; eliminate interest deductibility; switch to a territorial tax system for US multinational corporations; and otherwise simplify the federal tax system. The Tax Policy Center estimates the proposal would reduce federal revenue, before considering any macroeconomic feedback effects, by $6.8 trillion over its first decade and an additional $8.6 trillion over the subsequent 10 years. [1] About 60 percent of the revenue loss would come from individual income and payroll taxes and most of the rest from the corporate income tax.

The proposal would cut taxes at every income level, but the biggest cuts as a percentage of income would accrue to high-income taxpayers. The highest-income 0.1 percent taxpayers would experience an average tax cut of more than $800,000 in 2017, or 12.0 percent of after-tax income, compared with an overall average tax cut of $2,800, or 3.9 percent of income.

The proposal dramatically reduces marginal tax rates, which would boost incentives to work, save, and invest if interest rates do not change. The plan would also reduce some tax distortions on the allocation of capital. By limiting the value of itemized deductions such as the mortgage interest deduction, the plan would reduce the tax incentive for over-investing in housing. The proposal would also end businesses' ability to deduct interest, which would eliminate the long-standing tax bias in favor of debt over equity finance.

However, if the deficit effect is as large as we estimate, government borrowing would push up interest rates and crowd out private investment, possibly offsetting some or all of the positive incentive effects. The campaign has said it intends to cut spending to offset any revenue loss from its tax cuts. Offsetting a deficit this large would require very large cuts in entitlement and discretionary spending.

The main elements of the proposal are listed below.

***Individual Income Tax***

- Collapse the current seven tax brackets, which range from 10 to 39.6 percent, into three brackets of 10, 25, and 28 percent;
- Increase the standard deduction by $5,000 for single filers (to $11,300 in 2015) and by $10,000 for joint filers (to $22,600 in 2015);
- Leave personal exemptions unchanged ($4,000 per person in 2015);
- Tax investment income (interest, dividends, and capital gains) at a maximum rate of 20 percent;

- Modify itemized deductions:
    - Eliminate the deduction for state and local income, sales, and property taxes
    - Maintain the deduction for charitable contributions with current law limitations
    - Maintain all other itemized deductions, but subject them to a limitation that the tax savings from claiming them cannot exceed 2 percent of adjusted gross income;
- Double the size of the earned income tax credit for childless workers and expand the credit to workers ages 21 to 24 who are not full-time students (unspecified reforms to the earned income tax credit to reduce fraud would be implemented);
- For joint filers, allow the lower-earning spouse to file a separate tax return on his or her wage and salary income using tax rates for single filers. The higher-earning spouse would file a joint return for the rest of the couple's income and claim all other deductions and credits;
- Repeal the personal exemption phaseout and the limit on itemized deductions;
- Repeal the alternative minimum tax; and
- Tax carried interest as ordinary income.

***Payroll Tax***

- Eliminate worker's share of payroll taxes that fund Social Security and Medicare for workers who have reached full retirement age (currently 66 but phasing up to 67 for people born in 1960 or later).

***Estate Tax***

- Repeal estate and gift taxes; and
- Limit the step-up in basis for capital gains to $5 million per decedent (indexed from 2011 to changes in the consumer price index). The limit in 2015 would be $5.43 million. The adjusted basis would be passed on to the heir (carryover basis).

***Business Taxes***

- Reduce the top corporate tax rate to 20 percent (the top pass-through tax rate would be the 28 percent top rate that applies to all other individual income);
- Allow full expensing for new investments (thereby eliminating the need to depreciate assets);
- Eliminate the deduction for interest paid by businesses;
- Repeal most tax breaks for businesses, but permanently retain the research and experimentation tax credit;
- Repeal the corporate alternative minimum tax;
- Enact a territorial tax system under which firms would pay tax only on income earned in the United States; and

- Impose up to an 8.75 percent deemed repatriation tax on accrued profits held outside the United States by American companies on the effective date of the proposal, payable over 10 years.

***Affordable Care Act Taxes***

- Repeal the 3.8 percent net investment income tax on high-income taxpayers (single filers with income over $200,000 and couples with income over $250,000, unindexed).

## MAJOR ELEMENTS OF THE PROPOSAL

Governor Bush's objective is to overhaul the federal tax code in ways that would lower marginal tax rates, simplify tax filing, reduce tax preferences, and reform business taxes to make American firms more competitive internationally.[2]

***Individual Income Tax***

The proposal would reduce the number of individual income tax brackets from the current seven brackets to just three, with rates of 10, 25, and 28 percent (table 1). Those rates match three of the lowest four current rates and would cut the top tax rate by nearly a third (11.6 percentage points) from its current 39.6 percent. The plan would retain current preferential tax rates of 0, 15, and 20 percent on long-term capital gains and qualified dividends, and it would extend those rates to interest income. The effective tax rates on capital gains and qualified dividends would fall, however, because the plan would eliminate the 3.8 percent surtax on investment income of high-income taxpayers that was enacted as part of the Affordable Care Act.

The plan would maintain existing personal and dependent exemptions ($4,000 per person in 2015), but would increase the standard deduction by $5,000 for single filers (to $11,300 in 2015) and by $10,000 for married couples filing jointly (to $22,600). In effect, for nonitemizers, the Bush plan would reduce tax rates throughout the income distribution. Tax liability (before credits) would be eliminated on the first $5,000 of currently taxable income (the first $10,000 for joint filers); this income would otherwise be taxed at the taxpayer's highest marginal rate. Tax filers who itemize their deductions would not benefit from the higher standard deduction, but many people who currently itemize would stop itemizing both because their deductions are less than the proposed higher standard deduction and because, as described below, the plan would limit itemized deductions. We estimate that 39 million filers (88 percent) who would otherwise itemize deductions in 2017 would opt for the standard deduction under the proposal.[3]

TABLE 1

## Tax Rates Under Current Law and Under Bush Tax Plan

Among tax filers claiming the standard deduction, 2015[a]

| Single Filers | | | | Childless Married Couples Filing Jointly | | | |
|---|---|---|---|---|---|---|---|
| Adjusted gross income | | Current marginal rate | Bush plan marginal rate | Adjusted gross income | | Current marginal rate | Bush plan marginal rate |
| Over | But not over | | | Over | But not over | | |
| $0 | $10,300[b] | 0% | 0% | $0 | $20,600[b] | 0% | 0% |
| $10,300 | $15,300 | 10% | 0% | $20,600 | $30,600 | 10% | 0% |
| $15,300 | $19,525 | 10% | 10% | $30,600 | $39,050 | 10% | 10% |
| $19,525 | $47,750 | 15% | 10% | $39,050 | $95,500 | 15% | 10% |
| $47,750 | $101,050 | 25% | 25% | $95,500 | $171,800 | 25% | 25% |
| $101,050 | $199,600 | 28% | 28% | $171,800 | $251,050 | 28% | 28% |
| $199,600 | $421,800 | 33% | 28% | $251,050 | $432,100 | 33% | 28% |
| $421,800 | $423,500 | 35% | 28% | $432,100 | $485,450 | 35% | 28% |
| $423,500 | and over | 39.6% | 28% | $485,450 | and over | 39.6% | 28% |

**Source:** Urban-Brookings Tax Policy Center based on the Bush tax plan and IRS tax brackets.
**(a)** Tax filers who itemize deductions would not benefit from the Bush tax plan's increase in the standard deduction and would thus face tax brackets different from those shown in this table.
**(b)** The lowest tax bracket covers the standard deduction plus personal exemptions: $6,300 + $4,000 for single filers and $12,600 + $8,000 for childless married couples filing jointly. It does not include the additional standard deduction for elderly or blind people.

Governor Bush would trim itemized deductions in two ways. First, he would eliminate the deduction for state and local taxes, arguing that the deduction "subsidizes high tax states, which encourages poor fiscal policy."[4] Second, the plan would cap all other deductions except charitable contributions so the tax savings from those deductions do not exceed 2 percent of adjusted gross income (AGI).[5] Because tax savings from a given deduction are proportional to the taxpayer's marginal tax rate, those in higher tax brackets have their deductions limited to a smaller share of AGI. Thus, for example, a taxpayer in the 10 percent bracket could itemize deductions up to 20 percent of AGI, but someone in the 28 percent bracket could deduct no more than about 7 percent of AGI (table 2).

Itemizers would benefit, however, from the elimination of the limitation on itemized deductions (often called "Pease" after the Ohio Representative who helped devise it). This provision currenty increases taxable income by reducing itemized deductions for high-income taxpayers—single filers with AGI over $258,250 and joint filers with AGI over $309,900 in 2015.[6] The proposal would also provide a small additional benefit to high-income households, whether or not they itemize deductions, by eliminating the phaseout of personal exemptions, which now applies at the same income ranges.

TABLE 2

## Effect of 2 Percent of AGI Limit on Itemized Deductions for Proposed Tax Brackets

| | Tax Bracket | | |
|---|---|---|---|
| | 10 percent | 25 percent | 28 percent |
| Tax rate | 10% | 25% | 28% |
| Maximum deduction as a percentage of adjusted gross income | 20% | 8% | 7% |
| Tax savings as a percentage of adjusted gross income (= tax rate x deduction) | 2% | 2% | 2% |

**Source:** Urban-Brookings Tax Policy Center calculations based on Bush tax plan.

The proposal would reduce the tax incentive to donate to charity. Although charitable deductions would not be subject to the two percent of AGI limitation, the dramatic drop in itemizers would mean very few taxpayers would have a tax incentive to donate to charity. Most very high-income people, who account for the bulk of charitable donations, would continue to itemize and would thus retain a marginal tax subsidy, but it would be much smaller because of the large cut in the top marginal tax rates.

Governor Bush would leave most tax credits unchanged but would double the maximum earned income tax credit (EITC) for childless workers and extend EITC eligibility to nonstudent workers ages 21 through 24. Childless workers under age 25 are currently ineligible for EITC (as are workers over age 65, but Bush would leave the upper age limit unchanged). In 2015, the EITC for childless workers equals 7.65 percent of earnings up to $6,575, at which point the credit hits its maximum value of $503. The credit remains at that level until it begins to phase down at the same 7.65 percent rate when earnings exceed $8,015.[7] EITC disappears when earnings equal $14,590 or more.[8] Bush would leave those income thresholds and limits alone and double the maximum credit by doubling the phase-in and phaseout rates to 15.3 percent.[9]

The governor's plan would reduce marriage penalties in the income tax by allowing a lower-earning spouse to file a separate tax return using the single filing status. The lower-earning spouse would include only his or her earnings on the separate return as a single individual and claim only his or her own personal exemption in calculating taxable income. All other income, deductions, and credits would remain on the higher earner's tax return. The plan lacks further detail, but TPC's analysis assumes only wage and salary income would go on the lower earner's return and all other income, including self-employment earnings, would remain on the other spouse's return. Allowing separate filing would reduce but not eliminate marriage penalties—it does not directly affect the penalties associated with credits and other provisions that phase out as income increases.[10] And, because this provision would allow the higher earner to use the tax

rates for married couples filing jointly, the plan would increase marriage bonuses for some two-earner couples.

### *Business Taxes*

Governor Bush proposes cutting the top corporate rate from 35 to 20 percent while eliminating most business tax breaks, but he would retain the credit for research and experimentation. The plan would also repeal the corporate minimum tax. As under current law, pass-through entities such as partnerships and S corporations would be taxed at individual rates.

Businesses would be permitted to immediately deduct (expense) investment in equipment, structures, and inventory, rather than having to amortize the deductions over time. In addition, interest costs would no longer be deductible for business loans that originated in 2017 or later. Thus, the corporate income tax would be transformed into a cash flow tax, effectively a business-level consumption tax (but with the additional bonus of the research and experimentation credit). We discuss how these changes would affect the incentive to make new investment below.

The plan would also shift taxation of multinationals to a territorial tax system in which the United States, like most other countries, would exempt foreign-source income from US tax liability. Like former Ways and Means Committee Chairman Dave Camp's tax reform proposal,[11] Governor Bush would impose a one-time transition tax of up to 8.75 percent on existing unrepatriated foreign income of US firms, payable over 10 years.

Although moving to a territorial system would reduce the incentive for a US corporation to move its tax residence overseas (a so-called corporate inversion), it would also create a stronger incentive to recharacterize domestic corporate income as foreign-source to avoid the US corporate tax. Companies do this now by shifting intangible assets such as patents to subsidiaries in low-tax foreign jurisdictions, while allocating most business expenses to the US parent (so they can be deducted from US tax liability). Governor Bush has not specified how his territorial tax plan would work or how he would prevent multinationals from gaming the system, although the lower corporate tax rate and end to interest deductibility would reduce the incentives and opportunities for such gaming.[12]

### *Estate and Gift Tax*

The plan would repeal federal estate and gift taxes but limit the step-up in basis that heirs could claim on inherited assets. Under current law, the tax basis for inherited assets equals the value of those assets on the decedent's date of death (or six months later if the estate chooses the later date to value all assets). Step-up means that unrealized capital gains in an estate go untaxed: the decedent paid no tax on unrealized gains, and the heir only pays tax on future gains. The Bush plan would limit step-up in basis to the current threshold for the estate tax, which is $5.43 million

in 2015 (although spouses would continue to receive unlimited step-up).[13] Heirs or estate administrators would have to choose which assets would receive step-up treatment and report the election to the Internal Revenue Service to claim the option. All other assets would be passed on to heirs with the decedent's basis (carryover basis). Even with the limited carryover basis regime, only inherited gains from the largest estates would be subject to tax.

***Revenue Effects***

We estimate the Bush plan would reduce federal receipts (income, payroll, and estate taxes) by $6.8 trillion between 2016 and 2026[14] (table 3). This decade is the 10-year budget window plus 2016 (in which revenues would fall slightly because taxpayers would hold off realizing capital gains in expectation of a rate cut in 2017).[15] About two-thirds of the revenue loss would come from individual income tax provisions, especially the cut in individual income tax rates, which woud account for more than half the revenue loss. Among corporate income tax cuts, lowering corporate rates and repealing the corporate AMT would account for 70 percent of the revenue loss. Replacing the estate and gift tax with carryover basis for capital gains, in contrast, would have a comparatively modest effect on revenues, reducing them by $185 billion over the budget period.

TABLE 3

# Estimated Effect of Provisions in Bush Tax Plan on Tax Receipts

Billions of dollars, FY 2016–36

| Provision | Fiscal Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2016–26 | 2027–36 |
| **Individual income and payroll taxes** | | | | | | | | |
| Repeal alternative minimum tax | 0.0 | -22.4 | -31.3 | -33.2 | -34.6 | -36.1 | -361.0 | -580.4 |
| Impose individual income tax rates of 10, 25, and 28 percent | 0.0 | -157.4 | -219.6 | -235.7 | -252.5 | -267.9 | -2,741.7 | -4,764.3 |
| Repeal 3.8 percent net investment surtax; tax interest, qualified dividends and long-term capital gains at 0, 15, and 20 percent rates | -6.7 | -7.9 | -16.0 | -27.2 | -31.6 | -33.3 | -316.1 | -564.4 |
| Repeal personal exemption phase-out and limitation on itemized deductions (Pease) | 0.0 | -18.0 | -25.0 | -26.5 | -28.1 | -29.8 | -305.3 | -520.8 |
| Increase standard deduction | 0.0 | -53.9 | -73.1 | -75.1 | -77.9 | -81.1 | -815.1 | -1,199.9 |
| Repeal deduction for state and local taxes | 0.0 | 66.7 | 88.1 | 93.3 | 100.4 | 106.6 | 1,085.2 | 1,870.6 |
| Expand childless earned income tax credit (EITC) | 0.0 | -3.3 | -4.6 | -4.7 | -4.8 | -4.9 | -48.4 | -60.0 |
| Limit value of tax savings from itemized deductions to two percent of AGI | 0.0 | 16.8 | 25.8 | 30.3 | 33.9 | 37.0 | 381.5 | 764.1 |
| Allow second earners to file separate tax return | 0.0 | -34.5 | -47.1 | -48.7 | -50.5 | -52.4 | -526.7 | -824.3 |
| Eliminate 6.2 percent Social Security tax on workers 67 and older | 0.0 | -14.6 | -20.6 | -21.9 | -23.2 | -25.1 | -259.1 | -465.6 |
| Tax carried interests as ordinary income | 0.0 | 0.0 | 1.0 | 1.4 | 1.3 | 1.2 | 9.7 | 5.3 |
| Expense all investment and disallow interest deduction on new loans | 0.0 | -86.5 | -106.2 | -95.1 | -85.0 | -73.9 | -693.5 | -19.8 |
| Repeal section 199 and other tax expenditures for passthrough businesses | 0.0 | 17.4 | 30.1 | 32.4 | 33.8 | 34.4 | 339.4 | 488.8 |
| Permanently extend R&E credit (assumed effective Jan. 1, 2015) | 0.0 | -0.3 | -0.4 | -0.4 | -0.5 | -0.5 | -5.2 | -9.8 |
| **Total for individual income and payroll taxes** | **-6.7** | **-297.9** | **-398.7** | **-411.0** | **-419.2** | **-425.9** | **-4,256.5** | **-5,880.6** |
| **Corporate income tax** | | | | | | | | |
| Reduce corporate rate to 20% and repeal the corporate AMT | 0.0 | -24.4 | -66.3 | -104.4 | -142.0 | -182.7 | -1,653.3 | -3,070.4 |
| Expense all investment and disallow interest deduction on new loans | 0.0 | -154.8 | -253.4 | -195.0 | -121.7 | -69.7 | -812.5 | 504.3 |
| Territorial system of taxing foregin-source income earned after Dec. 31, 2016 | 0.0 | -16.0 | -29.2 | -26.9 | -20.1 | -13.6 | -159.2 | -144.1 |
| Deemed repatriation over 10 years of accumulated untaxed pre-2017 earnings of CFCs, with reduced rates | 0.0 | 6.2 | 12.4 | 13.8 | 13.8 | 13.8 | 129.3 | 9.0 |
| Repeal section 199 and other tax expenditures | 0.0 | 11.3 | 22.3 | 24.4 | 24.0 | 23.6 | 245.1 | 404.8 |
| Permanently extend R&E credit (assumed effective Jan. 1, 2015) | 0.0 | -4.7 | -5.5 | -6.2 | -7.0 | -7.7 | -80.8 | -151.8 |
| **Total for corporate income tax** | **0.0** | **-182.3** | **-319.6** | **-294.4** | **-253.0** | **-236.4** | **-2,331.4** | **-2,448.2** |
| **Estate and gift taxes** | | | | | | | | |
| Repeal the estate and gift tax with carryover basis regime | 0.0 | 0.4 | -13.7 | -20.5 | -21.7 | -21.8 | -184.8 | -246.1 |
| **Total for estate and gift tax revenues** | **0.0** | **0.4** | **-13.7** | **-20.5** | **-21.7** | **-21.8** | **-184.8** | **-246.1** |
| **Total revenue effect of all proposals** | | | | | | | | |
| **Total revenue change** | **-6.7** | **-479.8** | **-732.0** | **-725.8** | **-693.8** | **-684.0** | **-6,772.6** | **-8,574.9** |
| As a percentage of GDP | 0.0 | -2.4 | -3.6 | -3.4 | -3.1 | -2.9 | -2.6 | -2.3 |

**Sources:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3); TPC estimates.

**Notes:** CFC = controlled foreign corporation; R&E = research and experimentation; AGI = adjusted gross income; AMT = alternative minimum tax; GDP = gross domestic product.

We also estimate the effect of the tax changes in the second decade (2027–36) and find no evidence that the revenue losses are back-loaded. The second 10-year revenue loss of $8.6 trillion would be larger in nominal terms than the first 10 years, but it would actually be smaller as a share of cumulative gross domestic product (GDP) (2.3 versus 2.6 percent in 2026–36).

The revenue losses understate the effect on the national debt because they exclude the additional interest that would accrue as a result. Including interest costs, the proposal would add $8.1 trillion to the national debt by 2026 and $22 trillion by 2036 (table 4). Assuming the tax cuts are not offset by spending cuts, the national debt would rise by an estimated 28 percent of GDP in 2026 and by more than 50 percent of GDP by 2036.

TABLE 4

**Effect of Bush Tax Proposal on Federal Revenues, Deficits, and the Debt**

Billions of dollars, FY 2016–36

| | Fiscal Year | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2016–26 | 2027–36 |
| Revenue loss | 6.7 | 479.8 | 732.0 | 725.8 | 693.8 | 684.0 | 677.4 | 677.7 | 684.9 | 696.0 | 714.5 | 6,772.6 | 8,574.9 |
| Additional interest | 0.1 | 4.5 | 21.8 | 49.6 | 79.0 | 109.2 | 140.4 | 173.0 | 206.1 | 241.4 | 279.7 | 1,304.8 | 5,307.1 |
| Increase in deficit | 6.8 | 484.3 | 753.8 | 775.4 | 772.9 | 793.3 | 817.8 | 850.6 | 891.0 | 937.4 | 994.2 | 8,077.5 | 13,882.1 |
| Increase in debt[a] | 6.8 | 491.0 | 1,244.8 | 2,020.2 | 2,793.1 | 3,586.4 | 4,404.2 | 5,254.8 | 6,145.8 | 7,083.2 | 8,077.5 | 8,077.5 | 21,959.5 |
| **Increase in debt relative to GDP** | **0.0%** | **2.5%** | **6.1%** | **9.4%** | **12.5%** | **15.4%** | **18.2%** | **20.8%** | **23.3%** | **25.8%** | **28.2%** | **28.2%** | **51.3%** |
| Addendum: GDP (end of period) | 18,831.9 | 19,701.4 | 20,558.3 | 21,403.7 | 22,314.7 | 23,271.0 | 24,261.5 | 25,287.4 | 26,352.1 | 27,455.5 | 28,600.0 | 28,600.0 | 42,800.0 |

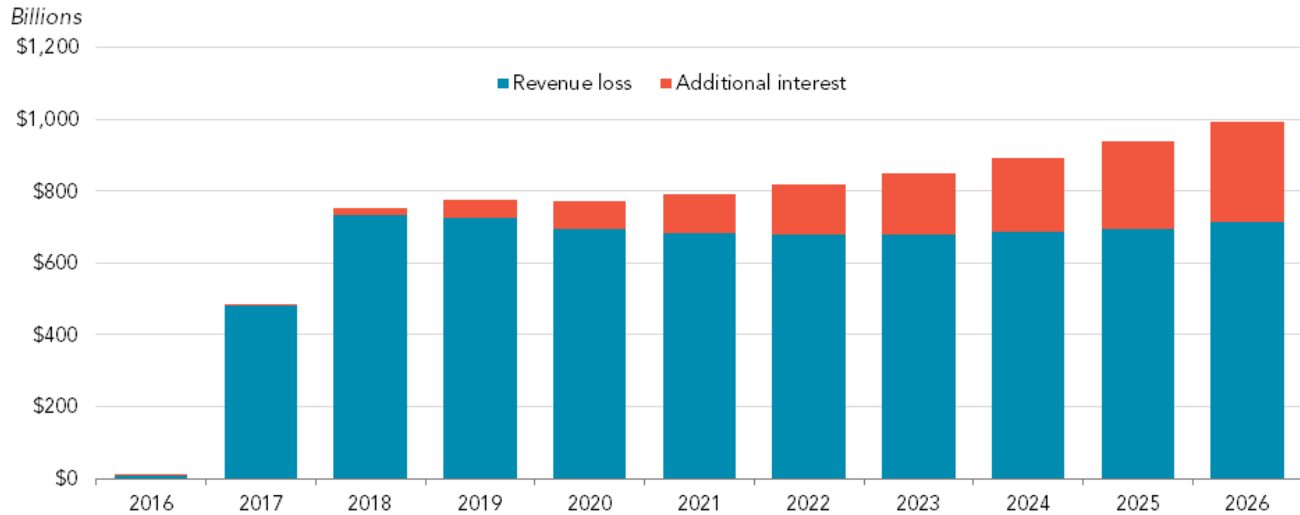
**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3); Congressional Budget Office (2015a and 2015b).
**(a)** Increase in debt equals the cumulative increase in deficit plus additional interest on the debt.

Finally, the exemption of older workers from the employer portion of the Social Security tax could have a small negative effect on Social Security's finances unless the lost revenues are made up from other sources. We estimate that this provision would reduce Social Security payroll taxes by roughly $600 billion through 2034, the date at which the trust fund is currently projected to be exhausted. Depending on the details, the revenue loss might be partially offset by a reduction in benefits for older retirees. The overall effect is that this provision might accelerate the exhaustion date for the trust fund, but by less than one year.

FIGURE 1

Effects on the Debt

FY 2016–26




**Source:** Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3); Congressional Budget Office (2015a and 2015b).
**Notes:** Increase in debt from 2016 to 2026 is $8,0777.5 billion ($6,772.6 billion in revenue loss and $1,304.5 billion in additional interest. Increase in debt from 2017 to 2036 is $13,882.1 billion ($8,574.9 billion in revenue loss and $5,3017.1 billion in additional interest).

### *Distributional Effects*[16]

The proposal would reduce taxes throughout the income distribution.[17] About 87.0 percent of tax units would receive a tax cut (or larger refundable tax credits) in 2017 compared with current law (table 5). The average tax cut would be roughly $2,800, or about 3.9 percent of after-tax income. Households at all income levels would receive tax cuts, but the largest cuts, both in terms of dollars and as a percentage of income, would accrue at the highest income levels. The top 20.0 percent of tax units would receive an average tax cut of almost $14,000, or 5.4 percent of after-tax income. The highest-income 1.0 percent would average a $167,000 tax cut (almost 11 percent of income), and the top 0.1 percent would get a tax cut worth over $800,000 per return, nearly 12 percent of after-tax income.

TABLE 5

## Distribution of Federal Tax Change

By expanded cash income percentile, 2017[a]

| Expanded cash income percentile[b,c] | Percent change in after-tax income[d] | Share of total federal tax change | Average federal tax change ($) | Average Federal Tax Rate[e] | |
|---|---|---|---|---|---|
| | | | | Change (% points) | Under the proposal |
| Lowest quintile | 1.4 | 1.8 | -185 | -1.3 | 3.1 |
| Second quintile | 1.9 | 4.6 | -593 | -1.7 | 6.8 |
| Middle quintile | 2.7 | 10.3 | -1,464 | -2.3 | 11.6 |
| Fourth quintile | 2.8 | 15.2 | -2,593 | -2.3 | 15.1 |
| Top quintile | 5.4 | 67.9 | -13,947 | -4.0 | 22.4 |
| All | 3.9 | 100.0 | -2,813 | -3.1 | 17.3 |
| | | | | | |
| **Addendum** | | | | | |
| 80–90 | 3.0 | 10.7 | -4,258 | -2.4 | 17.9 |
| 90–95 | 2.6 | 6.2 | -5,115 | -2.0 | 20.2 |
| 95–99 | 4.1 | 12.1 | -13,256 | -3.0 | 22.7 |
| Top 1 percent | 10.8 | 38.9 | -167,325 | -7.1 | 27.0 |
| Top 0.1 percent | 11.9 | 19.3 | -808,196 | -7.6 | 27.9 |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

**Notes:** Number of AMT Taxpayers (millions). Baseline: 4.5; Proposal: 0.

**(a)** Projections are for calendar year 2017; baseline is current law. The proposal includes all individual, corporate, payroll, and estate tax provisions. http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

**(b)** Includes both filing and non-filing units but excludes units that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class, but they are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

**(c)** The income percentile classes are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20%, $23,138; 40%, $45,264; 60%, $80,983; 80%, $143,029; 90%, $210,021; 95%, $296,946; 99%, $737,151; and 99.9%, $3,794,482.

**(d)** After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax; payroll taxes (Social Security and Medicare), estate tax, and excise taxes.

**(e)** Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

The proposal would provide even larger tax cuts in 2025—averaging almost $3,500, or 4 percent of after-tax income (table 6 and figure 1). The highest-income 0.1 percent would receive an average tax cut of about $1.3 million, or 13 percent of after-tax income. Lower-income households would also receive modest tax cuts relative to current law. However, the plan would allow the temporary expansions to the child tax credit and earned income tax credit to expire as scheduled at the end of 2017, which means that many low-income families could actually face a tax increase in 2018 compared with 2017. (The same risk, of course, occurs under current law and so is not a feature specific to the Bush tax plan.)

TABLE 6

## Distribution of Federal Tax Change

By expanded cash income percentile, 2025[a]

| Expanded cash income percentile[b,c] | Percent change in after-tax income[d] | Share of total federal tax change | Average federal tax change ($) | Average Federal Tax Rate[e] | |
|---|---|---|---|---|---|
| | | | | Change (% points) | Under the proposal |
| Lowest quintile | 1.4 | 1.7 | -251 | -1.3 | 4.4 |
| Second quintile | 1.8 | 4.6 | -785 | -1.7 | 7.5 |
| Middle quintile | 2.5 | 9.8 | -1,849 | -2.2 | 12.4 |
| Fourth quintile | 2.5 | 12.8 | -2,928 | -2.0 | 15.5 |
| Top quintile | 5.8 | 70.8 | -19,625 | -4.3 | 22.4 |
| All | 4.0 | 100.0 | -3,814 | -3.2 | 17.6 |
| | | | | | |
| **Addendum** | | | | | |
| 80–90 | 2.5 | 8.4 | -4,484 | -2.0 | 18.5 |
| 90–95 | 2.2 | 4.7 | -5,247 | -1.7 | 20.3 |
| 95–99 | 4.3 | 11.6 | -17,145 | -3.2 | 22.3 |
| Top 1 percent | 11.9 | 46.2 | -273,332 | -7.8 | 26.3 |
| Top 0.1 percent | 13.0 | 22.0 | -1,261,503 | -8.5 | 26.6 |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

**Notes:** Number of AMT Taxpayers (millions). Baseline: 5; Proposal: 0.

**(a)** Projections are for calendar year 2025; baseline is current law. The proposal includes all individual, corporate, payroll, and estate tax provisions. http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

**(b)** Includes both filing and non-filing units but excludes units that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class, but they are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

**(c)** The income percentile classes are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20%, $26,106; 40%, $51,093; 60%, $87,696; 80%, $148,141; 90%, $217,357; 95%, $289,948; 99%, $848,445; and 99.9%, $5,233,860.

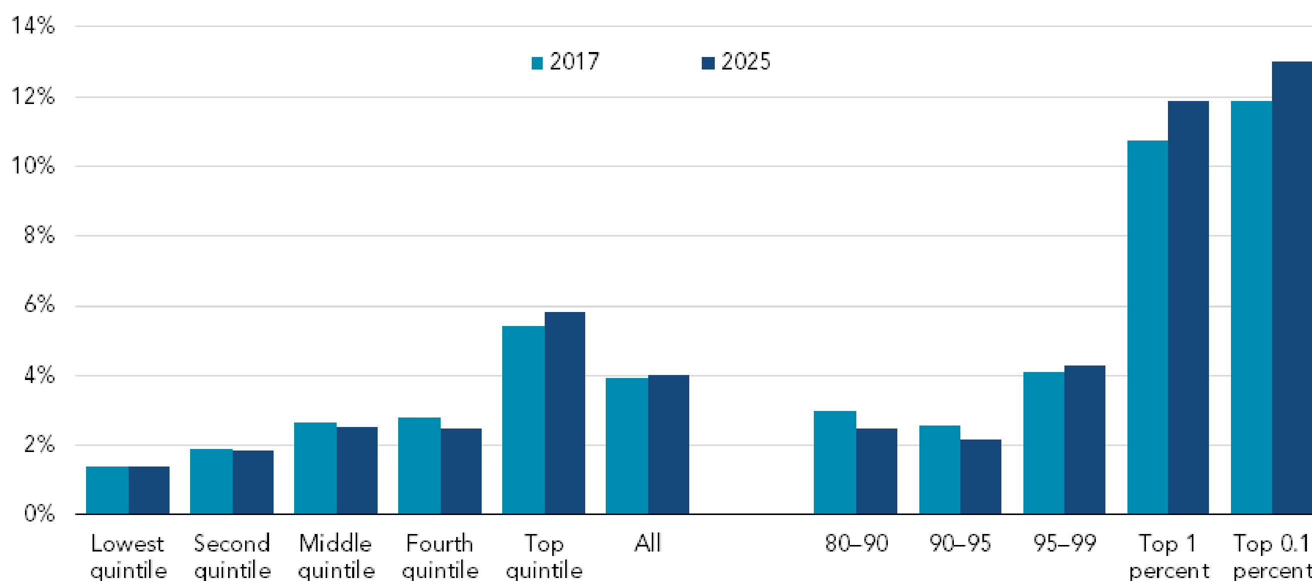
**(d)** After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax; payroll taxes (Social Security and Medicare), estate tax, and excise taxes.

**(e)** Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

FIGURE 2

### Percent Change in After-Tax Income Under Bush Proposal

By expanded cash income percentile, 2017 and 2025




**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

The financing of the tax cuts will ultimately affect the distribution of winners and losers. While a portion of the revenue loss might be offset by higher tax revenues arising from increased economic growth, the remainder of the financing would have to come from some combination of current or future spending cuts and tax increases. To the extent that the tax cuts are financed by spending cuts, the net effects of the plan are likely to be regressive, since the benefits of government spending tend to be distributed progressively.[18]

## COMPLEXITY

Governor Bush's tax reform plan would simplify the tax code in several ways, but it would also create some new complexities. It would eliminate many tax expenditures, thus reducing record-keeping and reporting requirements, and it would slash the number of tax units that itemize deductions. We estimate the proposal would cut the number of itemizers by about 39 million in 2017 (88 percent) and by 44 million (84 percent) in 2026 (table 7). Overall, the share of filers who itemize in 2017 would fall from 31 percent under current law to less than 4 percent, although that number would creep upward over time as incomes rise (as it would also do under current law). Eliminating the very complex AMT, the Affordable Care Act surcharge on investment income, the personal exemption phaseout, and the limitation on itemized deductions would also simplify tax preparation somewhat (although software makes dealing with these aspects of the code manageable). For businesses, expensing would eliminate the need for computing depreciation and other cost-recovery allowances,[19] and the proposal would also get rid of various special tax provisions that complicate record keeping and tax preparation.

TABLE 7

## Effect of Bush Tax Proposals on Number of Itemizers and Filers

In millions of tax units, 2017 and 2026[a]

| | Current law | Bush proposal | Difference | |
|---|---|---|---|---|
| | | | Millions | Percent |
| **2017** | | | | |
| Tax units | 173.8 | 173.8 | -- | -- |
| Filers | 146.6 | 145.9 | -0.7 | -0.5 |
| Itemizers | 44.8 | 5.5 | -39.3 | -87.7 |
| Share of filers | 30.5% | 3.7% | -- | -- |
| Share of all tax units | 25.8% | 3.1% | -- | -- |
| **2026** | | | | |
| Tax units | 186.6 | 186.6 | -- | -- |
| Filers | 162.0 | 160.8 | -1.2 | -0.7 |
| Itemizers | 52.4 | 8.2 | -44.2 | -84.4 |
| Share of filers | 32.3% | 5.1% | -- | -- |
| Share of all tax units | 28.1% | 4.4% | -- | -- |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

The proposal, however, would create new complexities. Optional single filing for married couples would require some couples to figure their taxes two ways to see which method would result in a lower tax. And the limitation on the value of itemized deductions would require the small share of taxpayers whose itemized deductions exceed their standard deduction to calculate their tax liability with and without itemizing to see whether the difference was greater than 2 percent of AGI. Essentially, the proposal would create a new kind of AMT. Software could simplify these calculations, but these new complexities would make it harder for taxpayers to understand exactly how the tax system affects them.

## ECONOMIC EFFECTS

### *Impact on Saving and Investment*

The Bush plan proposes various tax law changes that would alter incentives to save and invest in the United States. The combination of expensing (i.e., immediately deducting the full purchase price of capital assets) and the elimination of the interest deduction woud result in a zero tax rate on marginal investments at the firm level, lowering the cost of capital and equalizing the tax treatment across debt and equity financing. In addition, lower individual effective marginal tax rates on long-term capital gains and qualified dividends for very high-income taxpayers and

interest income throughout the distribution (table 8) would increase the after-tax return to savers. Assuming interest rates do not change (see discussion below), both effects would tend to increase the amount of saving and investment in the US economy.

TABLE 8

**Effective Marginal Individual Income Tax Rates on Capital Income**

In percent, 2017[a]

| Expanded cash income percentile[b,c] | Tax units (thousands) | Long-Term Capital Gains | | | Qualified Dividends | | | Interest Income | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Current law | Bush proposal | Change (percentage points) | Current law | Bush proposal | Change (percentage points) | Current law | Bush proposal | Change (percentage points) |
| Lowest quintile | 47,873 | 0.8 | 0.9 | 0.1 | 0.3 | 0.6 | 0.3 | 2.8 | 1.3 | -1.4 |
| Second quintile | 37,994 | 1.4 | 0.7 | -0.7 | 0.9 | 0.6 | -0.4 | 6.3 | 1.3 | -5.0 |
| Middle quintile | 34,309 | 6.2 | 6.1 | -0.1 | 7.2 | 6.5 | -0.6 | 18.0 | 6.2 | -11.9 |
| Fourth quintile | 28,561 | 9.8 | 10.0 | 0.2 | 11.0 | 11.3 | 0.3 | 22.0 | 10.0 | -11.9 |
| Top quintile | 23,805 | 22.5 | 18.8 | -3.7 | 22.0 | 18.9 | -3.1 | 34.7 | 18.5 | -16.2 |
| All | 173,829 | 20.7 | 17.4 | -3.3 | 18.8 | 16.4 | -2.4 | 27.4 | 13.9 | -13.5 |
| | | | | | | | | | | |
| **Addendum** | | | | | | | | | | |
| 80–90 | 12,246 | 12.1 | 13.4 | 1.3 | 14.0 | 15.5 | 1.5 | 25.0 | 14.1 | -10.9 |
| 90–95 | 5,954 | 14.1 | 15.1 | 1.0 | 16.4 | 17.6 | 1.3 | 28.1 | 17.1 | -11.0 |
| 95–99 | 4,469 | 19.6 | 16.2 | -3.4 | 22.4 | 18.7 | -3.7 | 35.5 | 18.7 | -16.8 |
| Top 1 percent | 1,136 | 23.9 | 19.6 | -4.3 | 24.0 | 19.7 | -4.3 | 37.5 | 19.5 | -18.0 |
| Top 0.1 percent | 117 | 24.1 | 19.8 | -4.2 | 24.0 | 19.7 | -4.3 | 36.8 | 19.6 | -17.2 |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

**(a)** Projections are for calendar year 2017. Effective marginal tax rates are weighted by the appropriate income source.

**(b)** Includes both filing and non-filing units but excludes units that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class, but they are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

**(c)** The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20%, $23,138; 40%, $45,264; 60%, $80,983; 80%, $143,029; 90%, $210,021; 95%, $296,946; 99%, $737,151; and 99.9%, $3,794,482.

The overall effect of taxes on incentives to save and invest can be summarized in the marginal effective tax rate (METR), which is a forward-looking measure of the impact of the tax system on the rate of return of a hypothetical marginal (i.e., just break-even) investment project.[20] The Bush proposal would generally impose much lower METRs than either current law or current law with expiring tax provisions permanently extended (table 9). Expiring provisions include 50 percent bonus depreciation and the research and experimentation tax credit, which expired at the end of 2014, but these provisions have been extended repeatedly in the past.

TABLE 9

## Marginal Effective Tax Rates on New Investment

In percent

| Category | Current law | Tax cuts extended | Bush proposal |
|---|---|---|---|
| **Business investment** | **25.4** | **23.2** | **7.7** |
| Corporate | 28.1 | 25.7 | 10.4 |
| Equipment | 25.5 | 21.6 | 10.9 |
| Structures | 30.7 | 29.5 | 10.9 |
| Intellectual property products | 9.6 | 1.3 | 5.8 |
| Inventories | 39.8 | 39.8 | 10.9 |
| Pass-through | 21.0 | 19.1 | 3.2 |
| Equipment | 18.4 | 15.8 | 3.7 |
| Structures | 23.3 | 22.4 | 3.7 |
| Intellectual property products | 4.6 | -3.3 | -2.1 |
| Inventories | 31.9 | 31.9 | 3.7 |
| | | | |
| **Memo** | | | |
| Corporate (equity financed) | 34.4 | 32.5 | 9.8 |
| Corporate (debt financed) | 0.8 | -6.2 | 11.7 |
| | | | |
| Variation (s.d.) across assets | 10.0 | 12.8 | 2.4 |
| Variation (s.d.) across industries | 5.1 | 6.4 | 1.1 |

**Source:** Urban-Brookings Tax Policy Center calculations. See Rosenberg and Marron (2015) for discussion.
**Notes:** s.d. = standard deviation. "Tax cuts extended" includes the effects of 50 percent bonus depreciation and the research and experimentation tax credit, which expired at the end of 2014.

The Bush proposal would lower the overall METR on nonresidential business investment by 70 percent (or 17.7 percentage points), from 25.4 to 7.7 percent. Most of that reduction would stem from expensing, which eliminates the entity-level tax from firms' cost of capital. METRs would decline for all assets, although the reductions would be proportionally larger for inventories and structures, which do not receive as favorable depreciation rules under current law. As under the current tax system, pass-through businesses would face a lower METR (3.2 percent) than would traditional C corporations (10.4 percent) due to the lack of a second layer of tax on equity at the individual level.

The Bush proposal promotes more uniform business taxation along a number of dimensions. Most significantly, the Bush plan would remove the tax preference for debt financing in the corporate sector by eliminating interest deductibility—putting interest payments on a par with dividends from the point of view of the corporation—and taxing interest income at the same rates as capital gains and dividends at the individual level. METRs for equity-financed corporate

investments would decline from 34.4 to 9.8 percent, and the METR on debt-financed corporate investment would rise from 0.8 to 11.7 percent. In fact, equity financing would receive a slight advantage in the corporate sector due to the lower effective tax rates on individual equity income that would arise from the ability to defer the tax on capital gains until realization or avoid it entirely by donating appreciated assets or holding them until death. The Bush proposal would also achieve equal tax treatment across most assets, significantly reducing the variation in METRs across assets and industries. Research and development would continue to receive preferential treatment because the Bush plan would extend the research and experimentation tax credit and make it permanent. More equal tax treatment across assets and financing arrangements should reduce the role of taxation in investment decisions, allowing investment to flow to projects with a higher social return rather than those with the most favorable tax status.

Our analysis assumes the Bush plan would not affect the overall level of interest rates (i.e., the risk-free return as proxied by the Treasury borrowing rate). However, large reductions in federal revenues that are not offset by some combination of spending cuts or increased revenues from higher economic activity are likely to drive up interest rates. Higher rates could negate some or all of the reduction in the cost of capital arising from the tax changes (Gale and Orszag 2005).

***Impact on Labor Supply***

The proposal would also cut effective tax rates on labor income (i.e., wages and salaries for employees and self-employment income for others). Including the effect of the payroll tax cut for older workers, the proposal would reduce METRs on labor income by an average of 4.7 percentage points, and by as much as 12 percentage points for the top 0.1 percent (table 10). Research suggests taxes play a small or negligible role on labor supply decisions for most workers. When tax rates fall, some workers choose to work more because the reward for working rises, but some choose to work less because it is easier to meet consumption goals with higher take-home pay.

TABLE 10

# Effective Marginal Individual Income Tax Rates on Wages, Salaries, and Self-Employment Income

In percent, 2017[a]

| Expanded cash income percentile[b,c] | Tax units (thousands) | Individual Income Tax | | | Individual Income Tax and Payroll Taxes | | |
|---|---|---|---|---|---|---|---|
| | | Current law | Bush proposal | Change (percentage points) | Current law | Bush proposal | Change (percentage points) |
| Lowest quintile | 47,873 | 1.7 | 0.2 | -1.5 | 15.5 | 13.9 | -1.6 |
| Second quintile | 37,994 | 15.7 | 11.4 | -4.3 | 29.5 | 25.0 | -4.5 |
| Middle quintile | 34,309 | 19.0 | 15.8 | -3.2 | 32.6 | 29.2 | -3.4 |
| Fourth quintile | 28,561 | 19.9 | 17.1 | -2.8 | 33.4 | 30.3 | -3.1 |
| Top quintile | 23,805 | 31.0 | 25.1 | -5.9 | 38.1 | 32.1 | -6.0 |
| All | 173,829 | 24.6 | 20.0 | -4.6 | 34.8 | 30.1 | -4.7 |
| | | | | | | | |
| **Addendum** | | | | | | | |
| 80–90 | 12,246 | 25.4 | 22.2 | -3.2 | 35.9 | 32.6 | -3.4 |
| 90–95 | 5,954 | 27.6 | 25.0 | -2.7 | 35.4 | 32.6 | -2.8 |
| 95–99 | 4,469 | 33.2 | 26.6 | -6.6 | 38.6 | 31.9 | -6.6 |
| Top 1 percent | 1,136 | 39.0 | 27.2 | -11.8 | 42.9 | 31.1 | -11.8 |
| Top 0.1 percent | 117 | 39.3 | 27.3 | -12.1 | 43.1 | 31.0 | -12.1 |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).

**(a)** Projections are for calendar year 2017. Effective marginal tax rates are weighted by the wages and salaries.

**(b)** Includes both filing and non-filing units but excludes units that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class, but they are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.

**(c)** The income percentile classes are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20%, $23,138; 40%, $45,264; 60%, $80,983; 80%, $143,029; 90%, $210,021; 95%, $296,946; 99%, $737,151; and 99.9%, $3,794,482.

Second earners—lower-earning spouses—are sensitive to taxes, however. A person married to a high earner might face a very high marginal tax rate on the first dollar of earnings, which, combined with the costs of working (e.g., paying for child care), can make working seem especially unappealing. By reducing marginal tax rates, the proposal would reduce the disincentive for entering the work force for potential second earners. In addition, the option to file singly would significantly increase the after-tax return from working, especially for those couples without substantial capital income (which must be pooled for those who elect single filing).

The marriage penalty relief provision is one of the more costly individual income tax provisions of the Bush plan, and in some circumstances it would increase marriage bonuses—the

tax savings most couples experience by virtue of being married—but it would undoubtedly provide a stronger incentive to participate in the labor force for married couples when spouses have similar earnings potentials (and thus tend to face marriage penalties under current law). This would be especially true for high-income two-earner couples since the 2001 and 2003 tax legislation eliminated marriage penalties for most middle income households and the Bush tax proposal does not address the sometimes significant marriage penalties that can be created under the EITC.[21]

In addition, the proposal would exempt workers who have reached full retirement age (currently 66 but phasing up to 67 for people born in 1960 or later) from the employee portion of Social Security and Medicare payroll taxes. This provision is designed to encourage older people to stay in the workforce as it would increase after-tax pay by 7.65 percent of gross earnings for all but the highest-earning seniors.

***Macroeconomic Effects***

Cogan and colleagues (2015) assume in their analysis that Governor Bush's tax plan would boost GDP by 5 percent over 10 years because lower tax rates and a broader tax base would boost incentives to work, save, and invest while reducing the incentive to engage in unproductive tax shelters.

Gale and Samwick (2014) discuss the impact of an income tax cut on the long-term growth rate of the economy. They suggest that the potential effects of a change in the individual income tax can be broken into four parts. The first effect, emphasized by Cogan and colleagues (2015), is that lower tax rates increase incentives to work, save, and invest—the substitution effect.

A second effect—the income effect—tends to offset the first, however. Tax cuts raise the after-tax return to labor, saving, and investment, which makes it easier to reach consumption targets, such as paying for college or retirement. Because taxpayers feel richer, some decide to work, save, or invest less.

The third effect of tax reform stems from whether financing mechanisms are primarily spending cuts or increased federal borrowing. If the immediate revenue loss from a tax cut is not offset with spending reductions, the higher federal deficits reduce net national saving. Increased federal borrowing crowds out private investment, raising interest rates and the cost of capital and depressing economic growth. Cogan and colleagues (2015) assume any deficit will be offset by spending cuts, but as noted earlier, the deficits arising from this plan are so large that offsetting spending cuts may be politically infeasible.[22]

The fourth effect stems from base broadening. Broadening the base by reining in distortionary tax expenditures reduces the role of taxation in determining the allocation of resources across the economy, which in turn can increase economic output. However, Gravelle

and Marples (2015) point out that some tax expenditures tend to increase with income, meaning that base broadening can effectively increase effective marginal tax rates. For example, state income taxes tend to increase with income. Thus, the deductibility of state taxes reduces the marginal effective income tax rate, and repealing it, as the Bush proposal would do, tends to increase marginal rates.

The actual effect of tax cuts is an empirical question, and researchers have applied many methods to estimate the impact.[23] Examination of particular historical examples of tax reform—including shifts between the pre- and post-World War II periods, and the tax changes that occurred in 1981, 1986, 2001 and 2003—suggest little impact of taxes on growth. Simulation models imply that deficit-financed tax cuts are less effective at promoting growth than tax cuts financed by cutting unproductive government spending (Auerbach and Slemrod 1997; Dennis et al. 2004; Desai and Goolsbee 2004; Gale and Potter 2002). Cross-country comparisons of changes in output and changes in top marginal tax rates suggest little or no impact of taxes on growth (Piketty, Saez, and Stantcheva 2014).

One challenge in estimating the effect of taxes on the economy is that tax changes are endogenous: for example, policymakers may choose to enact tax cuts when the economy is weak, which would lead to large apparent growth responses, or they might cut taxes when the economy is strong and revenues are surging, which would produce the opposite response. Romer and Romer (2010) identified plausibly exogenous US tax reforms in time-series data and measured a positive effect of net tax cuts on economic activity. While the authors could not distinguish short-term demand-side responses from more permanent supply-side responses, some recent research (Barro and Redlick 2011, Mertens 2015) finds evidence that it is a supply-side effect.[24]

The plan would require unprecedented spending cuts to avoid adding to the federal debt. We estimate the Bush proposal would reduce revenues by $715 billion in 2026 (before considering macroeconomic effects). That amount is more than the Congressional Budget Office's projected level of nondefense discretionary spending ($689 billion) and about as high as all baseline national defense spending ($711 billion). In fact, Governor Bush has proposed significant new spending on national defense, so a lower level of military spending seems unlikely. It is also unlikely that cuts in other discretionary spending would suffice to eliminate the deficit, which means a fiscally responsible plan would require substantial cuts in entitlement programs such as Social Security, Medicare, and Medicaid.

Barring politically difficult cuts in spending, the Bush tax cuts could produce deficits of as much as $8 trillion over the next decade, which could swamp any salutary effects arising from lowering marginal effective tax rates on work, saving, and investment. By 2036, we estimate that, with no change in spending, the proposal would raise the national debt by over 50 percent of GDP. That estimate is before considering any effect on interest rates.

## CONCLUSIONS

Governor Bush's tax reform proposal would boost incentives to work, save, and invest, and has the potential to simplify the tax code. By lowering marginal tax rates and eliminating many tax expenditures, it would reduce the incentive and opportunity to engage in wasteful tax avoidance. However, it could increase incentives for multinational companies to artificially shift profits to low-tax foreign countries because they would no longer have to face US tax on repatriated profits. The proposal would cut taxes on households at every income level, but much more as a share of income at the top.

The fundamental concern the proposal poses is that, barring implausibly large cuts in government spending, it could increase deficits by very large amounts. This problem could be eliminated by modifying the proposal, for example, by lowering tax rates significantly less and broadening the base more to achieve approximate revenue neutrality.

## APPENDIX A. QUESTIONS AND ASSUMPTIONS ABOUT GOVERNOR BUSH'S PLAN

Because candidate proposals rarely include enough detail to model accurately, we asked the campaigns for feedback on our assumptions about unclear elements. We sent the following document to a representative of the Bush campaign, who kindly reviewed all our assumptions and confirmed they were generally consistent with Governor Bush's intentions. *A campaign's review of our questions and assumptions does not imply that the campaign agrees with or endorses our analysis.*

### CLARIFYING QUESTIONS AND TPC ASSUMPTIONS ABOUT GOVERNOR BUSH'S REFORM AND GROWTH ACT OF 2017

The nonpartisan Tax Policy Center is currently modeling the economic, distributional, and revenue effects of Governor Bush's tax reform. Although the plan is detailed and well thought out, the campaign document leaves out many important details. Below we list a set of questions that are important to an accurate analysis of the Governor's plan, along with our current working assumptions. We would be grateful for answers to the questions where they are known, or clarification that no decision has been made about particular choices. If the campaign would like to discuss the implications of different choices (for example, about transition rules for corporate income tax changes), we'd be happy to discuss them on a confidential basis.

We have based the assumptions listed below on the Governor's statements, documents released by the campaign, the September 9 analysis of the plan by Cogan, Feldstein, Hubbard, and Warsh (http://thecge.net/wp-content/uploads/2015/09/Fundamental-Tax-Reform-An-Essential-Pillar-of-Economic-Growth.pdf), and the Tax Foundation's September 10 analysis (http://taxfoundation.org/article/details-and-analysis-governor-jeb-bush-s-tax-plan).

***1. Individual Income Tax***

**Q1.** Would the proposal repeal the Head of Household (HoH) filing status? Would it repeal the Married Filing Separately (MFS) status?
**A1.** We will assume the proposal retains the HoH filing status using the parameters given in the Tax Foundation analysis. We will also assume the proposal retains the MFS status.

**Q2.** The documentation states that the two percent of AGI cap would apply to all itemized deductions other than the deduction for charitable contributions. Would the cap apply to any other deductions or exclusions?
**A2.** We will assume the cap applies only to itemized deductions.

**Q3.** The documentation states that the top rate for capital gains, dividends, and interest income under the proposal would be 20 percent.

a. Does the 20 percent rate apply to all long-term gains, qualified dividends, and interest that would otherwise be taxed at the 10, 25 and 28 percent rates, or do lower rates apply in lieu of some of these rates?
b. Would short-term capital gains and non-qualified dividends be taxed at ordinary rates?

**A3.** We will match the Tax Foundation's assumption that a 0-15-20 percent rate structure applies to long-term gains, qualified dividends, and interest income. We will assume that short-term capital gains and non-qualified dividends will continue to be taxed at ordinary rates.

**Q4.** What would the parameters be for the expansion of the childless EITC (aside from the change in the age requirements)? The documentation suggests that the proposal would increase the phase-in rate from 7.65 percent to 15.3 percent. Is that correct? Would the proposal make any other changes to the parameters? For example, would it change the income level at which the credit begins to phase out or the phaseout rate?

**A4.** We will assume the proposal increases the phase-in rate from 7.65 to 15.3 percent and makes no other changes to the childless EITC (other than the age requirements).

**Q5.** Would the proposal define earnings to be only wage and salary income for the purposes of separate filing by secondary earners? If not, what other forms of income (e.g., SECA earnings) would be considered earnings?

**A5.** We will assume that earnings refers only to wage and salary income for the purposes of the secondary filer provision.

**Q6.** On the secondary earner's tax return, would the taxpayer be allowed only a personal exemption? On the primary earner's return, would the secondary earner's wage and salary income be excluded for all purposes?

**A6.** We will assume that taxable income for the secondary earner would equal his or her wage and salary income reduced—but not below zero—by a personal exemption. We will assume that taxable income on the primary earner's return would equal the couple's joint taxable income calculated under regular rules reduced—but not below zero—by the secondary earner's taxable income as calculated above. The couple's tax liability (before credits) would then be the lower of the tax (computed using joint rates) on their combined taxable income and the sum of the tax (computed using joint rates) on the primary earners' taxable income (as calculated above) and the tax (computed using single rates) on the secondary earners' taxable income (as calculated above). Credits would always be calculated on the basis of joint filing and their combined incomes.

**Q7.** Does the proposal allow the expansions to the earned income and child tax credits, and the replacement of the Hope credit with the American Opportunity Tax Credit to expire as scheduled at the end of 2017?
**A7.** We will assume the proposal allows these provisions to expire as scheduled under current law.

**Q8.** Does the proposal allow other individual income tax "extenders", such as the above-the line deduction for education expenses, to expire as scheduled?
**A8.** We will assume the proposal allows all individual income tax extenders to expire as scheduled under current law (and that no "extenders" that expired at the end of 2014 are reinstated).

**Q9.** Are there any other changes to any exclusions, above-the-line deductions, or credits that are not specified in the plan description?
**A9.** We will assume there are no other changes to exclusions, above-the-line deductions, or credits.

### *2. Payroll Taxes*

**Q10.** Does the "full retirement age" in the proposal to eliminate the employee portion of payroll taxes refer to the phased-in age (i.e. 67 for individuals born in 1960 and later) or would the age relevant for the proposal be 67 immediately upon enactment?
**A10.** We will assume the proposal applies to individuals 67 or older immediately upon enactment.

**Q11.** The documentation for the payroll tax relief for seniors refers only to the 6.2 percent rate for Social Security taxes. Would the proposal also apply to the 1.45 percent Medicare payroll tax?
**A11.** We will assume the proposal only applies to the 6.2 percent Social Security tax.

### *3. Estate and Gift Taxes*

**Q12.** The documentation states that the proposal would implement carryover basis for "capital gains in excess of the current estate tax thresholds". Does this mean the proposal would be similar to the modified carryover basis rules enacted by EGTRRA for 2010 in that the executor of an estate be allowed to allocate among heirs up to $5 million (indexed for inflation after 2011) of stepped-up basis on assets? Would stepped-up basis apply to all assets transferred to spouses?
**A12.** We will assume executors could allocate among up to $5 million (indexed from 2011) of stepped-up basis and that stepped-up basis would apply to all assets transferred to spouses.

*4. Affordable Care Act Provisions*

**Q13.** Would the proposal repeal any of the tax provisions enacted by the Affordable Care Act other than the 3.8 percent net investment income surcharge? For example, would it repeal the 0.9 percent surcharge on earnings or the excise tax on high-cost health plans (the "Cadillac Tax")?
**A13.** We will assume the proposal does not repeal any of the other tax provisions enacted by the Affordable Care Act. If the Governor subsequently releases a detailed health care proposal in which those provisions are explicitly repealed, we will update our analysis accordingly.

*5. Business Provisions*

**Q14.** Would expensing be allowed for new investments only? Would old investments continue to be depreciated under current law depreciation schedules? If not, how would they be treated?
**A14.** We will assume that only new investments are expensed, and that unused depreciation on old investments would continue to be deducted under current rules.

**Q15.** The proposal says it would apply expensing to equipment and structures. Would businesses also be able to expense inventory, or would current inventory rules be maintained?
**A15.** We will assume that new additions to inventory would be expensed and that the value of existing inventories would be recovered under current law rules.

**Q16.** Would businesses be allowed to deduct interest on existing debt or would the interest deduction be eliminated immediately for all interest? Would interest on new debt held by businesses be taxable?
**A16.** We will assume that interest on businesses' fixed interest rate loans outstanding the day before enactment would remain deductible and interest received on these loans would be taxable. Interest on new debt (like interest on old debt) received by pass-through businesses would pass through to individual owners and be taxable, but interest received on new debt by corporations would not be taxable. (However, see question below concerning interest paid and received by financial corporations.)

**Q17.** Would there be any new rules to prevent US multinationals from shifting assets and reported income to low-tax countries when the tax on repatriated dividends (from new profits) is eliminated? For example, is it contemplated that there would be some form of minimum tax on intangible income, as in the Camp tax reform proposal? Would current CFC rules that tax some forms of passive income on a current basis be retained?
**A17.** We will assume that there would be an effective set of (unspecified) rules to prevent shifting of assets and income to low-tax countries.

**Q18.** Would there be any rules to prevent closely-held businesses from switching from flow-through to C corporate status to take advantage of the differential between the top corporate and individual rates?

**A18.** We will assume that there would be an effective set of (unspecified) rules to prevent closely-held businesses from switching from flow-through to C corporate status.

**Q19.** Is the one-time repatriation tax similar to the Camp proposal in that it would apply the 8.75 percent rate only to accumulated untaxed CFC earnings held in cash and apply a lower rate to the remainder?
**A19.** We will assume that the one-time repatriation tax is structured in the same manner, with the same rates, as the Camp proposal, but the payments would be made over 10 years (rather than 8 under the Camp proposal).

**Q20.** Would the territorial system apply to corporations only? Would US individuals still pay tax on their worldwide income (with a foreign tax credit)?
**A20.** We will assume that the territorial system applies only to corporations.

**Q21.** Would the 20 percent rate be a flat rate tax on all corporate income, or would some form of graduated rate schedule be maintained?
**A21.** We will assume the corporate rate is a flat 20 percent.

**Q22.** Would all targeted business preferences that take the form of expensing be effectively retained (or expanded, if partial expensing) such as, for example, expensing of intangible drilling costs?
**A22.** We will assume that full expensing will apply to all business investment.

**Q23.** Would the research credit be made permanent? Retroactively extended to 2017?
**A23.** We will assume that the credit will be made permanent (in its current form), that Congress will extend it through 2016 (apart from the Bush plan), and that firms can claim unused R&E credits for 2016 and earlier years.

**Q24.** Would the following business tax preferences be eliminated or retained?

a. Inventory property sales source exemption
b. Tax credits for alternative energy production and investment, energy conservation, and investments in energy-efficient property.
c. Percentage depletion
d. Exclusion of interest on private-purpose tax-exempt bonds
e. Tax incentives for preservation of historic structures
f. Exemption of credit union income
g. Exclusion of interest on life insurance savings
h. Tax-exemption of insurance companies owned by tax-exempt organizations
i. Small life-insurance company deduction
j. Credit for low-income housing investments

k. Deduction for US production activities
l. Other targeted incentives for community and regional development
m. Tax credit for orphan drug research
n. Special blue cross blue shield deduction
o. Tax benefits for ESOPs

**A24.** We will assume that all of these provisions are repealed.

**Q25.** Would the proposal implement any new rules concerning the determination of SECA earnings from pass-throughs?
**A25.** We will assume there is no change is these rules.

**Q26.** Would the tax treatment of interest paid by financial institutions, or their leverage, be changed in some way?
**A26.** We will assume that financial institutions are subject to a special tax regime that raises the same revenue as current law, multiplied by the ratio of the Bush corporate tax rate to the current law top corporate rate of 35%.

### *6. Effective Date*

**Q27.** Are all provisions intended to go into effect in 2017, or some earlier? Are some (such as the corporate rate reductions) assumed to be phased in, and if so over what time period?
**A27.** We will assume the provisions would be effective beginning in 2017, after the Presidential election, and that only the corporate rate reduction would be phased in (the reduction would be 3 percentage points per year, starting in 2017, for 5 years).

# APPENDIX B. COMPARISON OF TPC REVENUE ESTIMATES WITH OTHER PUBLISHED ESTIMATES

Our revenue estimates differ from other published estimates of the revenue cost of Governor Bush's tax proposal (table B1). TPC's 10-year revenue cost ($6.8 trillion) is somewhat smaller than the estimate released by Citizens for Tax Justice (CTJ; $7.1 trillion) and significantly larger than the estimates released by the Tax Foundation ($3.7 trillion) and Cogan et al. (2015) ($3.4 trillion).

TABLE B1

## Tax Policy Center Revenue Estimates for the Bush Tax Proposal Compared with Other Public Estimates

In billions of dollars

| | CTJ 10 years | Cogan et al. 2016–25 | Tax Foundation 2015–24 | Tax Policy Center 2016–26 | | |
|---|---|---|---|---|---|---|
| | | | | Full model | Using TF provisions | Using CTJ provisions |
| Individual | N/A | N/A | -2,273 | -4,257 | -3,480 | -3,480 |
| Corporate | N/A | N/A | -1,154 | -2,331 | -2,172 | -2,331 |
| Estate | N/A | N/A | -237 | -185 | -224 | -237 |
| **Total** | **-7,100** | **-3,400** | **-3,664** | **-6,773** | **-5,876** | **-6,049** |

**Sources:** Citizens for Tax Justice (2015); Cogan et al. (2015); Pomerleau (2015); and authors' calculations.
**Notes:** CTJ = Citizens for Tax Justice; TF = Tax Foundation; N/A = not available.

A full reconciliation of these estimates is not possible based on the level of detail published. One source of difference is that the other analyses do not fully estimate all provisions included in the Bush proposal. For example, the Tax Foundation does not estimate the cost of provisions that would cut revenues by almost $900 billion, including the marriage penalty relief provisions, the exemption from Social Security tax of workers aged 67 and older, taxing carried interest as ordinary income, implementation of a territorial corporate income tax, and implementation of a carryover basis for some inherited assets. CTJ does not include the marriage penalty relief provisions, the exemption from Social Security tax of workers aged 67 and older, and taxing carried interest as ordinary income.

If we include only the provisions Tax Foundation and CTJ say they estimated, our estimate gets closer to Tax Foundation's and farther from CTJ's. Using comparable baselines, our estimate is more than $1 trillion less than CTJ's and about $2.2 trillion greater than Tax Foundation's.

The remaining differences could arise from different baselines or modeling differences, such as different assumptions about how responsive taxpayers are to changes in tax rates. Our baseline is calibrated to match the Congressional Budget Office's projections, and our estimates of the responsiveness of taxpayers to changes in tax rates are designed to match as closely as possible official Congressional estimates produced by the Joint Committee on Taxation.

# APPENDIX C. MEASURING DISTRIBUTIONAL EFFECTS OF TAX CHANGES

Analysts use a variety of measures to assess the distributional effects of tax changes. There is no perfect measure—often a combination of measures is more informative than any single measure.

The Tax Policy Center generally focuses on the percentage change in after-tax income because it measures the gain or loss of income available to households to buy goods and services, relative to the amount available before the tax change. A tax change that raises or lowers after-tax income by the same percentage for all households leaves the progressivity of the tax unchanged.

Other measures used to assess a tax change's effects include shares of the tax cut going to different parts of the income distribution, the size of each group's cut measured in dollars, and the percentage change in tax liability. The first two measures can poorly indicate the effects of a tax change because they ignore the initial distribution of taxes and thus do not assess changes in a tax's progressivity. The percentage change in tax liability can be particularly misleading because it relies too much on the initial distribution of taxes. Cutting the tax on a person making $1,000 from $50 to $10 is an 80 percent cut, while reducing taxes on a person making $100,000 from $250,000 to $150,000 is just a 40 percent cut. But the tax savings boosts after-tax income by only about 4 percent for the poorer person, compared with a more than 13 percent increase for the higher-income person.

Table C1 shows several different measures of the effects of the Bush tax proposal on households at different income levels in 2017. The tax cut is most significant as a share of income (column 1) for those with high incomes, as discussed above. It's also true that high-income people get the bulk of the tax cuts (column 2) and the average tax change is highest at high income levels (column 3). However, the tax cut actually is a much larger share of tax liability for low-income households (who have very little tax liability in the baseline) than for those with high incomes (column 4). Finally, the share of federal tax burdens falls for lower-income households and rises for those with moderate and higher incomes, although the share falls significantly for the top one percent (column 5).

TABLE C1

## Alternative Ways of Presenting Change in Distribution of Tax Burdens

By expanded cash income percentile, 2017[a]

| Expanded cash income percentile[b,c] | Percent change in after-tax income[d] | Share of total federal tax change | Average Federal Tax Change[e] | | Share of Federal Taxes | |
|---|---|---|---|---|---|---|
| | | | Dollars | Percent | Change (% points) | Under the proposal |
| Lowest quintile | 1.4 | 1.8 | -185 | -29.9 | -0.2 | 0.8 |
| Second quintile | 1.9 | 4.6 | -593 | -20.2 | -0.2 | 3.3 |
| Middle quintile | 2.7 | 10.3 | -1,464 | -16.5 | -0.1 | 9.4 |
| Fourth quintile | 2.8 | 15.2 | -2,593 | -13.3 | 0.4 | 17.7 |
| Top quintile | 5.4 | 67.9 | -13,947 | -15.1 | 0.1 | 68.6 |
| All | 3.9 | 100.0 | -2,813 | -15.2 | 0.0 | 100.0 |
| | | | | | | |
| **Addendum** | | | | | | |
| 80–90 | 3.0 | 10.7 | -4,258 | -11.7 | 0.6 | 14.5 |
| 90–95 | 2.6 | 6.2 | -5,115 | -9.0 | 0.8 | 11.4 |
| 95–99 | 4.1 | 12.1 | -13,256 | -11.8 | 0.6 | 16.3 |
| Top 1 percent | 10.8 | 38.9 | -167,325 | -20.8 | -1.9 | 26.6 |
| Top 0.1 percent | 11.9 | 19.3 | -808,196 | -21.5 | -1.0 | 12.6 |

**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-3).
**Notes:** Number of AMT Taxpayers (millions). Baseline: 5; Proposal: 0.
**(a)** Projections are for calendar year 2017; baseline is current law. The proposal includes all individual, corporate, payroll, and estate tax provisions. http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.
**(b)** Includes both filing and non-filing units but excludes units that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class, but they are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.
**(c)** The income percentile classes are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2015 dollars): 20%, $26,106; 40%, $51,093; 60%, $87,696; 80%, $148,141; 90%, $217,357; 95%, $289,948; 99%, $848,445; and 99.9%, $5,233,860.
**(d)** After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax; payroll taxes (Social Security and Medicare), estate tax, and excise taxes.
**(e)** Average federal tax includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes.

For further discussion, see “Measuring the Distribution of Tax Changes” at http://taxpolicycenter.org/taxtopics/How-to-Interpret-Distibution-Tables-2013.cfm.

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## NOTES

[1] Our estimates account for microeconomic behavioral responses, such as reduced use of tax preferences and increased capital gains realizations when marginal tax rates on income and capital gains decline. Our estimating methodology generally follows the conventional approach used by the Joint Committee on Taxation and the US Treasury to estimate revenue effects before considering the macroeconomic effects.
[2] "Backgrounder: Jeb Bush's Tax Reform Plan: The Reform and Growth Act of 2017." https://jeb2016.com/backgrounder-jeb-bushs-tax-reform-plan/.
[3] Governor Bush's economic advisers estimate 34 million taxpayers would stop itemizing (Cogan et al. 2015).
[4] "Backgrounder: Jeb Bush's Tax Reform Plan: The Reform and Growth Act of 2017." https://jeb2016.com/backgrounder-jeb-bushs-tax-reform-plan/.
[5] The itemized deductions subject to the 2 percent limit would include mortgage interest, unreimbursed medical and dental expenses in excess of 10 percent of AGI (7.5 percent for some older taxpayers), casualty or theft losses, unreimbursed employee expenses, and other miscellaneous itemized deductions. We assume that limit would not apply to other tax expenditures such as the tax exclusion on employer-sponsored health insurance, municipal bond interest tax-exemption, premium tax credits under the Affordable Care Act, and retirement tax incentives. (See Appendix A.)
[6] For more information, see http://www.taxpolicycenter.org/press/press-resources-phaseouts.cfm and https://www.irs.gov/uac/Newsroom/In-2015,-Various-Tax-Benefits-Increase-Due-to-Inflation-Adjustments.
[7] https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit/EITC-Income-Limits-Maximum-Credit-Amounts-Next-Year.
[8] The credit is also limited by a recipient's total income. This discussion omits that and other details the Bush tax plan does not address.
[9] The Bush tax plan does not say explicitly how it would double the credit for childless workers, but campaign staff have told the TPC that it is reasonable to assume the plan would double the phase-in and phaseout rates. For a discussion of issues related to the childless worker credit and some policy options, see Maag (2015).
[10] For an example of a marriage penalty that would remain under the Bush plan because of the phaseout of the earned income tax credit, see Williams, Roberton. 2015. "Despite Promises, Jeb Bush's Tax Plan Wouldn't Eliminate Marriage Penalties." September 16, http://taxvox.taxpolicycenter.org/2015/09/16/despite-promises-jeb-bushs-tax-plan-wouldnt-eliminate-marriage-penalties/#sthash.yUPLxHbS.dpuf.
[11] For more information, see the TPC summary page, "Tax Topics—Camp Reform Tax Plan" at http://www.taxpolicycenter.org/taxtopics/Camp_Tax_Reform_Plan.cfm.
[12] Most developed countries have a so-called territorial system, but they also have various degrees of anti-avoidance measures that tax some foreign income on a current basis. No country is either purely territorial or purely worldwide: all are hybrids. (See Altshuler, Shay, and Toder 2015.) The Camp tax reform plan follows this practice by proposing a minimum tax on above-normal profits earned by foreign subsidiaries. The Bush proposal does not stipulate anti-avoidance measures.
[13] This is a potentially very large estate tax preference for wealthy married couples, allowing many couples to escape capital gains taxation on a large share of their combined estate. A more equitable option would allow portability of the exemption between spouses to the extent that it is not applied to bequests made by the first spouse to die.
[14] Appendix B compares our revenue estimates with other published estimates.
[15] Repeal of the Affordable Care Act surtaxes would cut effective capital gains tax rates by 3.8 percent for high-income taxpayers; repeal of the AMT (and the phaseout of the AMT exemption) and the phaseout of itemized deductions (Pease) would also eliminate some implicit taxes on capital gains.
[16] This distributional analysis (as well as most of the revenue analysis) is based on the Tax Policy Center's microsimulation tax model, a brief description of which is available at http://taxpolicycenter.org/taxtopics/Brief-Description-of-the-Model-2013.cfm.
[17] Appendix C discusses alternative distribution measures and illustrates several alternatives for the Bush tax proposal.
[18] For example, Elmendorf et al (2008) present three sets of results regarding the distributional effects of the 2001 and 2003 tax cuts. First, they reproduce familiar tables based on the standard approach to distributional analysis. Using this approach, almost all households are at least as well off after the tax cut. Second, they add the financing of

the tax cuts under two alternative scenarios. In both scenarios, the total amount of financing exactly offsets the tax cuts when fully phased in, so the net effect on the budget is zero. The first scenario assumes that each household pays an equal dollar amount, while the second assumes that each household pays the same percentage of income. Under either scenario, about three-quarters of households are worse off because of the tax cuts, and after-tax income falls for the bottom four quintiles of the income distribution but increases for the top quintile. Third, they incorporate behavioral responses—i.e., working and saving more in response to lower tax rates—to try to approximate welfare changes. They conclude that the 2001 and 2003 tax cuts ultimately raised the well-being of only one-third of households and that more than half of those better-off households were in the top quintile of the income distribution.

[19] Note, however, that businesses would still have to calculate depreciation for financial accounting purposes.

[20] See Rosenberg and Marron (2015) for derivation and discussion of METRs.

[21] For a brief discussion of marriage penalties in the tax code, see http://www.taxpolicycenter.org/taxtopics/marriage-penalties.cfm.

[22] Spending cuts may also have an effect on economic growth. Well targeted spending on education and infrastructure, for example, may boost growth. Other spending may distort resource allocation in much the same way that poorly designed tax expenditures do.

[23] See Gale and Samwick (2014) for a recent review of the literature.

[24] If the economy is operating below capacity, deficit-financed tax cuts can boost the economy in the short run by increasing aggregate demand if individuals decide to spend their tax cuts (rather than saving them or paying down debt) or if temporary investment tax cuts encourage companies to boost purchases of machines and equipment. However, deficit-financed tax cuts can overheat an economy that is at full employment, which can lead to inflation and, ultimately, a recession if the Federal Reserve responds to the inflationary pressures by raising interest rates. There is also a growing consensus that for most economic downturns (2008 being a notable exception), monetary policy is a preferable instrument for stabilization policy.

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