

Five Questions for Rosanne Altshuler

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Five Questions for... the people behind the Urban Institute research. In traditional interview format, our experts talk about the nature of their work and offer insights on what they've learned.

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Rosanne Altshuler, codirector of the Urban-Brookings Tax Policy Center, answers five questions about tax reform and her experience as chief economist on President Bush's 2005 tax reform panel. The panel's report, Altshuler said, should serve as a blueprint for President Obama's tax reform commission—though the recession makes many of the proposed actions harder to take.

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1. Obama's tax reform panel was asked to recommend ways to simplify the tax code, among other goals. Why is the tax code so complicated?

Because it comes out of Washington. The tax code isn't written by economists or tax experts. You've got Congress throwing in one provision after another to try to make their different constituents happy and these additions build up over time. Also, there's no tax lobby or coalition pushing for simplification. You don't win any awards for simplifying the tax code.

But complexity can drown out potential benefits by confusing taxpayers. Let's take energy-saving tax incentives—it's very difficult for consumers to figure out how they can take advantage of energy-saving credits. What credits are out there? Does my energy-efficient dishwasher qualify? More important, do I qualify? Does the credit phase out as income increases? What's the cap? If I have to pay the alternative minimum tax, can I still get the credit? In the past, the hybrid car credit didn't survive the AMT. We may want to encourage certain behaviors like using energy efficiently, but amending the tax code may not be the best way to do that, especially if consumers can't figure out if they qualify.

There are trade-offs in tax policy—as in economic policy generally—among fairness, efficiency, and simplicity. So making tax policy simpler creates winners and losers. The 2005 tax reform panel I was on tried to simplify the earned income tax credit, the child credit, and the standard deduction and the refundable portion of the child tax credit. The goal was fewer steps for figuring out if you qualify and fewer steps for applying. As we tried to streamline the process, we realized why it was so complicated—families face all sorts of different circumstances and the credits we were trying to combine treated them differently in many cases. How will the new credit apply to U.S. citizens, say, that work abroad? Or to a parent who lives with his or her child only six months out of a year? Simplifying the tax code means defining who gets the credits without allowing exceptions and provisions. In some cases, it means that families that qualified for a big credit before the simplification may get a smaller credit or no credit after the reform. That's a trade-off between fairness and simplicity.

2. The tax reform panel will also look at ways to close the tax gap and ways to end corporate welfare. Are these the right goals?

Yes, but it's also great rhetoric. The tax gap—the difference between taxes owed and taxes paid—is an estimated \$350 billion. Cracking down on tax evasion sounds like an easy way to get a \$350-billion pot of gold. But, in reality, if there were an easy way to collect that money, we would have done it already. Most of the missing revenue stems from underreporting on individual income tax returns, especially by small businesses. Going after that money would involve the government more in taxpayers' lives, and that may not be very popular or effective.

The same goes for ending corporate welfare, which really means getting rid of special tax breaks for businesses and broadening the tax base. There are a boatload of corporate tax breaks that we could do without because they're inefficient and don't work. The research and experimentation credit, for instance, may reward research that would have been done without the incentive. Congress renews this tax break every year, so it may not be willing to allow it to expire. A better approach would be getting rid of these inefficient tax breaks and cleaning up loopholes so we can broaden the base and lower the corporate tax rate.

Simplification, base broadening, closing the tax gap—all these goals should be part of any kind of tax reform.

The sticking point is always constraints.

3. Obama's panel is constrained by the restriction that no one making under \$250,000 can pay higher taxes after reform. In your TaxVox blog entry, you said this pretty much rules out any sensible reforms. Why? And what's the best we can hope for under this restriction?

They're saying that this tax reform will be funded only by taxpayers making more than \$250,000 a year, and there just aren't enough of them. You'd be better off looking closely at all tax breaks and expenditures, not just provisions that affect only the wealthiest 5 percent. You may want to consider taxing the value of employer-sponsored health insurance or restructuring the mortgage interest deduction. You'd want to look at state and local tax deductions—all the big tax expenditures. Even if you came up with a tax-reform plan that simplified the lives of all American taxpayers and made taxes more fair and efficient, it would be a shame to rule it out only because the new plan raised taxes a little bit on the middle class.

4. As chief economist on President Bush's tax reform panel, what advice would you give the new panel?

Don't start from scratch! We came up with fair, revenue-neutral plans that can be adopted within the current tax system. I'd advise the panel to use our simplified income tax plan as a starting point and consider our recommendations for consolidating savings accounts, unifying work and family credits, reforming tax expenditures, turning the mortgage interest deduction into a credit and capping it, taxing health premiums above a certain level, and repealing the corporate AMT. From what I've heard, Obama's tax reform panel won't be issuing a big report like we did—it's not aiming for a fundamental reform and is zeroing in on a few key things instead.

5. President Bush didn't act on the 2005 panel's recommendations. Do you think this panel will have a better chance?

You need political capital and political will to make tax reform happen. In 2005, we had neither. Our report came out after Social Security reform had died and after Hurricane Katrina, so interest and will to reform taxes were at low tide. I think this new panel has the political will behind it and, so far, President Obama has the political capital to do it.

The Bush panel was extremely frustrated when our report went nowhere. We had worked long and hard on it. But the report got high marks from policy analysts and the press, so that was satisfying. And it's very rewarding, even a measure of success, to see that people are referring to it now. It's also heartening that Elizabeth Garrett—who served on the 2005 panel—has been nominated for assistant secretary for tax policy in the Treasury Department, where she's likely to be a voice for tax reform.

I didn't think I'd become so attached to the report when I was working on it. Now, looking back, I'm very proud of it and find myself talking about it all the time. I think that's how policy gets made in Washington—you just keep making your point.

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