

Tax Reform: The Wheels Are Beginning To Turn

Donald Marron

Abstract

In a contribution to the Christian Science Monitor, Donald Marron discusses strategies to reform America's broken tax code. Marron proposes ridding the system of corporate and individual tax preferences to create a fairer, simpler, and revenue-generating system with fewer tax breaks and lower rates across the board.

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America's tax system is broken. It's needlessly complex, economically harmful, and often unfair. It fails at its most basic task, raising enough money to pay government's bills.

Because of Washington's love affair with temporary tax cuts, it's also increasingly unpredictable. Americans deserve a simpler, fairer, more pro-growth tax system.

It won't be easy. Any reform creates losers as well as winners – and losers always let their representatives know how they feel. But Washington is giving hopeful signs that the journey toward tax reform – the first in a quarter century – may finally be under way.

In his State of the Union message, President Obama called on Congress to reform individual and corporate taxes. He reiterated the offer at a press conference Feb.15. Democrats and Republicans have been holding hearings and drafting legislation. The president's fiscal commission and the Domenici-Rivlin debt-reduction task force (on which I served) have proposed serious reforms, taking hatchets to the trillion-dollar thicket of tax preferences that complicate the code and distort economic activity.

Fixing the corporate tax code looks to be the easier task. Federal and state levies average more than 39 percent, the second highest in the world; we'll take the top spot in April when Japan slashes its rate. Add in rising concern about America's international competitiveness and slow economic recovery, and you have a recipe for a bipartisan push to cut corporate tax rates.

Given America's budget woes, however, we can't afford to reduce future revenues. Unless Washington demonstrates remarkable spending discipline, we will need all our existing revenues, and more, to cover the costs of an aging population and rising health-care costs.

That's where real reform comes in. Along with high corporate tax rates, we also have very generous tax breaks, leaving much corporate income untaxed or facing only low effective rates. Far better would be a system with fewer tax breaks and lower rates across the board.

Such reform would reduce distortions and allow economic fundamentals, not taxes, to guide business decisions. As Mr. Obama put it: "Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate ... without adding to our deficit."

Congress should pursue the same strategy with an even bigger challenge, the personal income tax. Dozens of exemptions, exclusions, deductions, and credits complicate the code and make Swiss cheese of our tax base. These preferences mean that trillions of dollars of income go untaxed. As a result, Congress must impose higher rates on the income that does get taxed, weakening economic growth and treating unfairly tax-payers who don't milk every preference.

Policymakers should cut those tax preferences, use some of the resulting revenue to cut tax rates, and use the remainder for deficit reduction. A good starting point would be the fiscal commission's proposal to eliminate many tax preferences and use the savings to deep-six the hated alternative minimum tax, cut tax rates across the board, and boost revenues by \$80 billion a year. That plan would also make taxes more progressive while retaining slimmed-down deductions for mortgage interest, retirement savings, and

charitable giving.

Tax reform will be a journey. The landmark reform in 1986 capped several years of effort. The same is likely to be true this time. If our leaders want to enact the landmark tax reform of 2013, they need to start sharpening their hatchets now.

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