writing role as global associate director for marketing and communication. He will also work closely with the firm's Center for Tax Policy and Washington Council Ernst & Young. Donmoyer was most recently a tax reporter for Bloomberg, where he worked since 2000, and he previously worked as a reporter for Tax Analysts.

Dena Battle has joined the Washington lobbying firm Capitol Counsel LLC as a principal in the tax policy practice. Battle was most recently a lobbyist for the National Association of Manufacturers, and she previously lobbied on behalf of the National Federation of Independent Business, where she led the Family Business Estate Tax Coalition. She also previously served as legislative director to House Ways and Means Committee member Dave Camp, R-Mich., the committee's current chair.

Noushin Jahanian has joined Intel Corp. in Washington as director of tax policy and government relations in the global tax and trade group. Jahanian was previously with the lobbying firm Washington Tax Group LLC, and she also previously served as chief counsel and policy director for Senate Finance Committee member Debbie Stabenow, D-Mich. She received her JD from the University of Chicago Law School. ■

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TAX ANALYSTS EXCLUSIVE

Conversations: Eric Toder

Interviewed by Meg Shreve — mshreve@tax.org


Photo courtesy of Eric Toder

Eric Toder is co-director of the Urban-Brookings Tax Policy Center and a fellow with the Urban Institute. He was previously Treasury deputy assistant secretary for tax analysis under President Clinton and served as director of the IRS Office of Research from 2001 to 2004. Earlier in his career, Toder was deputy assistant director for tax analysis at the Congressional Budget Office.

With the Obama administration and Congress gearing up for a potential tax reform effort, Toder recently spoke with Tax Analysts' Meg Shreve to discuss the challenges facing lawmakers as they consider tax reform.

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Tax Analysts: What did you think of President Obama's call for tax reform in his State of the Union address?

Eric Toder: When he said broaden the base, lower the rates, that's always what we like in tax reform. Having been through tax reform exercises before, going back for a long time, and looking at corporate tax preferences, I really was wondering if there was all that much there that could be done.

That's because the problem in the corporate area is a lot different than it was 25 years ago when the [Tax Reform Act of 1986] was done. In those days, there were very big tax preferences that had been legislated by the Congress in lieu of reducing rates. It seemed like an obvious trade-off for economic efficiency. If you weren't subsidizing targeted investments and could instead lower rates, you'd get rid of a lot of the tax shelter problems and you could come out with the same amount of revenue with a lower rate and a more efficient system. That made a lot of sense then.

With the corporate tax avoidance problems now, there are some tax preferences, and anyone can point to ones that are egregious. But in dollar value, they're really not that big. The ones that are big aren't necessarily ones that you'd go after. My feeling was he couldn't possibly be serious when I looked through the tax expenditure list and assessed what is realistic, what could be done, and given the people the president was listening to and his predispositions, what he would be willing to do.

When I looked at the budget, I felt vindicated in my initial impression. I went through all the corporate provisions, which included some preference reductions, some base broadening in the international area — which I don't think have any chance of being enacted, but it was there in any case — and of course some things like making the research and development credit permanent, expanding energy tax incentives — which go in the other direction. I added it up and looked at how much revenue they are raising from the net base broadening, and it basically would enable a 1 percent reduction in the corporate rate, which of course he didn't have in his proposal.

I think a lot of this stuff is smoke and mirrors. If you want to go after accelerated depreciation, fine, but they've just put in expensing for 2011 as an incentive. They've gone in the opposite direction.

TA: Should reform efforts focus only on the corporate tax?

Toder: I think it's a mistake to look at segmenting corporate from the individual income tax for two reasons. First of all, a lot of business in the United States is noncorporate or taxed as a flow-through. You really have to think about business income holistically; it's not just corporations. We've really changed our tax regime such that other than the large multinationals and other large publicly traded corporations, just about any other business entity can choose not to pay the corporate tax if it wants to.

Of course, the income of these businesses is taxed to individuals. In fact, that's probably the way economists think it should be taxed anyway — once at the rates that apply to individual owners. But for administrative reasons, you can't treat the big publicly traded companies that way. That's one piece of it.

The other thing is when you're looking at the taxation of Schedule C corporations, they do pay the corporate tax. They're taxed at two levels — at the corporate level and at the individual level. What we've been doing in the past decade and a half is we've been cutting the tax at the individual level on the grounds that it's inappropriate to tax this income twice. Now we're learning it's very hard to sustain a corporate tax at the level we've been having because other countries' rates are lower, and companies have ways of shifting their income to other jurisdictions. So you stop and say, wait a second, if you are going to lower the corporate rate — maybe you've got to do that — maybe you ought to rethink these preferences you've been giving to capital gains and dividends all these years. Why do you need to do that anymore?

This then puts you out of the frame of just thinking of the corporate tax. You're thinking of the whole way that income originating in the corporate sector is taxed at both the corporate and at the individual shareholder levels. You really need to think of that as a coherent whole, not just looking at corporate tax reform by itself. I don't think that's a productive way to break things down.

TA: It seems like Obama is putting a lot of emphasis on just the corporate side.

Toder: I understand that. I think part of it is because he doesn't want to address the individual issues, for political reasons perhaps. I think part of it is if you look at polls, most people think corporations pay taxes. They don't realize that corporate taxes are paid by individuals. They may be wealthy shareholders — there's a dispute who the burden lands on — part of it probably lands on very wealthy shareholders. Nonetheless, it's individuals who pay the tax. Just by definition, all taxes have to reduce the income of somebody, but I don't think that's the framework most people think about it. Nonhuman entities somehow are thought to be paying taxes.

TA: So where should the tax reform debate go?

Toder: It's not like people haven't put out ideas. They're all over the place. I think you could look at it narrowly, or you could look at it broadly. The president had this economic recovery board, which he gave a very narrow mandate to, but they actually came up with a lot of good ideas. There are a lot of things that can be done without changing the basic architecture of the tax code or changing total revenue or its distribution among income groups, or really even doing anything that anyone would broadly consider reform. There are a lot of things that could be done to clean up the tax system and make it simpler.

Why do we, for example, have multiple different ways that people can get tax-preferred savings? People can choose between Roth accounts and deductible accounts. You have to be a PhD to figure out what it is most advantageous to do. Another example is the multiple education credits and deductions and ways to save for higher education. When you use certain tax benefits, you lose the benefit of others. If you use Pell grants, you lose certain tax benefits. When you look at these different possibilities, it's mind-boggling how complicated it is. If you stepped back and said, well, we want to spend some money through the tax system helping people pay for college tuition — not saying that you should do that, but if you accept the fact that you should do that — you can do that in a whole lot simpler way. The same thing with promoting retirement saving.

We have this alternative minimum tax. Why are we asking people to fill out their tax return and have two different tax systems that they have to calculate? We could cut back on preferences directly if we wanted to. We could give them a little haircut. We could eliminate some of them.

If you think high-income people are paying too little, then raise the rates a little bit. Why go through all this nonsense? If you think people with more children should pay less in tax than people with fewer children, why not give the benefit to high-income people as well? Why are you phasing this out? You're not getting much revenue from it. You're giving the appearance of not giving a benefit to high-income people. But you could fix it through the rates.

There's just a whole lot of things you could do to just have the same architecture of the tax system and just make it a lot simpler. My guess is that isn't going to happen, because it's a lot of work for Congress to do that. No administration has seen fit to propose that kind of broad simplification, but just as a good-government sort of thing, you could start there. It would certainly give people a lot more confidence that somehow we were making policy in a rational way.

People would say that's not addressing the big problems, addressing the deficit. I really don't think it's a very productive exercise to have a lot of changes in rates and tax bases, big shifting around, if you're only going to end up raising the same amount of money.

TA: Does combining tax reform with deficit reduction make it a harder political sell to Congress and the public?

Toder: I think it's a hard political sell anyway. If you're getting rid of major tax preferences, some groups are going to end up paying a lot more tax even if you make it distributionally neutral by income group. Any tax reform plan that's serious is going to have to limit the mortgage interest deduction, for example. You're going to get huge howls of protest from doing that, even if you offset it with lower tax rates. Are you going to do that, and at the end of the day not do anything about the deficit? I just don't see it. In all of these things, the losers are always more vocal and more upset than the winners.

Is it politically feasible to do deficit reduction right now? Probably not. I'm not saying that. But I really think we are in a situation where due to the retirement of the baby boomers, and the fact that so much government spending is on entitlements, and healthcare costs are rising, there is no way to continue current benefits that have been promised to people. It's just going to blow out the budget going forward. Yes, you've got to squeeze back on those programs, but I don't think you get 100 percent there by squeezing back programs. I think at some point you've got to work on both ends of this, reducing spending and raising revenue.

TA: Was there anything included in the Bowles-Simpson proposal that struck you as where lawmakers should be going?

Toder: I think there are several pieces to this tax reform vision that I have and others have of tax reform now. One of the visions is substantially cutting back on spending through the tax code — which is what the Bowles-Simpson proposal did — and also lowering the rates. The Bowles-Simpson proposal brought the top rate down to 28 percent. It's not often discussed, but they were also eliminating preferences for capital gains and dividends and taxing all income at the same rate. That's something that some people focus on as being regressive because they reduce the top rate, but it's actually progressive when you take into account everything else they were doing.

So, yes, whether you endorse everything they did and the way they did it, I think you can't get rid of all tax expenditures. You have to pick and choose like you have to pick and choose with direct spending. Cutting back on tax expenditures fairly drastically has got to be one component of any major tax reform. Lowering the corporate rate, I think, is something we're going to have to do in today's international economy. If we do lower the corporate rate, we'll have to probably lower the individual rate also. We don't want too big a gap between the corporate rate and the individual rate. That is going to necessitate something like the Bowles-Simpson plan or what the Bipartisan Policy Center was proposing for lowering rates and broadening the base.

I think — Bowles-Simpson didn't have it, but the Bipartisan Policy Center did — we need to think about new revenue sources. Bowles-Simpson did have an increase in the gas tax. I think we need to look at the value added tax, as the Bipartisan Policy Center did. We also need to look at gas taxes and the carbon tax as ways of raising revenue that promote other policy objectives, such as reduced dependence on imported oil or a reduction in greenhouse gas emissions. There isn't one solution. I think we have to change our tax system to rely more on consumption-based taxes. And if we do that, we have to have some expansion of refundable credits to keep low-income people whole, to relieve them of some of the burden of those taxes.

Those are really the main elements — new taxes, lowering the individual and corporate rates, base broadening — the basic building blocks of tax reform. They can be put into different proportions; there are lots of different specifics that can be done. I think that's what you're talking about when it comes to closing corporate preferences. I just don't think that when you end up with this whole thing, it's necessarily going to be revenue neutral in the corporate sector.

TA: How does this all get done? Senate Budget Committee Chair Kent Conrad, D-N.D., has been pushing for some sort of summit to discuss the fiscal situation. Will it take something like that to hash out a deal?

Toder: Eventually what comes out of it has to be some kind of bipartisan agreement. The pure-left Democratic solution, where it's all tax increases, or the pure-right Republican solution, where it's all slashing spending, is not going to be able to be rammed down on the other side. It might not even be doable within each party with that kind of extreme solution.

The only age demographic that Republicans carried in the last election was voters over the age of 65. That's becoming a very big part of the Republican coalition. I think even if you tell that demographic that we're going to keep your Social Security and Medicare, it's only the next generation that will be affected, that still doesn't sell. I think in dealing with the Social Security and health spending, they're going to have a very hard time even with their own constituents, let alone worrying about the Democratic side of the aisle. If Democrats try to do it all by taxes, they're going to find they're going to get a lot of pushback on that as well. I do think it has to be a bipartisan solution, or a centrist solution if you will.

I think Conrad's vision is getting a group of moderate senators from both parties to come up with something and try and move out from the center. I think the odds of that being successful now are pretty low, but that's the only game in town right now.

TA: A lot of times when people talk about 1986, they talk about the leadership of President Reagan. It seems like we're not really seeing that from Obama right now on this issue. Do you think that's because Democrats are all over the board on the issue, or is it just not that important to the American public right now?

Toder: It's important to the American public to have a solution to the problem. I think people are worried about it. I think the American public doesn't understand or doesn't accept the kinds of measures a solution would require. On the Democratic side, Obama has been saying all you need to do is raise taxes on rich people. On the Republican side, they are saying you don't need to raise taxes on anybody. A lot of the Democrats are saying you don't really need to reduce entitlements.

TA: They've had tax reform hearings on Capitol Hill and have promised more. Is this something where you have hearings this year before the presidential election, and in 2013 you'll see movement?

Toder: You might see a different environment because we don't know who's going to be in power in 2013. And it's very hard to know at what point our long-term fiscal imbalance is going to start causing us serious problems. It hasn't to date. We know eventually it will, but we don't know when. At some point adjustments will be forced on us. I think that's when you start looking at the need for more revenue, and you're going to look at the current tax system and say we just can't get there just by jacking up the rates on the existing tax bases. And that's when tax reform starts to become a necessity.

It will be much less painful and disruptive to address these problems soon instead of waiting until investors in financial markets force us to, but I'm not optimistic that we will. ■