

How Could We Improve the Federal Tax System?

Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, Report of the President's Advisory Panel on Federal Tax Reform, November 2005

RECENT COMPREHENSIVE
TAX REFORM PROPOSALS

Q. Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, Report of the President's Advisory Panel on Federal Tax Reform, November 2005

A. The President's Advisory Panel on Federal Tax Reform recommended two simpler and fairer alternatives to the US income tax system, but both come with some big catches.

The President's Advisory Panel on Federal Tax Reform was created by President Bush in 2005 to recommend options to make the tax code simpler, fairer, and more conducive to economic growth. The panel developed two proposals, outlined below. Both contain features of income and consumption taxes, simplify taxes and streamline filing, eliminate the alternative minimum tax, eliminate most tax expenditures, and decrease the effective tax rate on capital income. As directed by President Bush, the panel designed the plans to be revenue neutral, though with the assumption that tax cuts proposed in President Bush's budget would be enacted.

The panel's report, *Simple, Fair, and Pro-Growth*, outlines the Simplified Income Tax Plan and the Growth and Investment Tax Plan (as well as how a value-added tax might be added to the former). The final chapter examines the possibility of replacing the income tax with a retail sales tax and finds that doing so would be deeply problematic.

SIMPLIFIED INCOME TAX PLAN

The Simplified Income Tax Plan would streamline the tax code by eliminating several exemptions. It would lower individual income tax rates to a range of 15–33 percent and set the top corporate rate at 31.5 percent. And it would encourage greater use of Roth-style savings accounts, such that a family of four could contribute up to \$60,000 per year in plans for retirement, health, education, and housing.

Major Changes to Tax Expenditures

- Replace the standard deduction, personal exemption, and head-of-household family credit with a single family credit.
- Replace the earned income tax credit (aimed at the working poor) with a less generous version.
- Convert the mortgage interest deduction to a 15 percent credit and reduce the cap on eligible interest payments to increase the number of people qualifying for the credit by 60 percent.
- Allow any taxpayer to deduct charitable contributions in excess of 1 percent of income.
- Eliminate the state and local tax deduction.

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- Allow taxpayers to deduct non-group health insurance up to the amount of the average premium. Employer-paid premiums in excess of caps would be taxable.

Savings and Retirement

- Replace all current tax-preferred savings options with three savings vehicles and a refundable saver's credit that phases out with increases in income. Each account would have a Roth-like structure (no initial deductions) and would not have income eligibility limits.
- Implement Save at Work plans that would consolidate all employer-provided defined-contribution plans and 401(k) plans, encourage automatic contribution as a default, and maintain the current 401(k) contribution limits.
- Implement Save for Retirement plans that would replace all savings plans not provided by employers, such as individual retirement accounts. Save for Retirement plans would have a \$10,000 annual contribution limit.
- Implement Save for Family plans that would replace education and health savings plans and could be used for education, medical care, home purchases, and retirement. Up to \$1,000 could be withdrawn each year for any purpose and up to \$10,000 could be contributed annually.

Corporate Taxation

- Divide businesses into small, medium, and large, with separate rules for each.
- Eliminate most deductions and credits.
- Move to a territorial system that taxes only domestic income.
- Eliminate the income tax on dividends received from US companies.
- Exclude 75 percent of corporate capital gains received from US companies from personal taxation.
- Tax interest received at regular individual income tax rates.

GROWTH AND INVESTMENT TAX PLAN

The Growth and Investment Tax Plan alternative would move the system closer to a consumption tax. It would be composed of a hybrid X-tax (a tax that mixes a European-style value-added tax with an income tax on wages) plus an individual-level 15 percent surcharge on capital income. Most proposals in the Simplified Income Tax Plan regarding major credits and deductions, as well as individual savings and retirement, would also apply to the Growth and Investment Tax Plan.

Main Provisions

- The X-tax would be a flat 30 percent levy similar to a value-added tax, with deductions for wages and other compensation. Investments would be expensed, interest and other financial inflows would not be taxed, and interest payment deductions would be eliminated.
- Individuals' interest, dividends, and capital gains would be taxed at 15 percent.
- All front-loaded 401(k) plans would be converted to back-loaded Roth plans.
- Individual income tax rates would be consolidated into three brackets with rates of 15, 25, and 30 percent.

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How Could We Improve the Federal Tax System?

The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, December 2010

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Q. The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, December 2010

A. The 2010 report of the National Commission on Fiscal Responsibility and Reform recommends policy reforms, collectively known as the Bowles-Simpson plan, intended to stabilize America's fiscal path.

President Obama tasked the National Commission on Fiscal Responsibility and Reform with recommending ways to bring the federal budget back into balance and to improve its long-run viability. The commission created a six-part plan outlining comprehensive tax reform, Social Security reform, cuts in discretionary spending, health care cost containment, mandatory personal savings, and changes to the budget process.

As a whole, the Bowles-Simpson plan would reduce the deficit to 2.3 percent of gross domestic product (GDP) by 2015, cap total tax revenue at 21 percent of GDP, and reduce spending to less than 22 percent of GDP. It would also stabilize the debt by 2014 and reduce the debt to 40 percent of GDP by 2035 (from about 60 percent when the report was written). The plan would cut the fiscal gap with an almost equal mix of revenue increases and spending cuts.

COMPREHENSIVE TAX REFORM

The commission's plan for tax reform set multiple goals: lower tax rates, broaden the base, cut tax expenditures, reduce the deficit, and maintain or increase tax progressivity.

Key Provisions

- Create three individual income tax brackets of 12, 22, and 28 percent, as well as a single 28 percent corporate rate.
- Eliminate the alternative minimum tax.
- Tax capital gains as normal income.
- Eliminate all tax expenditures except as follows:
 - Keep the child tax credit and earned income tax credit.
 - Replace the mortgage interest deduction with a 12 percent nonrefundable credit for all taxpayers for mortgages on principal residences only. Cap mortgage eligibility at \$500,000.
 - Cap the exclusion for employer-sponsored health care at the 75th percentile of average premiums in 2014. Reduce the excise tax on high-cost health care plans (the Cadillac tax) to 12 percent.

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- Replace the charitable contribution deduction with a 12 percent nonrefundable credit for contributions over 2 percent of adjusted gross income.
- Tax interest on newly issued state and municipal bonds.
- Consolidate retirement accounts and cap tax-preferred contributions at the lower of \$20,000 or 20 percent of adjusted gross income, while expanding the saver's credit.
- Eliminate all tax expenditures benefiting corporations.
- Implement a territorial tax system for active foreign-source income.
- Increase the excise tax on gasoline by 15 cents between 2013 and 2022.

SOCIAL SECURITY REFORM

To reduce Social Security's projected funding shortfall, the commission would increase the taxable wage base by 2050 to include 90 percent of earnings, increase the full- and early-retirement ages to 69 and 64, respectively, by 2075, cover newly hired state and local workers after 2020, and create a hardship exemption allowing those who cannot work past age 62 to receive benefits early. In addition, a chained consumer price index (which is generally lower than the unchained consumer price index) would be used to index benefits. To aid the lowest earners, the proposal included provisions to make the benefit formula more progressive and to create a minimum benefit for low-wage workers and the long-term disabled.

CUTS IN DISCRETIONARY SPENDING

The commission recommended that discretionary spending be capped through 2020 to force a reckoning of priorities, and that security and non-security spending be reduced by equal percentages.

HEALTH CARE COST CONTAINMENT

The commission recommended changes to the Medicare Sustainable Growth Rate, a system designed to control Medicare payments to physicians. Other savings would come from changes in cost sharing, malpractice law, and prescription drug costs. Overall, the commission recommended that health care spending growth be held to GDP plus 1 percent.

MANDATORY PERSONAL SAVINGS

The commission recommended several reforms, including reforming civilian and military retirement programs, reducing agricultural program spending, eliminating in-school subsidies in federal student loan programs, and giving the Pension Benefit Guaranty Corporation the authority to increase premiums.

CHANGES TO THE BUDGET PROCESS

Finally, the commission proposed changes to the budgeting process, including switching to a chained consumer price index where cost-of-living indexes are used to set spending, establishing a debt-stabilization process to enforce deficit reduction targets, allowing budgetary cap adjustments for program integrity efforts, and reviewing budget-scoring practices.

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The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, December 2010

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TAX REFORM PROPOSALS

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How Could We Improve the Federal Tax System?

Debt Reduction Task Force, "Restoring America's Future,"
Bipartisan Policy Center, November 2010

RECENT COMPREHENSIVE
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Q. Debt Reduction Task Force, "Restoring America's Future," Bipartisan Policy Center, November 2010

A. The task force proposed changes to the tax system, federal spending, health care spending, and Social Security to improve America's fiscal condition.

The Debt Reduction Task Force, chaired by Senator Pete Domenici and Alice Rivlin, created a plan to recover from the 2008 recession in the near term and reduce the national debt in the long term. The task force provided recommendations to reduce and stabilize the debt, streamline the tax code, restrain health care costs, strengthen Social Security, and freeze defense and domestic discretionary spending. The plan would reduce the debt to 60 percent of gross domestic product (GDP) by 2020 and balance the primary budget (excluding interest payments) by 2020. Federal spending would shrink to 23 percent of GDP by 2020, with revenues at 21.4 percent of GDP.

REVIVE THE ECONOMY AND CREATE JOBS

The task force recommended a one-year payroll tax holiday to create between 2.7 and 7 million new jobs over two years.

TAX REFORM

The task force's plan would cut tax rates and broaden the base by eliminating tax expenditures and establishing a new debt reduction sales tax.

Major Reform Provisions

- Consolidate individual income tax rates into two brackets: 15 and 27 percent.
- Set the corporate income tax rate at 27 percent.
- Tax capital gains and dividends as ordinary income, while allowing a \$1,000 exclusion for capital gains.
- Eliminate the standard deduction and personal exemptions, along with most tax expenditures.
- Replace the earned income tax credit and other family and child provisions with a \$1,600 per child universal credit and a credit of 21.3 percent on the first \$20,300 of earnings for each worker.
- Replace the mortgage interest deduction and deduction for charitable contributions with 15 percent credits available to everyone regardless of income (the 15 percent mortgage interest credit would only be available for expenses on a principal residence, and only up to \$25,000).

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Debt Reduction Task Force, "Restoring America's Future,"
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- Eliminate deduction for state and local taxes.
- Allow individuals and employers to contribute up to 20 percent of annual earnings to qualified retirement plans, up to \$20,000 per year.
- Introduce an expanded refundable savings credit for taxpayers in the 15 percent tax bracket.
- Repeal the alternative minimum tax.
- Increase the excise tax on alcohol from about 21 cents per ounce to 25 cents.
- Phase in a 6.5 percent debt reduction sales tax over two years. The tax would be structured similarly to a broad-based value-added tax

DOMESTIC DISCRETIONARY AND DEFENSE SPENDING

The task force recommended that domestic discretionary spending be frozen for four years and defense spending be frozen for five years. After this time, spending growth would be allowed to increase at the rate of GDP growth. All spending limits would be enforced through statutory caps. If the caps were exceeded, spending would automatically be cut across the board. Cuts to domestic discretionary spending would save \$1 trillion, and cuts to defense spending would save \$1.1 trillion through 2020.

HEALTH CARE

The task force proposed short-term and long-term changes to all aspects of the health care system. As a whole, the reforms would save \$756 billion through 2020.

Changes to Medicare

- Raise Part B premiums from 25 to 35 percent of program costs over five years.
- Use the government's bargaining power to increase rebates from pharmaceutical companies.
- Modernize benefits package and copayment structure.
- Bundle payments for post-acute care.
- Transition to a premium-support option to limit growth per beneficiary and increase competition among private plans.
- Eliminate barriers to enroll dual-eligible patients (Medicare beneficiaries who are also eligible for Medicaid) in managed care.

Other Major Changes

- Reduce excess cost growth in Medicaid by 1 percentage point per year.
- Require states to cap awards for non-economic and punitive damages for medical malpractice and test other reforms to the malpractice system.
- Impose an excise tax on beverages sweetened with sugar and high-fructose corn syrup.
- Reform the sustainable growth rate mechanism for physician payments.

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- Cap the exclusion for employer-provided benefits in 2018 and phase it out over 10 years. This would replace the "Cadillac tax" that is part of the Affordable Care Act.

SOCIAL SECURITY

The task force proposed several changes to Social Security to ensure its long-run sustainability. Major reforms include increasing the portion of wages subject to the payroll tax to 90 percent, changing the cost-of-living calculation, indexing the benefit formula for increases in life expectancy, reducing benefit growth for the top 25 percent of beneficiaries, and covering newly hired state and local government workers. To aid the most at-risk populations, the task force proposed increasing the minimum benefit for long-term low-wage earners and the most vulnerable elderly.

OTHER SAVINGS

Cuts and reforms to smaller federal programs were projected to save \$89 billion by 2020. The task force recommended reducing farm program spending by eliminating payments to producers with an adjusted gross income over \$250,000, consolidating and capping conservation programs, and reforming crop insurance. In addition, they proposed changing the benefit calculation for civilian government retirees and changing the age at which career military personnel can retire.

BUDGET PROCESS

To enforce the proposed reforms, the task force recommended that changes to the budget system be imposed to increase accountability. Examples of reforms included statutory spending caps, a pay-as-you-go requirement to prevent the fiscal situation from getting worse, and a fiscal accountability commission that would meet every five years to evaluate program growth and other budget issues.

Updated May 2020

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How Could We Improve the Federal Tax System?

The Tax Reform Act of 2014: Fixing Our Broken Tax Code So That It Works for American Families and Job Creators, House Ways and Means Committee

RECENT COMPREHENSIVE
TAX REFORM PROPOSALS

Q. The Tax Reform Act of 2014: Fixing Our Broken Tax Code So That It Works for American Families and Job Creators, House Ways and Means Committee

A. The Tax Reform Act of 2014, an ambitious plan for broadening the tax base and simplifying both the corporate and personal income taxes, was designed to be revenue neutral over the 10-year budget horizon.

The Tax Reform Act of 2014 was proposed by former chair of the House Ways and Means Committee Dave Camp as a point of reference for tax reform. The Camp plan would reduce tax rates and eliminate or limit most tax expenditures. It would be revenue neutral and income distribution neutral over the 10-year budget horizon but would lose revenue and become more regressive after then.

INDIVIDUAL INCOME TAX

- Consolidate individual tax rates into three brackets: 10, 25, and 35 percent. The 35 percent bracket would be composed of the 25 percent rate plus a 10 percent surtax that would only apply to modified adjusted gross incomes over \$450,000 (\$400,000 for single taxpayers).
- Increase the standard deduction for all taxpayers and add an additional deduction for single taxpayers with at least one dependent child.
- Eliminate the personal exemption, state and local tax deduction, deduction for medical expenses, and other smaller tax expenditures.
- Reduce the cap on the interest deduction over four years to mortgages of \$500,000.
- Allow deductions for only those charitable contributions in excess of 2 percent of adjusted gross income.
- Increase and expand the child tax credit.
- Modify the earned income tax credit, index the parameters to the chained consumer price index, and reduce eligibility for children to those younger than 18. The earned income tax credit would thereby be reduced for almost all families.
- Consolidate higher education incentives into an American Opportunity Tax Credit.
- Modify the rules for individual retirement accounts (IRAs) and 401(k) plans by barring deductible contributions to traditional IRAs and removing income limits on contributions to Roth IRAs.
- Repeal the alternative minimum tax.
- Tax capital gains and dividends as ordinary income, with a 40 percent exclusion.

How Could We Improve the Federal Tax System?

The Tax Reform Act of 2014: Fixing Our Broken Tax Code So That It Works for American Families and Job Creators, House Ways and Means Committee

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CORPORATE INCOME TAX

- Set the top corporate rate at 25 percent; phase in the reductions over five years.
- Shift to a territorial system (which would exempt the foreign income of US multinational firms from US taxation).
- Institute a retroactive tax on foreign-earned income of 8.75 percent on cash assets and 3.5 percent on noncash assets, with the option to spread payments over eight years. All revenue would be allocated to the Highway Trust Fund.
- Institute a 0.035 percent excise tax on big banks that is levied quarterly on consolidated assets in excess of \$500 billion.
- Repeal the corporate alternative minimum tax, along with the deduction for domestic production activities and most other business tax preferences.

ANALYSIS

The Joint Committee on Taxation predicted the Camp plan would be revenue neutral in the initial 10 years. However, when considering the macroeconomic effects, the committee found that the plan could boost GDP by between 0.1 and 1.6 percent in that 10 years, increasing federal revenue by between \$50 billion and \$700 billion.

Beyond the first 10 years, though, the fiscal impact would be uncertain. Many provisions that initially increased revenue would expire. In addition, the official estimates may have misstated the cost of making certain tax extenders permanent, thereby increasing long-term costs. These additional costs could have been partially offset by adopting the chained consumer price index to index tax rates, credits, and so on.

Tax burdens for heads of households would significantly increase in all quintiles of the income distribution except the lowest. Further, households in high-tax states that itemize their deductions, families with older children, and households that previously benefited from tax preferences that would diminish or expire would probably bear a higher tax burden in the long run.

Updated May 2020

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How Could We Improve the Federal Tax System?

The Graetz Competitive Tax Plan, Updated for 2015

RECENT COMPREHENSIVE
TAX REFORM PROPOSALS

Q. The Graetz Competitive Tax Plan, Updated for 2015

A. Graetz's proposal recommends cutting income and payroll taxes and making up the revenue with a value-added tax.

Columbia University law professor Michael Graetz introduced his "Competitive Tax Plan" more than a decade ago and has recently updated it. Broadly, the plan shifts the tax system, which is based on income, to one based on consumption. The plan is revenue neutral and would not change the overall income distribution.

The Competitive Tax Plan contains five components.

- A value-added tax (also called a goods and services tax) with a broad base and a single rate of 12.9 percent. Businesses with less than \$1 million in gross receipts would be exempt. There would be 18 to 24 months between enactment and implementation, which Graetz expects would accelerate purchases of durable goods and provide a short-term boost to the economy. The tax would be modeled after modern value-added taxes in New Zealand, Australia, Canada, Singapore, and South Africa. States would be given incentives to harmonize their tax policies with the federal tax.
- An individual income tax in which the first \$100,000 of income for married couples would be exempt from taxation (\$50,000 for singles and \$75,000 for heads of household). Above this threshold, tax rates would be 14, 27, and 31 percent. The alternative minimum tax and surtax on investment income would be repealed. With these reforms, less than one-fifth of the households now paying income tax would be required to file returns.
- A corporate income tax with a reduced rate of 15 percent. All credits except the foreign tax credit would be eliminated, and the corporate alternative minimum tax would be repealed. The plan may also subject large businesses (even if they are not corporations) to the corporate income tax while simplifying the taxation of small businesses.
- The current payroll tax, but with credits of 15.3 percent of wages for workers with earnings up to \$10,000 and a credit of \$1,530 for workers earning between \$10,000 and \$40,000. The credit phases out for incomes above \$40,000.
- Refundable child credits would be established and distributed through debit cards. Each child would qualify for \$1,500 per year, with a phaseout provision for higher-income earners. Low- and moderate-income earners, on the other hand, would receive an additional rebate of up to \$3,500 for one child and \$5,200 for two or more children.

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How Could We Improve the Federal Tax System?

The Graetz Competitive Tax Plan, Updated for 2015

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