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

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.

How Could We Improve the Federal Tax System?

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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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Further Reading

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Furman, Jason. 2005. "The Tax Reform Panel's Costly Proposal." Washington, DC: Center on Budget and Policy Priorities.

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