

## **Major Tax Issues in 2016**

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A good tax system raises the revenues needed to finance government spending in a manner that is as simple, equitable, and growth-friendly as possible. The United States does not have a good tax system. Long considered an outrageous affront by many observers, the U.S. tax system has generated perennial calls for everything from minor tune-ups to comprehensive reform. There is massive disagreement, however, about which issues are the most important and how they should be addressed.

In this essay, we highlight five areas where tax policy could be improved: raising long-term revenue; increasing environmental taxes; reforming the corporate tax; treating low- and middle- income earners equitably and efficiently; and ensuring appropriate taxation of high-income households.

Before addressing these issues, we start with two caveats. First, whether a Presidential candidate wishes to discuss these issues in a political campaign is a different question than whether the issues are important. As experiences over the last few years have shown, in particular with dealings between a Republican Congress and a Democratic President, often times the worst way to advance change is to talk openly about a particular proposal. This constraint may prove relevant in a campaign, too. Hence, our essay is less about what policies the candidates should propose and more about describing the important issues that they should address. We leave the political strategy questions to the political strategists.

Second, picking just five areas out of the entire tax system surely omits important issues. Comprehensive tax reform is easy to talk about, but hard to do. The pursuit of sweeping tax simplification is a noble goal, but quixotic. The effects of taxes on entrepreneurship are important, but elusive. These and other issues are worth addressing, but they are beyond the scope of this essay.

### Long-Term Revenue

Under current law projections, federal debt as a share of the economy will rise from its current level of 74 percent—the highest level ever except for a few years around the Second World War—to about 103 percent by 2040 under generous assumptions, and to as much as 120 percent under reasonable alternative policy scenarios.<sup>1</sup> Current law revenues will slightly increase to 19 percent of GDP in 2040 from about 18 percent currently. Total spending is projected to reach 25 percent of GDP, up from 21 percent currently, with the rise largely due to increases in net interest, Social Security, and health spending.

High and growing levels of debt will crowd out future investment and stymie growth. They will also reduce fiscal flexibility, or the ability to respond to future recessions.

Alan Auerbach of the University of California at Berkeley and William Gale of Brookings estimate that, in order to return the debt level to its 1957-2007 average of 36 percent of GDP by 2040, immediate and permanent (through 2040) [spending cuts and/or tax increases equal to 3.0 percent of GDP](#) will need to be implemented. It seems unlikely that changes of this magnitude could be managed on the spending side. Entitlements have proven difficult to reform, especially Social Security, as there is significant public and political backlash against cutting benefits. Moreover, any Social Security changes would likely be phased in slowly, and reasonable changes in the program would not affect the overall fiscal balance that much. In addition,

discretionary spending has already been cut dramatically and is already slated to fall to historically low shares of GDP over the next 25 years. As a result, tax increases need to be part of a long-term fiscal solution.

Increasing federal revenues does not mean that marginal income tax rates have to go up. New revenue sources could be explored through energy taxes (discussed in the next section), a change in the treatment of tax expenditures, or a value-added tax (VAT).

[One way to raise revenue](#) is to broaden the tax base by reducing the number of specialized credits and deductions in the tax code. For example, under current law, a dollar's worth of deduction reduces taxable income by a dollar and hence reduces the tax burden in proportion to the marginal tax rate. A high-income household saves 39.6 cents for a given dollar of deduction, whereas a low-income household only saves 10 cents or nothing at all for each dollar's worth of deduction. Setting the tax benefit of each dollar of itemized deductions to 15 cents would affect mostly high-income households and raise, on average, about 0.6 percent of GDP per year over a decade, or roughly a cumulative \$1.4 trillion over the next 10 years. Current itemized deductions are expensive, regressive, and often ineffective in achieving their goals. The mortgage interest deduction, for example, does not seem to raise home ownership rates, yet it costs around \$70 billion per year. Limiting the benefits of the deductions for high-income households is a way of reducing the distortions created by the tax code, making taxes more progressive and raising revenue. Alternatively, the United States could cap the total amount of tax expenditures that an individual can claim. For example, [Martin Feldstein, Daniel Feenberg, and Maya MacGuineas propose](#) that tax expenditure benefits be capped at 2 percent of a taxpayer's adjusted gross income. According to their model, this would have increased revenues in 2011 by 1.8 percent of GDP.<sup>ii</sup>

An alternative way to raise revenue is through the creation of a VAT, as a supplement to the current system, rather than a replacement.<sup>iii</sup> A VAT is essentially a flat-rate consumption tax with administrative advantages over a national retail sales tax. Although it would be new to the United States, the VAT is in place in about 160 countries worldwide and in every OECD country other than the United States. Experience in these countries suggests that the VAT can raise substantial revenue, is administrable, and is minimally harmful to economic growth. Additionally, a properly-designed VAT might help the states deal with their own fiscal issues. Although the VAT is regressive relative to current income, the regressivity can be offset in several ways, and we should care about the distributional impact of the overall tax and transfer system, not just specific taxes. While the VAT is not readily transparent in many countries, it would be easy to make the VAT completely transparent to businesses and households by reporting VAT payments on receipts just like state sales taxes are reported today. While the VAT has led to an increase in revenues and government spending in some countries, higher revenues are precisely why the VAT is needed in the U.S., and efforts to limit spending should be part of an effort to enact a VAT. Making the VAT transparent should also reduce the extent to which a VAT would fuel an increase in government spending, a concern that is sometimes [overstated by critics](#) in the first place. While a VAT may lead to a one-time increase in prices, it is not the case empirically that VATs inevitably, or even usually, lead to continuing inflation.

Specifically, a [new 10 percent VAT, applied](#) to all consumption except for spending on education, Medicaid and Medicare, charitable organizations, and state and local government, could be paired with a cash payment of about \$900 per adult and about \$400 per child to offset

the cost to low-income families (the equivalent of annually refunding each two-parent, two-child household the VAT owed on the first \$26,000 of consumption).<sup>iv</sup> In all, this VAT could raise about a net 2 percent of GDP or about \$360 billion in 2015, after allowing for the offsetting effect on other taxes. None of this implies that the VAT would unilaterally solve the country's fiscal problems; nor would it be painless. Nevertheless, the VAT is a relatively attractive choice, given the need to close the fiscal gap and the other options for doing so.

Higher overall tax burdens do not necessarily hurt the economy. Over the 1970-2012 period, taxes as a share of GDP were 7 percentage points higher in the rest of the OECD countries (32 percent) than in the United States (25 percent). Yet, per capita annual growth was virtually identical in the rest of the OECD (1.80 percent) compared to the United States alone. Even the massive [tax increases during and after World War II](#)—amounting to a permanent rise of ten to fifteen percent of GDP—did not hamper U.S. economic growth.

None of this means that the United States needs to move to European levels of taxation. But between the very low tax revenues we raise now and the high levels of taxation in other developed countries, there is room to raise revenue in a way that achieves serious medium- and long-term debt reduction and supports a reasonable level of government.

#### Environmental Taxes

The discovery and exploitation of natural resources by humans gave rise to the advanced civilization in which we live today. Coal, petroleum, and natural gas fueled industrialization, which raised living standards and life expectancy for most. Energy use continues to fuel economic growth and development today. But along with the benefits of energy consumption come substantial societal costs—including those associated with air and water pollution, road congestion, and climate change. Many of these costs are not directly borne by the businesses and individuals that use fossil fuels, and are thus ignored when energy production and consumption choices are made. As a result, there is too much consumption and production of fossil fuels.

Economists have long recommended specific taxes on fossil-fuel energy sources as a way to address these problems. The basic rationale for a carbon tax is that [it makes good economic sense](#): unlike most taxes, carbon taxation can correct a market failure and make the economy more efficient. It could also serve to raise revenue as an alternative to the taxes described above.

Although a carbon tax would be a new policy for the federal government, the tax has been implemented in several other countries. In 2007, the carbon tax raised revenue equivalent to about 0.3 percent of GDP in Finland and Denmark, and 0.8 percent in Sweden. A well-designed tax in the United States could raise similar amounts. In fact, according to [Tax Policy Center](#) and Congressional Budget Office (CBO) estimates, a reasonably designed U.S. carbon tax alone could, on average, raise revenue by about 0.7 percent of GDP each year from 2016-2025 (around \$160 billion per year). Revenue from a carbon tax could be used to reduce other tax rates or pay down the debt.

Carbon taxes are a good idea even if we did not need to increase revenues because they can contribute to a cleaner, healthier environment by providing price signals to those who pollute. They have foreign policy benefits as well, as they plausibly reduce U.S. demand for oil and dependence on oil-producing nations.

Not surprisingly, most analyses find that a carbon tax could indeed significantly reduce

emissions. [Gilbert Metcalf of Tufts University](#) estimates that a \$15 per ton tax on CO<sub>2</sub> emissions that rises over time would reduce greenhouse gas emissions by 14 percent, while [Jenny Sumner, Lori Bird, and Hillary Smith of the National Renewable Energy Laboratory](#) estimate that the European countries' carbon taxes have had a significant effect on emissions reductions, attributing reductions of up to 15 percent to the carbon tax. Furthermore, the [University of Ottawa](#) found that the carbon tax implemented in British Columbia led to a 9.9 percent reduction in greenhouse gas emissions in the province, compared to just 4.6 percent for the rest of Canada, where comprehensive carbon taxes were not applied.

In addition to reducing emissions, [a carbon tax could improve other economic incentives](#) by reducing other tax rates or paying down the deficit. It would also reduce the U.S. economy's dependence on foreign sources of energy and create better market incentives for energy conservation, the use of renewable energy sources, and the production of energy-efficient goods. The permanent change in price signals from enacting a carbon tax would stimulate new private sector research and innovation to develop new ways of harnessing renewable energy and energy-saving technologies. The implementation of a carbon tax also offers opportunities to reform and simplify other climate-related policies that affect the transportation sector.

While it receives high marks on efficiency criteria when looking at the United States in isolation, a carbon tax could hurt the country if other countries do not adopt similar measures. [Robert Stavins of Harvard](#) notes that the largest efficiency gains would come in the form of internationally-shared reduced greenhouse gas emissions. While the United States is the largest per capita emitter of carbon dioxide, China is the largest overall emitter, and the European Union makes a significant contribution as well. Therefore, enacting a program that would lead to better cooperation with other countries, and reduce emissions across the world, would more effectively deal with the well-known problems brought about by climate change, such as rising sea levels, and higher frequency of extreme temperatures, among others.

However, no one claims that the carbon tax is a perfect solution. For example, it can have a large impact on low-income households who use most of their income for consumption. Nevertheless, this regressivity could be offset in a number of ways, including refundable income or payroll tax credits. Thus, while distributional effects are clearly a concern, they can be minimized and should not prohibit the implementation of a carbon tax.

Another way to raise revenue through energy taxation, and a method that may be more feasible than a carbon tax, is to increase the gasoline tax. The current federal rate on gas has been fixed in nominal terms at 18.4 cents per gallon since 1993. An increase in the gas tax would generate revenues to finance repairs to our crumbling infrastructure, stabilize the Highway Trust Fund, and help pay down the debt. Ian Parry of Resources for the Future estimates that raising gasoline and diesel fuel taxes to the levels justified by the externalities that gasoline consumption creates would increase revenue by around \$100 billion per year, while [CBO estimates](#) that an inflation-indexed 35 cent increase in the gasoline excise tax alone would raise about 0.2 percent of GDP (about \$46 billion per year) over 10 years. Raising the gas tax by 25 cents per year for 10 years would raise substantially more revenue, but would still leave U.S. gas tax rates well below those of European countries.

#### Corporate Taxation

In the standard textbook setup, the major problem with the current approach to corporate taxation is the double taxation of corporate equity. The earnings of equity holders are taxed

under the corporate tax when they are earned, and then again, under the individual income tax, when they are paid to shareholders as dividends or capital gains. This standard summary both overstates and misstates the real problem. First, no corporate income is fully taxed under the individual income tax, since dividends and capital gains are taxed at preferential rates and capital gains are only taxed when the asset is sold. Second, a significant share of dividends and capital gains accrues to non-taxable entities—non-profits or pensions—thus reducing the tax burden further. Third, a large share of corporate profits is never taxed at the corporate level in the first place. Aggressive corporate tax avoidance, including shifting funds out of the country through transfer pricing or other mechanisms, is an important factor in corporations reducing their tax burden.

The United States has the highest top corporate rate in the world at 35 percent. For many businesses, the tax distorts choices in favor of the non-corporate sector over the corporate sector. For other businesses, the corporate tax burden is offset by tax preferences. In the corporate sector, the tax favors debt over equity and retained earnings over dividends. As a result of numerous loopholes, aggressive corporate tax avoidance, and the large share of U.S. businesses that takes the form of non-C-corporation activity (which is in itself a form of corporate tax avoidance), U.S. corporate tax revenues as a share of GDP are only average compared to other countries, despite the high tax rate. In recent years, for example, corporate profits have equaled 12 percent of GDP, but corporate tax revenues have hovered around 2 percent of GDP.

Hence, the problem is not just that some forms of corporate income face two levels of tax; it is also that some forms face no tax. As a result, the main goal of corporate tax reform should be to tax all corporate income once and only once, at the full income tax rate. Given all of the flaws in the corporate tax, it should not be surprising there are several approaches to reform that could help. None is without problems; each would address different aspects of the system.

One option, [emphasized by Robert Pozen of Harvard](#) and others, is to reduce or limit the interest deduction and use the resulting revenues to reduce rates. This would reduce the bias toward debt in the tax system. Allowing firms to deduct some part of dividend payments could put dividends and interest on the same tax footing. Other ways to close loopholes and broaden the base would generate additional reductions in rates.

A totally different, and radical, approach would be to replace the corporate income tax with a tax on shareholder wealth accumulation, as proposed by Eric [Toder and Alan Viard](#). Under this approach, there would be no corporate tax. Instead, “American shareholders of publically-traded companies would be taxed on both dividends and capital gains at ordinary income tax rates, and capital gains would be taxed upon accrual,” rather than realization.

Alternatively, [Auerbach proposes](#) that the United States convert the corporate income tax into a corporate cash-flow tax. This would encourage new investment by replacing deductions with immediate expensing for physical investment. Auerbach also calls for applying the tax on a destination basis, which essentially limits the focus of the tax to transactions occurring exclusively on domestic soil and thus avoids all international transfer pricing issues.

A major change in the treatment of foreign source income should be considered as part of any overall corporate tax reform. In a pure worldwide system, all income from around the world is taxable, and all costs are deductible. In a pure territorial system, income earned outside

the country is not taxable, and costs incurred outside the country are not deductible. A key issue, of course, is how income and expenses are allocated to each country because firms go to great lengths to move income to low-tax countries and deductions to high-tax countries. Most advanced countries lean toward a territorial system. The United States, on the other hand, leans toward a worldwide system, but there is an important exception—taxes on actively-earned foreign income are deferred until the income is repatriated to the United States. Currently, US firms have an estimated \$2 trillion in actively-earned funds that have not been repatriated and therefore go untaxed.

This income is often described as being [trapped](#) outside the United States. This characterization is only partially correct, though. The money may actually be in a bank in the US and funding investment in the US. However, the funds cannot be used to pay dividends to shareholders or to buy back firm shares until the funds are “repatriated” to the corporation, a legal procedure that then generates a tax liability. There are two general proposals to deal with the issue of funds sitting “abroad.” One is to move to a worldwide system [without deferral](#). The other is to move toward a [territorial system](#). As noted, a big issue with territorial systems is that they increase the incentives that already exist to shift income into low-tax countries and deductions/costs into high-tax countries. So, the implementation of a territorial system would need to be accompanied by very stringent rules about income and cost-shifting. There has been a desire on the part of [some lawmakers](#) to have a one-time repatriation tax holiday, perhaps to finance infrastructure. This [would be a mistake](#) and would simply encourage firms to shift more funds overseas in an effort to gain a future tax advantage.

A related issue was raised by a recent [wave of corporate inversions](#), which occur when an American company is bought by a foreign firm and thus qualifies as a non-U.S. company for tax purposes. Although they are not quite “stroke of the pen” transactions, inversions can be accomplished without moving actual factories or human resources to another country. As a result, most observers believe that companies [invert for tax reasons](#). Some argue the companies are [showing a lack of patriotism](#).

Some recent, well-publicized inversions, coupled with the absence of Congressional action, led the Obama Administration to issue [new regulations](#) that limited the practice. These new regulations and the potential threat of additional ones [may have slowed](#) the pace of new inversions. Still, Congress has not addressed the underlying tax causes of inversions, including high statutory U.S. corporate tax rates. Some believe that converting the U.S. corporate tax to a territorial system would curb inversions, but this is controversial, as Berkeley lawyer Eric Talley has [noted](#).

“Patent boxes” raise another issue concerning cross-national income. Patent boxes, or intellectual property (IP) boxes, give preferential tax treatment for profits generated by IP investments. Ireland created the first [patent box regime](#) in the 1970s. Currently, around a dozen European countries, including the United Kingdom and France, offer patent boxes with preferential rates ranging from 5 to 15 percent, considerably lower than the standard corporate tax rates in those countries. Recently, Senators [Portman and Schumer](#) proposed similar treatment for the United States.<sup>v</sup>

The hope is that lower rates will attract research and development to the country with the patent box. But critics argue that patent boxes will just lead to a “race to the bottom” since IP income is easy to shift across countries without any effect on the location of real activity. It is

therefore unclear whether these tax benefits actually increase research expenditures in the country in question. Studies have generally [failed](#) to identify a definitive relationship between similar U.S. strategies such as Section 174 and the research investment. To address these coordination issues, the OECD released an [agreement](#) in February 2015, tightening the conditions under which tax benefits from IP income would be awarded, but the issue is not settled.

### Taxation of Low- and Middle-Income Earners

Under a progressive income tax, the highest statutory marginal tax rates are placed on the highest-income households. Under our current system, however, low- and middle-income earners often face very high effective marginal tax rates. These earners are in income ranges where increased earnings cause phase-outs of tax subsidies and benefit programs. The net effect of earning more—including higher wages, higher income tax payments, and lower program benefits—can turn out to impose quite significant effective tax rates on such households. This situation is unfair to those families, is inefficient, and discourages actions that would enhance social and economic mobility.

For example, [Melissa Kearney and Lesley Turner](#) note that a secondary earner in a married household typically pays a higher effective tax rate on the margin than the primary earner. This issue arises because the two incomes are combined to form one tax unit even though the secondary earner often has a lower *individual* income than the primary earner (and would have a lower marginal tax rate if filing as a single person). This is particularly problematic for low- and middle-income households because it discourages additional work to support their family which could result in extra income that may reduce their benefits or even render the family ineligible for programs such as food assistance or the Earned Income Tax Credit (EITC). On both fairness and economic grounds, Kearney and Turner propose a 20 percent secondary-earner tax deduction until a cap is reached. This deduction would improve the incentive to work, provide more economic security to working low- and middle-income families, and mitigate the secondary earner penalty. On net, the authors estimate their proposal would cost the federal government \$8.2 billion per year.

[Eugene Steuerle of the Urban Institute](#) points out that as a worker's income increases, marginal tax rates may increase, and benefits from social programs may be phased out. This creates higher effective tax rates for beneficiaries of welfare programs such as SNAP and government-subsidized healthcare and reduces the incentives for work and marriage. According to Steuerle, as a family's income rises, the phase-out of benefits from social programs effectively results in a combined marginal tax rate of about 60 percent for low- to middle-income earners, as compared with top income tax rate of 39.6 percent for high-income households. Those who receive more means-tested benefits initially may face combined rates closer to 75 percent. This is all compared to the earner's statutory marginal tax rate of 25 percent if filing single or 15 percent if married. To combat this issue, Steuerle proposes that the government should "make combined tax rates more explicit and make work a stronger requirement for receiving some benefits."

Of course, another option to mitigate the tax burden faced by low- and middle-income earners is to [expand eligibility](#) for the Earned Income Tax Credit (EITC) or [transform the Child and Dependent Care Credit](#) (CDCC) to a refundable benefit. Both of these programs are already executed through the tax code in an effort to aid low- and middle-income families, and changes

to the programs could expand economic opportunity or increase the degree of fairness in the system. Specifically, EITC benefits could be raised for families with fewer than two children. This improves the incentives for work in these households, and it can lead to better economic outcomes for the associated families. By converting the CDCC to a refundable credit, low-income families would be able to reap greater benefits from the program and retain more disposable income. Additionally, it would incentivize the use of higher-quality child care. In order to make these options revenue-neutral and prevent them from exacerbating the long-term revenue issues described above, the income eligibility caps for these programs could be lowered or other provisions could be removed.

#### Taxing the Rich

There are three major reasons to increase the tax burden on high-income households. First, their income has increased dramatically over the past several years, yet their tax payments have not kept pace. Second, if the fiscal reforms described above are implemented, the main benefit will be economic growth, but such growth in the past several decades has accrued largely to high-income households, who should thus be expected to pay for it. Third, despite much rhetoric to the contrary, reasonable variations in taxes on high-income households do not appear to have any negative discernible impact on growth.

Over the past several decades, the share of income accruing to high-income households has gone up dramatically. In 1979, the top 1 percent received about 10.5 percent of all market income. By 2011, that figure had risen to 16.9 percent. In real terms, market income among households in the top 1 percent was 174.4 percent higher in 2011 than in 1979. In contrast, for the middle three quintiles, real market income was only 15.6 percent higher.

In a progressive tax system, when someone's income rises, their average tax rate is supposed to rise. Adjusting for overall growth of the economy, this means that as a group's income rises relative to average, its tax burden ought to rise relative to average. This has not happened in the United States. The average federal income tax rate for households in the top 1 percent was 23 percent in 1979 compared to 20 percent in 2011. Thus, one reason to impose more taxes on high-income households is simply that they are not bearing their fair share of tax payments.

It is worth emphasizing that top income households currently pay the vast share of overall federal taxes (and income taxes in particular), and that the share of taxes paid is not a good metric of how progressive the tax system is. For example, suppose we changed to a tax system where no one paid any taxes except the richest person, who paid \$1. This change would obviously provide the biggest benefits to the richest people in the country, who would be relieved of the current progressive tax burdens they face. Yet, under this new system, it could be pointed out that the rich are now paying 100 percent of all taxes. The point is that the share of taxes paid is not a good measure of burden when either tax revenues or income levels are changing.

A second reason for increasing the tax burdens of wealthy households has to do with paying for the benefits of fiscal reform and consolidation. If fiscal reform could boost growth (as estimates suggest), but the benefit of that growth accrues disproportionately to high-income households (as the experiences of the last 35 years suggest it will), then the burdens of fiscal retrenchment should be disproportionately placed on high-income households. One such policy would be to means-test Social Security and Medicare, or otherwise adjust benefits downward

for high lifetime income earners. But in practice, having the rich pay more means increasing their taxes, since neither the major entitlements nor any other government spending program affect the very wealthy that much.

The notion of increasing taxes for high income earners will cause horror in some circles, but a wide variety of evidence suggests that high tax rates are only weakly related to economic growth. For example, the vaunted Reagan tax cuts in the early 1980s produced a period of average growth, when growth is (appropriately) measured from peak to peak of the business cycle. Indeed, [research](#) by Martin Feldstein, President Reagan's former chief economist, and Doug Elmendorf, the former Congressional Budget Office Director, concluded that the 1981 tax cuts had virtually no net impact on growth. They found that the recovery in the early 1980s could be ascribed wholly to monetary policy. It's also worth noting that they found no evidence that the big 1981 tax cuts induced people to work more.

Virtually no one now claims that the 2001 and 2003 Bush tax cuts stimulated growth. The two enabling acts did have the word "growth" in their titles (the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Jobs and Growth Tax Relief Reconciliation Act of 2003) and slashed tax rates on ordinary income, capital gains, dividends, and estates, but economic growth remained sluggish between 2001 and the beginning of the Great Recession in late-2007. Again, the gains that did occur are generally attributed to the Fed's easy money policy.

Even the 1986 Tax Reform Act, the standard bearer in terms of broadening the base and reducing top rates, generated little impact on growth.<sup>vi</sup> Moreover, in 1993, the top income tax rate in the United States rose to 39.6 percent, yet [the economy flourished](#) for the rest of the decade. Cross-country research provides similar evidence. [Research by Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva](#) found no relationship between how a country changed its top marginal tax rate and how rapidly it grew between 1960 and 2010. The United States, which cut its top rate by over 40 percentage points during that period, grew just over 2 percent annually per capita. Germany and Denmark, which barely changed their top rates at all, experienced about the same growth rate.

There are many ways to boost revenue collected from high-income households. The most prominent examples would include higher taxes on capital gains and dividends, restrictions on tax expenditures, higher income tax rates, or a tighter estate tax. Taxing carried interest as ordinary income also makes sense in principle, but is difficult to implement without creating new forms of avoidance and, as a result, would raise very little revenue.

### Conclusion

Reforming the tax system so that it pays for government spending, treats taxpayers fairly, and improves incentives for productive activity can only be a plus from an economic standpoint. Even though the politics have been, and will continue to be, a major barrier to reform, the next President may well be judged a success or failure in significant part based on how he or she handles tax policy.

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<sup>i</sup> For current law projections, see Congressional Budget Office, "The 2015 Long-Term Budget Outlook" (Washington: 2015). For current policy projections, see Alan J. Auerbach and William G. Gale, "The Fiscal Problem: Gone Today, Here Tomorrow" (Washington: Brookings, 2015).

<sup>ii</sup> For further analysis of tax expenditure reform options, see Daniel Baneman et al., "Options to Limit the Benefit of Tax Expenditures for High-Income Households" (Washington: The Tax Policy Center, 2011).

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<sup>iii</sup> Yale University law professor Michael Graetz also has proposed a VAT, but he would use the revenues gained to cut the income tax substantially—raising the exemption to about \$100,000 and taxing income above that level at a flat 25 percent—and to halve the corporate tax rate. See: Michael J. Graetz, “100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System,” *Yale Law Journal* 112 (2004): 263–313.

<sup>iv</sup> For more discussion, see: William G. Gale and Benjamin H. Harris, “Proposal 10: Creating an American Value-Added Tax” (Washington: The Hamilton Project, 2013); Eric Toder and Joseph Rosenberg, “Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes” (Washington: The Tax Policy Center, 2010).

<sup>v</sup> For more information, see: Rob Portman and Charles Schumer, “Senate Finance Committee International Tax Reform Working Group: Final Report” (Washington: U.S. Senate Finance Committee, 2015).

<sup>vi</sup> Alan Auerbach and Joel Slemrod, “The Economic Effects of the Tax Reform Act of 1986.” *Journal of Economic Literature* 35 (1997): 589-632.