



Policy Paper

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Redesigning the Tax Code for a New Generation

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EXECUTIVE SUMMARY

At nearly 75,000 pages, including all the guidelines, the federal tax code is perhaps the most onerous thing ever spawned by government. Around every 32 years it seems (1922, 1954, 1986), Congress implements broad-based, large-scale tax reform. Now in 2017 – or 2018 – it is ripe for the same to happen once again. We believe that today presents an important opportunity for Congress and President Trump to take bold, dramatic steps to redesign our nation’s complex tax system.

It is important that Congress complete meaningful tax reform that embodies certain cornerstone principles. Tax reform must lower the burden on taxpayers by both reducing rates and collapsing brackets; it must simplify the code by limiting double taxation and increasing neutral treatment; it must broaden the base; and it must promote a territorial system. Tax reform, therefore, must *not* be temporary like 2001 or 2003. Although the so-called “Bush tax cuts” were targeted, pro-growth policies, they largely consisted of tax rate cuts and tax rebates. There was no real reform – no reductions in the number of brackets, no wide-scale elimination of deductions and loopholes, no broadening of the tax base and no simplification of the code. Make no mistake: tax rate cuts are better than the status quo, but they should not be confused with substantial tax reform.

Congress is currently processing options for changing our nation’s tax code through the *Tax Cuts and Jobs Act*. The House of Representatives and the Senate each have similar pieces of legislation that differ in several significant ways. Both propose changes on the individual and business tax fronts, and would likely result greater economic growth, higher wages, and more jobs for Millennials and others in the economy. However, neither version of the *TCJA* would take sufficient steps to preclude Congress from having to once again undergo the same process 32 years from now.

In this paper, we present several basic principles for tax reform before offering a comprehensive evaluation of many of the provisions included in both *TCJA* variations. Subsequently, we offer an alternative proposal, “The 2050 Plan,” that would undertake a bold and momentous redesigning of the nation’s tax code from the bottom up to dramatically boost prosperity and preclude the need to return to tax reform once again in 2050 – which is precisely what Millennials need most.

Section One: Establishing Guiding Principles for Tax Reform

Criteria for an Efficient, Fair, Growth-Oriented, Limited Tax System

When Congress and the president act on a legislative priority, they do so with certain goals in mind. Yet those objectives often lack specific *principles* to guide their approach in achieving said goals. In reshaping the tax code, we believe there are several crucial principles that policymakers must keep in mind for the new Millennium.

The Role of Taxation in a Free Society

Ultimately, taxation in a free society should be fair to those from which the tax is drawn. The 19th Century philosopher-economist Frédéric Bastiat provides guidance on taxation in a free society. In his 1850 writings *The Law* and *That Which Is Seen, and That Which Is Not Seen*, Bastiat addresses taxation in two different ways. He posits that taxation must offer value for value, principally in exchange for justice and defense. All else is plunder. Bastiat observes:

[I]f you wish to create an office, prove its utility. Show that its value to James B., by the services which it performs for him, is equal to what it costs him. But, apart from this intrinsic utility, do not bring forward as an argument the benefit which it confers upon the official, his family, and his providers; do not assert that it encourages labour. When James B. gives a hundred pence to a Government officer, for a really useful service, it is exactly the same as when he gives a hundred sous to a shoemaker for a pair of shoes.¹

Yet Bastiat cautions that the law can be abused to assess taxes for invasive purposes:

Nothing can enter the public treasury for the benefit of one citizen or one class unless other citizens and other classes have been forced to send it in. If every person draws from the treasury the amount that he has put in it, it is true that the law then plunders nobody. But this procedure does nothing for the persons who have no money. It does not promote equality of income. The law can be an instrument of equalization only as it takes from some persons and gives to other persons. When the law does this, it is an instrument of plunder. With this in mind, examine the protective tariffs, subsidies, guaranteed profits, guaranteed jobs, relief and welfare schemes, public education, progressive taxation, free credit, and public works. You will find that they are always based on legal plunder, organized injustice.²

Bastiat offers wisdom on the role of taxation in a free society, noting that its purpose to raise revenue for the fundamental functions of government may transcend their appropriate scope. However, we do not mean to argue for the overall elimination of government's contemporary role in providing a hand up to the indigent. Indeed, in accordance with the social contract among man, society, and state, government is obliged to fulfill certain basic functions, and a plausible case can certainly be made for government assistance to the needy on some level. Yet Bastiat's words are still instructive that there are limits to taxation – and that it can become abusive to the point that it violates the fundamental tenets of a free society.

Fundamental Principles of Tax Reform

We believe that there are several core principles that must guide any meaningful tax reform effort. Tax reform *lowers the burden* on taxpayers by slicing rates and reducing brackets; it does not simply cut rates. Tax reform *simplifies the code* by eliminating deductions and loopholes, *limiting or ending double taxation* and *increasing neutral treatment*; it does not add to its complexity or contribute to government's propensity to pick winners and losers. Tax reform *broadens the base*, meaning that more Americans

have some skin in the game; it does not maintain the status quo. And finally, tax reform *promotes a territorial system*; it does not discourage repatriation of profits from overseas.

Simplified Tax Code

“Searching for simplicity” must be one of the central missions of meaningful tax reform. If government’s primary purpose is to serve the interests of the people, its actions and its laws must be comprehensible to the people. The code today is extraordinarily complex, causing the majority of Americans to barely understand how they are taxed. This confusion is simply not acceptable. A simplified tax code must be one of the most fundamental goals of comprehensive tax reform and a core component of a fair and decent tax code.

Low Burden and Rates

One of the most widely-accepted notions about tax reform is that its objective should be a code that establishes low rates and inflicts a low burden on taxpayers. This is essential for a free society for two key reasons. First, at a basic level, individuals should be able to keep most of what they earn, because it is the fruits of *their* labor or risks taken with *their* capital investments. Second, the ability to keep one’s earnings promotes added incentive to produce even greater output or to invest in new enterprises, promoting greater economic growth and opportunities for more individuals.

Broaden the Base

Today, tax deductions, exclusions, and other special tax treatments make it so that large portions of economic consumption are not part of the tax base. To broaden the base means to raise revenue by ending all tax preferences and increasing the amount of economic activity that is subject to full taxation. In such a system, federal taxes would be imposed on *all* economic activity. “[B]roadening the tax base can raise the necessary revenue to cut federal tax rates without increasing the deficit.”³

Neutral Treatment

The neutral treatment of all people being taxed is paramount to solid tax reform. Neutral treatment (tax neutrality) means that the government does not and should not use the tax code to pick winners and losers through various preferences like deductions, exclusions, and credits. Tax neutrality limits distortions in the economy and ensures a level playing field among different industries. The goal is for businesses and individuals to make decisions based on economic merits and not particular tax benefits, with taxes influencing economic decisions as rarely as possible.

Territorial System

A territorial tax system taxes business solely on income they earn inside a given country’s borders, irrespective of where its headquarters are located. The United States currently has a worldwide tax system, whereby business income is taxed at the U.S. rate irrespective of where it is earned—here or overseas—but maintains a territorial system for foreign-owned companies. Switching to a territorial tax system across the board, as a basic principle of taxation, levels the playing field with foreign competitors who do not operate under a worldwide tax system like the United States. It fosters greater competitiveness of American businesses.

No Double Taxation

Double taxation occurs when income taxes are “paid twice on the same source of earned income. It can occur when income is taxed at both the corporate level and personal level.”⁴ Double taxation is an unjust concept because it presumes that a dollar earned can, and should, be taxed two times over based on the circumstances – and in particular, if the intention is to reuse that dollar for savings and investment. As economist Daniel J. Mitchell observed in 2011, it breaks down thus:

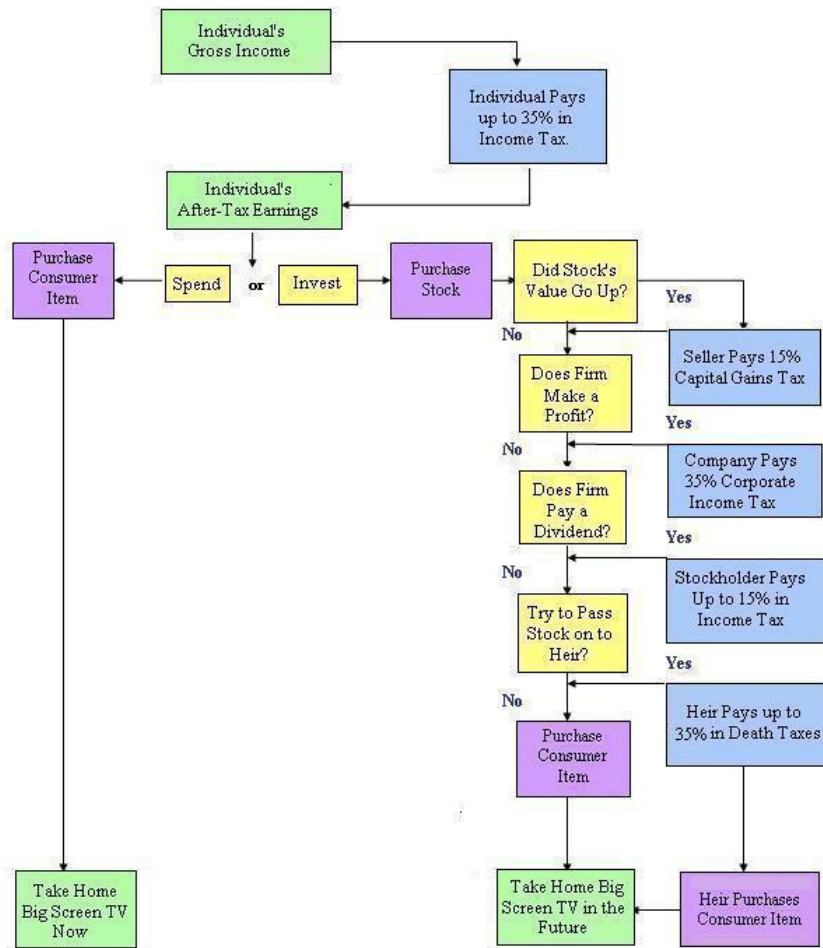


Figure 1

1. We earn income.
2. We then pay tax on that income.
3. We then either consume our after-tax income, or we save and invest it.
4. If we consume our after-tax income, the government largely leaves us alone.
5. If we save and invest our after-tax income, the government penalizes us with as many as four layers of taxation.⁵

In short, double taxation represents a government-dictated bias against one form of economic activity that it deems of less value, distorting the market and weakening investment.

Limited government

There should be meaningful limits on the government's ability to tax. At the core of this principle lies the precepts laid out in the role of taxation in a free society. If and when government's taxation powers transcend its rightful authority to tax, this violates the principle of limited government.

Section Two: Evaluating the Republican Tax Reform Plans

Assessing the House and Senate Variations of the Tax Cuts and Jobs Act

As Millennials enthusiastic for economic opportunity in the short-term and sustainable growth in the long-term, we are encouraged by much of the *Tax Cuts and Jobs Act (TCJA)* before the United States Congress. The different variations being considered by the House of Representatives and the Senate envision a system which in many ways meets the principles set forward in the previous section. However, they also miss the mark in some key areas. We examine many of the principle individual and business tax components of the bills below.

Collapsing Personal Exemptions into a Larger Standard Deduction

Currently there are two primary options for taxpayers when it comes to deductions for personal income tax purposes: they may take a standard deduction, or they may itemize their deductions. Generally, the standard deduction in 2017 was \$12,700 for married couples filing jointly and surviving spouse filers, \$9,350 for head of household filers, and \$6,350 for other single filers and married filers filing separately, indexed for inflation.⁶ A 2017 personal exemption was also allowed for taxpayers, spouses, and dependents which amounted to \$4,050, indexed for inflation and phased out for taxpayers with higher incomes.

Both versions of the *TCJA* collapse all personal exemptions for taxpayers and spouses with the existing standard deduction into a new standard deduction. In the House bill, this would amount to \$24,400 for married taxpayers filing jointly and \$12,200 for single filers in tax year 2018. The Senate bill makes these amounts \$24,000 and \$12,000, respectively. Both essentially “double the standard deduction.” The provision in the Senate proposal, however, would expire after December 31, 2025. We object to this idea and believe that the measure should be made permanent.

There is broad agreement from a variety of policy analysts that collapsing exemptions and doubling the standard deduction are good policy moves to simplify and streamline the individual tax code. For instance, a December 2016 paper for the left-leaning Tax Policy Center essentially recommends both and provides calculations to justify their numbers.⁷ The authors figure that the standard deduction for a single filer, as an example, of \$6,350 would be added to the eliminated personal exemption of \$4,050 and the eliminated additional standard deduction for age or blindness of \$1,550. In turn, they suggest a new standard deduction of \$11,950 – not far below the Republican proposals’ levels. This level is also very close to parity with the poverty level for a single individual, creating a “zero tax bracket” of income exempt from taxation for the poorest in the United States. As the TPC paper points out, “Fewer standard deduction amounts will reduce complexity, remove inequities, and mitigate marriage penalties.”

Restructuring and Collapsing the Individual Tax Brackets

Coupled with the above, restructuring and collapsing the seven existing individual tax brackets is a strategic, pro-growth strategy that will benefit all Americans through a simpler code, lower rates, and a smaller burden on the American people. We generally favor this approach, which the House variation *attempts* to do but the Senate bill decidedly does not.

The Senate bill would maintain seven rates as follows: 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 38.5 percent. These rates would revert to their current levels after December 31, 2025, a policy that we oppose. The House bill, on the other hand, would more-or-less collapse the seven brackets to four. First, it would eliminate the 10 percent tax bracket and reduce the 15 percent rate to 12 percent, offering an effective marginal tax rate cut to all Americans

but especially benefiting the struggling middle class. Second, it would collapse the 33 percent and 28 percent brackets into a single 25 percent rate. It would also maintain the 35 percent rate.

Under significant political pressure, however, Republican leadership has decided to maintain the top marginal tax bracket of 39.6 percent for the wealthiest Americans. Furthermore, they have included a “bubble tax,” or surcharge, bracket of 45.6 percent for millionaires to “claw-back,” or phase out, the 12 percent bracket so that the government can secure otherwise “lost” revenue to help pay for the deficit score – an estimated \$50 billion over the next decade.⁸ This bracket exists from approximately \$1 million to \$1.2 million for single filers and \$1.2 million to roughly \$1.6 million for married couples filing jointly. Coupled with the elimination of most itemized deductions, including the state and local income tax deduction and capping of the mortgage interest deduction (all of which we support, as discussed below), this may increase the load on those who already shoulder most of the federal income tax burden.

We object to the 39.6 percent rate for two key reasons. First, it violates the principles of simplicity, a low rate, and limited government. The preservation of an additional bracket is counter to the goal of simplifying the code to as few tax brackets as possible. Moreover, by eliminating itemized deductions, as proposed and discussed below, the wealthiest among us would be hard-hit – further justifying a tax rate reduction. Finally, to maintain an additional tax bracket simply because the wealthier an individual is, the more they can pay, violates the precept of limited government. It immediately subscribes policymakers to the belief that the greater success one has means they should carry a greater burden. We dispute this premise at a fundamental level.

The second reason why an additional tax bracket for the wealthy is simply bad policy is because it does not promote overall economic growth. The wealthier an individual is, the more likely they are to invest in and create new businesses and to contribute to charitable causes. In doing so, they expand the economic “pie,” promoting higher wages and greater economic growth. To encourage growth, a tax rate *reduction* to (at most) 35 percent for the highest marginal rate makes sense.

Our opposition to the 39.6 percent rate is, for these stated reasons, even more emphatic for the 45.6 percent bubble rate. We find the surcharge to be a perverse approach to governing and a punitive disincentive to productivity and economic growth. Simply because millionaires can contribute more to the tax base does not mean that they should be penalized simply for their ability to do so. The Senate bill does not include a “bubble tax” and actually cuts the top rate to 38.5 percent.

The tables below lay out the tax brackets and rates for single individuals and married couples filing joint returns for both the House and Senate proposals.

Proposed Tax Brackets and Rates Under *Tax Cuts and Jobs Act*

HOUSE BILL: PROPOSED SINGLE TAXABLE INCOME BRACKETS AND RATES (2018)

TAX RATE	TAXABLE INCOME BRACKET	TAX OWED
12 PERCENT	\$0 - \$45,000	12% of Taxable Income
25 PERCENT	\$45,000 - \$200,000	\$5,400 plus 25% of the excess over \$45,000
35 PERCENT	\$200,000 - \$500,000	\$44,150 plus 35% of the excess over \$200,000
39.6 PERCENT	\$500,000 - \$1,000,000	\$149,150 plus 39.6% of the excess over \$500,000
45.6 PERCENT “BUBBLE BRACKET”	\$1,000,000 - \$1,207,000	\$347,150 plus 45.6% of the excess over \$1,000,000
39.6 PERCENT	\$1,207,000+	\$441,542 plus 39.6% of the excess over \$1,207,000

HOUSE BILL: PROPOSED MARRIED FILING JOINT TAXABLE INCOME BRACKETS AND RATES (2018)

TAX RATE	TAXABLE INCOME BRACKET	TAX OWED
12 PERCENT	\$0 - \$90,000	12% of Taxable Income
25 PERCENT	\$90,000 - \$260,000	\$10,800 plus 25% of the excess over \$90,000
35 PERCENT	\$260,000 - \$1,000,000	\$53,300 plus 35% of the excess over \$260,000
39.6 PERCENT	\$1,000,000 - \$1,200,000	\$312,300 plus 39.6% of the excess over \$1,000,000
45.6 PERCENT	\$1,200,000 - \$1,614,000	\$391,500 plus 45.6% of the excess over \$1,200,000
"BUBBLE BRACKET"		
39.6 PERCENT	\$1,614,000+	\$580,284 plus 39.6% of the excess over \$1,614,000

SENATE BILL: PROPOSED SINGLE TAXABLE INCOME BRACKETS AND RATES (2018)

TAX RATE	TAXABLE INCOME BRACKET	TAX OWED
10 PERCENT	\$0 - \$9,525	10% of Taxable Income
12 PERCENT	\$9,525 - \$38,700	\$952.50 plus 12% of the excess of \$9,525
22 PERCENT	\$38,700 - \$70,000	\$4,453.50 plus 22% of the excess over \$38,700
24 PERCENT	\$70,000 - \$160,000	\$11,339.50 plus 24% of the excess over \$70,000
32 PERCENT	\$160,000 - \$200,000	\$32,929.50 plus 32% of the excess over \$160,000
35 PERCENT	\$200,000 - \$500,000	\$45,739.50 plus 35% of the excess over \$200,000
38.5 PERCENT	\$500,000+	\$150,739.50 plus 38.5% of the excess over \$500,000

SENATE BILL: PROPOSED MARRIED FILING JOINT TAXABLE INCOME BRACKETS AND RATES (2018)

TAX RATE	TAXABLE INCOME BRACKET	TAX OWED
10 PERCENT	\$0 - \$19,050	10% of Taxable Income
12 PERCENT	\$19,050 - \$77,400	\$1,905 plus 12% of the excess over \$19,050
22 PERCENT	\$77,400 - \$140,000	\$8,907 plus 22% of the excess over \$77,400
24 PERCENT	\$140,000 - \$320,000	\$22,679 plus 24% of the excess over \$120,000
32 PERCENT	\$320,000 - \$400,000	\$65,879 plus 32% of the excess over \$290,000
35 PERCENT	\$400,000 - \$1,000,000	\$91,479 plus 35% of the excess over \$390,000
38.5 PERCENT	\$1,000,000+	\$301,479 plus 38.5% of the excess over \$1,000,000

Eliminating Deductions and Scaling Back Credits

Both variations of the *TCJA* eliminate most itemized deductions, but they differ in certain areas. While both maintain the home mortgage interest deduction, the House bill halves the deductible value of a home loan from \$1 million to \$500,000, while the Senate bill maintains the \$1 million deductibility. Each version maintains the charitable deduction as well. Both variations eliminate the deductibility of state and local income taxes, but differ in that the House version maintains the property tax deduction (capped at \$10,000) while the Senate bill does not. We agree with the premise of eliminating itemized deductions, but we would take it one step further to eliminate *all* deductions – including mortgage interest, charitable giving, student loan interest, and state and local tax deductions entirely.

Below we address the overall case for eliminating individual deductions and focus in on three key deductions: state and local taxes, home mortgage interest, and charitable contributions. We also address the overall case for eliminating or consolidating tax credits and concentrate on three key

areas that especially impact Millennials: the child tax credit, a paid leave tax credit, and higher education tax benefits.¹

Eliminating Individual Deductions

Some of the most significant and perverse complexities in the individual tax code include the various individual deductions. Deductions violate the principles of simplicity and neutral treatment, while making it more challenging to lower rates across the board. A tax deduction (or exemption) works by reducing a taxpayer's final tax liability within an individual's marginal tax rate. For instance, someone in a 25 percent tax bracket would save \$0.25 for every marginal tax dollar they deduct.

Tax deductions are considered by the IRS to be “tax expenditures.”⁹ Unlike cuts in tax rates, which allow taxpayers to keep more of their money, a tax expenditure is circumstantial. That is, it is conditional upon whether the taxpayer engages in specific behavior approved of by the government. For example, to take advantage of the charitable deduction, someone must give to a tax-qualified nonprofit. It is not simply about letting people “keep more of their hard-earned money” – it is virtually paying them back for specific behavior *deemed acceptable by the government*.

Moreover, it is demonstrably clear that the ability to itemize deductions is an option elected predominantly by wealthier taxpayers who see less benefit in utilizing the standard deduction, making it more difficult to lower overall rates. For these reasons, the *TCJA* variations are right to, at the very least, advocate for the elimination of most of these tax breaks. According to 2015 IRS data, 69.0 percent of all tax return filers claimed a standard deduction, while taxpayers itemized their deductions on 29.6 percent of all returns filed. The IRS calculated that, while greater than two thirds of filers claimed the standard deduction, itemizers totaled “58.3 percent of the total deduction amount of the year.”¹⁰ As the Tax Foundation observed in 2016, “the higher a household's income, the more likely it is to itemize deductions. Only 6.0 percent of tax returns with under \$25,000 in income chose to itemize deductions in 2013. On the flip side, 93.5 percent of tax returns with over \$200,000 in income were itemizers.”¹¹

It is important to note here that the Senate proposal's provisions eliminating specified itemized personal deductions would expire after December 31, 2025, along with the expiration of the tax rate cuts and standard deduction. This is deeply concerning, and we oppose such a measure.

Eliminating the Deduction for State and Local Taxes

Since the federal income tax went into effect in 1913, taxpayers have been able to deduct the state and local income and property taxes they pay, along with interest they get from owning state or local bonds. This State and Local Tax (SALT) deduction is a tax expenditure which subsidizes higher-tax states at the expense of lower-tax states in the form of higher federal tax rates. Last month, analysts at the Heritage Foundation released a report detailing the affirmative case for SALT's elimination:

By requiring higher federal marginal tax rates to replace lost revenue, the state and local tax deduction further severs the link between taxes paid and services received, forcing all federal taxpayers to pay, in part, for services provided to residents of other states. Moreover, the deduction on interest from state and local bonds distorts infrastructure spending decisions and makes it easier

¹ It is important to note that tax-advantaged programs like health savings accounts and 401(k) plans will be untouched and that many tax credits will remain in place. For example, the bill envisions consolidating the personal exemptions for children and dependents into an expanded tax credit and a new family tax credit. By way of simplifying the tax code and promoting neutral treatment in most areas, we generally believe that policymakers should eliminate or consolidate most tax existing tax credits, and that new tax credits should not be created.

for states to accumulate debt, which could harm state economies and result in requests for federal bailouts... We estimate that by replacing the state and local tax and bond interest deductions with a revenue-neutral and distribution-neutral reduction in marginal tax rates, policymakers could reduce federal tax rates by as much as 16.4 percent and an average of 7.3 percent. Alternatively, without maintaining distributional neutrality and instead focusing on middle-class tax cuts only, marginal income tax rates for the three middle-income brackets could decline by an average of 13.3 percent.¹²

The Tax Foundation reports that, over the next decade, the SALT deduction (tax expenditure) will cost the federal government \$1.8 trillion. Fewer than 22 percent of filers claim SALT and, as with itemized deductions generally, these individuals are disproportionately wealthy. Of those making more than \$200,000, 78 percent claim the deduction, but only seven percent of those earning between \$30,000 and \$40,000 annually do. Furthermore:

The Joint Committee on Taxation calculates that for those earning more than \$200,000, the SALT deduction cuts their federal tax bill by an average \$6,295. For those with incomes of between \$100,000 and \$200,000, it's just \$857. Those earning from \$30,000 to \$40,000 get an average of \$93 off their federal tax bill. As a result, 88% of the \$1.8 trillion cost of this tax break goes to the 10% of families with incomes above \$100,000.¹³

Unfortunately, while the House version of the *TCJA* eliminates most of the state and local tax deduction, it maintains up to \$10,000 of the property tax deduction. For the reasons discussed above, as well as the purposes of simplification, neutral treatment, and reducing rates across the board, we agree with the Senate version and favor the complete abolition of both the state property tax *and* income tax deductions.ⁱⁱ

Eliminating the Deduction for Home Mortgage Interest

A centerpiece of the “American Dream” for generations, homeownership has long been deemed worthy of government encouragement. However, the home mortgage interest deduction is not only inefficient and ineffective, but it has proven to be very costly.

In fact, a recent paper for the National Bureau of Economic Research found that such a deduction does not encourage taxpayers to buy a home in the first place; rather, it simply encourages wealthier taxpayers to purchase bigger, more expensive homes.¹⁴ As with so many tax deductions, the Reason Foundation also concludes that this tax expenditure primarily benefits wealthier taxpayers making \$100,000 or above; only one-fourth of all taxpayers claimed this deduction.¹⁵ Furthermore, in fiscal year 2016 the deduction was estimated to cost the federal government \$77 billion – which could otherwise go toward lowering overall rates.¹⁶ In addition, the Reason Foundation found that the deduction is a “fairly ineffective tool for increasing homeownership” because:

those households that rent but would prefer to own a home – if they had just a bit more financial flexibility – are typically low income families. As such, even if they bought a home, they would be much less likely to itemize their deductions and unlikely to claim the MID. As a result, rather than increasing the homeownership rate, the primary impact of the MID is to increase the amount spent on housing by consumers who would choose to own anyway, subsidizing spending on housing rather than homeownership.¹⁷

While the Senate bill leaves this deduction intact, the House version touches the provision. The House *TCJA* sees the inherent issue with this deduction in the current system and attempts to get at the challenge in the new proposal, which limits this deduction to \$500,000 of the principal for new

ⁱⁱ Both bills do maintain the SALT deduction for taxes paid or accrued in carrying on a trade or business. Here we are only addressing the personal side, however.

home loan purchases, down from \$1 million, with existing loans grandfathered in. This is a welcome improvement, but it does not go far enough. Eliminating altogether the inefficiency, ineffectiveness, and costliness of the home mortgage interest deduction would discourage economic distortions and increase the capacity for government to lower overall rates, which is truly the dynamic boon for the economy.

Eliminating the Deduction for Charitable Contributions

The deduction for charitable contributions, in place since 1917, is sacrosanct because of the false presumption that a tax deduction for charitable giving necessarily means that giving to nonprofit organizations goes up. The connection between the two is tenuous at best.

The deduction does little to encourage donations to charity, adds a layer of complexity to the tax code, and the IRS reports that it will cost the federal government over \$60 billion in fiscal year 2018.¹⁸ Moreover, as the deduction is a tax expenditure, government is effectively subsidizing charities that may or may not be the types of programs that could or would be supported by federal funds and with taxpayer support. Why should taxpayers be subsidizing organizations and ideas with which they may not agree?

Furthermore, it is worth noting that the primary beneficiaries are, once again, the wealthiest among us. The Pew Research Center noted in 2016 that two-thirds of the deduction benefits households making above \$200,000.¹⁹ Some might argue that this is precisely why we should maintain the deduction: because the wealthiest are better-suited to contribute and, because of the tax deduction, more likely to contribute. But we suggest that lower rates would boost giving more.

In his 2017 book *A Fine Mess: A Global Quest for a Simpler, Fairer, and More Efficient Tax System*, the reporter T.R. Reid recounts that, in 1986, nonprofit organizations “predicted a disastrous drop” in giving when the top tax rate was cut from 50% to 28%. A lower tax rate, they thought, would make the charitable deduction less valuable. Instead of getting \$500,000 back from a charitable deduction, the rich would only get \$280,000. In the end, researchers found that lowering the tax rate had only a small negative effect on giving, limited to the most wealthy philanthropists. It turned out that donors are not quite as sensitive to tax benefits as many researchers thought.²⁰

To simplify the tax code, limit distortive behaviors, and help justify lower rates for *all*, we advocate for the outright elimination of the deduction for charitable contributions.

Eliminating or Consolidating Tax Credits

Like tax deductions, tax credits are also tax expenditures. The key difference, however, is that taxpayers can subtract tax credits from their tax liability dollar-for-dollar, making them more favorable than tax deductions or exemptions and more likely to influence behavior. Thus, a credit offered to an individual in a 20 percent tax bracket would reduce the tax liability by a full \$1.00. In addition, there are two types of tax credits. Whereas nonrefundable tax credits offer a refund only up to the amount an individual owes for taxes, a refundable tax credit provides a refund even if it is more than what a taxpayer owes, regardless of their income or tax liability.

According to the IRS, there are 20 separate tax credits directed to individuals in five categories: family and dependents, health care, income and savings, education, and homeowners. The voluminous number of credits complicates the tax code and often, such as in the case of education tax credits, requires that individuals evaluate various factors to determine which credit(s) they qualify for and should apply to their tax returns. Moreover, by attempting to dictate certain behaviors, tax credits explicitly violate the tenet of neutral treatment and make it more difficult to lower tax rates

across the board, which would benefit all, and to broaden the tax base. For these reasons, tax credits should be consolidated and eliminated wherever possible.

Eliminating the Child Tax Credit

Both the House and Senate versions of the *TCJA* rightly eliminate the personal exemption for dependents (valued at a phased-out amount of \$4,050 per child under the age of 19) and enhance the child tax credit (CTC) (currently valued at a nonrefundable, phased-out amount of \$1,000 per child under the age of 17) in its place. Although eliminating the child exemption is a favorable move, we oppose enhancing the child tax credit and instead endorse lower tax rates than proposed.

While both versions of the *TCJA* eliminate this personal exemption, the House bill replaces it with an expanded child tax credit from \$1,000 to \$1,600. The bill also increases the phase-out threshold from \$75,000 to \$115,000 for single filers and \$115,000 to \$230,000 for married filers. It makes the first \$1,000 of the credit refundable and increases it with inflation; it also boosts the tax credit by \$600, but that portion is not refundable – meaning that it will not impact lower-income families that arguably would benefit the most from a tax credit.ⁱⁱⁱ

The Senate bill increases the tax credit, doubling it to \$2,000. The version makes the first \$1,000 refundable and indexes it to inflation, increases the eligibility age to 18, and begins to phase out at \$1 million for married taxpayers filing jointly and \$500,000 for all other taxpayers. The Senate version's \$1 million phaseout provision is more-or-less a universal subsidy, including a large number of taxpayers that do not need the costly assistance. The changes would sunset after 2025, however.

The estimated cost of the House bill's child tax credit expansion, coupled with the family tax credits, is \$640 billion.²¹ Although a refundable tax credit might appear on paper to take a load off for Millennials and others with growing, young families, we would all be better served by the short- and long-term benefits that would come from saving the \$640 billion and directing those funds toward lower tax rates across the board instead.

In a 2013 study, the Tax Foundation found that, subject to the elimination of the existing CTC, “rates could be lowered 4.8 percent (for example, the 15 percent bracket would become 14.3 percent)...[Trading the CTC] for lower rates would boost GDP by a net \$90 billion and federal revenue by a net \$21 billion, once the economy had fully adjusted. The higher GDP and pre-tax incomes would partially offset the loss of the tax credit for low-income households, although the net effect would be less redistribution.”²²

Under this model, the proposed House GOP rates, for example, could be further reduced to 11.4 percent, 23.8 percent, and 33.3 percent, respectively. The model did not consider, however, the elimination of the personal exemption for children, but presumably there would be similar economic effects. Consequently, we believe that the rates could be appropriately rounded down to as low as 11 percent at the low end, 23 percent at the mid-level, and 33 percent for the top marginal rate.

Paid Leave Tax Credit

There has also been a new proposal in the Senate legislation which would permit a tax credit for businesses that offer at least two weeks of paid family and medical leave to full-time employees each

ⁱⁱⁱ It is worth mentioning here that the *TCJA* also creates two different, nonrefundable family tax credits expiring after five years and valued at \$300 each. The income thresholds are identical to the child tax credit. The first family tax credit is for nonchild dependents (over age 17), such as a disabled adult or an elderly parent. The second is a credit for each spouse filing jointly or a head of household for a single filer. We find that this tax credit has no useful utility.

year. This tax credit would be equal to 12.5 percent of the amount of wages paid to an employee if the employee is earning no less than 50 percent of their normal pay. The tax credit would rise by 0.25 percent for every percentage point that the payer pays above the 50 percent wage replacement, up until a maximum of 25 percent. Qualifying employees must earn less than \$72,000. While the concept is supportive of lower-income and middle-class families in theory, it is likely to be a costly tax expenditure that will make it more difficult to lower rates. Furthermore, it adds another entitlement and layer of complexity into the code that will be difficult, if not impossible, to remove in the future once people have become reliant upon it.

Consolidating or Eliminating Higher Education Tax Benefits

The *TCJA* also addresses the existing provisions in the tax code that relate to higher education financing, specifically impacting the Lifetime Learning Tax Credit, Hope Scholarship Tax Credit, and American Opportunity Tax Credit. It also impacts the Student Loan Interest Deduction and the expired Tuition and Fees Deduction. In a policy paper published earlier this year, Millennial Policy Center President Jimmy Sengenberger addressed these tax benefits for higher education, making the case for the consolidation or elimination of each.

Like the birth of other student aid programs, these tax credits were intended to help make it more possible for lower-income individuals to attend college. However, a 2006 working paper by the National Bureau of Economic Research, which analyzed the behavioral effects of such credits, concluded that the credits did not make it more likely that a student would attend college. Instead, those who primarily benefited from the program were found to be those who were already likely to go to college.²³ Indeed, tuition tax credits “provide tax savings only if students attend college, increasing the demand for college and thus college prices, defeating some of the benefit of the tax credit.”²⁴

...Congress should at the very least consolidate the three higher education tax benefits into one, single tax credit, as Florida Senator Marco Rubio and former Congressman Aaron Schock of Illinois proposed... And yet, given the costs to taxpayers, the failure of these tax credits to help constrain costs, and their apparent role in stimulating greater costs, it makes far more sense to eliminate all the higher education tax incentives altogether. Therefore, while there are advantages to at least consolidating tax benefits into one, single credit, it is preferable to do away with tax credits and deductions altogether.

In fact, the House *TCJA* implements many of the above proposals. First, it does away with the Deduction for Education Expenses by declining to renew the Tuition and Fees Deduction and rescinds the Student Loan Interest Deduction. Under current law, borrowers working to pay off their student loans can deduct up to \$2,500 in interest paid on those loans. This means that the maximum a graduate can subtract from his or her tax liability thanks to this deduction works out to \$625. The average savings is just \$202, according to an American Enterprise Institute analysis.²⁵ Millennials constitute the majority of student loan borrowers today.

According to ValuePenguin, those in their 20s or 30s account for almost 65 percent of all student loan debt in 2017, yet make an average salary of less than \$40,000 per year.²⁶ In other words, most Millennials are paying a lower marginal rate and aren’t likely benefiting much from the deduction anyway. Meanwhile, chances are strong that they are taking the standard deduction, as 69 percent of taxpayers do, and will therefore gain much more from the doubling of the standard deduction under the tax reform plan than they will lose from the disappearance of this tiny deduction.

Second, the bill eliminates the Lifetime Learning Credit. Instead, it maintains the refundable American Opportunity Tax Credit (AOTC) and it makes the AOTC a five-year tax credit. The AOTC allows students to get up to \$2,500 back if they spend \$4,000 on tuition and fees, but the

TCJA would extend the credit for an additional fifth year, making it available for \$1,250 (half of the value for the previous four years).

Single filers earning less than \$90,000 or married taxpayers filing jointly and earning less than \$180,000 are eligible for the AOTC. This multipronged approach to consolidate higher education tax incentives is a step in the right direction, although including support for a fifth year does not make strong financial sense for taxpayers in the long-run.

Unfortunately, the Senate bill does not take these steps. We hope the final legislation includes these measures in exchange for lower rates, despite the political challenge of such a step.

Eliminating the Death and Generation-Skipping Transfer Taxes

The death tax taxes an individual's ability to transfer property after his or her death. If a deceased individual's gross estate exceeds the exempt amount (\$5.49 million in 2017), an estate tax return must be filed. The generation-skipping transfer tax (GST) is a tax on transfers to generations that are at least twice removed. Both are variations of the estate tax, along with the gift tax (a tax on wealth transfer that takes place during life).

According to the Tax Foundation, the overall estate tax (including all three components) is the smallest revenue source out of any major U.S. tax – and the charitable deduction, along with “stepped up basis” asset valuations, enable taxpayers to avoid the tax. Consequently, the Tax Foundation finds that revenue gained from the tax is “largely illusory, as lost revenue from estate tax repeal would be made up in other areas of the tax code.”²⁷ They further note that studies cast doubts on the case that inheritance drives income inequality and that the estate tax promotes equity.

The economic effects of the estate tax, in all its forms, is to discourage savings and investment by wealthy individuals and to encourage short-term consumption, which is less beneficial to the economy in the long run. The death tax in particular hurts many family-owned businesses like farms and manufacturing companies that may appear especially valuable on paper because they are high on assets but low on cash-on-hand. Since their assets are illiquid and needed to generate income and pay for expenses, when a family member dies, the death tax requires the business to sell some of its assets to cover the tax liability. This is fundamentally unjust and may result in lost jobs, depressed wages, or decreased capacity to hire new workers or boost wages for existing employees.

For these reasons, and because the estate tax is double taxation and penalizes saving and investment, the death tax should be eliminated in all its forms. The House *TCJA* does this, but unfortunately it simply increases the exemption to \$10 million, indexed for inflation, and delays the repeal until 2024. The Senate proposal, on the other hand, does not abolish the tax; rather, it doubles the exemption to \$11.2 million to provide “relief” for taxpayers. We disagree with both approaches, and favor the outright and immediate abolition of the death tax.

Eliminating the Alternative Minimum Tax

The Alternative Minimum Tax (AMT) was put in place to make sure that high-income households paid at least some income tax, yet it now impacts nearly five million income tax filers, “most of whom already pay significant amounts of income tax and are far from the top of the income distribution.”²⁸ The AMT requires that many taxpayers calculate their tax liability two times over, under two separate rules: one for the regular income tax and one under AMT rules. Then, they are to pay whichever amount is higher.

Given its inherent complexities, the frequent historical need to “fix” the AMT, and its wide burden on not only the wealthiest Americans but also a great many middle-class taxpayers, institutions ranging from the Tax Policy Center²⁹ to the Heritage Foundation³⁰ have called for significant reforms to or the outright elimination of the tax. While acknowledging that it will likely result in a revenue decrease of up to \$30 billion annually on a static scoring basis, we agree with both bills’ elimination of the AMT in favor of a simpler, less burdensome tax code. We disagree, however, with the Senate provision that would reinstate the AMT after December 31, 2025.

Zeroing the Obamacare Individual Mandate

One positive thing that the Senate proposal includes that the House bill does not is the zeroing of the *Affordable Care Act*’s individual mandate tax. In Senate Finance Committee Chairman Orrin Hatch’s press release, he noted that, “According to the [IRS], nearly 80 percent of Americans who paid the penalty in 2015 made less than \$50,000. According to the Joint Committee on Taxation (JCT), reducing the individual mandate tax penalty to zero will raise \$318 billion over 10 years – money that can be used to provide further tax relief to American families.”³¹ The CBO similarly scores the repeal as resulting in an estimated \$338 billion in deficit savings over the 2018-2027 period, because of a projected 13 million-person increase in the number of uninsured who will no longer be forced to purchase insurance.³²

In addition, our healthcare team at the Millennial Policy Center observed in a policy paper earlier this year that the individual mandate has failed – especially among Millennials. They noted:

In the fall of 2016, an estimated 27 million individuals still lacked insurance. A survey by the Kaiser Family Foundation found that the number one reason why individuals remain uninsured is because health insurance is too expensive.³³ Indeed, a 2016 study by the Centers for Disease Control (CDC) shows that adults between the ages of 25 and 34 are among the highest rate of uninsured in the U.S.³⁴

Most Millennials realize it makes more financial sense to pay the individual mandate rather than pay for insurance under Obamacare. The average Obamacare plan in 2017 costs \$3,624 in annual premiums; roughly 520 percent more expensive than the tax penalty.³⁵ A report by the American Action Forum finds that 62 percent of Millennials in 2016 found it “financially advantageous to forego health coverage, and instead pay the mandate penalty and cover their own healthcare costs.”³⁶

The failure and burdens of the individual mandate alone justify its repeal.

Reducing the Corporate Tax Rate

At an average of 39.1 percent (including the federal and state average statutory rates), the statutory income tax rate on corporations is the fourth highest in the world and the highest of all the members of the Organization for Economic Cooperation (OECD).³⁷ Both the House and the Senate versions of the *TCJA* propose reducing the statutory tax rate to 20 percent, although the Senate bill postpones the implementation to 2019 to manipulate the ten-year budget impact estimates. But the Senate seems to be forgetting the purpose of tax reform, which is to stimulate economic growth, job creation, and wage increases. The economy will benefit from an immediate reduction of the federal corporate tax rate to 20 percent.

Effective Tax Rates and International Comparisons

Such a rate cut would make our corporations more competitive internationally due to cost reductions to the business. Highlighting the fact that it would bring the US corporate tax rate to be slightly lower than the average statutory rate of the OECD. It is often asserted that the average, effective corporate tax rate is, in actuality, lower than the 35 percent statutory rate, and therefore it is unnecessary and perhaps damaging to reduce the rate to 20 percent. This does not present the full

picture, nor does it offer justification for maintaining the rate at its present level. Many, if not most, corporations do in fact pay at least more than a 20 percent rate. Additionally, compliance, tax team expenses, etc. add to the real cost.

According to the Congressional Budget Office, in 2012 the average corporate tax rate was 29 percent and the effective corporate tax rate was 18.6 percent.³⁸ The first measure is essentially how much tax corporations pay divided by its income, and the second rate measures, as the CBO explains, “a company’s corporate income tax burden on returns from a marginal investment (one that is expected to earn just enough, after taxes, to attract investors).”

Compared with other nations in the G20, the United States is third for the average tax rate and fourth for the effective rate. This means that we are still comparatively high, by either metric, and offers ample justification for reducing the federal statutory rate to be more competitive.

In addition, due to certain deductions and credits offered to particular industries and businesses, the range of corporate taxes paid by individual businesses is dramatic, with some paying more than the statutory rate and others paying no corporate income tax. (For example, in the third quarter of 2017, Apple paid an effective rate of roughly 25.5 percent³⁹ – less than the statutory rate but more than the proposal.) Consequently, while some corporations may not see much benefit from the reduction, others will, and some will see near-parity with the rate change. The fundamental benefit to the reduction of the corporate tax rate is that, in making the United States more competitive, it should mean economic growth and, most especially, much-needed wage growth.

Economic and Wage Growth

The economic growth benefits are certainly noteworthy. For example, a 2015 analysis by the Tax Foundation found that the GDP would improve by a “healthy 3.3 percent” with a 20 percent corporate tax rate.⁴⁰ However, the wage boost is where the real benefits come in. It stands to reason that high corporate tax rates stunt wage growth, as fewer after-tax profits are available for firms and workers to negotiate over and, potentially, allow for wages to rise. A 2007 LIS study found that “a ten percentage point increase in the corporate tax rate of high-income countries reduces mean annual gross wages by seven percent.” Furthermore, the study finds that, “Using U.S. data on corporate tax revenues and total wages, these estimates predict that labor’s burden is more than four times the magnitude of the corporate tax revenue collected in the U.S.”⁴¹

Likewise, the German ZEW Research Group concluded in a 2015 study that workers bear approximately 40 percent of the total burden of corporate taxes, likely to exclude companies with profit-sharing arrangements.⁴² And a paper for the Congressional Budget Office finds that labor could bear more than 70 percent of the corporate income tax burden,⁴³ which would be relieved by a reduced corporate tax rate. The Tax Foundation found that wages would rise by an average of 3.1 percent with a 20 percent corporate tax rate.⁴⁴

Pass-Through Taxation Changes

Both the House and Senate Republican proposals are change how the tax code deals with the pass-through businesses (sole proprietorships, partnerships, LLCs, and S-Corporations). Three-quarters of small businesses – the vast majority of businesses in the United States – are structured as pass-through entities.

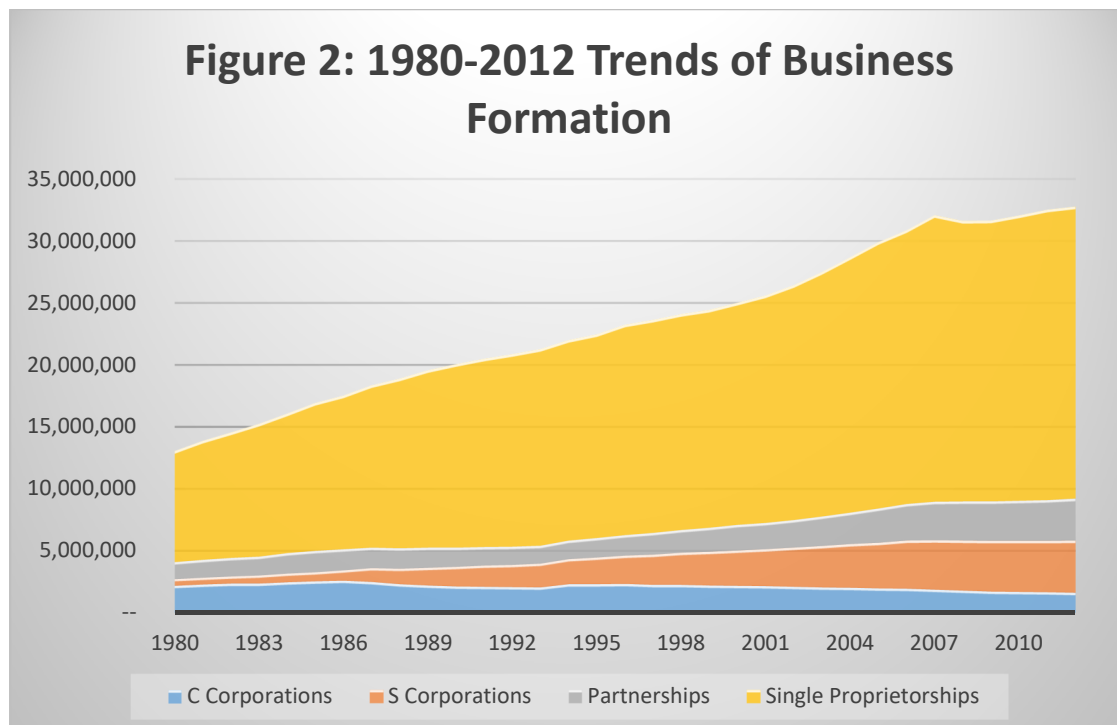
The House for its part changes the tax structure of pass-through businesses by instead permitting *certain* ones (i.e. passive investors in a business) to be taxed up to a cap of 25 percent on the “capital percentage” of a business, rather than the traditional ordinary income of other pass-through

businesses. The House bill has a series of complicated “buts,” however, like precluding service businesses – such as accountants and lawyers – from qualifying for the 25 percent rate. This is because the capital percentage for non-service businesses is by default 30 percent while it is zero percent for service businesses, which are entirely reliant upon labor. And the rate does not apply to the remaining “labor percentage” that is attributed to the officer and/or owners. It is possible for a pass-through entity to use an “alternative capital percentage based on the business’s capital investments,” but that may not make much of a difference for most businesses.⁴⁵

The House bill does phase in a provision which would by 2023 allow the first \$75,000 of *all* pass-through business income to be taxed at a nine percent rate for married couples filing jointly. The benefit will phase out beginning at \$150,000 and fully by \$225,000. The income threshold is \$37,500 for unmarried individuals making less than \$75,000 in pass-through business income.

Differing substantially from the House proposal, the Senate repeals the tax regulation that forced Personal Service Corporations to be taxed at the 35 percent rate rather than at the graduated income rate. Additionally, the Senate version looks at the other pass-through businesses and provides them with a deduction equal to 17.4 percent of their taxable income. Specific service industries (health, law, professional services) are not included, except insofar as a filer has income below \$150,000 if filing jointly or below \$75,000 if filing individually, in which case they may claim the full deduction on income from service industries. Like the House, the Senate keeps other pass-through businesses’ taxable income treated as ordinary income.

Including changes to pass-throughs is an important component in any tax reform package. This is especially so considering that the likelihood of someone filing as a pass-through entity instead of a C-Corporation has been increasing (see Figure 2 below⁴⁶). Moreover, pass-through entities account for 50 percent of the private work force. Nonetheless, in some jurisdictions these entities, even under the tax reform, would still pay more than a 50 percent marginal tax rate.⁴⁷ Therefore, it makes sense to include the same rate of 20 percent for *all* pass-through businesses, as would be given to C-corporations. We believe that this reduction would be a boon for hiring and GDP growth.



Immediate and Full Expensing

The principle of tax neutrality is violated when companies must take into consideration the tax impact on the timing of purchasing assets rather than letting the economics of the market drive expansion or contraction. Although imperfect, immediate and full expensing would help reduce the impact on the economic decision of a company on whether to acquire or sell assets that will help with its business production. Furthermore, given the last-minute nature of Congress when it comes to tax policy, which has been the modus operandi of even prior Congresses, companies often find themselves scrambling last-minute to adjust their budgets to the latest gimmick coming out of Washington. This policy would remove some uncertainty in the tax code and would go a long way toward tax neutrality.

Over the next five years, the House bill in particular will permit businesses to immediately deduct the cost of business investments from their tax bill in the year they make those investments, instead of dividing them up over multiple years. This is a step in the right direction but should be made permanent.

Other Deduction Changes

Given the current statutory corporate tax rate of 35 percent and even higher rate for highly-profitable pass-through businesses, deductions can be an incredible lifeline. However, they make it more difficult to have reductions in tax rates and are also cumbersome. In addition, they have the harmful effect of the government influencing business activity. Despite the Republican proposals seeking to reduce the advantage of these deductions, it does not go far enough. Below are a couple examples of where the *TCJA* bills are not going far enough and some where they are.

Net Operating Loss Deduction

The Net Operating Loss (NOL) deduction has been one of those great lifelines to business start-ups and businesses who had a bad year. A NOL deduction “is a loss taken in a period where a company's allowable tax deductions are greater than its taxable income.”⁴⁸ Although it is not used on the year that it is generated, it can generate a refund for taxes paid in the previous two years or a deduction on the next 20 until the NOL is depleted or it expires. The NOL deduction has been a symbol of much criticism in that it has allowed some corporations to pay little to no taxes.⁴⁹ The proposals would limit the NOL carryover or carryback to 90 percent of the tax year. In other words, it prevents a corporation from paying zero percent through the NOL alone. It is a move in the right direction toward repeal. Both the House and Senate bills address the NOL similarly.

Likewise, both proposals are also weakening the net interest expense deduction by disallowing deduction amounts greater than 30 percent of the business' adjustable tax income. This is definitively a move in the right direction. Although there are many good reasons for why a business may decide to accumulate some debt, it is practice that should not be encouraged by the government through a deduction. Financial leveraging is a practice that should be made entirely with sound business practices not due to incentives from Washington D.C.

Other Business Deductions

We wanted to include a couple examples of where the House plan got it 100 percent right. The first is a small deduction in terms of financial impact, but it is good one. The proposal would repeal a deduction for lobbying expenses to local governments. Petitioning of the government is an important component of our civics, but it certainly does not need financial encouragement.

A second one where the plan got it right was doing away with the domestic production activity deduction. The deduction allowed a six-to-nine percent deduction of the qualified production activities income or taxable income to be deducted during that tax year. Although it is a laudable goal to encourage domestic production, it would be even better to become more competitive through a simpler a significantly lower tax rate. Some of the other deductions repealed by the House are: enhanced oil recovery credit, work opportunity tax credit, and rehabilitation credit. There are many other business deductions that the House bill describes as being eliminated partially or in full.

Unfortunately, in terms of the Senate, they have significantly fewer deductions that are repealed, particularly: the deduction for certain unused business credits and the revocation of the tax preference for professional sports stadiums, as well as the repeal of the deduction for income attributable to domestic production activities. We are in full support of the complete repeal of as many deductions and credits as possible, so long they are offset by a significant tax rate reduction.

Territoriality

One of the best theoretical objectives of both bills' business tax reforms is the goal of moving toward tax territoriality. Today, unlike most countries, American corporations who earn profits overseas have to pay on the overseas profits in addition to what they make at home as well as the local country's tax. Likewise, a foreign subsidiary to a domestically domicile company must pay additional taxes whenever the money is repatriated back to the US from the subsidiary. Our global taxation policy makes it more difficult for our companies to compete overseas and for their subsidiaries to return dollars earned back to the US. The move toward territoriality would bring greater economic growth, boost wages, and increase the competitiveness of American companies.⁵⁰

Both the House and Senate legislations move tax policy in the right direction, but the strategy misses the mark. The House bill enacts deemed repatriation of currently deferred foreign profits at seven percent for illiquid assets and fourteen percent for liquid assets, while the Senate bill does so at five percent for illiquid assets and ten percent for liquid assets. "Deemed repatriation" is a one-time tax on profits considered to be repatriated in the United States. Both bills additionally address international income. The House version moves to a territorial system with complex base erosion rules, as well as an excise tax on payments made to foreign firms with particular exceptions. The Senate version entails its own set of anti-abuse rules and its own base erosion minimum tax rules.

If the goal is indeed to bring profits to the United States to foster investment at home, rather than abroad, we believe that these rules are unnecessary and counterintuitive. We favor a simpler and more streamlined approach entailing the straight elimination of all double taxation on profits earned overseas, both past earnings as well as future earnings. We do recognize that there are certain, inherent complications in moving toward this system, but meaningful tax reform should forcefully begin the process of moving the United States in this targeted direction.

Addressing the Deficit and Debt

At nearly \$20 trillion, the national debt is of paramount concern to the United States in the long-term. Many are worried that the *TCJA* will contribute to the deficit by at least \$1.5 trillion over a ten-year timespan, which is the "revenue-neutral" level that the Senate must achieve in order to pass the bill using reconciliation (which requires only 51 votes for passage). While we are troubled by the growing national debt in the long-term and the impact it will have on the Millennial generation and our posterity, we believe that mild, short-term deficits, with the express purpose of long-run economic growth, are acceptable.

Recent patterns of GDP growth in the realm of two percent are unacceptable, and they consequently may have a role in reducing tax revenue receipts. For example, “Tax revenues have historically averaged 18 percent of GDP, ranging from between 17 percent to 20 percent of GDP, whether top rates were 90 percent or 28 percent. This suggests that the most efficient way to increase revenues is expand GDP, which has grown at less than 3 percent this calendar year” (2012).⁵¹ From 2009 to 2015, federal tax receipts averaged 16 percent while growth averaged 1.5 percent (including one year, 2009, of negative GDP). By revving up economic growth today, beyond three percent, we may be able to raise tax revenue beyond what might otherwise be feasible without the growth.

It is also worth noting that, in our analysis of the *TCJA*, we frequently propose the elimination of more deductions, exemptions, and credits than the House and Senate bills propose. These steps would constitute more “pay-for’s” and allow for the steeper rate cuts that we propose.

The important thing to recognize, however, is that – whether deficits are increased in the short-run or not – it is not cutting tax rates and letting people keep more of their money that is the problem. *Spending* is the issue. Congress must closely examine its current spending habits, including and especially enacting *sweeping* reforms of entitlement programs, and reduce expenditures by a substantial margin. Only by substantially reducing federal outlays will we solve our budgetary issues.

Section Three: Overhauling the Complex and Onerous Tax Code

Designing and Implementing Real, Long-Term Tax Reform Through a Low Flat Tax

Although there are many positive and commendable aspects of the House and Senate Republican proposals that may lead to noteworthy economic growth prospects across the economy and with special emphasis on the middle class, as the Tax Foundation estimates^{52,53}, they lack the necessary boldness to create a lasting solution. It will become part of the repeated 32-year cycle of significant tax reforms that have taken place since the implementation of the 16th amendment (1922, 1954, 1986). However, Congress has a real opportunity to pass legislation that will avert the need for another significant reform in 2050, but will instead stand the test of time. This is why our proposal is named “**The 2050 Plan.**” It is a fair and simple taxation plan whose rates are as follows:

Proposed Changes	Standard Deduction Numbers	Social Security & Medicare Tax	Above Standard Deduction
Single	12,228	Unchanged	15% Flat Tax
Married	24,563		
Head of Household	15,569		
Pass-through Businesses	None	Unchanged	9% Flat Tax
Corporate			

The 2050 Plan: Why a Flat Tax?

There are several reasons why a personal and business flat tax, as prescribed above, is superior to the existing system as well as the current proposals.

Simplicity

One of the great benefits of a flat tax is the incredible simplicity that it brings to taxpayers of all means. It allows taxpayers to file their taxes without the need of an advisor(s), which are often needed to ensure error-free tax returns and to avoid overpaying. This reform would help taxpayers

with the anxiety that is often felt as tax season nears. The worry often being, whether they will be receiving a refund or if additional taxes will need to be paid. Consequently, this plan would make it easier for taxpayers to budget more effectively. Furthermore, it eliminates most concerns regarding double taxation, ensures a low rate, limits government, and guarantees a territorial tax treatment of businesses.

Elimination of Loopholes and Tax-Related Backroom Deals

Apart from benefitting family budgeting, one of the greatest benefits of a flat tax is the spotlight that it would shine on any and all backroom deals that seek to change minor details of the tax code in the benefit of the few. When the tax code is as complex and complicated as it is today, it is easier to sneak in a new rule without much public oversight or outcry since most of the public will not know what changed. However, attempt to do the same when the law is simple and understandable as is the case with a flat tax and see if there is not a public outcry that ensues.

Revenues and Tax Reductions

One concern that is frequently expressed about a flat tax is that revenues to the government will decrease. However, on a static basis, our simulation finds that revenues from personal income taxes are estimated to reduce by very little.⁵⁴ However, we believe that these losses would be more than offset by the economic gains provided by such reforms, as alluded to and discussed previously in this paper. We do still acknowledge that the 2050 Plan should, as with any tax plan, be accompanied by significant reductions in government spending and sweeping reforms to entitlement programs.

The 2050 Plan: Standard Deduction

Taxpayers of lesser financial means are significantly burdened by 15 percent taxation of their income. Thus, it makes sense that there would be a standard deduction to prevent taxpayers from being negatively impacted to the point where they might need government assistance. We believe that this standard deduction should be fixed to the federal poverty line as it is a good descriptor of where the poorest among us are financially. In our proposal, married taxpayers filing jointly would have a standard deduction equivalent to a family of four's poverty line, while a head of household is equivalent to that of a two-person household's poverty line. In addition, by fixing the standard deduction to the poverty line, we are in effect – as proposed in both Republican proposals – doubling the standard deduction. Consequently, while some will experience a greater reduction in tax percentage owed than others, each tax bracket will have the opportunity to receive an effective tax cut or to potentially maintain an amount due similar to what they currently pay.

The 2050 Plan: 9 Percent for Corporate Tax and Pass-through Businesses

The 2050 Plan includes a nine percent business flat tax on income earned within the United States. On first sight, it may seem odd to select a tax bracket for business that is lower than for personal income. However, as many economists would point out, corporations do not pay corporate taxes, workers do through reduced wages and job opportunities.⁵⁵ As seen by examples such as Ireland, businesses flock to places where the cost to do business is significantly less and leave places where it increases.^{56,57} After all, capital is able to move from one country to another relatively seamlessly. As such, capital is often allocated to generate the greatest returns on investment. This being true gives companies two options: reduce costs or increase revenues.

A country's taxation policy will influence the first option for companies. Consequently, when the tax rates are lowered and there is a cost reduction that merits a move, companies will choose to move. A 2013 paper by Boston University economist Laurence J. Kotlikoff and his colleagues inspired the nine percent figure.⁵⁸ In it, the authors estimate that a nine percent flat corporate tax would generate a wage increase of six percent in the short-term and nine percent in the long-term. They also

estimate a six percent growth in GDP. Additionally, this corporate tax would prove revenue neutral by removing all the loopholes that we have learned to loathe.

A Regressive Tax?

One of the most prominent arguments against the flat tax is that it unfairly favors the rich and is regressive to the poor. The 2050 Plan offers a low rate of 15 percent for all taxpayers and, most importantly, provides a standard deduction tied directly to the poverty line – offering the opportunity for the poor to pay no income tax and thereby creating a “zero tax bracket.” Since it collapses existing exemptions and doubles the standard deduction, this will also level out the amount of tax due for most Americans so that they will only need to pay a similar balance to what they currently pay or may see a noticeable tax rate cut. It is also fair to all Americans because it treats all Americans equally with the same percentage tax levied on income across the board, and it allows taxpayers to keep more of their money.

Furthermore, as discussed throughout this paper, the existing tax code contains numerous deductions and credits that tend to benefit the wealthiest Americans, enabling them to pay significantly less in taxes than the sticker price would suggest and thereby making it more difficult to reduce rates across the board. Our flat tax will help ensure that each person pays their *fair and equal* share, without being able to take advantage of special interest tax loopholes.

Finally, with the significant reduction in the business tax to a flat rate of nine percent, the opportunity for boosting wages, job gains, and economic growth are considerable. While it will reduce tax liability on business owners, this is an intentional way to benefit all income groups. It will enable business owners to invest even more capital and resources back into their businesses – resulting in an ever more widespread effect on Millennials and Americans of all stripes.

Section Four: Let's Reform the Tax Code for a New Generation *Concluding Thoughts*

It is abundantly clear that tax reform is necessary for all people to prosper, especially the rising Millennial Generation. The *Tax Cuts and Jobs Act* put forth by the Republican Congress is a great start to make this reform a reality; from collapsing personal exemptions and doubling the standard deduction to changing the tax rates and brackets. It would likely promote economic growth, boost wages, and improve livelihoods for Americans of all backgrounds. However, the proposal does not go far enough. For real, lasting change to occur, policymakers will need to take bold steps guided by the principals that simplify and broaden the base of our tax system. While this is no easy task, it is necessary for the continuation of a thriving America.

History shows that the issue of tax reform is constantly recurring. Every 30 years or so the matter is reintroduced in Congress, and that is because the “reform” that session made was merely a temporary fix that didn't get to the root of the problem. The current legislatures owe it to all Americans to do more than put a Band-Aid on a recurring problem.

The 2050 Plan does just that. This sweeping departure from the status quo would not only vastly simplify the tax code for all Americans; it would create a productive revenue stream that would actually improve the state of the economy. Rather than changing and amending the confusion that is the current code, it seems much more favorable to remove the loopholes and disorder and reduce it all to a single, easy-to-follow structure.

This is the time for meaningful and lasting tax reform. The bills presented by the House and Senate do not go far enough to dismantle our burdensome tax system. We encourage Members of Congress to reevaluate their tepid proposals and present the public with real, permanent tax reform. The American people deserve nothing less.

Endnotes

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