

Reforming the Tax Code

December 2017



**COMMITTEE FOR A
RESPONSIBLE FEDERAL BUDGET**

CRFB.org

The Case For Tax Reform

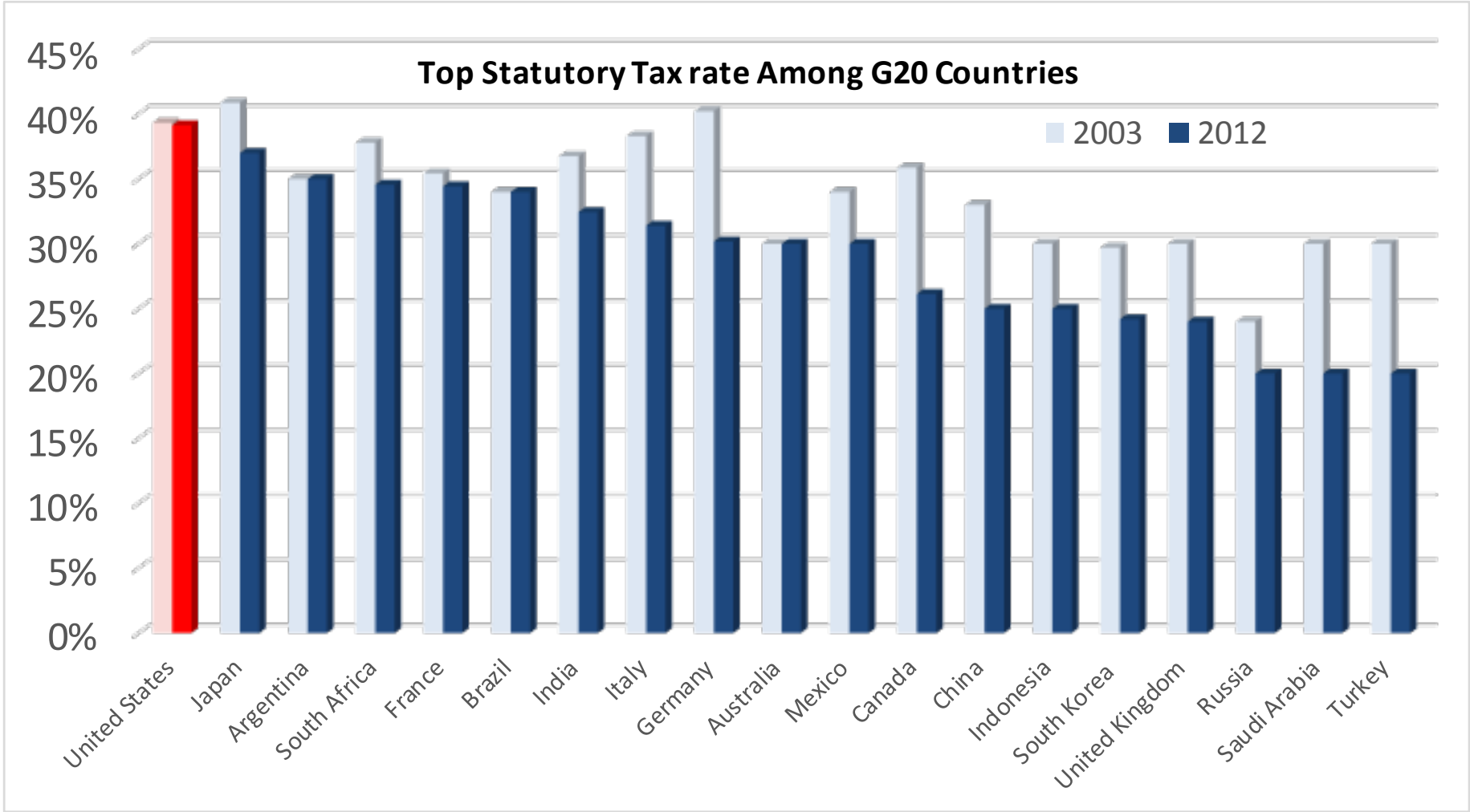
The Need for Tax Reform

- ✓ Business Taxes are Uncompetitive
 - Highest corporate rate in developed world
 - Broken international system of taxation
 - Bias toward debt-finance
 - Outdated depreciation schedules
 - Distorting tax breaks
 - Uneven treatment of C-Corps and Pass-throughs

- ✓ The Individual Income Tax is a Mess



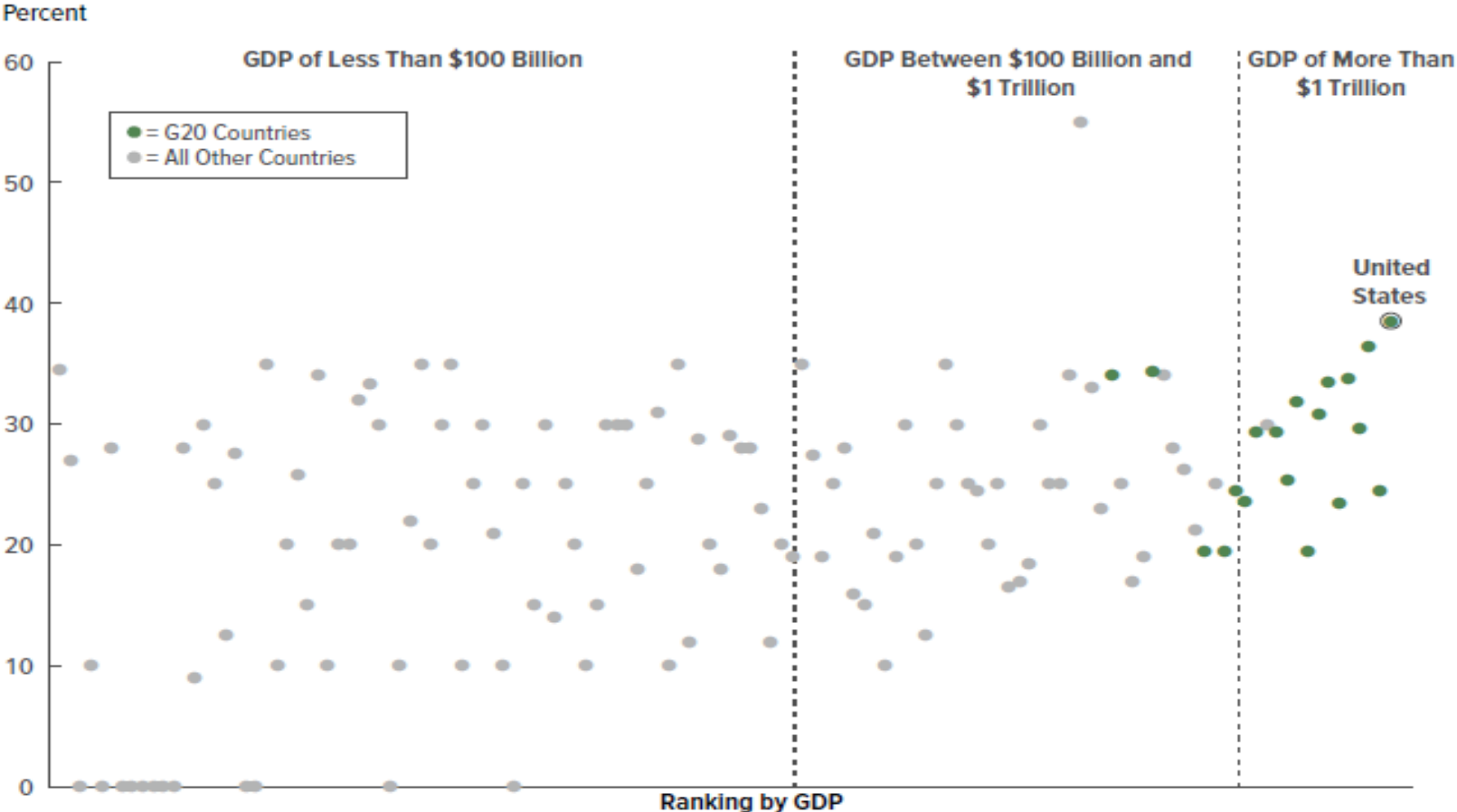
The Tax Code Is Increasingly Uncompetitive



The Tax Code Is Increasingly Uncompetitive

Exhibit 2.

Top Statutory Corporate Income Tax Rates in Selected Countries, Arrayed by GDP, 2012



Source: Congressional Budget Office, using data from KPMG International and the Organisation for Economic Co-operation and Development.

GDP = gross domestic product; G20 = Group of 20.



The Tax Code Is Increasingly Uncompetitive

Worldwide system: Tax all income immediately, regardless of where its earned

Territorial system: Tax only income earned in the United States, immediately

U.S. Hybrid: Tax all income, but only when it is repatriated to the United States



The Individual Tax Code is a Mess

- ✓ Business Taxes are Uncompetitive
- ✓ The Individual Income Tax is a Mess
 - No real reforms since 1986, only “deform”
 - Top rate climbed by 12 points
 - Many new tax breaks added to the code
 - Hodge-podge of phase-ins, phase-outs, surtaxes, and alternative taxes
 - Taxes fall on income, not on consumption
 - Rising cost of “tax expenditures” that distort behavior and keep rates high
 - Insufficient revenue to cover current spending



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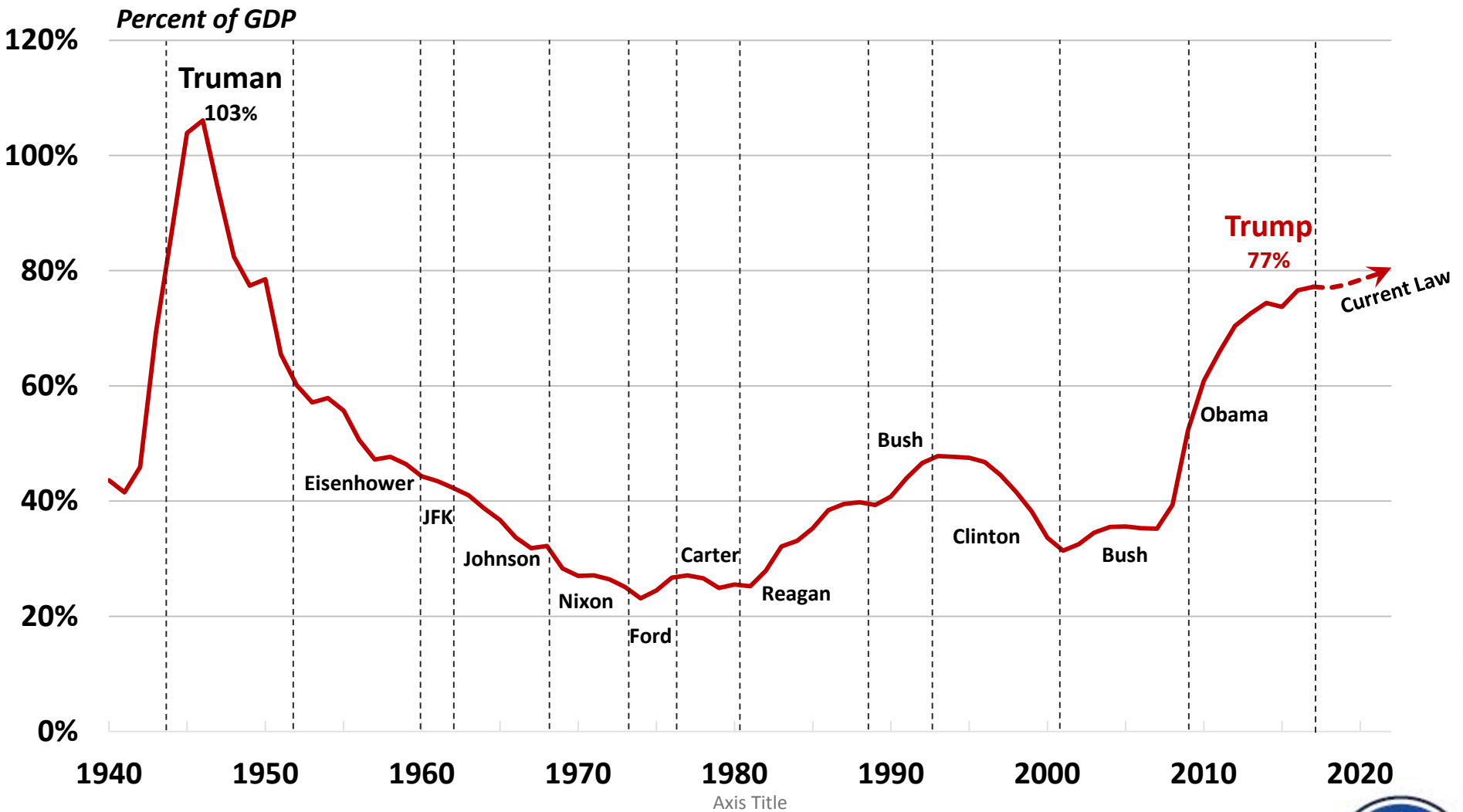


Tax Expenditures Are Rising



We Can't Afford a Tax Cut

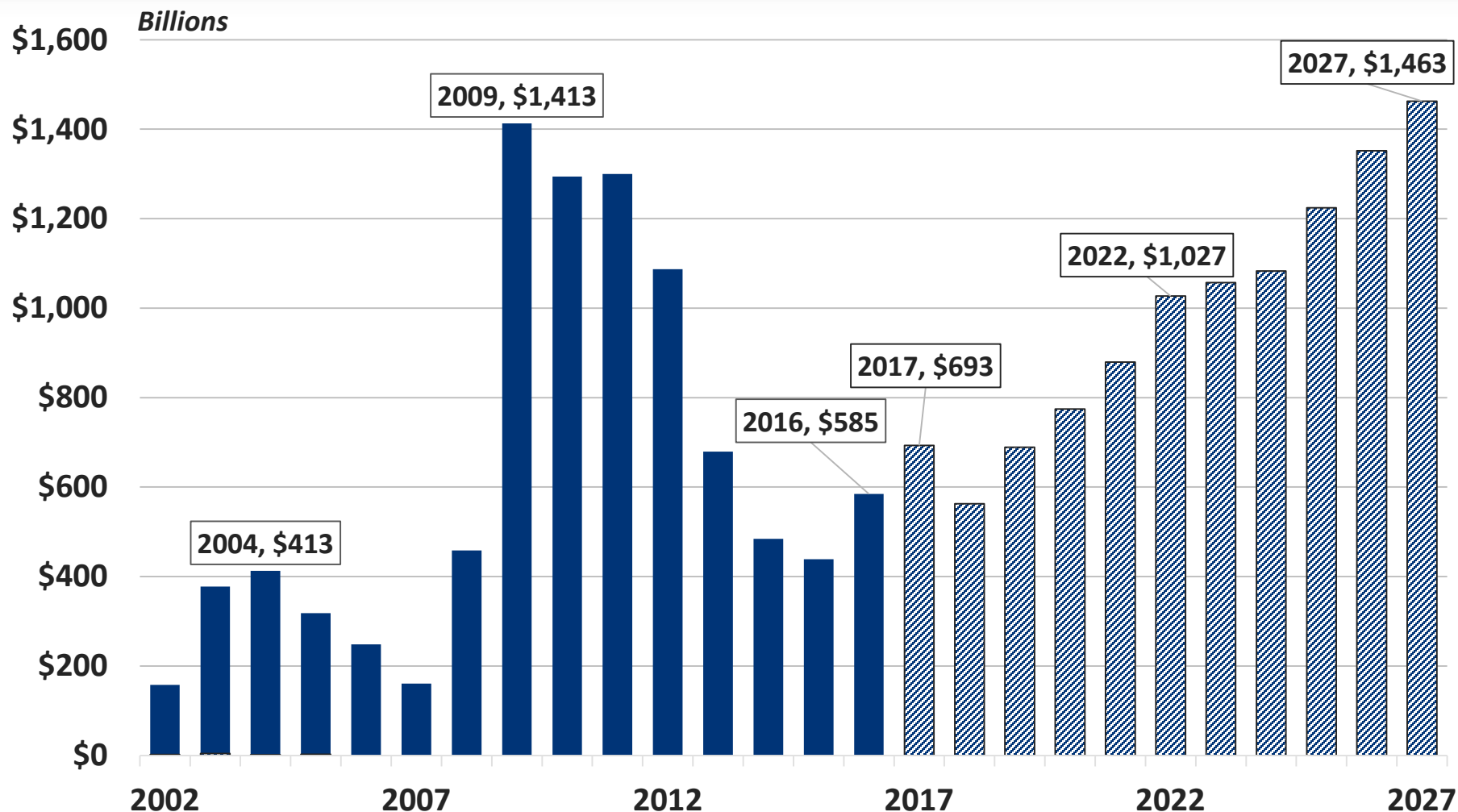
Debt is At Record-High Levels



Sources: Congressional Budget Office, Office of Management and Budget, and the Committee for a Responsible Federal Budget.

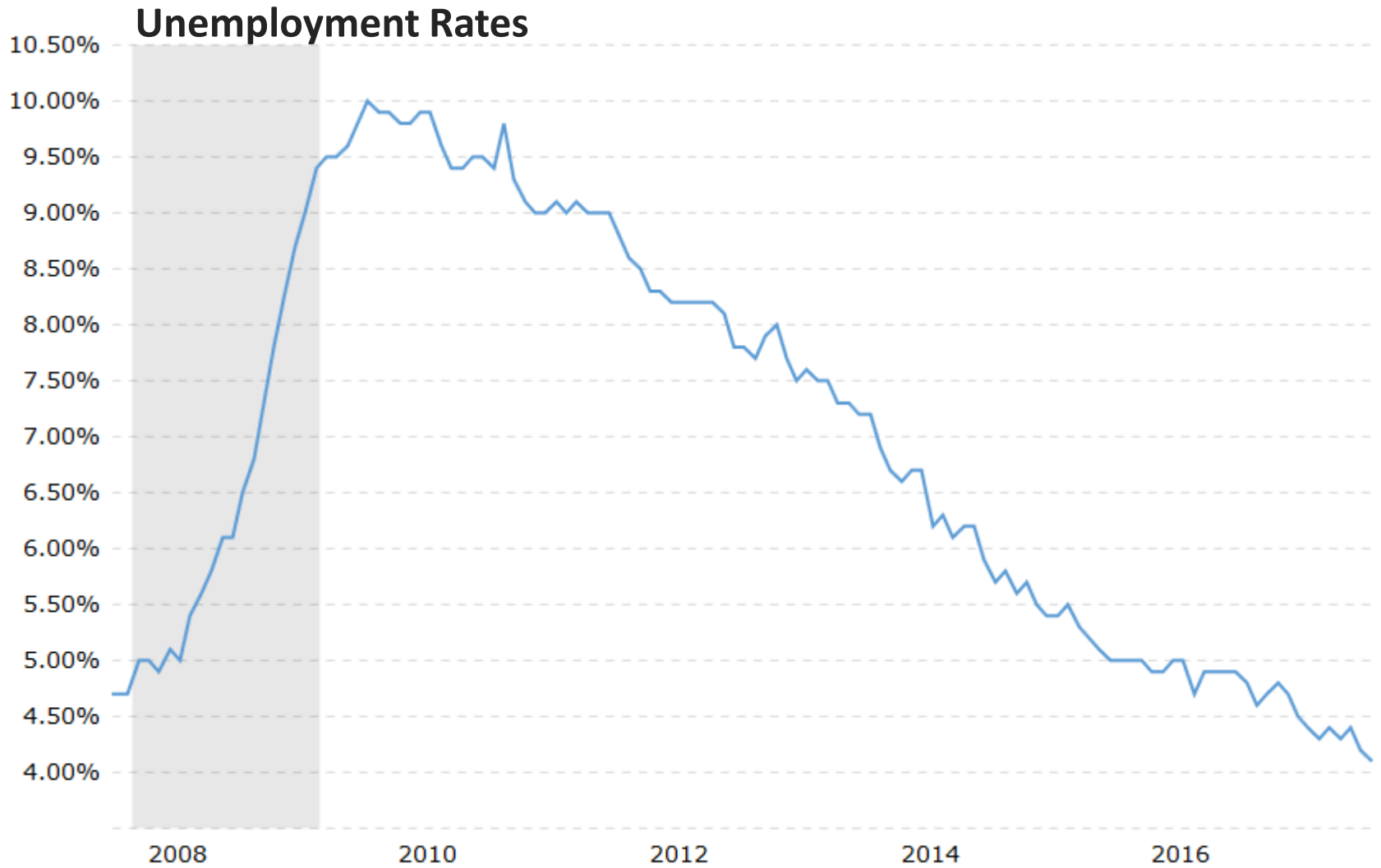


Trillion-Dollar Deficits Will Return by 2022 under Current Law

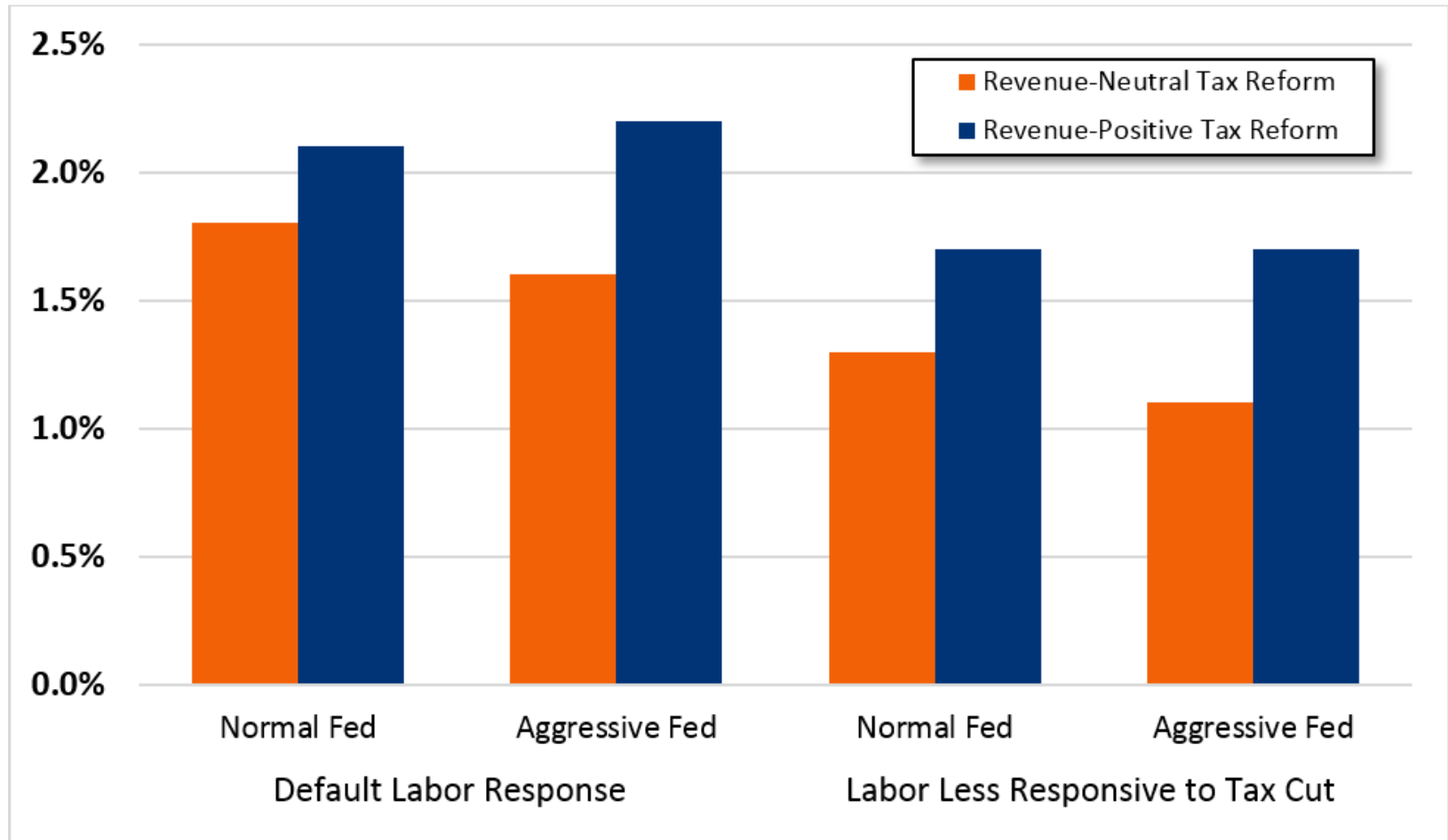


Sources: CBO June Baseline, CRFB calculations.

The Economy Doesn't Need Stimulus



Tax Cuts are Less Pro-Growth Than Tax Reform



The Tax Cuts and Jobs Act

Where We Started: “The Better Way” Plan

- 1. Replace Business Taxes w/ a Consumption Tax**
- 2. Enact 1986-Style Individual Income Tax Reform to Lower the Rates and Broaden the Base**
- 3. Raise Roughly as Much Revenue as Today**

Where We Started: “The Better Way” Plan

Replace Business Taxes w/ a Consumption Tax

- Make all investment immediately deductible (“Expensing”)
- Repeal deduction for interest (borrowing) costs
- Impose “border adjustment” to tax imports & exempt exports
- Repeal many corporate tax breaks
- Reduce corporate rate to 20%
- Reduce top “pass-through” rate to 25%

~Revenue neutral

Where We Landed: The Tax Cuts and Jobs Act

Replace Business Taxes w/ a *Smaller Corporate Income Tax* ~~Destination-Based Business Consumption Tax~~

- Make ~~many~~ *a few* all investments immediately deductible (“Expensing”) for *five years, maybe phased out*
- ~~Repeal~~ *Modestly limit* deduction for interest costs
- ~~Impose “border adjustment” to tax imports & exempt exports~~
- Repeal ~~many~~ *a few* corporate tax breaks
- Reduce corporate rate to 20% (*or 22%*)
- Reduce top “pass-through” rate to *somewhere between 25% and 45.6% depending on income, type of business, sources of income, and many other factors*
OR create a 23% deduction for business income

~~~Revenue Neutral~~ *Loses ~\$1 Trillion over ten years*

# Where We Started: “The Better Way” Plan

## 1986-Style Individual Income Tax Reform

- Reduce and consolidate rates to 12, 25, and 33
- Eliminate Alternative Minimum Tax
- Repeal most itemized deductions, personal exemption, and many tax preferences
- Reform but don't repeal tax preferences for mortgage interest, charitable giving, education, and retirement
- Expand standard deduction and child tax credit
- Tax capital gains/dividends at half ordinary rate
- Repeal the estate tax

~Revenue neutral



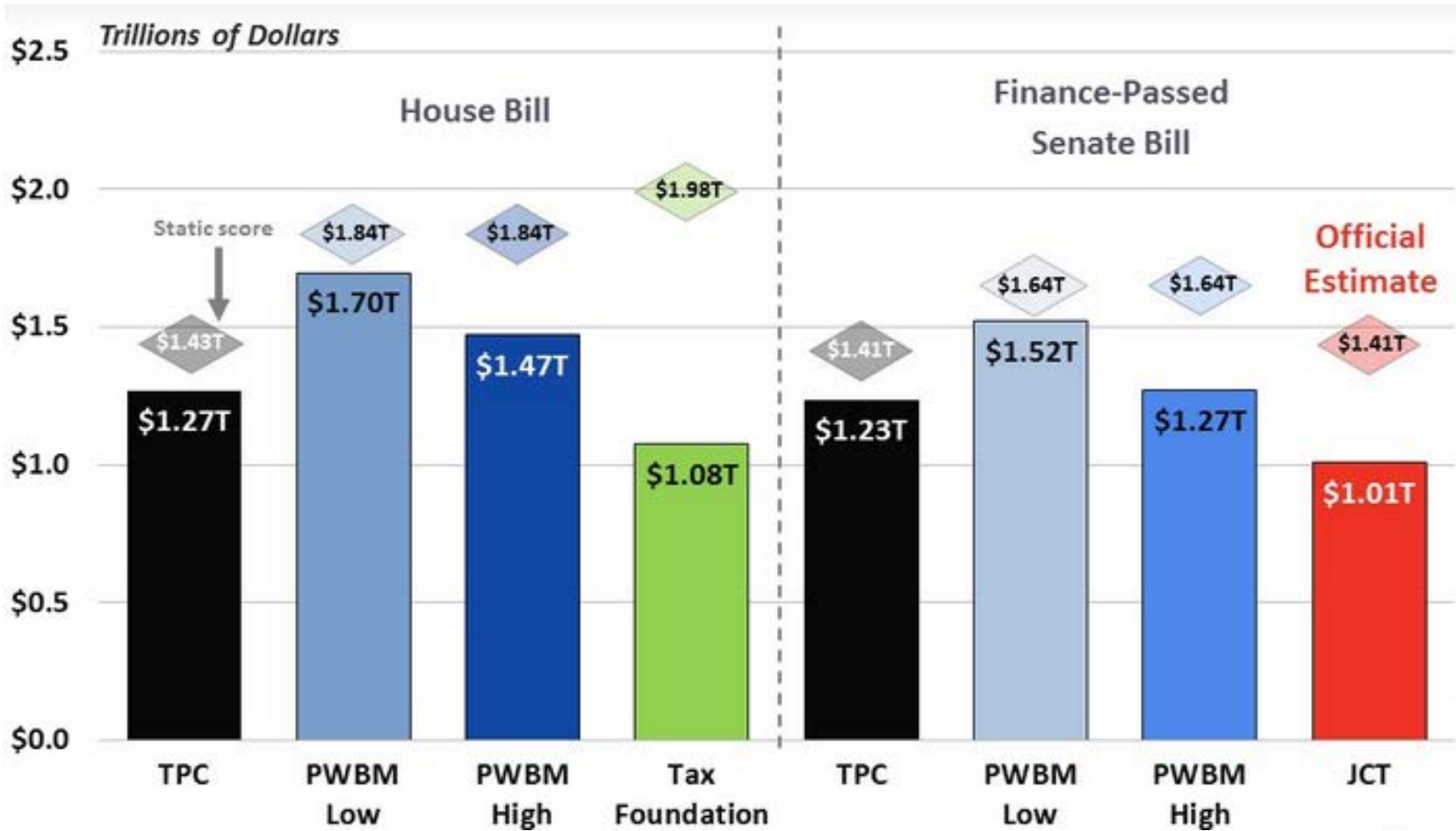
# Where We Landed: The Tax Cuts and Jobs Act

## 1986-Style *Temporary* Individual Income Tax Reform/*Cut*

- Reduce and consolidate rates to ~~12, 25, and 33~~  
*12, 25, 35, § 39.6 OR 10, 12, 22, 24, 32, 35, 38.5*
- Eliminate *or shrink but retain* Alternative Minimum Tax
- ~~Repeal~~ *Scale back some most* itemized deductions, personal exemption, and ~~many~~ *a few other* tax preferences
- ~~Reform but~~ don't repeal tax preferences for mortgage interest, charitable giving, education, and retirement
- Expand standard deduction and child tax credit
- ~~Tax capital gains/dividends at half ordinary rate~~
- *Scale back* ~~Repeal~~ the estate tax *and maybe repeal it eventually*
- *Maybe repeal the "Individual Mandate" for health insurance*

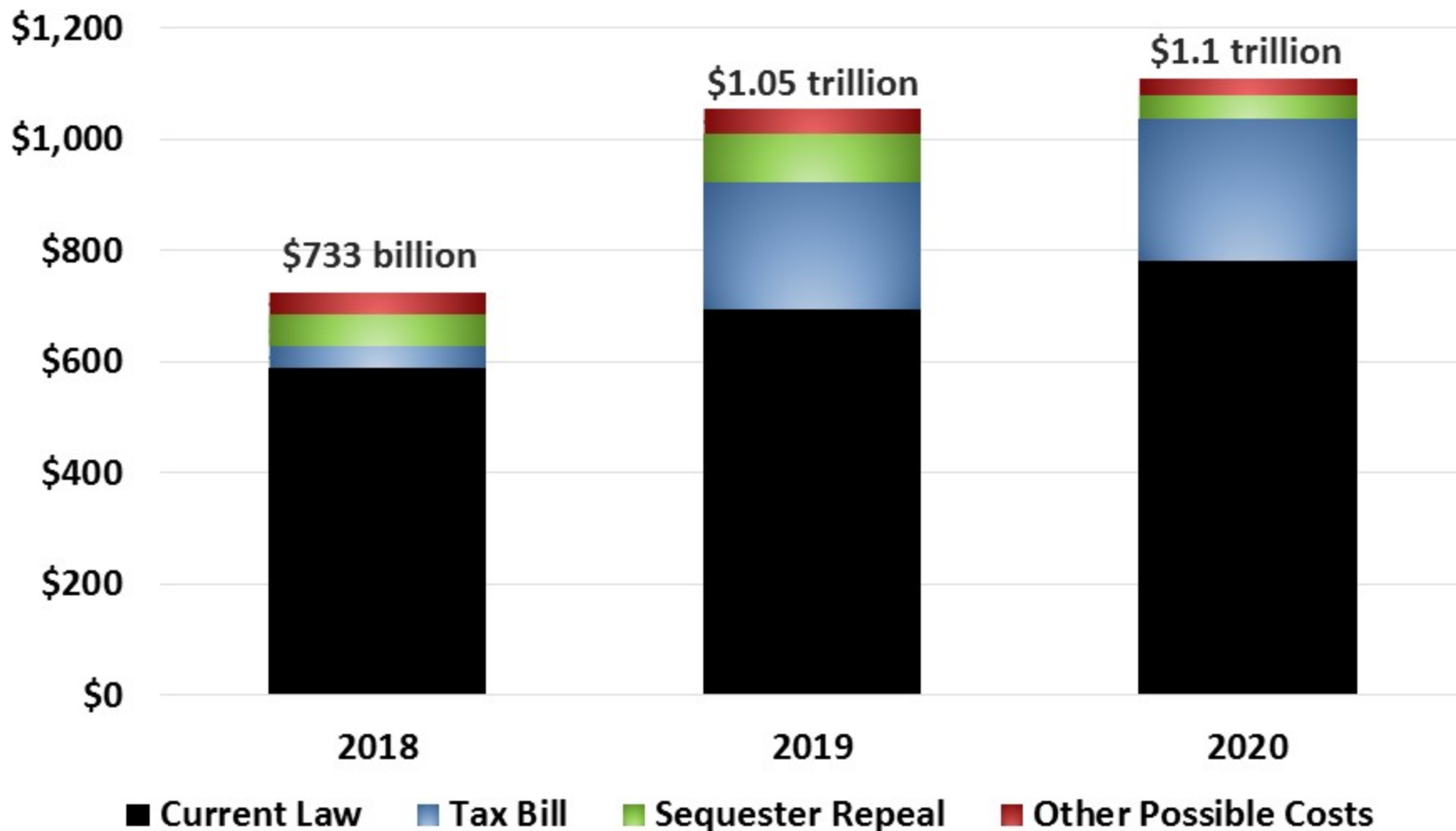
~~~Revenue Neutral~~ *Loses ~\$500 billion over ten years*

How Much Will The Tax Cuts Cost?



Trillion-Dollar Deficits Could Return Next Fiscal Year

Billions of Dollars

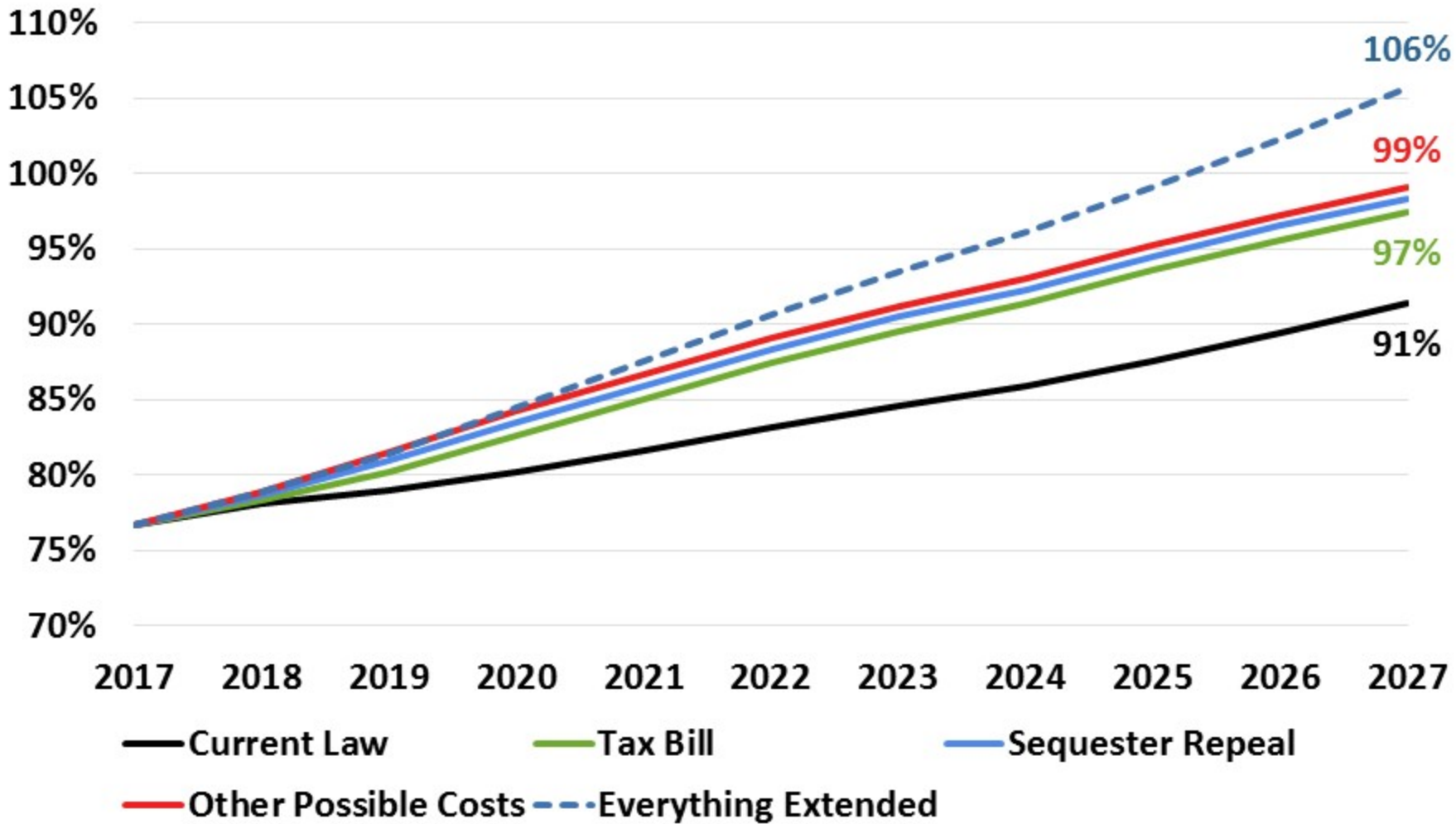


Sources: CRFB calculations based on Congressional Budget Office and Joint Tax Committee data.

Note: Current law includes disaster relief policies passed since the last CBO baseline. Tax bill assumes Senate version of Tax Cuts and Jobs Act.

December Legislation Could Push Debt to 99% of GDP by 2027

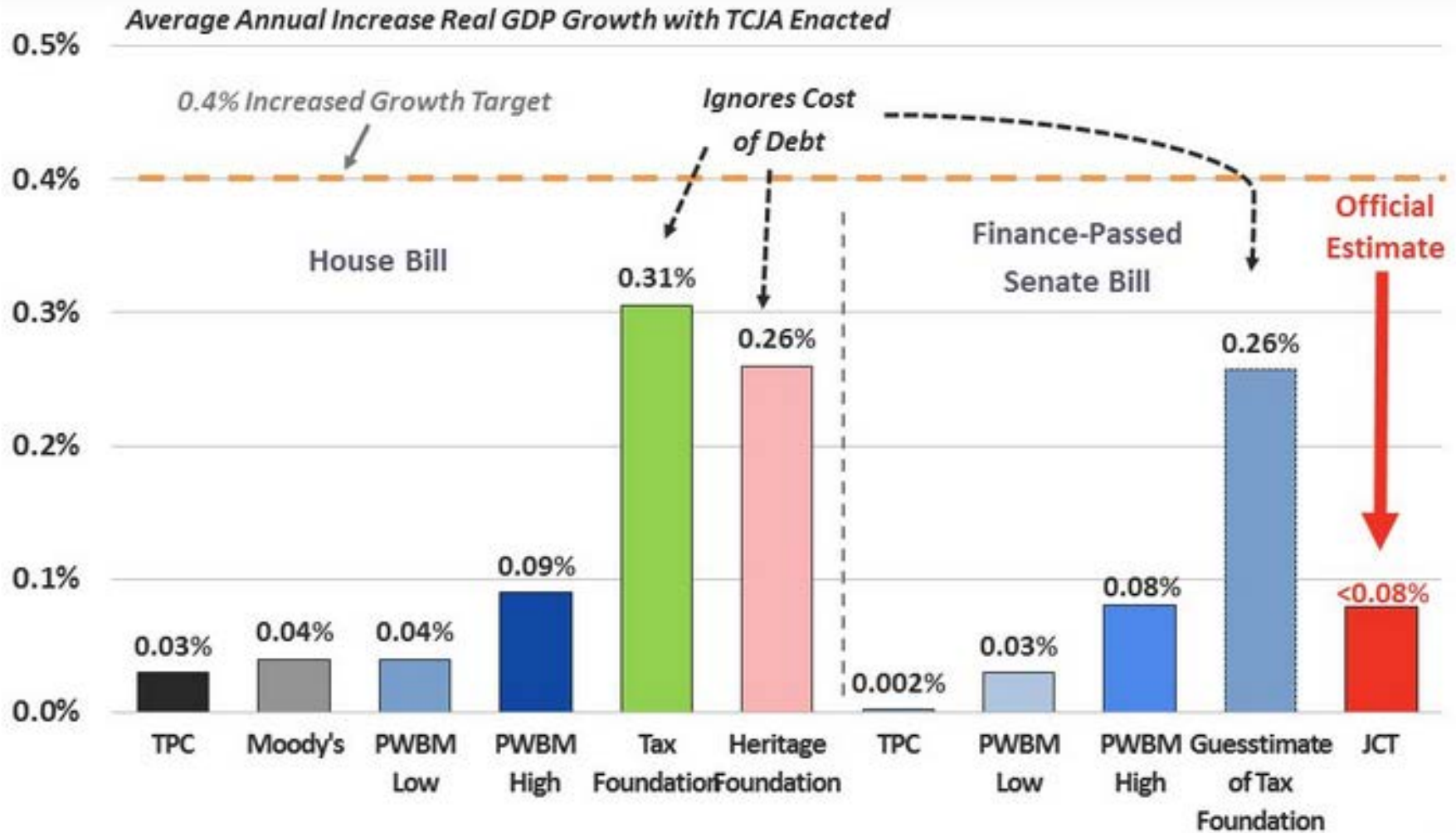
Percent of GDP



Sources: Office of Management and Budget, Congressional Budget Office



Will The Tax Cuts Grow the Economy?



What's Next for Tax Reform?

| Area | House Version | Senate Version |
|---|--|--|
| Individual Tax | | |
| Tax Rates | 12% 25% 35% 39.6% | 10% 12% 22% 24% 32% 35% 38.5% |
| Standard Deduction | \$12,200 (single) / \$24,400 (married) / \$18,300 (head of household) | \$12,000 (single) / \$24,000 (married) / \$18,000 (head of household) |
| Personal Exemptions | Replaced with \$300 credit per person through 2022; eliminated without replacement after | Eliminated |
| Child Tax Credit and Dependent Exemptions | Dependent exemption replaced with \$300 credit through 2022; CTC increased to \$1,600/child – phased out at higher income than current law | Dependent exemption eliminated; CTC increased to \$2,000/child – phased out at higher income than House bill; separate \$500 nonrefundable credit for non-child dependents |
| Alternative Minimum Tax | Eliminated | Exemption amount increased |
| Earned Income Tax Credit | Same as current law but with program integrity measures | Same as current law |
| Mortgage Interest Deduction | Limit lowered to \$500,000 of debt for new mortgages on primary residences | Mostly retained; \$100,000 home equity interest deduction eliminated |
| Charitable Deduction | Mostly similar to current law | Mostly similar to current law |
| Health Exclusion | Same as current law | Same as current law |
| State & Local Tax Deduction | Eliminated for income and sales taxes; limited to \$10,000 for property taxes | Eliminated for income and sales taxes; limited to \$10,000 for property taxes |
| Medical Expense Deduction | Eliminated | Retained; floor lowered to 7.5% of AGI for 2017 & 2018 |
| Municipal Bond Exclusion | Private activity and advance refunding bond exclusion eliminated for new bonds | Advance refunding bond exclusion eliminated for new bonds |
| Capital Gains from Home Sales | Exclusion phased out for high earners | Residence requirement increased |
| 401(k) Retirement Accounts | Same as current law | Same as current law |
| Capital Gains and Dividends | Same as current law | Same as current law |
| Higher Education Tax Benefits | Consolidated to single benefit | Same as current law |
| Indexing of Tax Provisions | Chained CPI used for inflation adjustments | Chained CPI used for inflation adjustments |
| Other Itemized Deductions | Mostly eliminated | More retained than House bill |
| Other Tax Provisions | Several provisions repealed | Preserves more tax provisions than House bill |
| Expirations | \$300 family and personal credits expire after 2022 | All individual provisions except chained CPI expire after 2025; expanded medical expense deduction expires after 2018 |



What's Next for Tax Reform?

| Area | House Version | Senate Version |
|-------------------------------------|--|--|
| Business Tax | | |
| Corporate Rates | Flat rate of 20%; corporate AMT repealed | Flat rate of 20% starting in 2019; corporate AMT retained |
| Pass-Through Businesses | Top rate limited to ~35% for active owners; 25% for passive owners | Creates a 23% deduction for business income capped at 50% of wage income; disallowed for active owners; expires after 2025 |
| Depreciation Schedule | Full expensing of certain equipment for 5 years; current law afterwards | Full expensing of certain equipment for 5 years, then phases out over 5 years; permanently shortens depreciation lives for buildings |
| Small Business Expensing | Increases limit to \$5 million and phaseout to \$20 million for five years | Increases limit to \$1 million and phaseout to \$2.5 million permanently |
| Domestic Production Deduction | Eliminated | Eliminated starting in 2019 |
| Interest Deduction | Limit lowered from 50% to 30% of income before interest, taxes, depreciation, and amortization for businesses with gross receipts > \$25 million | Limit lowered from 50% to 30% of income before interest and taxes for businesses with gross receipts > \$15 million |
| Inventory Accounting | Same as current law | Same as current law |
| R&E Expenses | Amortized starting in 2023 | Amortized starting in 2026 |
| Meals and Entertainment Expenses | Deduction eliminated for entertainment expenses; retained for meals | Deduction eliminated for entertainment expenses; retained for certain meals |
| Executive Compensation | Performance pay exception eliminated | Performance pay exception eliminated |
| International Tax | Territorial w/ base erosion provisions and one-time transition tax | Territorial w/ base erosion provisions and one-time transition tax |
| Fringe Benefit Deductions | Eliminates most deductions for fringe benefits | Eliminates most deductions for fringe benefits |
| Other Tax Provisions | Several provisions repealed | Several provisions repealed; more retained than House bill |
| Expirations | Temporary expensing and expanded small business expensing expire after 5 years | Sunsets various business provisions related to pass-throughs, expensing, base erosion, family leave, and alcoholic beverages |
| Other Taxes | | |
| Excise Tax on University Endowments | 1.4% tax on endowments exceeding \$250,000 per student | 1.4% tax on endowments exceeding \$500,000 per student |
| Estate Tax | Exemption increased to \$11.2 million through 2024, then tax is eliminated | Exemption doubled; tax retained |
| Individual Mandate Penalty | Same as current law | Penalty reduced to \$0 |

Tax Cuts or Not, We Still Need Entitlement Reform

Social Security and Medicare Reform



How Old Will You Be When Social Security's Funds Run Out?

Enter your year of birth:

Social Security's trust funds will run out when you are: **17 years old**

Under current law, your retirement benefits will be **cut 27%** below what is scheduled.

For a typical person, that's a **\$260,470 cut** in lifetime benefits. *

To prevent this cut, we must work together to make Social Security solvent.

[Design your own fix here.](#)

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