The Tax Reform Road Not Taken – Yet

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Reflections of the Holland Medal Recipient

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The United States has traveled a unique tax policy path, avoiding value added taxes (VATs), which have now been adopted by every OECD country and 160 countries worldwide. Moreover, many U.S. consumption tax advocates have insisted on direct personalized taxes that are unlike taxes used anywhere in the world. This article details a tax reform plan that uses revenues from a VAT to substantially reduce and reform our nation's tax system. The plan would (1) enact a destination-based VAT; (2) use the revenue produced by this VAT to finance an income tax exemption of $100,000 of family income and to lower income tax rates on income above that amount; (3) lower the corporate income tax rate to 15 percent; and (4) protect low-and-moderate-income workers from a tax increase through payroll tax credits and expanded refundable child tax credits. This revenue and distributionally neutral plan would stimulate economic growth, free more than 150 million Americans from having to file income tax returns, solve the difficult problems of international income taxation, and remove the temptation for Congress to use tax benefits as if they are solutions to the nation's pressing social and economic problems.

Keywords: tax reform, consumption tax, U.S. tax plan, VAT, Tax Policy Center

JEL codes: H24, H25

I shall be telling this with a sigh…
Two roads diverged in a wood and I—
I took the one less traveled by
and that has made all the difference.

Robert Frost, "The Road Not Taken"

I. THE FOLLY OF INCOME TAX REFORM

Three decades ago, in November 1984, Treasury Secretary Donald T. Regan submitted his department's tax reform recommendations to President Ronald Reagan (U.S. Department of the Treasury, 1984). This document, soon known as Treasury I, provided

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the template for the Tax Reform of 1986, a law widely viewed as the most significant change in the U.S. income tax since that tax was extended to the masses during World War II. President Reagan regarded the 1986 tax reform as his most important domestic policy accomplishment: embellishing reality, he claimed it was "the best antipoverty measure, the best profamily measure, and the best job-creation measure ever to come out of the Congress of the United States" (Reagan, 1986).

The 1986 Tax Reform soon began to unravel (Graetz, 2007). In the years that followed, Congress amended the tax laws annually, narrowing both the individual and corporate income tax bases and raising the top individual income tax rates. It does not take very long after a good cleansing of the income tax before Congress defiles it again. Many of the 1986 Act's reforms have been reversed. How can anyone remain optimistic about repeating a repair of the income tax without radical surgery?

Nevertheless, on February 26, 2014, House Ways and Means Committee Chairman Dave Camp (R. MI) unveiled a massive tax reform proposal, reflecting an extraordinary multi-year effort to reprise the 1986 reform by broadening the bases of both the corporate and individual taxes and lowering their rates (Committee on Ways and Means, 2014). This time, however, there was no readily accessible source of revenues to finance the rate reductions — a role played in 1986 by repealing the investment tax credit and eliminating widespread individual tax shelters. Instead, Chairman Camp's base-broadening proposals had to tackle what heretofore had been income tax sacred cows, including itemized deductions for home mortgage interest, state and local taxes, and charitable contributions, and exclusions from income of employer-provided health insurance and municipal bond interest (Committee on Ways and Means, 2014; Joint Committee on Taxation, 2014). Even with these provisions, however, rather than the 22 percentage point reduction in the top individual marginal tax rate that Ronald Reagan accomplished in 1986, Chairman Camp was able to move only from a top individual rate of about 40 to 35 percent and to reduce the corporate income tax rate from 35 to 25 percent. And under his plan those rate reductions would be substantially financed by a number of timing and transitional provisions that accelerate revenues into the 10-year budget window.

The limited potential and inevitable instability of income tax reform is now obvious. Nevertheless, tax reform advocates applauded Congressman Camp's efforts, as they did a similar endeavor in 2010 by the National Commission on Fiscal Responsibility and Reform, better known as the Simpson-Bowles Commission (National Commission on Fiscal Responsibility and Reform, 2010; Steuerle, 2014). Political prognosticators, of course, are extremely skeptical about such a plan's prospects for passage by Congress. Nevertheless, our nation's political leaders — all of whom agree that our nation desperately needs major tax reform — cleave steadfastly to the path of 1986-style income tax reform. As Robert Frost said, "Sigh."

II. CONSUMPTION TAX ALTERNATIVES

Long before 1986, many distinguished public finance economists and a few lawyers had praised the advantages of taxing consumption. In 1974, William Andrews attempted

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to rekindle interest in expenditure taxes (Andrews, 1974), which had been advanced in the 1950s by Nicholas Kaldor but adopted only in Sri Lanka and India and soon repealed by both. Expenditure taxes also featured prominently in the Treasury's *Blueprints for Tax Reform* (U.S. Department of the Treasury, 1977; Graetz, 1979). Various forms of consumption taxes also were promoted by the Meade Report released in the United Kingdom a year later (Institute for Fiscal Studies, 1978). These studies were soon followed by innovative consumption tax proposals in the United States, most notably Robert Hall and Alvin Rabushka's Flat Tax (Hall and Rabushka, 1983, 2007) and David Bradford's progressive-rate "X-tax" variation on their idea (Bradford, 1986). The most important choice made by the Reagan Administration and Congress in 1986, therefore, was to shun consumption taxation and instead to persist in our nation's uniquely heavy reliance on income taxation.

In stark contrast to their colleagues abroad, U.S. public finance economists have remained remarkably wedded to personalized or "direct" forms of consumption taxes despite their drawbacks — a road not taken by any other nation, which rely exclusively on "indirect" or transactions-based consumption taxes. Recent examples include Alan Viard and Robert Carroll's effort to breathe life into Bradford's X-tax (Carroll and Viard, 2012), Alan Auerbach's "Modern Corporate Tax" (Auerbach, 2010; Auerbach and Devereux, 2013; Auerbach, Devereux, and Simpson, 2011), and Lawrence Lindsey's recommendation to the Senate Finance Committee in 2014 to replace the income tax with a "cash-flow" tax (Lindsey, 2014). The November 2005 report of the tax reform panel established by President George W. Bush and headed by former Senators John Breaux (D. LA) and Connie Mack (R. FL) also endorsed a 1986-type income tax reform or, alternatively, a new consumption tax (modeled on Bradford's X-tax, which it labeled a "Growth and Investment Tax") coupled with a separate schedular individual level tax on income from capital (President's Advisory Panel on Federal Tax Reform, 2005).

The panel's report almost immediately disappeared into history's dustbin, but not before it injected some sorely needed political and practical reality into the tax reform debate. First, after careful consideration, this quite conservative panel rejected both the Flat Tax and a National Retail Sales Tax, the two most popular consumption tax ideas among House Republicans. In doing so, the panel concluded that *both* progressive tax rates and the taxation of capital income were essential elements of any tax reform proposal that the American people would regard as fair. Increased economic, political, and public concern with increasing inequalities in the distribution of income and wealth, including concern about the share of gains in both going to those at the very top, has served to make both of those judgments more secure (Piketty, 2014).

Second, and equally importantly, President Bush's panel concluded that any consumption tax must be border-adjusted to function properly — that, regardless of economic assumptions that sometimes imply that border tax adjustments are irrelevant, such adjustments are essential to tax compliance — a conclusion I endorse. Surprisingly, the Bush panel still proposed a unique form of consumption tax — a variation of Bradford's X-tax — that it conceded would require not only enactment by Congress, but also renegotiation of all of our bilateral income tax treaties and our multilateral trade treaties. This was a colossal mistake that inevitably consigned this panel's recommendations to oblivion. Clinging to unfamiliar consumption taxes that violate our treaty obligations and fail to mesh with international practice and norms is a dead end. Sigh.

What our nation needs now is a new and better tax system, one that is far simpler, fairer, and more conducive to economic growth. The rest of the world has taken a very different road. By 1980, 25 countries, mostly in Western Europe and South America, had adopted value-added taxes (VATs), a tax on sales of goods and services, collected by withholding the tax at all stages of production and distribution. Today, *more than 160 countries* employ a VAT, and the United States is the only OECD country without a national-level tax on sales of goods and services (Figure 1). Even though the United States is a relatively low tax country — with tax revenues of about 25 percent of GDP compared to nearly 40 percent in Europe and almost 35 percent in the OECD — it is not a low income tax country. Our income tax revenues are about 12 percent of GDP, similar to that in Europe and the OECD (OECD, 2013; EuroStat, 2013). Instead, the United States relies much less on consumption taxes than other countries—less than 5 percent of GDP, compared to more than 11 percent in Europe and the OECD. In the United States, consumption taxes, mostly state sales taxes, supply only 15 percent of total taxes, about half the OECD average (OECD, 2013).

The United States hobbles itself in today's international economy by continuing to rely so heavily on income taxation. To have a tax system capable of financing fairly the necessary level of federal expenditures in a manner that is conducive to economic growth, we need to rebalance our federal tax system to rely less on income taxation. Simply reforming our income tax is inadequate to meet today's economic challenges. After the Second World War, with Europe and Japan in shambles and China entering a dark communist period, even a horrible tax system could not impede our nation's success in the world economy. This century we cannot afford to so disadvantage ourselves.

It is folly, however — when destination-based value-added taxes have proved to work so well globally — to insist on unique, untested forms of consumption taxation that conflict with our international tax and trade commitments. To be sure, the barrier to enacting a VAT for the United States is political. But, given their failure to gain any traction after decades of legislative efforts, political hurdles also loom large for the direct or personalized forms of consumption taxes urged for the United States by public finance economists over the past four decades.

Former Treasury Secretary Lawrence Summers once remarked that Republicans don't like value-added taxes because they are a "money machine" for the government and Democrats don't like them because they are regressive. We will get a VAT, he said, when Democrats realize that it is a money machine and Republicans realize that it is regressive (quoted in Rosen, 1988). To the contrary, we will get a VAT only when such a tax on sales of goods and services is included as part of a tax reform designed to ensure that it is *neither* regressive nor a money machine. That is what my Competitive Tax Plan is designed to do.

Figure 1

Countries with Value-Added Tax Systems

Sources: Ebrill et al. (2001); Organisation for Economic Co-operation and Development (2012).

III. THE GRAETZ COMPETITIVE TAX PLAN

My proposed Competitive Tax Plan (Graetz, 2010) has four components, each of which is described in detail below. The discussion draws on a detailed analysis of the plan by the Tax Policy Center (Toder, Nunns, and Rosenberg, 2012), which has recently been updated to reflect the new baseline resulting from the 2013 Fiscal Cliff legislation and to take into account simplifications of the plan's payroll tax reductions and child tax credits (Toder, Nunns, and Rosenberg, 2013). The plan would:

- First, enact a destination-based VAT, a broad-based tax on the consumption of goods and services, similar to that now used by more than 160 countries worldwide. Many English-speaking countries call this a goods and services tax (GST).
- Second, use the revenue produced by this VAT or GST to finance an income tax exemption of $100,000 of family income — freeing more than 120 million American families from income taxation — and to lower the income tax rates on income above that amount. The $100,000 family allowance would be indexed for inflation.
- Third, lower the corporate income tax rate to 15 percent.
- Fourth, protect low-and-moderate-income workers from a tax increase through payroll tax credits, which would increase take-home pay, and expanded refundable tax credits for children, which would be administered through government-issued debit cards.

A. Enact a Tax on Sales of Goods and Services

The widespread application of the VAT around the world — even in countries with limited tax administration capacity — demonstrates that the United States could readily administer a VAT. The best VAT practices are found not in Europe but rather in the more modern VATs, such as those enacted in New Zealand, Australia, Canada, Singapore, and South Africa. These taxes are imposed on broad consumption tax bases at a single rate to minimize distortions and simplify compliance and administration. As in my proposal, the consumption tax is made less regressive with measures targeted to low-and moderate-income households, rather than by exemptions for items such as food and clothing, which are poorly targeted and expensive since they also apply to purchases by high-income households.[1] Canada's experience has demonstrated that a national VAT and state retail sales taxes can be imposed simultaneously, while also making evident that it is more efficient for states, over time, to replace their retail sales taxes with a harmonized VAT to minimize compliance and administrative costs. Compliance costs should also be reduced, as in Singapore and many other countries, with a generous small business exemption, on the order of $500,000 or $1 million of sales. Finally, while many countries do not publicize their VAT rates to consumers, Canada requires its VAT to be separately stated on sales receipts, creating public awareness of the tax burden and public resistance to rate increases. In Canada, federal revenues and spending have fallen relative to GDP since that nation first introduced a VAT in 1991.

[1] For details on the VAT, see Toder, Nunns, and Rosenberg (2012), Table 1.

There is no reason the United States could not follow the Canadian example, in which case arguments that the VAT is a "hidden tax" would be false.

The Tax Policy Center has estimated that a 12.9 percent VAT would be necessary to finance the income tax reforms, payroll tax cuts, and expanded child credits of my proposal. Its enactment would make the extent to which the United States relies on consumption taxation similar to that of our trading partners (Figures 2 and 3).

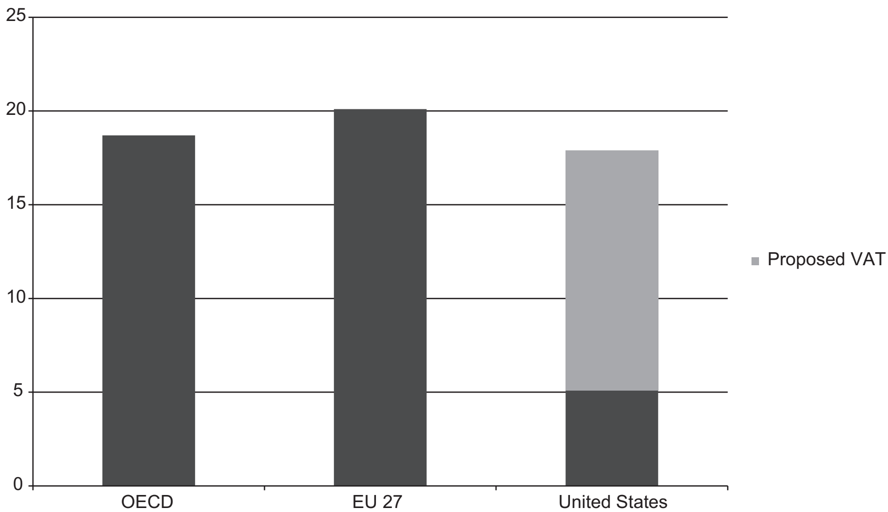
B. Shrink the Income Tax

The Competitive Tax Plan would return the income tax to its pre-World War II status in the United States — a lower-rate tax limited to high income earners to ensure appropriate federal tax progressivity. This would be accomplished through the following steps:

- Provide a "family allowance" of $100,000 for married couples ($50,000 for singles, $75,000 for heads of households).
- For taxable incomes above the new thresholds, apply income tax rates ranging from 14 to 31 percent as shown in Table 1.
- Repeal the Alternative Minimum Tax and repeal the 3.8 percent surtax on investment income.

Figure 2

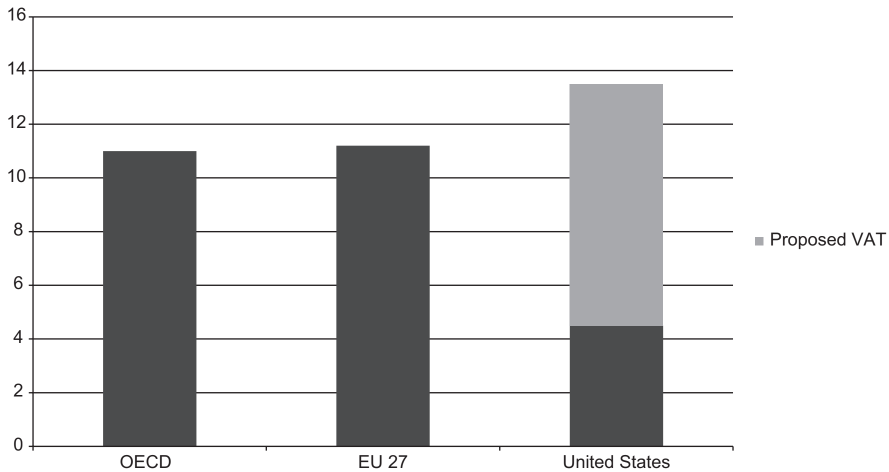
Consumption (VAT) Tax Rates in the EU, OECD Members, and United States Under the Graetz Proposal



Sources: Organisation for Economic Co-operation and Development (2011); European Commission (2011); current U.S. tax rates reflect unweighted average state and local sales tax rates based on data from Tax Foundation, "State and Local Sales, 2011–2013," http://taxfoundation.org/article/state-and-local-sales-tax-rates-2011-2013.

Figure 3

Consumption Taxes as a Percent of GDP



Sources: Organisation for Economic Co-operation and Development (2012); European Commission (2013).

I have included some broadening of the individual income tax base in the plan, such as 2 percent floors on deductions for charitable contributions and home mortgage interest and repeal of the deduction for state and local taxes. The reduction of the corporate tax rate to 15 percent and lowering the individual rates allows dividends and capital gains to be taxed at the same rates as ordinary income. Nevertheless, my plan envisions considerably less base broadening than recommended by Chairman Camp. (For more details on my base-broadening suggestions, see Toder, Nunns, and Rosenberg (2012), Table A-2.) Additional income tax base broadening would of course allow even lower rates, and the Camp proposal offers many examples of additional base-broadening possibilities for the individual income tax (Committee on Ways and Means, 2014; Joint Committee on Taxation, 2014). Figure 4 shows the differences in tax liability by income level under the proposal and current law.)

The changes I have proposed would free more than 150 million Americans from the income tax and eliminate more than 120 million income tax returns, so that fewer than 20 percent of all U.S. families would be required to file income tax returns (Figures 5 and 6). For the vast majority of Americans, April 15 would become just another spring day. Moreover, limiting the income tax to a relatively thin slice of high-income Americans would eliminate any temptation for Congress to use tax breaks as if they are the solutions to America's most pressing social and economic problems. We have tried that in many contexts, including, for example, health insurance and financing higher education, and it doesn't work.

Table 1

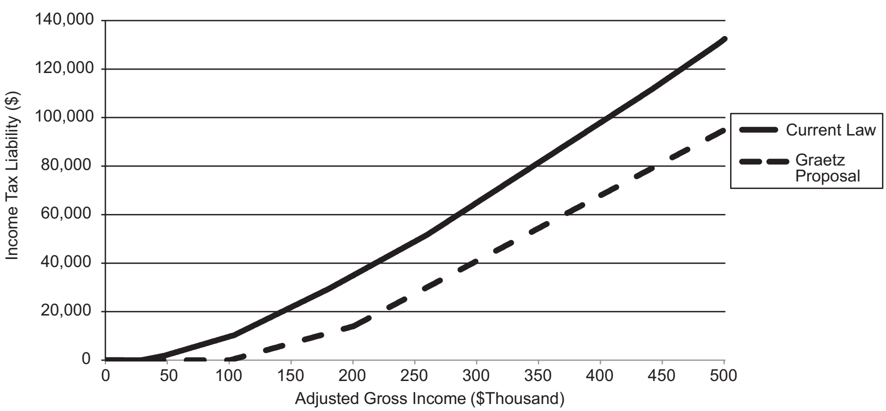
Individual Income Tax Rates Under the Graetz Proposal, Tax Year 2015 (2015$)

Taxable Income ($) Before Family Allowance	Tax Rate (%) Under Graetz Proposal
Married Filing Jointly	
100,000–199,999	14
200,000–599,999	27
> 600,000	31
Single	
50,000–99,999	14
100,000–299,999	27
> 300,000	31
Head of Household	
75,000–124,999	14
125,000–324,999	27
> 325,000	31

Source: Calculations using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2).

Figure 4

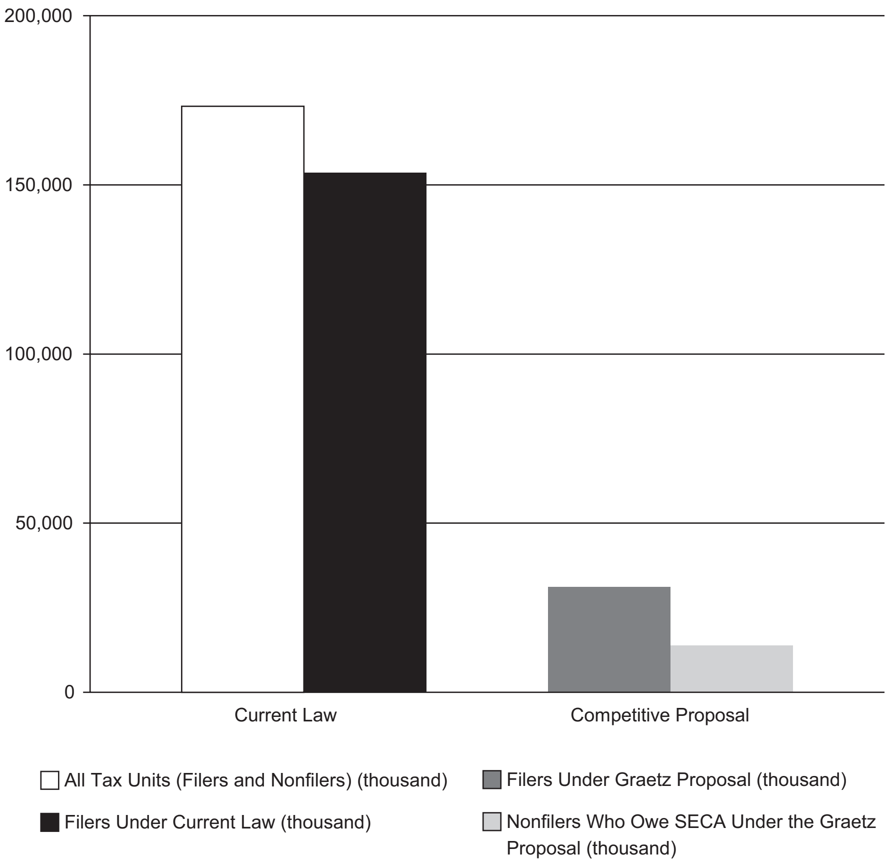
Income Tax Liability (Before Credits) for a Family of Four with No Itemized Deductions Under Current Law and the Graetz Proposal



Source: Toder, Nunns, and Rosenberg (2013), Chart 1.

Figure 5

Number of Individual Income Tax Filers Under Current Law and the Graetz Proposal in 2015 (Thousand)



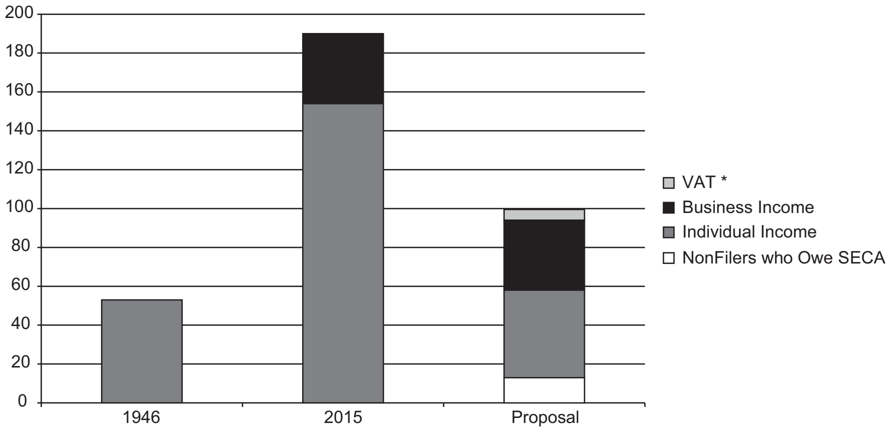
Source: Toder, Nunns, and Rosenberg (2013), Chart 1.

C. Lower the Corporate Income Tax Rate

The internationalization of economic activity and increased competition from abroad make a reprise of the reliance on increased taxation of corporate income that occurred under the Tax Reform Act of 1986 neither desirable nor possible. Corporations and other businesses holding large amounts of capital move money and intangible assets quickly and easily around the world, making it much more difficult for any nation — including the United States — to tax their income. Differences in tax rules among nations and low

Figure 6

Total Tax Returns Under Current Law and the Graetz Proposal



Notes: The 5.5 million VAT returns is the estimated number that would be filed with a $500,000 registration threshold. This includes approximately 2.5 million businesses that would be required to file plus an additional 3 million that would elect to file. At a $1 million threshold, these numbers would be 1.4 million and 4.5 million, respectively. These estimates were provided by the PwC National Economics and Statistics Group.

Sources: U.S. Bureau of the Census (1946); calculations using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2).

tax rates elsewhere, especially on various kinds of intangible income, also facilitate tax planning opportunities (Kleinbard 2011a, 2011b; Graetz and Doud, 2013). And the current ability of businesses to access large pools of private capital, for example, through private equity and sovereign wealth funds, has resulted in significant growth in large partnerships, which now account for an unusually large share of business income. All of these developments further complicate the quest for business income tax reform in the absence of a very low corporate rate.

The interdependence of the world economy makes trying to impose high income tax rates on multinational corporations and large business partnerships counterproductive. Multinational businesses shift their deductions to high-tax-rate countries, and their income to those with low rates. The United States has limited ability to solve this problem unilaterally. Our current high-rate system with its incentives to borrow here and to invest and shift income abroad inhibits domestic economic growth. In order to entice capital and improve conditions for American workers and businesses, the United States must be an attractive place for both foreign and domestic investors. Companies headquartered in the United States also should be positioned to take full advantage of global markets for goods and services, labor, and capital.

No issue of tax policy more divides the Obama Administration and Senate Democrats, on the one hand, from Congressional Republicans, on the other, than how to tax U.S. multinationals. Republicans would be satisfied with income taxation only of U.S. source income, while the Obama Administration and many Congressional Democrats want to expand current taxation of the worldwide income of U.S. multinationals. Only a low corporate tax rate will serve to bridge that divide. Chairman Camp, for example, would impose a 25 percent corporate rate on domestic income and a minimum tax of 12.5 to 15 percent on most foreign income of U.S. companies (Committee on Ways and Means, 2014). At a hearing on April 1, 2014, of the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations concerning a series of transactions that the subcommittee claimed had enabled Caterpillar, Inc. to shift more than $8 billion in taxable income to a Swiss affiliate, Thomas F. Quinn of PriceWatershouseCoopers said that if the U.S. tax rate were 20 percent or less, there would be little incentive to move activities outside the United States (Arora, 2014). But achieving such a low rate without a new revenue source, such as a VAT, does not seem possible. Absent broad international agreement and cooperation to limit tax competition — a transformation that certainly is not on the horizon — a low statutory corporate tax rate is essential.

Unlike 1986, the corporate income tax now should not — and as a practical matter will not — be used to finance tax cuts for individuals. At most, reforming corporate income taxation will be revenue neutral.

We can solve the most vexing problems of international income taxation and reverse the incentives under current law to locate deductions here and income abroad only with a low corporate tax rate. We currently have the highest statutory corporate tax rate in the developed world. High tax rates on corporate income in today's global economy are not a good way to achieve economic growth or maintain or increase progressivity in the distribution of our nation's tax burden. My plan would reduce the corporate income tax rate to 15 percent. At that low rate, the differences between a dividend exemption and a foreign tax credit system would be greatly reduced. And, unlike other proposals that have been advanced, such a low rate would promote domestic investment and enhance the attractiveness of locating company headquarters in the United States.

My proposal would also repeal the corporate alternative minimum tax, and would broaden somewhat the corporate income tax base, for example, by eliminating all credits (except the foreign tax credit). (For additional detail on my proposed changes to the corporate income tax base, see Toder, Nunns, and Rosenberg (2012), Table A-3.) To eliminate the distinctions in business taxation based on their organizational form, we should subject all large businesses to the corporate income tax. Moreover, we should also simplify greatly the taxation of small businesses.

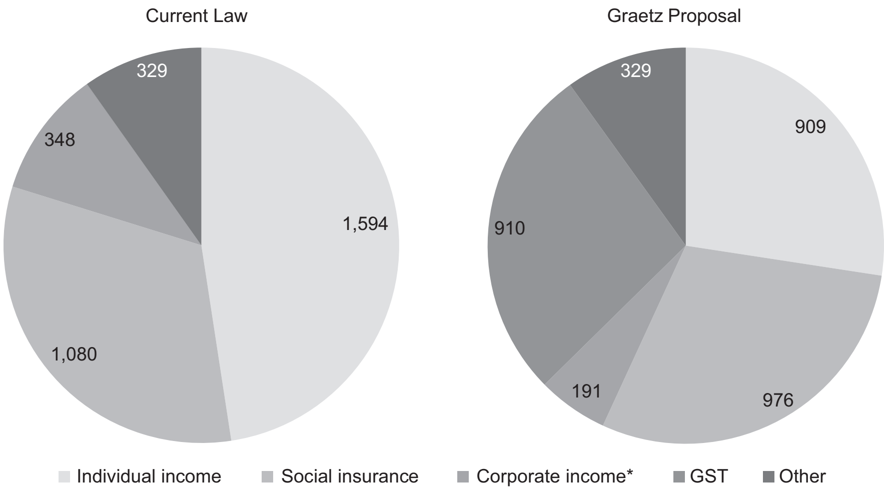
In combination, the individual and corporate income tax reforms I have proposed would greatly reduce the U.S. income tax burden relative to current law and in comparison to income taxes in the OECD and Europe (Figures 7 and 8).

D. Expanded Refundable Child Credits and Payroll Tax Reductions

To ensure that low and moderate income families do not bear any significant tax increase, my proposal would expand refundable child credits and reduce payroll taxes.

Figure 7

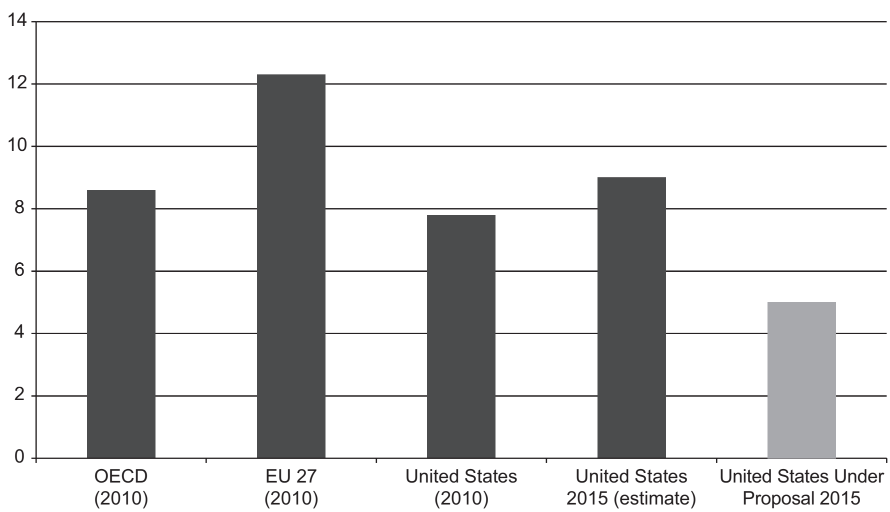
Composition of Federal Revenues Under Current Law and the Proposal, 2015



Note: The Graetz proposal is at fully phased in at levels adjusted to the 2013 ratio of revenues to GDP.
Source: Figures are based on data provided in Toder, Nunns, and Rosenberg (2013).

Figure 8

Current Law and the Proposal: Income Tax Revenue as a Percentage of GDP



Sources: Organisation for Economic Co-operation and Development, Taxation: Key Tables from OECD, Table 3, "Taxes on income and profit," http://www.oecd-ilibrary.org/taxation/taxes-on-income-and-profit_20758510-table3s; EuroStat, Government finance statistics, "Main national accounts tax aggregates," http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/database.

The child credits would be delivered through debit cards and would offset the tax on goods and services. The parameters of these credits are as follows. All children would qualify for a credit of $1,500 per child. For married couples with taxable income greater than $150,000 ($75,000 for singles and heads of households), these credits would be phased-out at a rate of 5 percent. (These phase-outs would be administered as additions to income tax.) Low and moderate income workers would get an additional credit of up to $3,500 for one child and $5,200 for two or more children.[2]

In addition to the expanded child credits, my plan would also provide a payroll tax credit of 15.3 percent for wages up to $10,000 and $1,530 per worker for all workers with earnings between $10,000 and $40,000. This credit would eliminate all payroll taxes for workers with $10,000 or less of earnings, and would eliminate at least the employees' share (half) of payroll taxes for workers with earnings below $20,000. For workers with earnings below $40,000, the credit would eliminate at least one-quarter of payroll taxes. Above $40,000 the credit would phase out at a rate of 7.65 percent (Toder, Nunns, and Rosenberg (2013), Table 2A). It would be straightforward to administer this per-worker credit through reduced wage withholding. The payroll tax credits, like the earned income tax credit of current law, need not reduce trust fund balances for Social Security or Medicare.

E. The Competitive Tax Plan Is Revenue Neutral and Distributionally Neutral

As shown in Tables 2 and 3, the Tax Policy Center has estimated that my plan is revenue neutral, that is, it does not increase the deficit relative to current law in 2015. In addition, the plan does not change the distribution of federal tax burdens, as shown in Table 4 and Figure 9, which present the Tax Policy Center's estimates of the distributional effects of the plan (Toder, Nunns, and Rosenberg, 2013, Table 4). These data show that after-tax income would increase slightly in the bottom four quintiles of the income distribution and would be slightly reduced for the top quintile, with the greatest reductions in after-tax income occurring for the top 0.1 percent.

IV. CONCLUSION: WHY WE NEED THE COMPETITIVE TAX PLAN

Enactment of the Competitive Tax Plan would have three important advantages for the U.S. economy. First, it takes advantage of our status as a low-tax country by transforming the United States into a low income-tax country. Most Americans would owe no tax on their savings, and all Americans would face lower taxes on their savings and investments. Moreover, the plan provides for an interval of 18 months to two years between enactment and implementation of the VAT, during which time Americans would accelerate their purchase of durables, such as cars and large appliances, providing a

[2] These additional credits would phase-out at a 12.5 percent rate when wages (or self-employment earnings) exceed $18,000 (families with one child) or $27,000 (families with two or more children); see Toder, Nunns, and Rosenberg (2013), Table 2B.

Table 2

Deficit Neutrality of the Competitive Tax Plan: Summary of the Revenue and Spending Effects of the Competitive Tax Plan Relative to Current Law in 2015 (Amounts Shown are Effects on Deficit)

Individual Income Tax Provisions	
Total for Individual Income Tax Provisions (before Rebate)	564.3
Corporate and Non-Corporate Business Income Tax Provisions	
Flat Corporate Income Tax Rate of 15%	–177.7
Other Corporate and Business Income Tax Provisions	63.3
Total for Corporate and Business Income Tax Provisions	–114.4
Value-Added Tax (VAT) of 12.9%	
Net VAT Receipts (before Rebate)	1,186.8
Combined Child and Worker Credits and Rebates	–545.1
Change in Nominal Federal Spending	
Cash Transfer Payments	139.1
Grant to State and Local Governments	– 102.1
Net Change in Nominal Federal Spending	37.0
Change in Federal Deficit	0

Source: Toder, Nunns, and Rosenberg (2013), Table 3.

short-term boost to the economy. Over the longer term, such a tax reform would make the United States a much more favorable place for savings and investment, and promote economic growth without shifting the tax burden down the income scale.

The Joint Committee on Taxation provided a range of estimates of the economic benefits of Chairman Camp's tax reform proposal and concluded that it might increase GDP by as much as 1.6 percent over 10 years and private sector employment by as much as 1.5 percent over the same period (Joint Committee on Taxation, 2014(a)). While no comparable estimates have been made for my plan, it is clear the replacement of much of the income tax with a consumption tax, as I have proposed, would have a substantially greater positive impact on economic growth and employment. George Zodrow and John Diamond, for example, have analyzed a related proposal and estimated that GDP would be higher by 2 percent in the short-run, and by 5 percent in the long run (Diamond and Zodrow, 2007).

Second, by returning the income tax to its pre-World War II role as a relatively small tax limited to high income Americans, there would be no temptation for Congress to use tax breaks as if they are solutions to America's social and economic problems. Experience demonstrates the ineptitude of that path. Moreover, the vast majority of Americans would never have to deal with the IRS.

Table 3

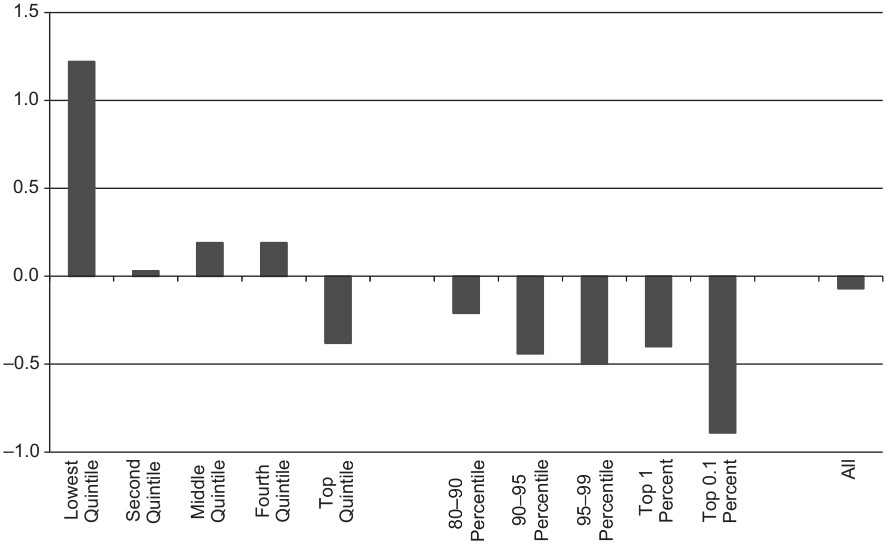
Revenue Effects of the Income Tax Provisions and Revenue and Spending Effects of the VAT Provisions of the Competitive Tax Plan Relative to Current Law in 2015

Provision	Amount in 2015 ($Billions)
Individual Income Tax Provisions	
Repeal the AMT	–43.9
Tax Rates of 14%, 27% and 31% (Repeal 3.8% Surtax on Investment Income)	–79.9
Replace Standard Deduction and Personal Exemption with Family Allowance	–697.6
Eliminate Deduction for State and Local Taxes	85.4
Floors of 2% of AGI on Contributions and Mortgage Interest	29.1
Eliminate All Credits Except the Foreign Tax Credit	142.6
Total for Individual Income Tax Provisions (before Rebate)	–564.3
Corporate and Non-Corporate Business	
Income Tax Provisions Flat Corporate Income Tax Rate of 15%	–177.7
Other Corporate and Business Income Tax Provisions	63.3
Total for Corporate and Business Income Tax Provisions	–114.4
Value-Added Tax (VA T) of 12.9%	
Gross VAT Revenue	1,454.6
Less: Individual Income Tax Offset	142.3
Less: Corporate Income Tax Offset	21.5
Less: Payroll Tax Offset	104.0
Equals: Total Revenue Offsets	267.8
Net VAT Receipts (before Rebate)	1,186.8
Integrated Income Tax and VAT Rebate[1]	–545.1
Change in Nominal Federal Spending	
Cash Transfer Payments	139.1
Grant to State and Local Governments	–102.1
Net Change in Nominal Federal Spending	37.0
Change in Federal Deficit	0

[1]The cost of the rebate also includes the adjustment of all cash transfer payments to pre-VAT levels.

Sources: Toder, Nunns, and Rosenberg (2013), Table 3; calculations using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2); the Tax Policy Center estimates are based on sources described in the text.

Figure 9
Distributional Neutrality of the Competitive Tax Plan
(Percentage Changes in After-Tax Income)



Source: Toder, Nunns, and Rosenberg (2013), Table 4.

Third, a 15 percent corporate tax rate would solve the difficult and controversial problems caused by both international tax planning by multinational corporations and international competition for corporate investments among nations. Importantly, unlike other direct or personalized consumption tax proposals, such as the Flat Tax, the Bradford X-Tax, and the Bush tax reform panel's Growth and Investment Tax, this proposal fits well with existing international tax and trade agreements. Moreover, by taxing imports and exempting exports, it would yield hundreds of billions of dollars for the U.S. Treasury from sales of products made abroad in the decade ahead — $600 billion to $700 billion at current trade levels.

A 1986-style tax reform is a dead end. So are other forms of consumption taxes found nowhere in the world. It is time to move down a different, well-traveled road. The tax reform I have described would introduce a tax on purchases of goods and services into the U.S. tax system in a manner designed to ensure that it neither becomes a money machine nor redistributes our nation's tax burden down the income scale. Simultaneously, it would rearrange the U.S. tax system in a manner more conducive to economic growth and make it better able to meet our nation's revenue needs in the decades ahead.

Table 4

Distributional Analysis of the Competitive Tax Plan Fully Phased-in Relative to Current Law at Income Levels in 2015 (Percentage Changes in After-tax Income)

	Individual Income Tax Provisions (Before Rebate)	Corporate and Business Tax Provisions	VAT (Before Rebate)	Integrated Income Tax and VAT Rebate	Total Changes
Lowest Quintile	–4.9	0.3	–10.9	19.1	1.2
Second Quintile	–0.8	0.4	–11.2	13.1	0.0
Middle Quintile	4.3	0.5	–11.1	7.5	0.2
Fourth Quintile	6.7	0.6	–10.6	4.5	0.2
Top Quintile	6.2	1.4	–8.4	1.1	–0.4
All	4.7	0.9	–9.8	4.8	–0.1
Addendum					
80–90 Percentile	7.3	0.7	–9.9	2.5	–0.2
90–95 Percentile	7.2	1.0	–9.1	1.3	–0.4
95–99 Percentile	6.5	1.2	–8.1	0.4	–0.5
Top 1 Percent	4.3	2.3	–6.8	0.1	–0.4
Top 0.1 Percent	3.2	2.9	–6.7	0.0	–0.9

Notes: Provisions are stacked in order listed. Total changes are relative to current cumulative from left to right. For example, for the middle quintile the total change is $(1+.043)\times(1+.005)\times(1-.111)\times(1+.075)-1 = 0.2\%$.

Source: Toder, Nunns, and Rosenberg (2013), Table 4; calculations using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2).

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