2013

Updating the Competitive Tax Plan: A New Epilogue for 100 Million Unnecessary Returns

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THE "COMPETITIVE TAX PLAN" UPDATED FOR 2015

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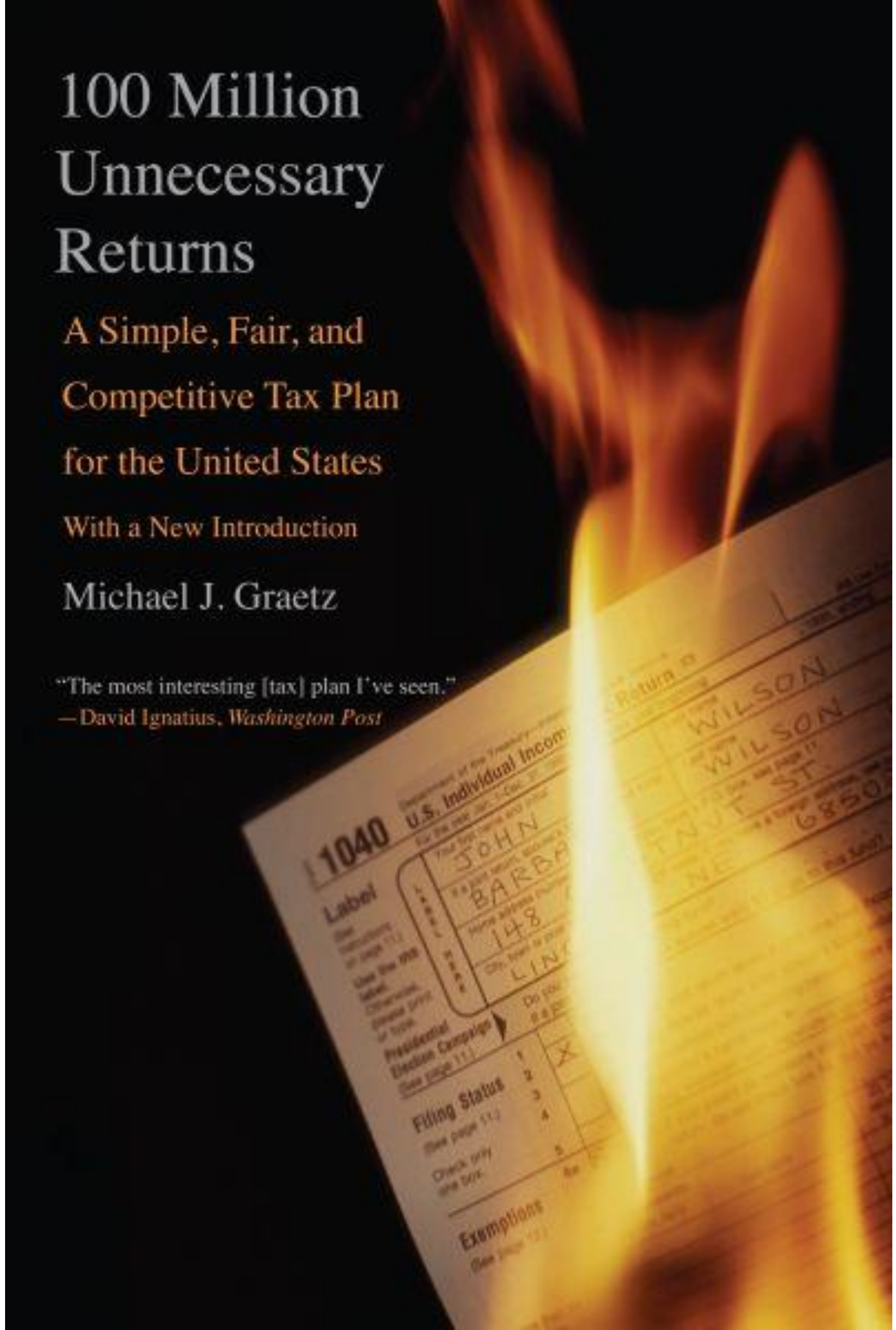
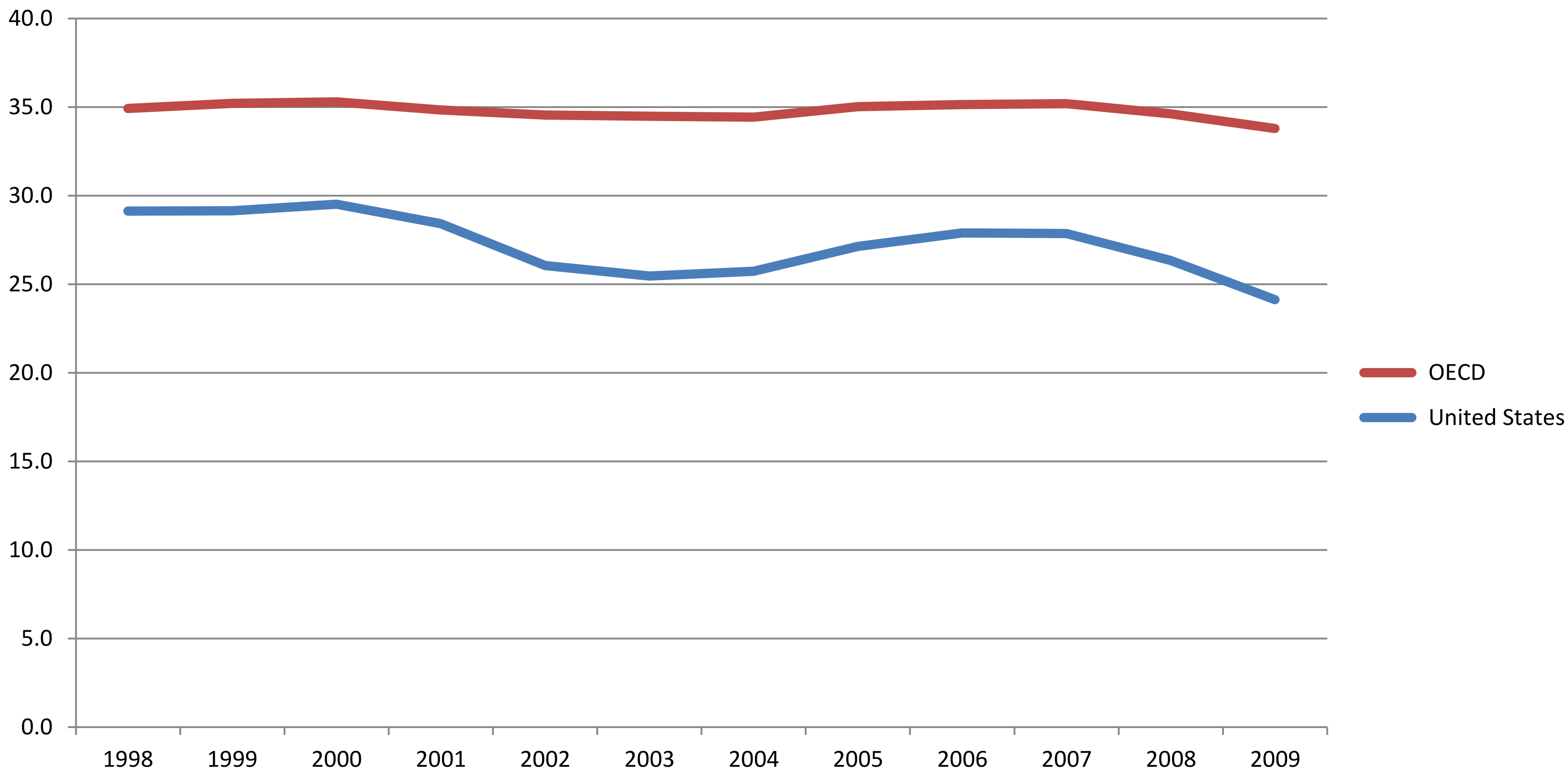
November 21, 2013


100 Million
Unnecessary
Returns
A Simple, Fair, and
Competitive Tax Plan
for the United States
With a New Introduction
Michael J. Graetz
"The most interesting [tax] plan I've seen."
—David Ignatius, Washington Post
1040
U.S. Individual Incom
Label
Filing Status
Exemptions

The U.S. is a Low-Tax Country

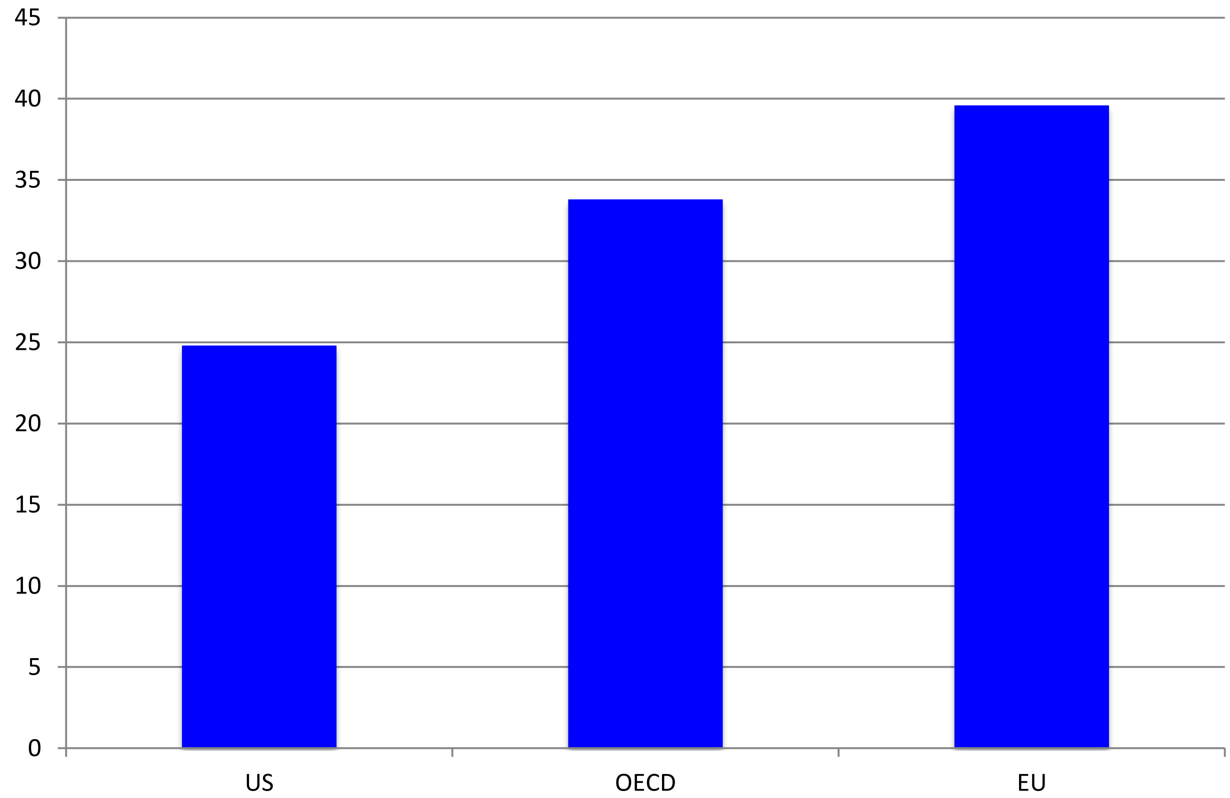
Total Federal, State & Local Tax Revenues as a Percentage of Gross Domestic Product U.S. and OECD Countries, 1998-2009



OECD Factbook 2012: Economic, Environmental and Social Statistics

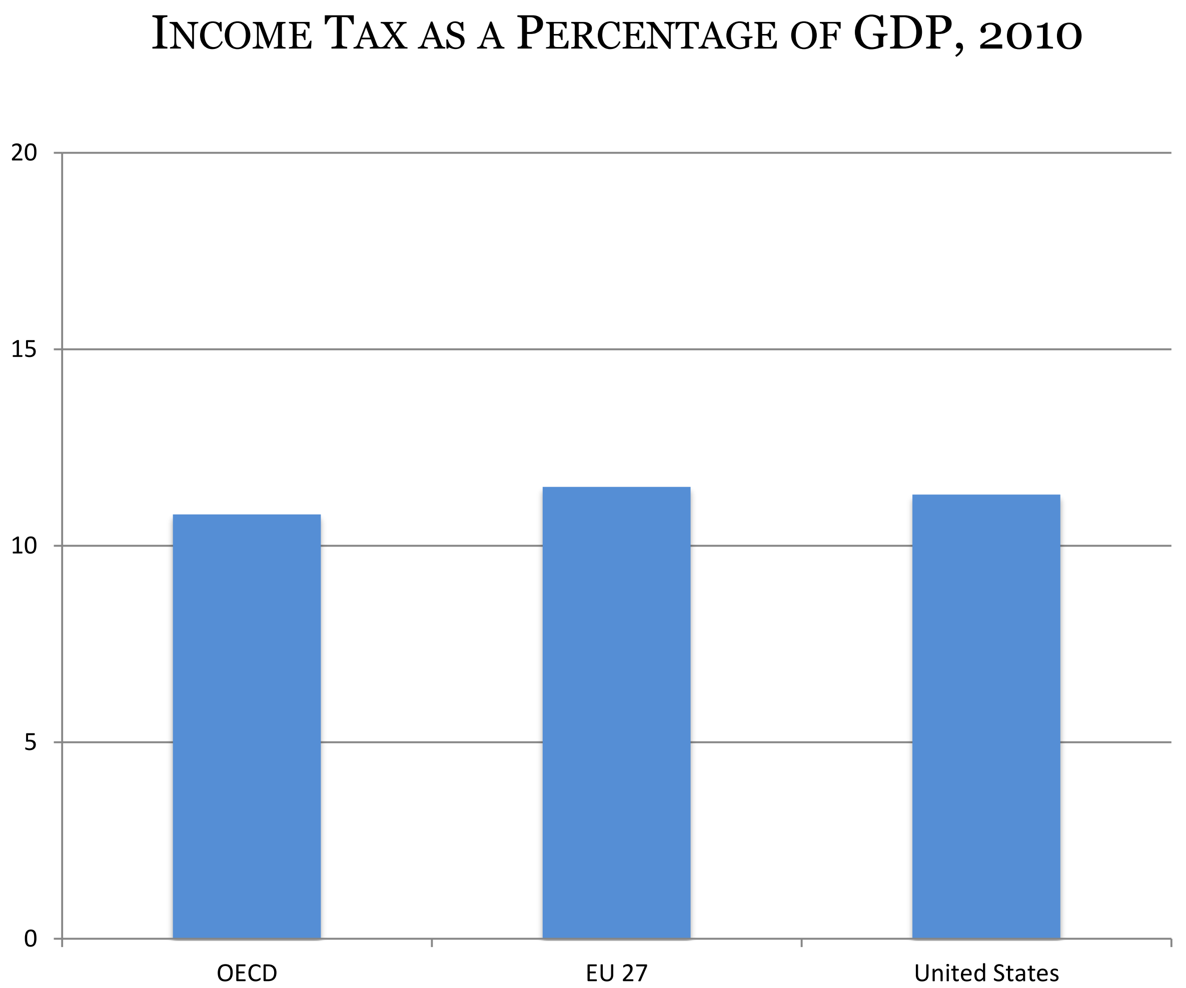
The U.S. is a Low-Tax Country

Total Taxes as a Percentage of Total GDP, 2010



OECD, iLibrary, Key Tables, Total Tax Revenue and EuroStat, Main national accounts tax aggregates, Total Receipts.

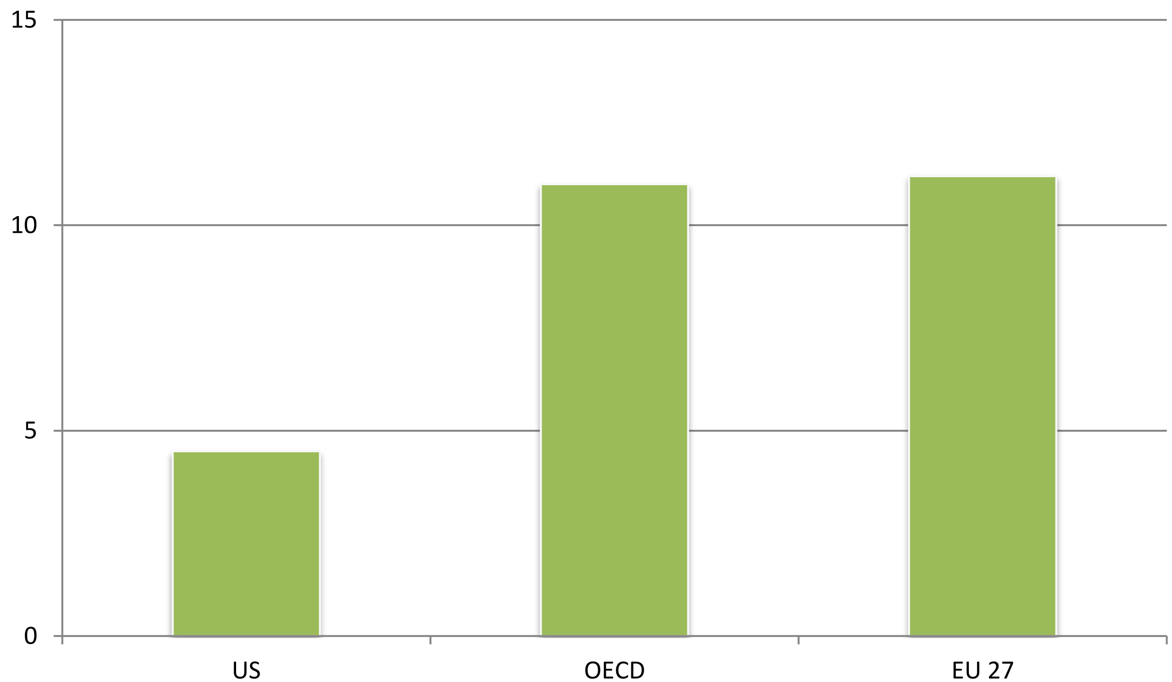
But the U.S. is Not a Low Income Tax Country



OECD, iLibrary, Key Tables, Taxes on Income and Profits, EuroStat, , Main national accounts tax aggregates, Taxes on Individual or Household Income and Taxes on Income or Profits of Corporations.

The U.S. is a Low Consumption Tax Country

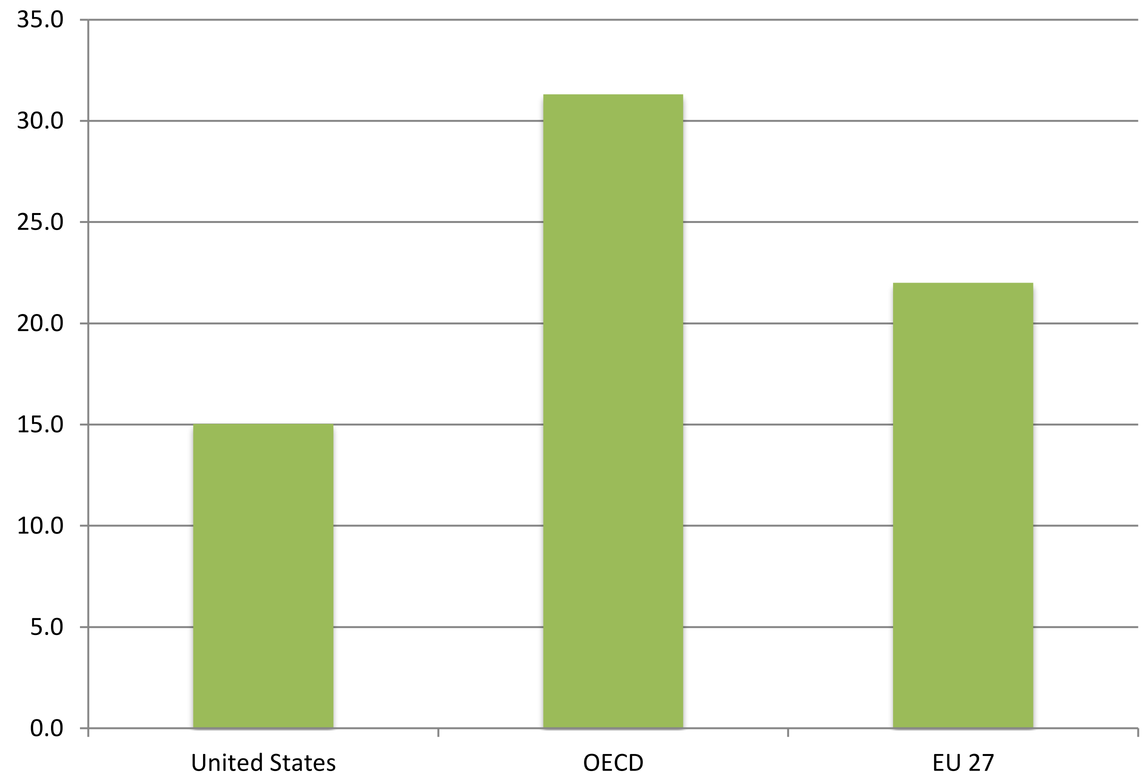
CONSUMPTION TAX AS A PERCENTAGE OF GDP, 2010



Source: OECD, iLibrary, Key Tables, Taxes on Goods and Services and Eurostat, Main national accounts tax aggregates, Taxes on Products

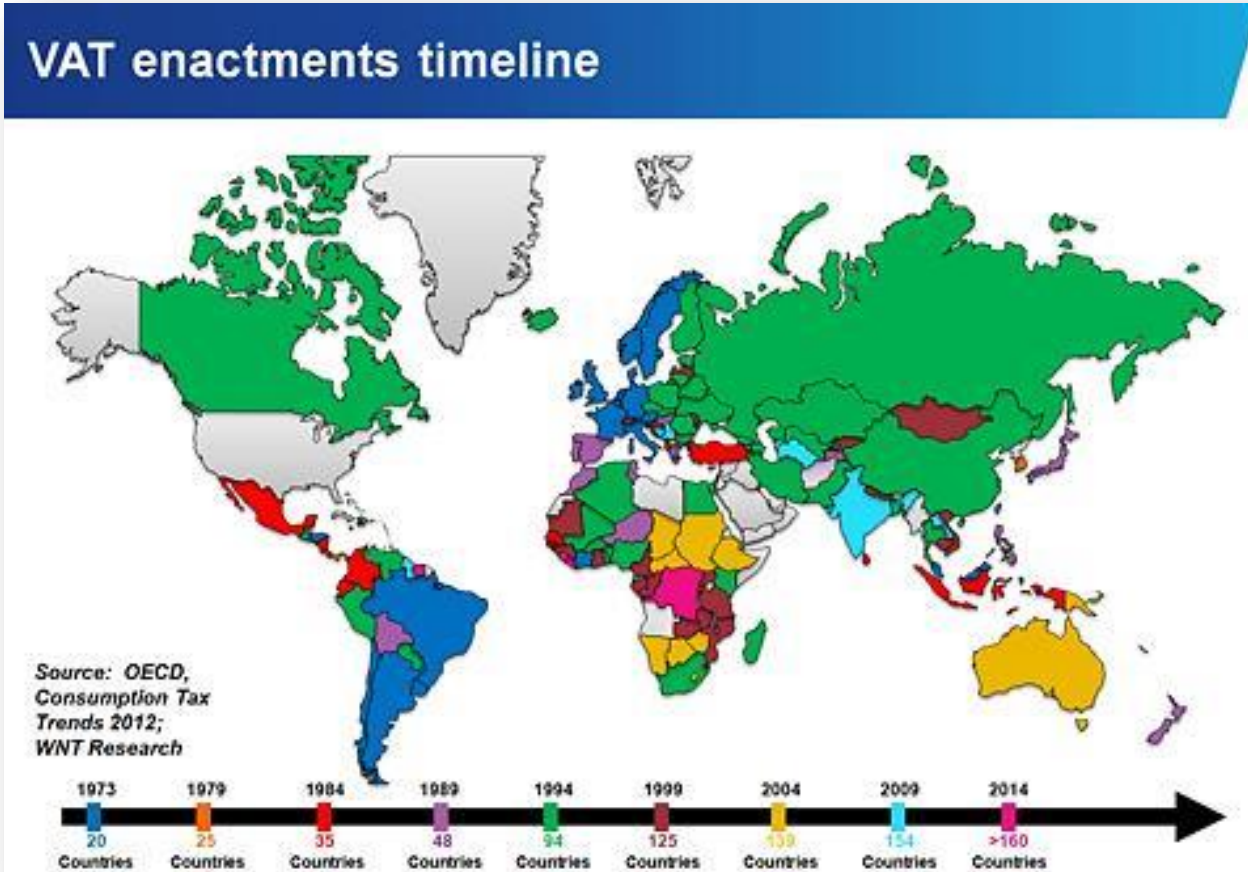
The U.S. is a Low Consumption Tax Country

CONSUMPTION TAX AS A PERCENTAGE OF TOTAL TAXATION, 2010



OECD, Consumption Tax Trends, 2012 and European Commission, Taxation Trends in the European Union, 2013

The U.S. is the Only OECD Country Without a VAT
More Than 160 Countries Now Have a VAT



The Five Pieces of the "Competitive Tax Plan"

- First, enact a VAT, a broad-based tax on sales of goods and services, 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 consumption tax to finance an income tax exemption of $100,000 of family income—freeing more than 120 million American families from income taxation—and lower the income tax rates on income above that amount.

- Third, lower the corporate income tax rate to 15 percent.

- Fourth, protect low-and-moderate-income workers from a tax increase through payroll tax cuts.

- Fifth, protect low-and-moderate income families from a tax increase by substantially expanded refundable tax credits for children, delivered through debit cards to be used at the cash register.

A Deficit-Neutral and Distributionally-Neutral "Competitive Tax Plan" in 2015

- The New Goods and Services Tax
- The Shrunken Individual Income Tax
- The Corporate Income Tax
- Payroll Tax Reductions
- Expanded Refundable Child Credits

* These parameters for the Competitive Tax Plan were provided by the Tax Policy Center in November 2013. They are updated and somewhat revised from January 2012 estimates to reflect the "fiscal cliff" legislation of January 2013 and new baselines. The earlier analysis and estimates were funded by the Pew Charitable Trusts. See Eric Toder, Jim Nunns, and Joseph Rosenberg, "Using a VAT to Reform the Income Tax," Tax Policy Center, January 2012. Special thanks to Jim Nunns and Joseph Rosenberg for this update.

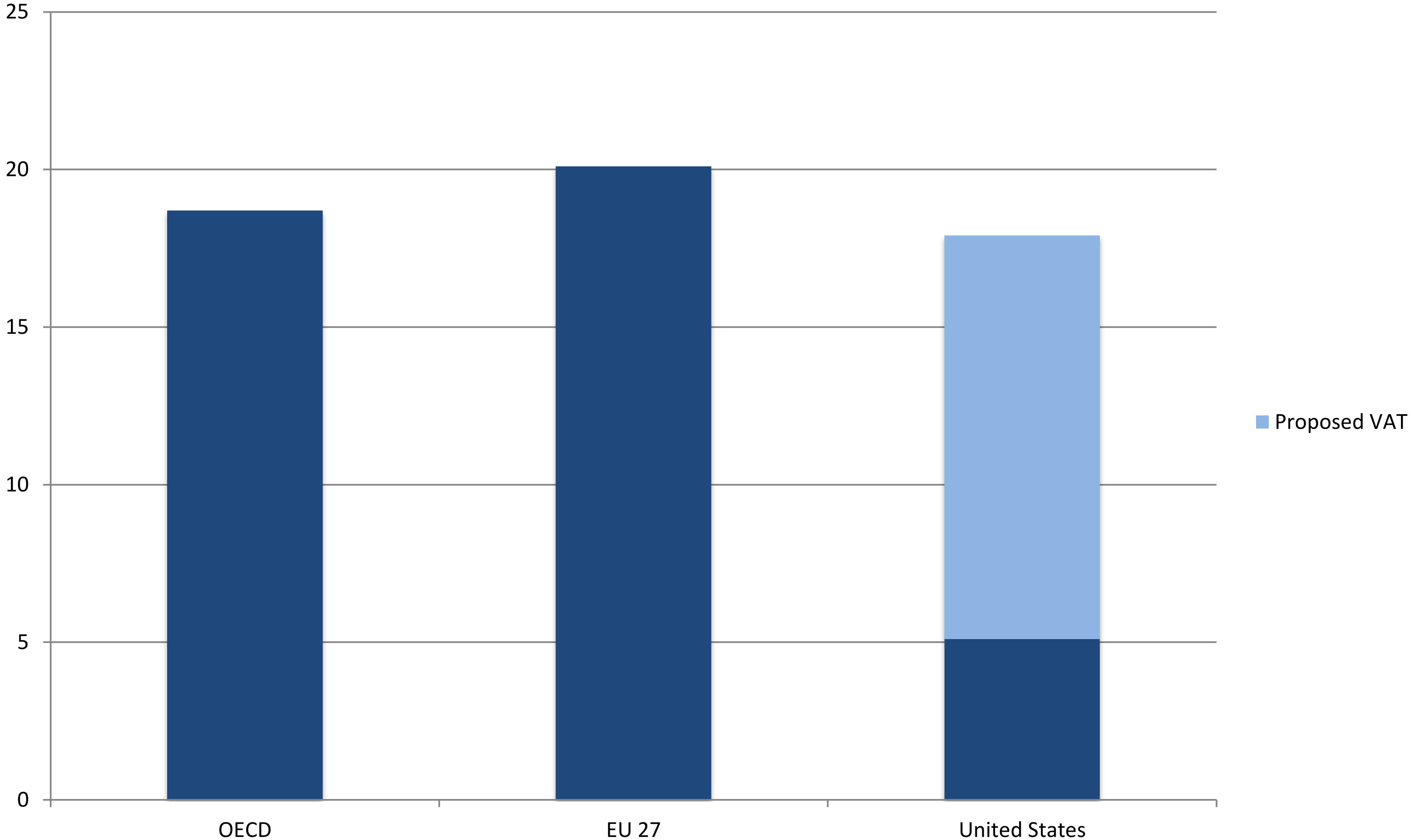
The Proposal:
Goods and Services Tax (GST) Design

- Some Principles:

  - Broad-base, Single Rate, Credit-Method
    - Conforms to international practice and treaties
    - Offers much better protections to tax base in case of exemptions (e.g., for small businesses)
  - Models are modern VATs like New Zealand, Australia, Canada, Singapore, and South Africa, not the archaic European VATs.
  - Destination-Based, Border-Adjusted
    - Taxing imports and exempting exports is consistent with international tax and trade treaties.
    - Taxing imports will produce substantial revenues in the years ahead from production abroad.
  - High-threshold for Registration
    - Exempt small businesses with less than $500,000-$1,000,000 of gross receipts to minimize compliance and administrative costs.
  - Incentive for States to piggy back
    - Canadian experience demonstrates that a federal VAT and state (or local) retail sales tax can operate together and that piggy-backing may occur over time.
  - Eighteen Month to Two-Year Interval between enactment and implementation for businesses and IRS to gear up
    - Will accelerate durable goods purchases (New Zealand and Japan), providing short-term boost to the economy.

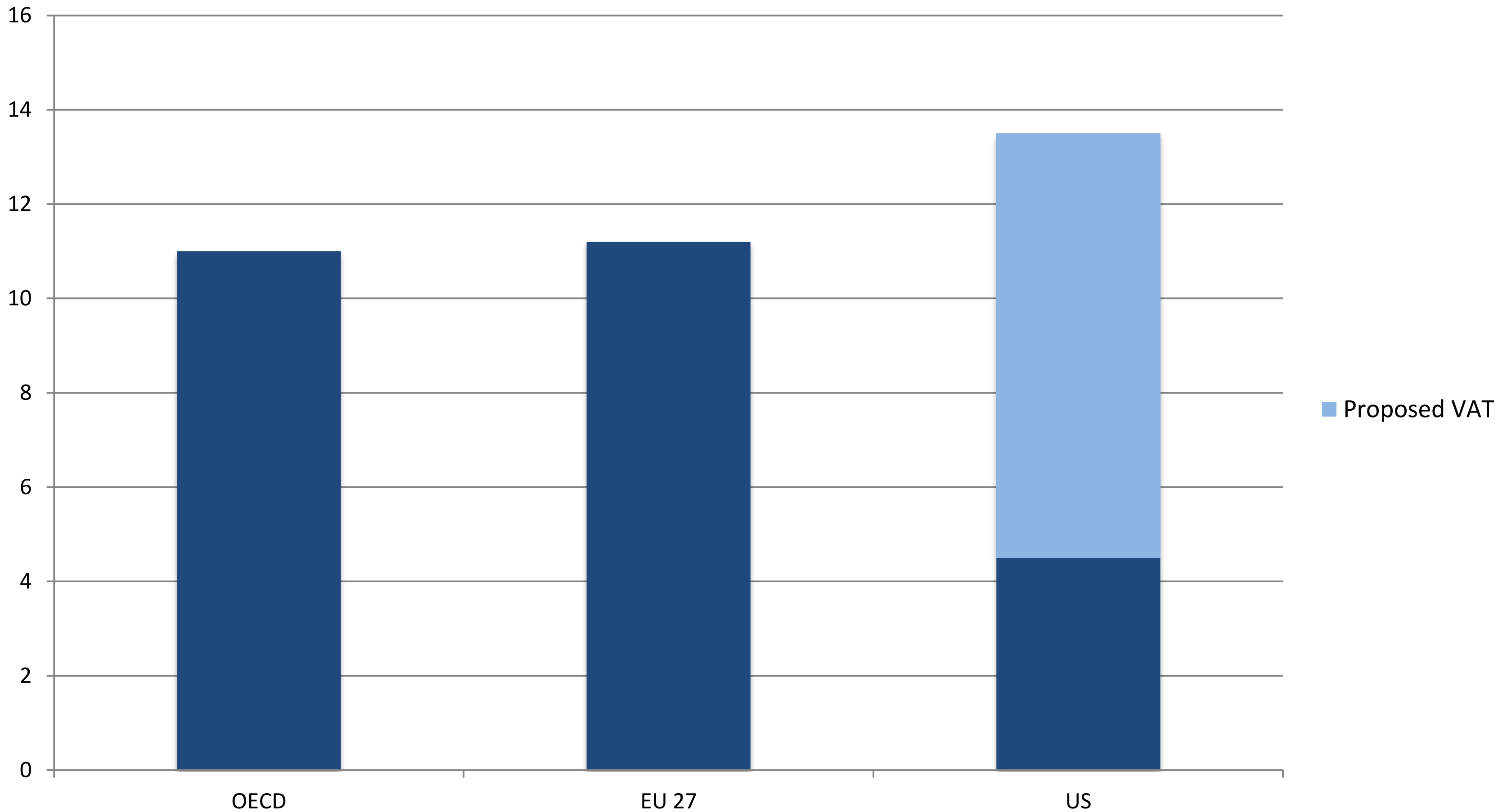
- The VAT Rate: 12.9 %

The Proposal: Consumption (VAT) Tax Rates in the EU, OECD members, and US



Source: Consumption Tax Trends 2011 (OECD) Table 3.8; Taxation Trends in the EU, 2011, Table E; U.S. computations based on data from http://taxfoundation.org/article/state-and-local-sales-tax-rates-2011-2013 (visited 11/14/2013) (unweighted rate averages)

The Proposal:
Consumption Taxes as a Percent of GDP



OECD, Consumption Tax Trends, 2012 and European Commission, Taxation Trends in the European Union, 2013

The Proposal: Shrink the Income Tax

- Return the Income Tax to its pre-World War II status—limited to high income earners to ensure federal tax progressivity.

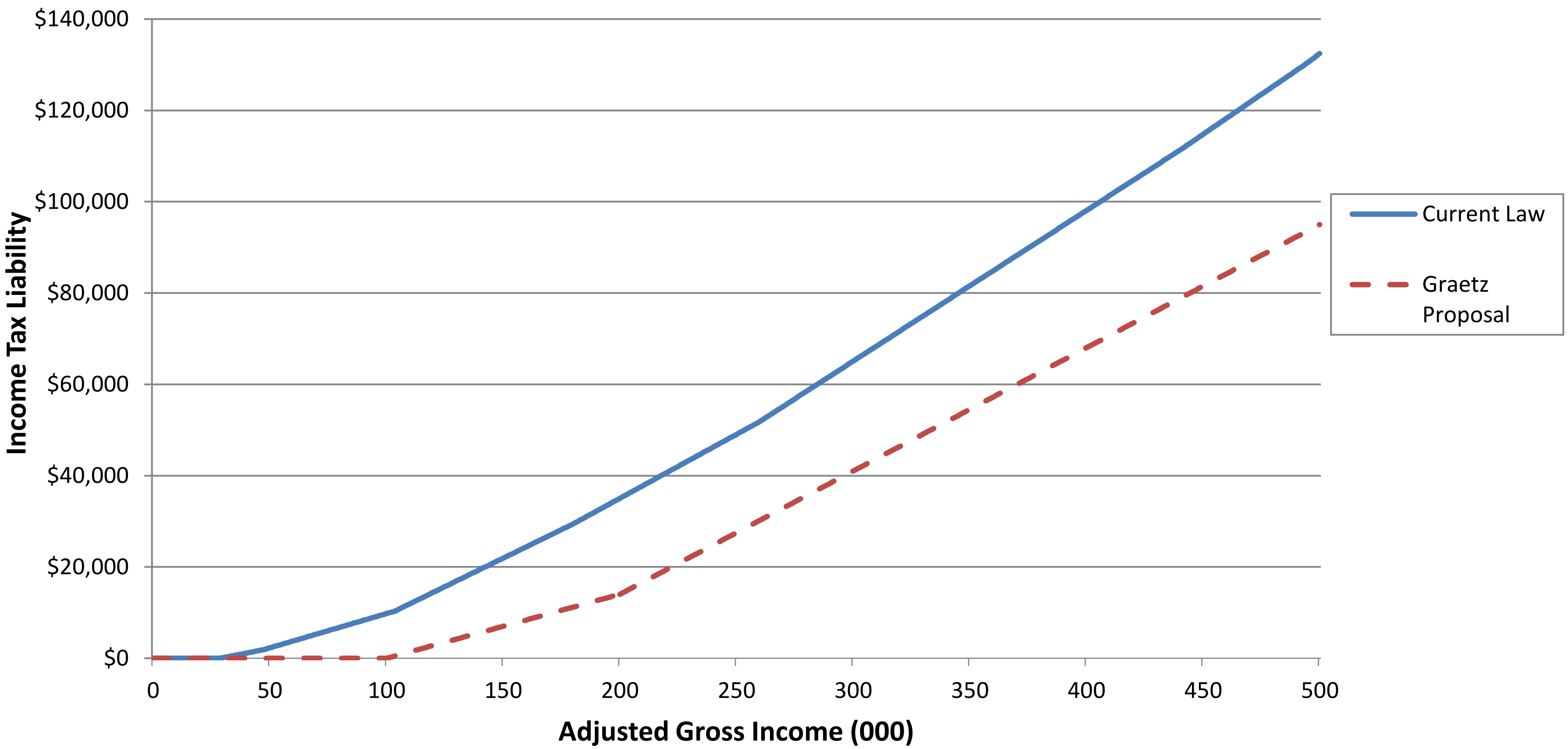
- Provide a Family Allowance of $100,000 for married couples ($50,000 for singles, $75,000 for heads of households)
  - Eliminates more than 120 million income tax returns
  - Fewer than 20 percent of all U.S. tax units will be required to file income tax returns. For the vast majority of Americans, April 15 will just be another day in the spring.

- Income Tax Rates Above the New Threshold (married couples)*
  - 14% for income between $100,000 and $200,000
  - 27% for income between $200,000 and $600,000
  - 31% for income over $600,000

- Repeal the AMT. Repeal the 3.8% surtax on Investment Income. (More broadening of income tax base might allow lower rates.)

* A full income tax rate schedule is provided in Table A-1 of TPC, Update November 2013, reproduced here partially as Table A-3 of the Appendix. **NOTE:** The tax rates here are expressed relative to income **before** the family allowance. TPC Table A-1 is a rate schedule based on **taxable** income **after** the family allowance.

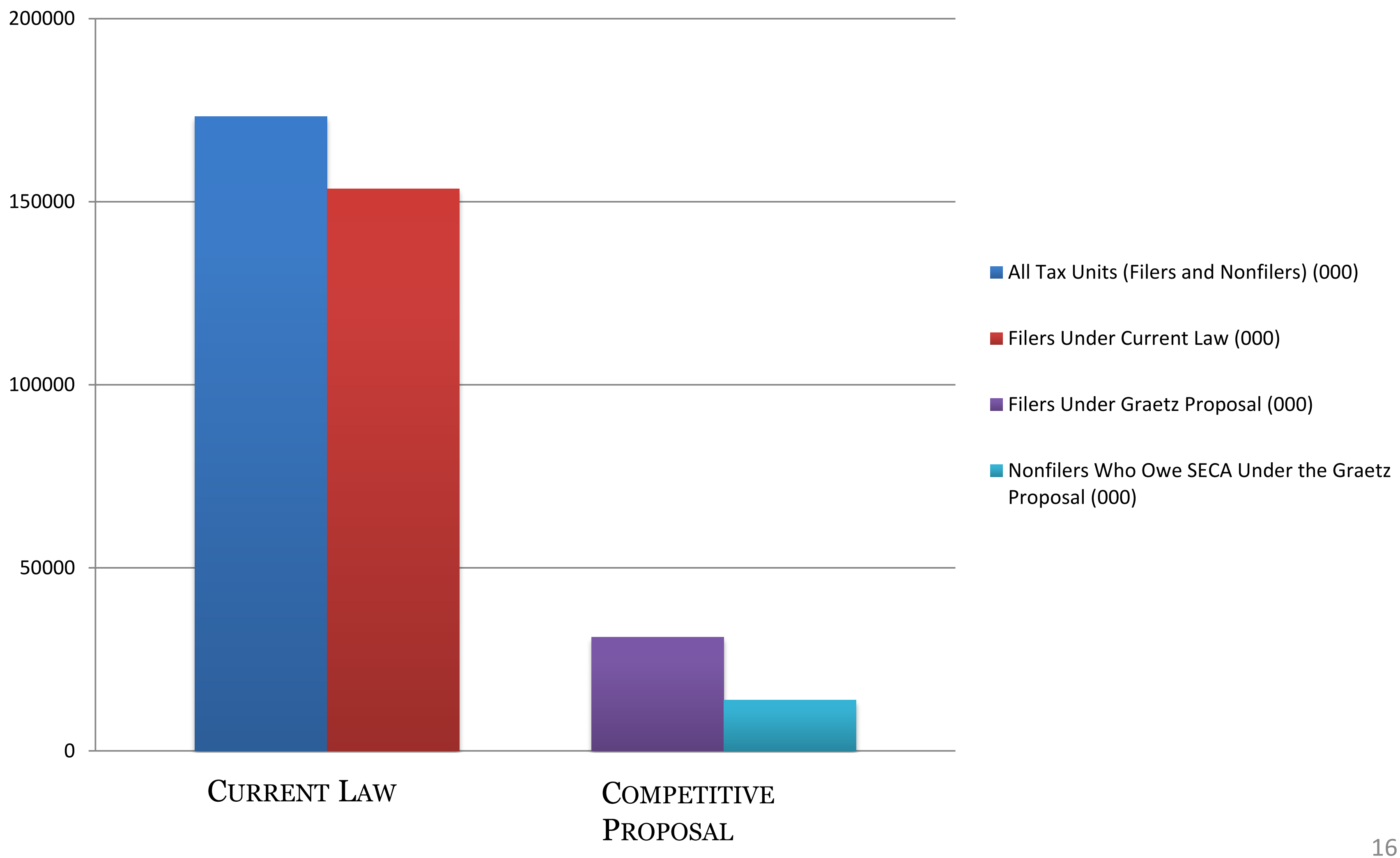
Income Tax Liability (before Credits) for a Family of Four with No Itemized Deductions under Current Law and the Competitive Tax Plan



TPC Update, November 2013, Chart 1.

Number of Individual Income Tax Filers Under Current Law and the Proposal in 2015

(Numbers in Thousands)



The Proposal: Reduce and Reform the Corporate Income Tax

- Reduce the Corporate Income Tax Rate to 15 percent
  - A low corporate rate solves the most vexing problems of international income taxation by reversing current law's incentives to locate deductions here and income abroad.
  - Will work well with either dividend exemption or foreign tax credit system.

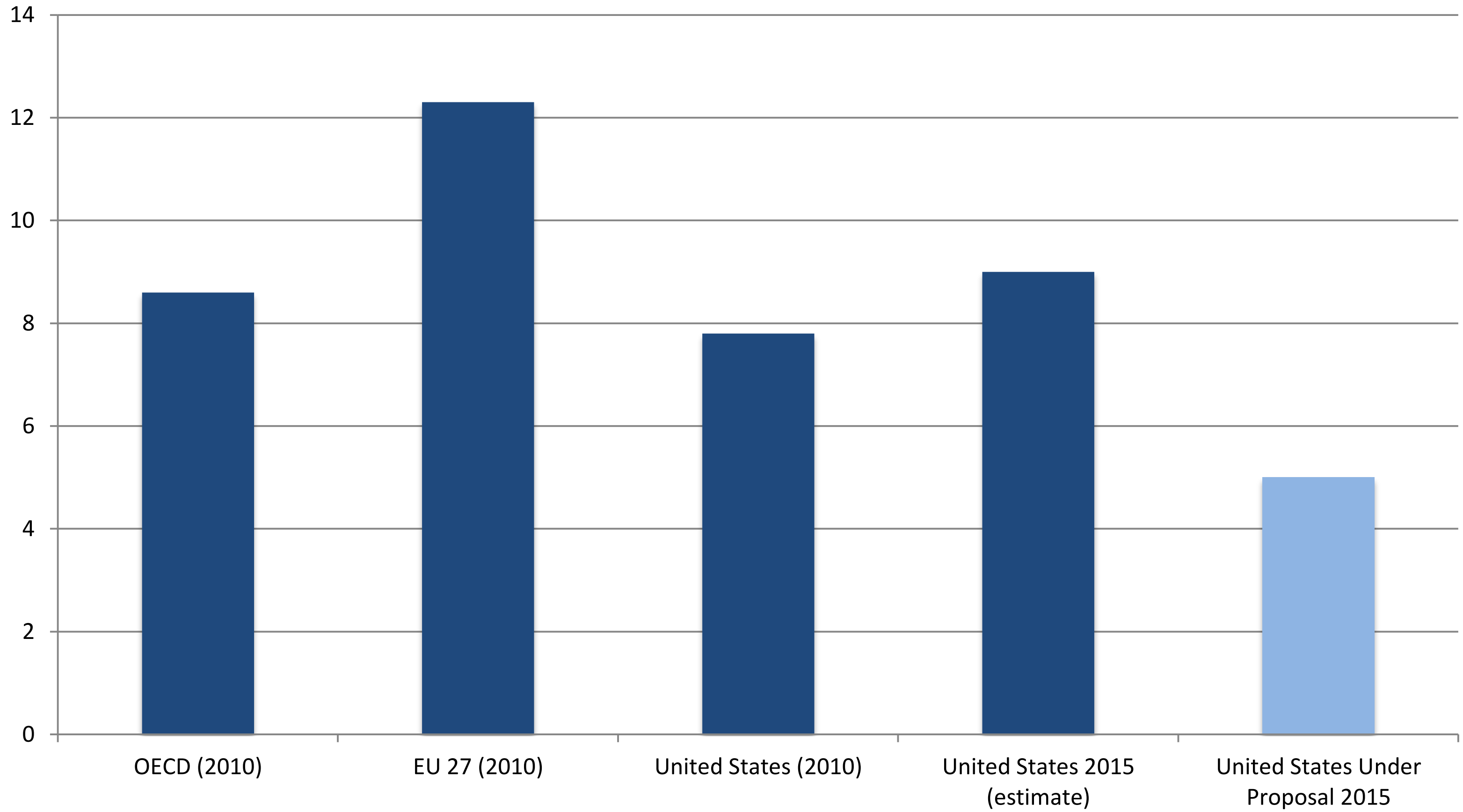
- Repeal the Corporate Alternative Minimum Tax.

- Broaden the Corporate Income Tax Base somewhat: For example, eliminate all credits (except the foreign tax credit).

- Consider subjecting all large businesses to the Corporate Income Tax.

- Simplify taxation of small businesses.

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



OECD, iLibrary, Comparative Tables, Taxes on Income and Profits, EuroStat, Main national accounts tax aggregates, Current Taxes on Income Wealth, Etc.

The Proposal: Protecting Low and Middle Income Families: Expand Refundable Child Credits

- Deliver new child credits through debit cards that can be used at the cash register

- All children qualify for $1,500 per child
  - For married couples with more than $150,000 ($75,000 singles and heads of households), these credits phase-out at a rate of 5%*

- Low and moderate income workers get an additional rebate of up to $3,500 for one child, $5,200 for two or more**

* These levels are above the income tax thresholds and the phase-outs are administered as additions to income tax.

** These additional credits phase-out (at a 12.5% rate) as wages (or self-employment earnings) exceed $18,000 (one-child) or $27,000 (two or more children). See TPC update, November 2013, Table 2B.

The Proposal: Protect Low and Moderate Income Workers: Reduce Payroll Taxes

- 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 eliminates all payroll taxes for workers with $10,000 or less of earnings.
  - This credit eliminates at least the employees' share (half) of payroll taxes for workers with earnings below $20,000.
  - This credit eliminates at least one-quarter of payroll taxes for workers with earnings below $40,000.
  - Above $40,000 this credit phases out at a rate of 7.65 percent.*
  - It will be straightforward to administer the per-worker credit through reduced wage withholding.

* See TPC update, Table 2A, November 2013.

Deficit Neutrality of the Competitive Tax Plan

Summary of Revenue and Spending Effects of the Competitive Tax Plan* Relative to Current Law in 2015:

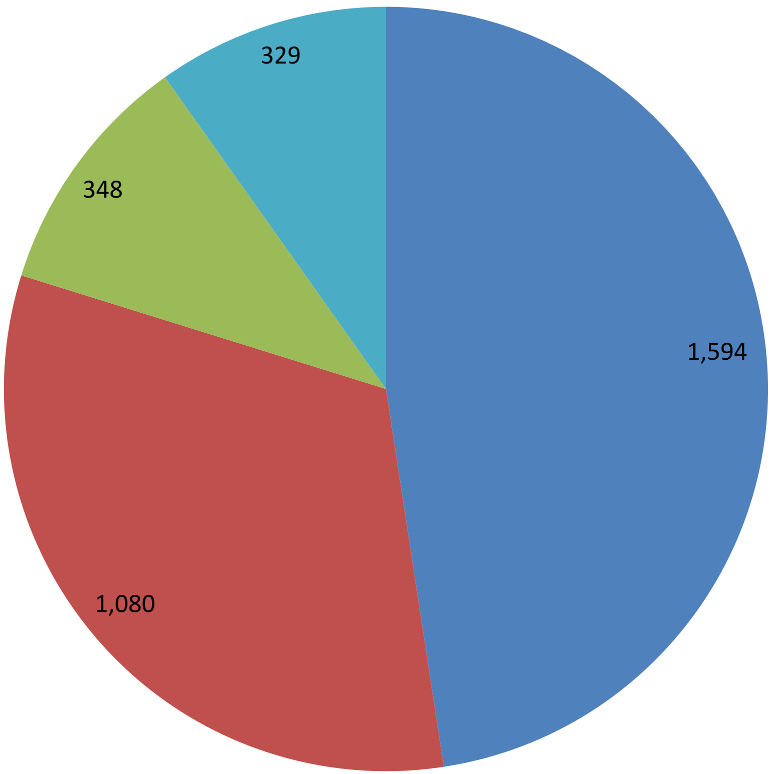
<u>Individual Income Tax Provisions</u>	
Total for Individual Income Tax Provisions (before Rebate)	**-564.3**
<u>Corporate and Non-Corporate Business Income Tax Provisions</u>	
Flat Corporate Income Tax Rate of 15%	-177.7
Other Corporate and Business Income Tax Provisions	63.3
Total for Corporate and Business Income Tax Provisions	**-114.4**
<u>Value-Added Tax (VAT) of 12.9%</u>	
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**

* For more detail, see TPC Update, November 2013, Table 3, reproduced here as Appendix Table A-1.

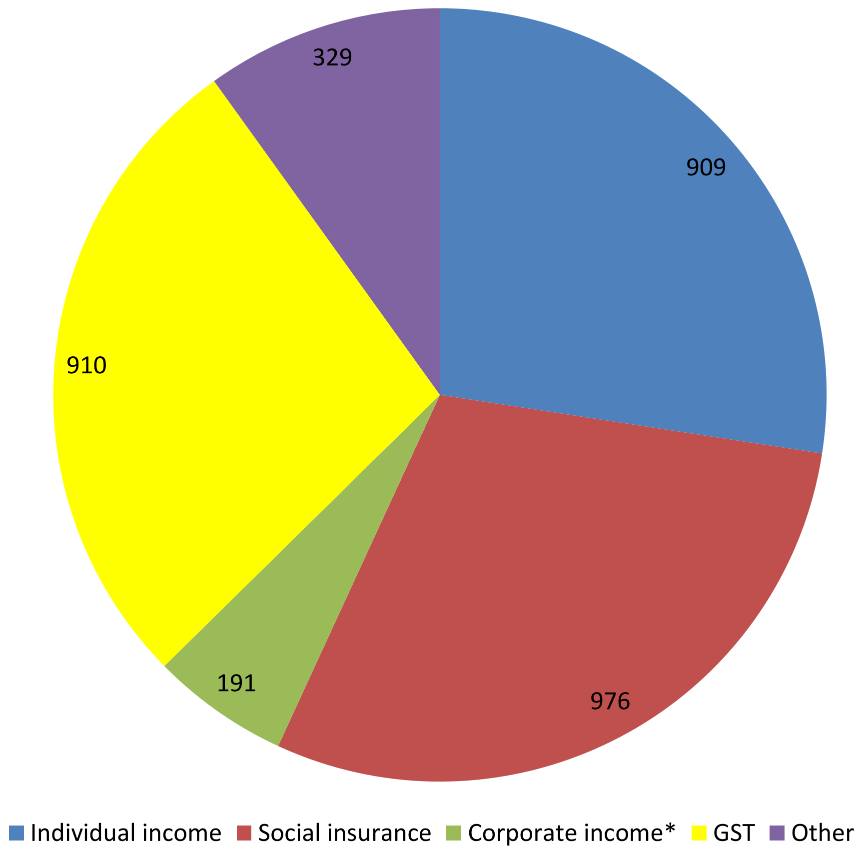
** Amounts are shown as effects on the deficit.

Composition of Federal Revenues Under Current Law and the Proposal 2015

CURRENT LAW



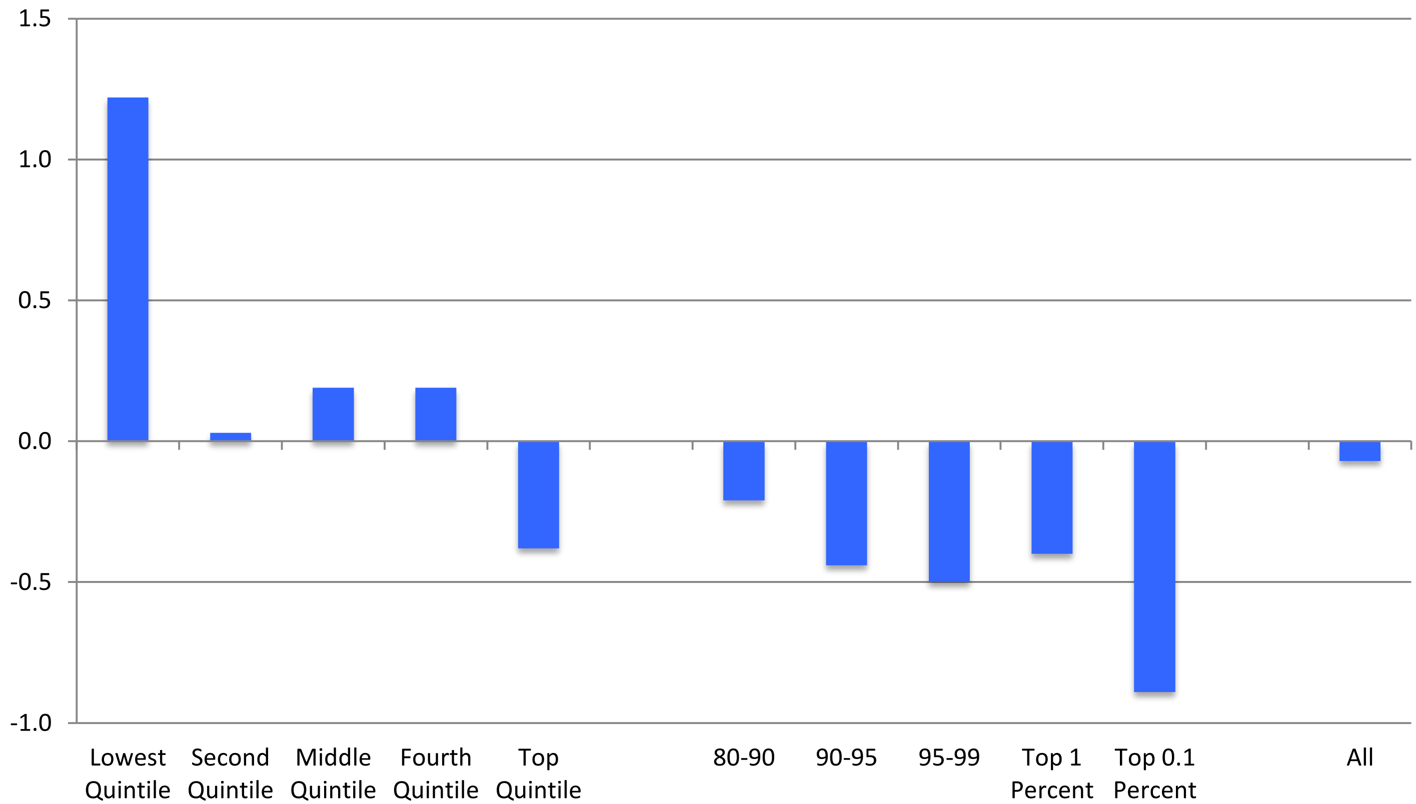
GRAETZ PROPOSAL



Source: Derived From TPC Update, November 2013. Proposal is at fully phased in levels adjusted to 2013 ratio to GDP.

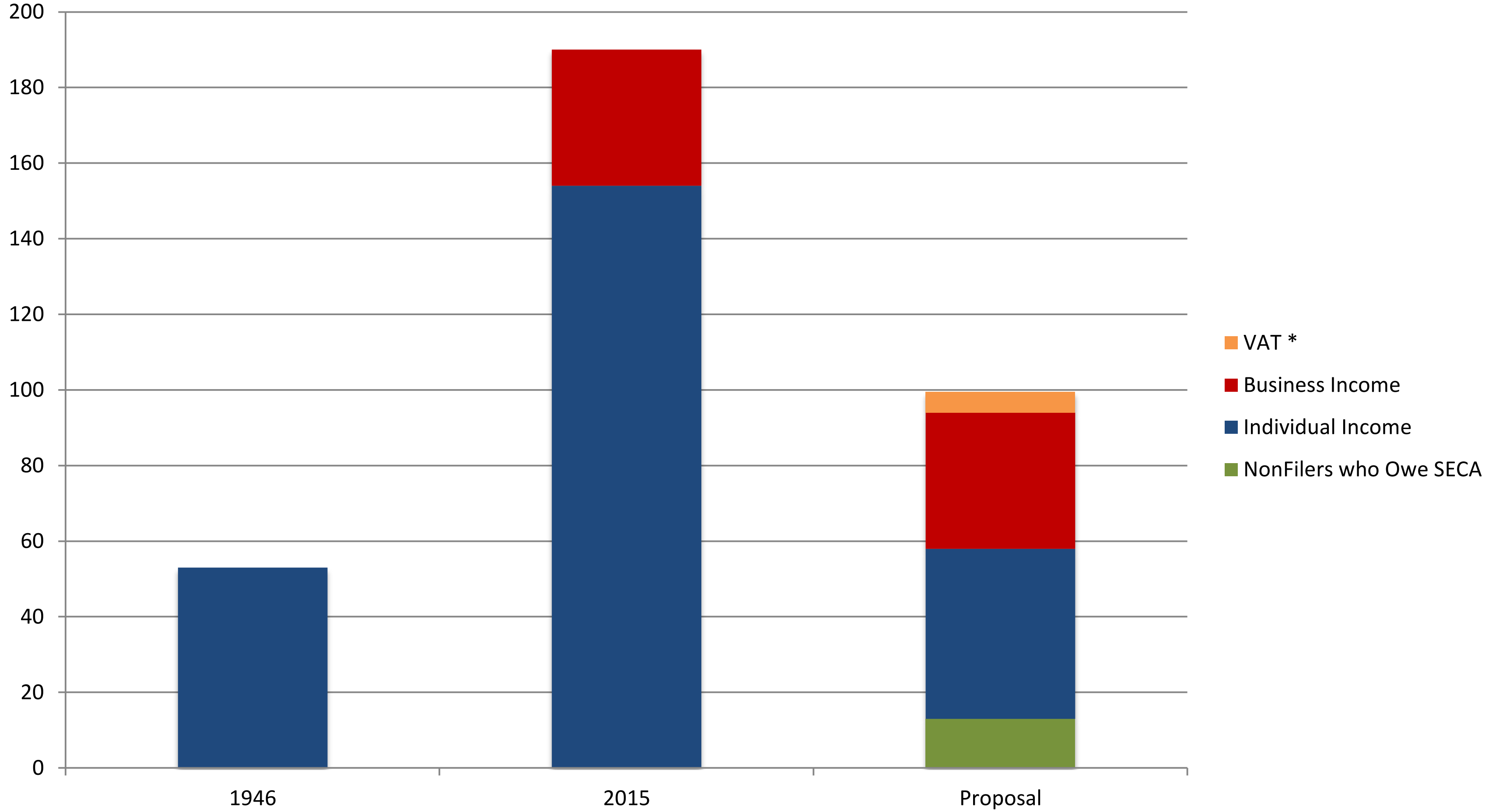
Distributional Neutrality of the Competitive Tax Plan

PERCENTAGE CHANGES IN AFTER-TAX INCOME



TPC Update, November 2013, Table 4. For more detail, see that table, reproduced as Table A-2 in the Appendix.

Total Tax Returns Under Current Law and the Proposal



Statistical Abstract of the United States (1946) and Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2).

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

Advantages of the Competitive Tax Plan

- Takes advantage of our status as a low-tax country, making the U.S. a low income-tax country.

- Most Americans would owe no tax on their savings and all Americans would face lower taxes on savings and investments.

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

- The vast majority of Americans would never have to deal with the IRS.

- By returning the income tax to its pre-World War II role as a relatively small tax on a thin slice of 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. We have tried that, and it doesn't work.

Advantages of the Competitive Tax Plan

- Unlike other unique consumption tax proposals (e.g., the Flat Tax; David Bradford's X-Tax; George W. Bush's Panel's Growth and Investment Tax), this proposal fits well with existing international tax and trade agreements.

- A 15 % corporate tax rate solves the problems caused by international tax planning by multinational corporations and competition for corporate investments among nations.

- 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 to $700 billion at current trade levels.

- During the interval of up to two years between enactment and commencement of the VAT, Americans would accelerate their purchase of durables, such as cars and large appliances, providing a short-term boost to our economy.

- 1986-style tax reform is a dead end.

APPENDIX

TABLE A-1

Revenue Effects of the Income Tax Provisions and Revenue and Spending Effects of the VAT Provisions of the Graetz Proposal 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 Percent 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**

TABLE A-1 CONT'D

<u>Value-Added Tax (VAT) of 12.9%</u>	
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**

Source: TPC Update, November 2013, Table 3, Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2) and TPC estimates based on several sources (see text).

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

TABLE A-2

Distributional Analysis of the Graetz Proposal

Fully Phased-in Relative to Current Law at Income Levels in 2015 [1]

(percentage change 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 [2]
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	7.3	0.7	-9.9	2.5	-0.2
90-95	7.2	1.0	-9.1	1.3	-0.4
95-99	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

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

[1] Provisions are stacked in the order listed.

[2] Total changes are relative to current law and cumulative from left to right. For example, for the middle quintile the total change is (1+.043)x(1+.005)x(1-.111)x(1+.075)-1 = 0.2%.

TPC Update, November 2013, Table 4. Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-2).

TABLE A-3

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

Taxable Income Before Family Allowance		Tax Rate Under Graetz Proposal
Over	**But Not Over**	
Married Filing Jointly		
$100,000	$118,450	14%
$118,450	$175,000	14%
$175,000	$200,000	14%
$200,000	$251,400	27%
$251,400	$330,700	27%
$330,700	$512,000	27%
$512,000	$566,950	27%
$566,950	$600,000	27%
$600,000	--	31%

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

TABLE A-3 CONT'D

	Single	
$50,000	$59,225	14%
$59,225	$87,500	14%
$87,500	$100,000	14%
$100,000	$140,850	27%
$140,850	$239,500	27%
$239,500	$300,000	27%
$300,000	$462,000	31%
$462,000	$465,050	31%
$465,050	--	31%
	Head of Household	
$75,000	$88,200	14%
$88,200	$125,000	14%
$125,000	$125,250	27%
$125,250	$204,750	27%
$204,750	$285,100	27%
$285,100	$325,000	27%
$325,000	$487,000	31%
$487,000	$516,000	31%
$516,000	--	31%