Tax Reform in Theory and Practice

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Differences between Theory and Practice

- Limited Bandwidth

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- Horse and Rabbit Stew

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- Keeping Up Appearances

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- Don’t Be Negative

Limited Bandwidth

Go with What You Know

- Omnibus Budget Reconciliation Act of 1993 (OBRA93)
  - Introduced two new personal income tax rates (36% and 39.6%)
- Where did 39.6% come from?
  - Millionaires’ 10% surtax introduced in failed 1992 legislation (H.R. 4210: Tax Fairness and Economic Growth Act of 1992); rate kept even though no longer applicable only to millionaires (>250k)
  - Brackets for 36% rate (115k/140k) also carried over from 1992, even though the original 1992 proposal had different brackets

Go with What You Know

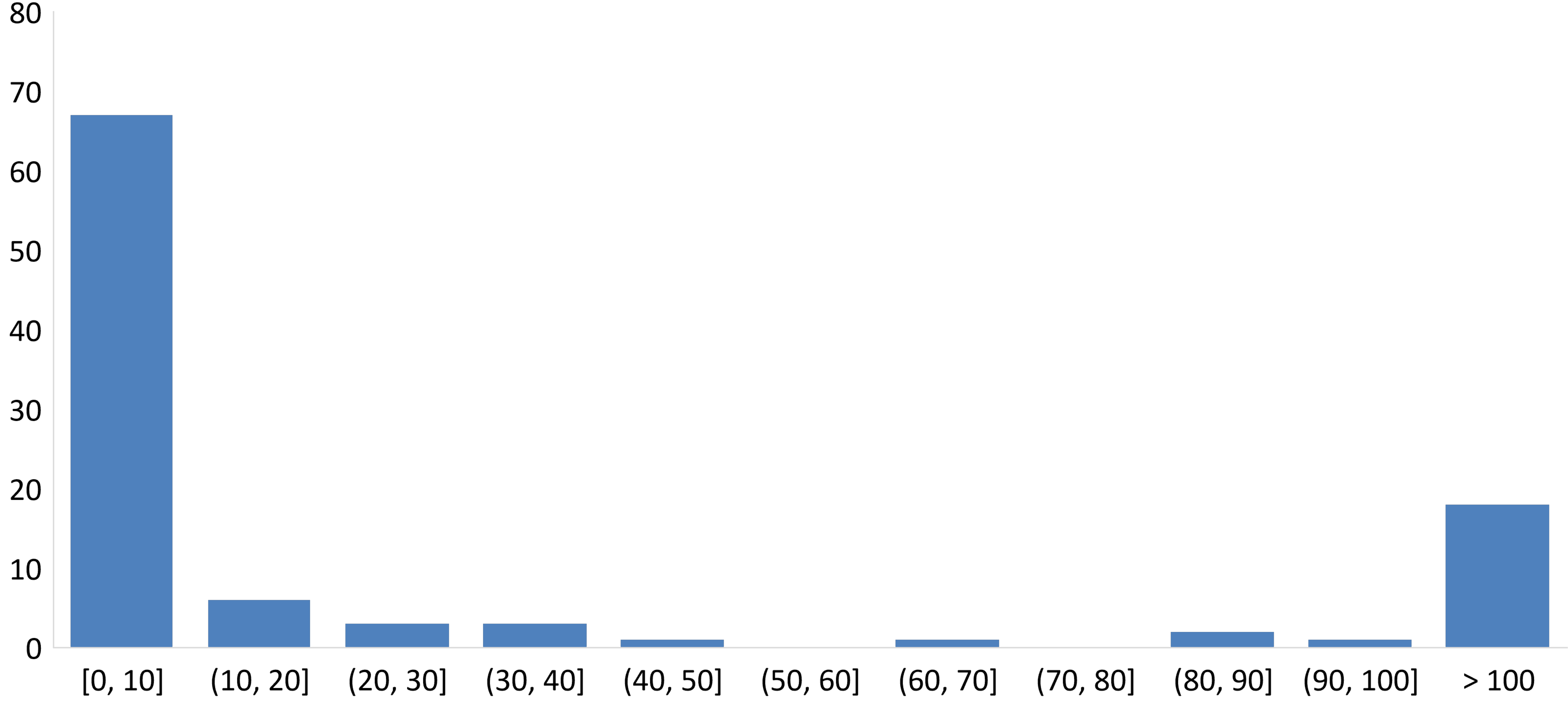
- Ever since Bush tax cuts of 2001, 39.6% has served as a goal for those wishing to increase taxes on high-income individuals
  - American Taxpayer Relief Act of 2012 extended Bush marginal tax rate cuts indefinitely except at the top, reinstating 39.6% bracket
  - Biden's 2021 American Families Plan would have reinstated 39.6% rate at the top, undoing TCJA cut to 37%.

Go with What You Know

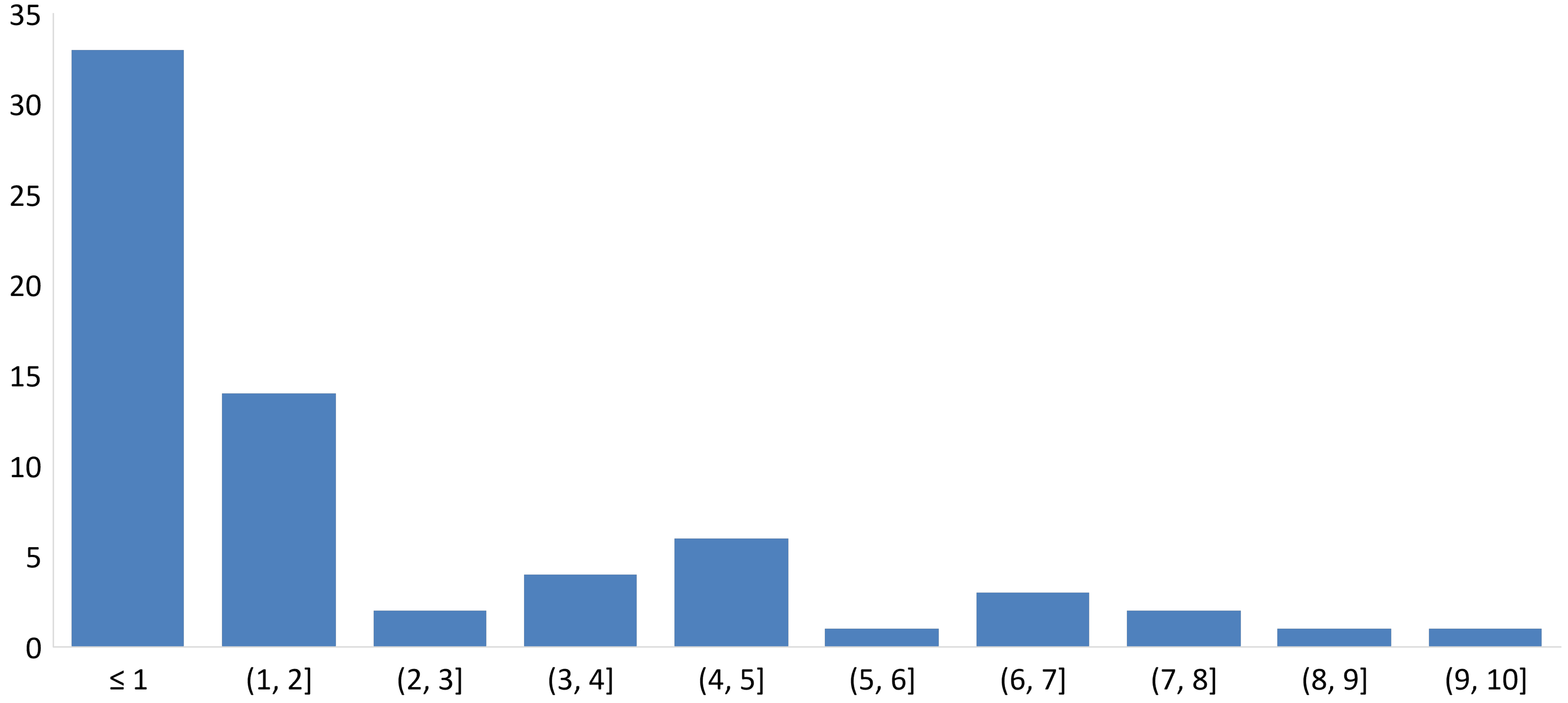
- Biden also proposed to limit itemized deductions to 28% tax rate for incomes > $400k
  - Same capped rate as proposed in 2011 by the Obama administration, even though the rate schedule is different now and under the Biden plan than it was then (e.g., there is no longer a 28% bracket)

Horse and Rabbit Stew

Tax Cuts & Jobs Act: Number of Provisions by Size of 10-Year Revenue Gain/Loss ($Billions)



TCJA: Number of Provisions (< $10 Billion) by Size of 10-Year Revenue Gain/Loss ($Billions)



Some Small Provisions in TCJA

- Limitation on wagering losses (sunset 12/31/25)
- Length of service awards for public safety volunteers
- Treatment of certain individuals performing services in the Sinai Peninsula of Egypt (sunset 12/31/25)

Some Small Provisions in American Jobs Creation Act (ACJA)

- Simplification of excise tax imposed on bows and arrows
- Reduce excise tax on fishing tackle boxes to 3 percent
- Temporary suspension of customs duty on certain ceiling fans (sunset 12/31/06)

The KISS Principle

Keeping it Simple

- Jobs And Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)
  - Initial Bush proposal based on 1992 Treasury plan for an imputation system to "tax business income once"
  - Would have reduced taxes at the shareholder level only to the extent of taxes paid at the corporate level
  - In the end, seen as too complicated, replaced with a simple dividend tax cut

Keeping it Simple

- TCJA
  - Arguments for reducing federal deduction for state and local taxes suggest distinguishing among uses to which taxes are put (e.g., “public” vs. “private” goods)
  - Would imply scaling back deduction for some types of S&L taxes, or some share of S&L taxes
  - TCJA simply capped state and local tax deduction at $10,000 per household

Keeping it Simple

- 10-5-3 depreciation proposal at beginning of Reagan administration
- Became 15-5-3 in the 1981 Economic Recovery Tax Act (ERTA)
- Replaced a large range of different depreciation schedules
- Economic argument against a reduced number of classes, but simple to explain

Keeping it Simple

- Carter Administration proposal for a Taxable Bond Option
  - Instead of federal tax exclusion of S&L bond interest, provide a direct subsidy to issuers of 35% or 40% of interest
  - Would have reduced cost of tax expenditure by eliminating inframarginal subsidies to higher-bracket taxpayers
  - Never enacted

Through a Glass Darkly

Not Transparent

- Tax Reform Act of 1986 (TRA86)
  - 33% bracket implemented by a 5% surcharge over 28% to phase out benefit of 0% and 15% brackets, rather than being described as simply a 33% bracket

Not Transparent

- Omnibus Budget Reconciliation Act of 1990 (OBRA90)
  - “Read my lips: no new taxes”
  - Raised top bracket to 31%
  - But also raised higher-income marginal tax rates through introduction of personal exemption phase-out (PEP) and itemized deduction limitation (“Pease”), both phasing out based on AGI

Not Transparent

- Affordable Care Act (2010)
  - Introduction of 3.8% Medicare tax on net investment income
  - Moved further away from idea of Medicare being an earnings-related entitlement, but less straightforward than a simple income-tax surcharge

Keeping Up Appearances

Who paid that tax?

- Affordable Care Act, again
  - 40% excise tax on "Cadillac" insurance premia over threshold – a tax on insurance companies
  - Design meant to lessen resistance, but failed to do so

Who paid that tax?

- ERTA 1981, again
  - "Safe Harbor" leasing: used a relaxation of leasing requirements to effect a sale of tax benefits from companies with NOLs to taxable companies
  - Although subject to valid criticisms in terms of its effects, did appear to create a fairly efficient market for the transfer of tax benefits
  - But caused a furor and was repealed in part because profitable companies were paying no tax (i.e., they were purchasing tax deductions to offset their tax liabilities)

Don’t Be Negative

Zero Matters

- Lack of full refundability of many tax credits, e.g., child tax credit as originally designed
- Logic?
  - Not an expenditure, but a reduction in taxes
  - Outcome would likely have been different with a direct expenditure

Zero Matters

- Limited ability to deduct NOLs, so must carry forward
  - Carry-backs eliminated in 2017
- Logic?
  - Fraud?
  - As with household credits/deductions, a different perception of outcomes <0.

Conclusions