The Daily Dish

Tax Reform, Now Comes the Hard Part

DOUGLAS HOLTZ-EAKIN | OCTOBER 2, 2017

Eakinomics: Tax Reform, Now Comes the Hard Part

Last week the White House, House and Senate released their unified framework for guiding the development of tax reform legislation. The Framework is just that: a framework and not a fully specified piece of legislation. For example, while it promises either 3 tax rates (12, 25, and 35 percent) or those plus an unspecified 4th rate, it does not identify the incomes at which the rates kick in. Similarly, it is silent on the individual-level taxes on interest, dividends, and capital gains. It specifies the corporation income tax rate (20 percent) but not the rate at which accumulated overseas earnings will be taxed when deemed to be repatriated to the United States. But perhaps most significantly, the Framework has only the most limited of information regarding the base-broadening (elimination of deductions, credits, etc.) necessary to hit the economic growth and revenue targets.

The preliminary nature of the document hasn't stopped anything and may even be fomenting advocacy activity. For example, despite the fact that there is no plan yet and that the overt purpose of any plan is to generate better growth, the Tax Policy Center immediately issued a report that ignored growth (the best thing that could happen to the working class) and purported to analyze the distributional consequences of the Framework. It immediately became grist for the class warfare crowd.

However, the most common tactic will be to focus on only a single aspect of the plan as it develops. For example, the National Association of Realtors commissioned a report on the impact of reduced itemization that eliminates deductibility of state-local taxes, but dictated a framework so narrow —

- A fixed supply of housing — no building, no conversion to or from rental, no home improvements
- No economic growth, increase incomes, changes in stock prices, movements in interest rates
- No impact of corporation tax reform, and so forth

— that they could only find one answer: housing prices fall 10 percent. The report isn't wrong, it just isn't tax policy analysis. It's paleo policy analysis — people live in a fixed number of natural caves and the world around them is frozen in time. Cave-based tax preferences do make caves more attractive, and *vice versa*. But they are also pointless: because they are immediately offset dollar for dollar, they do not make housing more affordable; neither are they permitted to increase the availability of housing. It is not a framework suitable for understanding how tax reform would genuinely affect the housing sector.

More generally, it feeds the notion that the choice is between the Framework or the Framework without any elimination of the deduction of state-local income, sales and property taxes, or any other single provision. That cannot be true for all the individual base-broadener simultaneously. The real choice is between this (anemic) economy and (broken) tax code and the (hopefully improved) economy and (hopefully cleaner, more efficient) tax code.

It also cuts off the discussion of important questions, like: should state-local income taxes be deductible to begin with? The simple answer is: no. Households will make the right decision of how much they want in the way of local public services — schools, police, parks, etc. — when they face the full cost, in the form of taxes, of those services. Deductibility makes those costs lower because as local taxes are raised federal taxes fall somewhat. Why should the federal government give up revenue and distort choices at the local level?

The Framework advertised the potential good news from tax reform. But base-broadening is the harder-to-sell bad news. Now comes the hard part of tax reform.