Research

Tax Reform Initiative Group: Briefing Book

DOUGLAS HOLTZ-EAKIN, GORDON GRAY, KIMBERLY VANWYHE, ANNE KRUEGER, APARNA MATHUR, IRWIN STELZER | MARCH 27, 2017

Executive Summary

The American Action Forum (AAF) prepared the following briefing book that identified key elements of a base-broadening, rate reducing (BBRR) tax reform proposal. AAF formed a Tax Reform Initiative Group (TRIG) which developed a consensus that the largest problem with the existing tax structure in the U.S. is an uncompetitive corporate tax system (Corporate Income Tax, or CIT), and there should be bipartisan interest in reducing the CIT.

The TRIG focused on strategies to reduce the tax rate to an internationally competitive rate of roughly 20 percent. In the end, TRIG developed a consensus “20/20” proposal for tax reform. Having concluded that politically feasible base-broadening would not be sufficient to achieve its target tax rate, TRIG considered additional revenue sources. Under this proposal, a $20 per ton tax on carbon (increasing by 5 percent annually) would pay for reducing the CIT to a statutory rate of 20 percent (approximately, and down from 35). This 20/20 proposal would eliminate most traditional corporate tax expenditures, but retain incentives for research and development and allow for the deductibility of interest.

Although the group extensively discussed other issues inherent to tax reform, such as payroll taxes, border adjustments, value added taxes (VATs), and fairness issues, it was in the end decided that those policies did not need to be specified to achieve the core policy aim. The TRIG acknowledges that those issues will likely arise in any for tax reform legislation.

Key Findings

AAF relied primarily on Quantria Strategies’ individual and corporate income tax models for estimates of the tax reform provisions and its input-output (I-O) model of the U.S. economy for our estimate of the TRIG consensus proposal.

Key findings are as follows

- For corporate-only tax reform, base-broadening provisions would allow the maximum corporate tax rate to be reduced to 23 percent.
- Retention of interest deductibility and the R&D, however, would only allow a reduction of the corporate rate to between 27-28 percent.
- A carbon tax could provide a viable alternative revenue source to allow for a lower, more internationally competitive rate.
- A $20 per ton tax on carbon (increasing by 5 percent + inflation annually) could raise adequate revenue to

reduce the rate to 20 percent.

Overview

TRIG was comprised of several accomplished economists with backgrounds in academia and policy. The TRIG developed a consensus that the largest problem with the existing tax structure in the U.S. is an uncompetitive corporate tax system, and there should be bipartisan interest in reducing the CIT (though it was acknowledged that politically such an idea has opposition). It was also the consensus of the TRIG that any attempt to reduce the CIT would necessitate raising some revenue to offset the losses, and a tax on carbon would be a preferred avenue for achieving this.

The conclusion of the TRIG was a consensus on a “20/20” proposal for tax reform. Under this proposal, a $20 per ton tax on carbon (increasing by 5 percent real annually) would pay for reducing the CIT to a statutory rate of 20 percent (down from 35). This 20/20 proposal would eliminate all corporate tax expenditures, but retain incentives for research and development and allow for the deductibility of interest, except incentives for research and development and the deductibility of interest. Although the group extensively discussed other issues inherent to tax reform, such as payroll taxes, border adjustments, VATs, and fairness issues, it was in the end decided that those policies did not need to be specified to achieve the core policy aim. The TRIG recognizes that those issues will likely arise in any formal proposal for tax reform.

The goal of the TRIG as convened by AAF was to prepare a briefing book that identifies key elements of a BBRR tax reform proposal. The following document will highlight points of consensus and/or general agreement among members of the study group, and guide future discussions and study of the essential elements of a desirable tax reform. The modeling and quantitative work reflected in this briefing book should bolster the case for the reform and serve as an important addition to the body of corporate tax reform literature.

AAF envisions the briefing book as the first step in laying the groundwork for any public outreach effort should external events so dictate.

The Group

AAF convened economists from academia, policy institutions, and private industry; it was a mix between conservative economists who were most influential during congressional debate and the conservative economists who have expended the most effort researching a carbon tax.

The Tax Reform Initiative Group included:

- Doug Holtz-Eakin, American Action Forum
- Anne Krueger, SAIS Johns Hopkins
- Aparna Mathur, American Enterprise Institute
- Irwin Stelzer, Hudson Institute

This group in turn consulted with others as they developed this proposal

The Process

The American Action Forum, a leading center-right nonprofit policy think tank organized and facilitated communications with this expert group. AAF policy research often provides third party validation for center-right reforms, and builds a consensus for a free-market oriented policy options. AAF used innovative communication strategies to target appropriate audiences and was well suited to convene such a group effectively and with an eye toward an actionable goal.

The study group had the full the support of AAF's President Doug Holtz-Eakin, Director of Fiscal Policy Gordon Gray, and Director of Energy Policy Kimberly VanWyhe. Dr. Holtz-Eakin served in an advisory and editorial capacity. Mr. Gray has expertise in fiscal and economic policy generally, and tax reform specifically. Ms. VanWyhe' s experience lies in the tradeoff between tax reform proposals and the revenue opportunity of a carbon tax. Mr. Gray and Ms. VanWyhe served as the primary AAF staff coordinators of the study group.

Core Activities and beyond: AAF invited and organized a volunteer study group composed of experts listed above, and hosted three major meetings over the course of 18 months, beyond the core activities AAF alternated between conference calls and in-person meetings to ensure maximum participation. AAF staff initiated and maintained regular email and phone conversations beyond these meetings to ensure a quality finished product. Topics of discussion at these meetings were based around tax policy modeling work and a collection of the most pressing and difficult-to-resolve tax policy questions central to the attainment of corporate tax code reform.

Principles for Reform

- The corporation income tax is in need of reform
- A satisfactory tax reform would significantly lower the corporation income tax rate to the range of 18 to 25 percent, while eliminating many corporate tax expenditures
- As a realistic matter, this internationally competitive tax rate would require an additional revenue source
- Among those options examined, a carbon tax would be the least distortionary option for a new revenue source to finance a corporation tax reform
- Additional goals for tax reform including issues with perceived fairness, efficiency, and health care can be pursued as part of a more comprehensive tax reform that includes the individual tax code

Corporation Income Tax Reform

Tax reform specifications

- Repeal or modify all conventional corporate tax expenditures for all corporations except interest deductibility and R&D expenditure– $1,277.5 billion
- The group agreed to a "20/20" plan; i.e. a carbon tax at $20 going up 5 percent real and a 20 percent corporate rate.
- $20 per ton + 5 percent + inflation – approx. $1,235 billion ($20 per ton in 2016 – $37 in 2025)

International Reforms

- A move to a territorial system, paired with base erosion rules and other transition effects could be achieved without significant net revenue affects

- There is no significant revenue impact with border adjustments for a carbon tax, and are thus not considered in the context of this tax reform/revenue analysis.

The Need for Business Tax Reform

The single most important characteristic of the U.S. corporate tax is that the rate is too high. The combined federal-state U.S. corporate tax rate of 38.9 percent is the highest among all major developed economies. The high U.S. rate is seemingly not a matter of deliberate choice. Instead, it stems from a failure to acknowledge and keep abreast of broader global trends.

The U.S. corporate tax rate is essentially unchanged since 1986, when a significant rate reduction was enacted. However, during the interim competitor nations have made significant changes to their business tax systems, by reducing tax rates and moving away from the taxation of worldwide income. Relative to other major economies, the United States has gone from being roughly on par with major trading partners to its current position of imposing the highest statutory rate of corporation income. While less stark than the U.S.'s high statutory rate, the United States also imposes large effective rates. According to a study by PricewaterhouseCoopers, "companies headquartered in the United States faced an average effective tax rate of 27.7 percent compared to a rate of 19.5 percent for their foreign-headquartered counterparts. By country, U.S.-headquartered companies faced a higher worldwide effective tax rate than their counterparts headquartered in 53 of the 58 foreign countries."

While statutory tax rates are critical to firm investment decisions, other measures of corporate taxation also warrant consideration. A firm's effective tax rate includes other facets of the corporate tax code, such as credits and deductions, which figure in the determination of a firm's tax burden.

The United States fails another competitiveness test in the design of its international tax system. The U.S. corporation income tax applies to the worldwide earnings of U.S. headquartered firms. U.S. companies pay U.S. income taxes on income earned both domestically and abroad, although the U.S. allows a foreign tax credit up to the U.S. tax liability for taxes paid to foreign governments. Active income earned in foreign countries is generally only subject to U.S. income tax once it is repatriated, giving an incentive for companies to reinvest earnings anywhere but in the U.S. This system distorts the international behavior of U.S. firms and essentially traps foreign earnings that might otherwise be repatriated back to the U.S.

While the U.S. has maintained an international tax system that disadvantages U.S. firms competing abroad, many U.S. trading partners have shifted toward territorial systems that exempt entirely, or to a large degree, foreign source income. Of the 34 economies in the Organization for Economic Cooperation and Development (OECD), for example, 28 have adopted such systems, including recent adoption by Japan, the United Kingdom and New Zealand. According to a 2015 study by the Tax Foundation, the US ranks last in corporate income tax competitiveness compared to OECD countries.

Finally, it is an important reminder, particularly in the current political climate, that the burden of the corporate tax is borne by everyone. Corporations are not walled off from the broader economy, and neither are the taxes imposed on corporate income. Taxes on corporations fall on stockholders, employees, and consumers alike. The incidence of the corporate tax continues to be debated, but it is clear that the burden on labor must be acknowledged. Indeed, one recent study found that labor bears as much as 70 percent of the corporation income tax rate. Other studies have found similar implications, with a study by economists at the American Enterprise Institute concluding that for every one percent increase in corporate tax rates, wages decrease by about one percent.   These wage effects should be considered in thinking about the impact of tax reform

Fairness

It is the sense of this group that further economic burdens to benefit the environment are inevitable. Within the range of potential mechanisms for reducing carbon emissions, a carbon tax represents the most economically efficient means of reducing emissions. In addition to its efficiency, a carbon tax also creates opportunities for reducing distortions within the existing tax code. If a carbon tax is combined with reductions to the Corporate Income Tax, the result could be a more competitive U.S. tax code without loss of revenue.

The American Action Forum estimates the total projected burden of all finalized energy and environment regulations will be $588 billion through 2050. Of these regulations, fourteen of the top twenty are focused on either energy conservation or greenhouse gas emissions, with a burden of $371.2 billion. A carbon tax could eliminate the need for some of these regulatory burdens, and if revenue is returned to the economy could achieve the same results at a lower cost.

Over a ten-year period, an initial $20 per ton carbon tax (thereafter growing) would generate approx. $1,235 billion. In attempting to avoid the economic drag of such a pervasive tax, the most efficient use of the revenue would be to reduce the most distortionary taxes. The Corporate Income Tax is the ideal target of such reduction, not just for its distortions and double taxation, but in order to make the U.S.' corporate tax rate more competitive with other developed nations.

After combining a $20 per ton carbon tax with corporate tax reform, the statutory rate of the corporate income tax could be reduced to about 20 percent, or perhaps lower. In this sense, the revenue bought from a carbon tax would help reduce inversions, and encourage repatriation of capital. Further, a carbon tax would bring the U.S. tax system more in line with that of other Western nations that price carbon, but would do so in a more business-friendly manner than European Cap-and-Trade systems which contribute to uncertainty in carbon pricing.

This method of a carbon tax is revenue neutral, and makes more sense economically than standard sin taxing, or tax and fee redistribution. However, the U.S. tax code is largely based around a concept of fairness, with the wealthiest paying the most. A carbon tax is regressive by nature, meaning that the poor pay more (as a proportion of their income) than the wealthy. Offsetting this regressivity is important to achieving political feasibility, and this group would recommend achieving this by adjusting payroll tax rates, as well as some other provisions to address the non-working, so the benefits of tax reform are distributed neutrally.

To achieve distribution neutrality, taxes on the poor must be cut to allow them more income to pay the carbon tax. Any of these tax cuts on the poor must be paid for by tax hikes on the wealthy, who already benefit the most from reduced corporate income tax. The net result is a tax reform that is revenue neutral, as well as distributionally neutral.

If implemented as envisioned, the outcome of this reform is as follows: all Americans pay roughly the same or lower tax rate that they did before the reform, no socio-economic group is unduly helped or harmed by their treatment under a new tax code, the tax reform should be inherently pro-growth with more incentives for business and corporate investment, corporations will no longer invert as a result of the U.S.' high tax rate, the burdens created by carbon focused regulations will no longer be justifiable and thus eliminated, and the projected reduction of carbon emissions will be equal to or lower than current regulations can achieve. This framework for tax reform should be politically feasible due to its equitable treatment and ability to address policy concerns of both parties.

Meeting Materials Provided to the Group

*All materials referenced will be included in appendix

AAF received tax reform estimates from John O'Hare of Quantria Strategies, LLC. The estimate contained a $60/ton carbon tax as part of the Growth and Investment Tax plan. As a result, the plan was found to be essentially revenue neutral over the 10-year budget horizon. In particular, the plan, while losing revenue in each of the first 5 years, raises revenue in each of the last 5 years.

The 2005 Advisory Panel on Federal Tax Reform defined "revenue neutrality" as revenues from individual and corporate taxes that come within one-half of one-percent of forecasted revenues over the period. His estimates show the plan to be within that tolerance. These estimates were used as the basis of this study.

As a concrete first step, AAF enclosed materials that outlined the revenue and distributional estimates for two approaches to tax reform. Broadly, AAF presented examples of two types of reforms: (1) corporate-only tax reform, and (2) comprehensive reforms. For each type, AAF presented two options: (a) income tax reform, and (b) reform that includes an additional revenue source. For the latter, AAF made the judgment that of the three-leading possible new revenue sources – a value-added tax, a financial transactions tax, and a carbon tax – that the carbon tax had the most political viability.

The specifics of each reform option are outlined below. Our hope was that these reforms and the associated estimates would serve as a starting point for a fruitful discussion of a future tax reform policy. To start the discussion, the options were accompanied by some questions for the group that would help to guide future work.

The threshold question was whether the group would like to focus on comprehensive tax reform, corporate-only reform, or continue with both options. Similarly, the estimates shown below do not incorporate any impact of reform on overall economic growth. In this sense they are "static"; does the group feel that "dynamic" scores are essential to this discussion? *With regards to the latter, dynamic scores were useful but not essential.*

Option #1: Corporate Only Reform

(Enclosures: Table 1: Revenue Effects of Corporate Reform, Table 2: Revenue Effects of Corporate Reform w/ Carbon Tax Revenue, Table 3: Revenue Estimates for Base-Broadeners)

- American Action Forum -

Table 1. ESTIMATED REVENUE EFFECTS OF CORPORATE TAX REFORM

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
I. Repeal or Modify Tax Expenditures for All Corporations......	tyba 12/31/15	129.5	192.3	203.0	205.7	205.2	205.0	200.1	200.6	202.1	205.2	935.7	1,948.7
II. International Tax Reforms [1]......................................	tyba 12/31/15	-	-	-	-	-	-	-	-	-	-	-	-
III. Reduction in Corporate Rate to 23 percent.....................	tyba 12/31/15	-75.0	-117.0	-120.6	-122.3	-130.4	-134.1	-135.4	-137.3	-139.8	-143.1	-565.3	-1,255.0
IV. Interaction With Corporate Rate Change [2]..................	-	-44.4	-65.9	-69.6	-70.5	-70.4	-70.3	-68.6	-68.8	-69.3	-70.4	-320.8	-668.2
NET TOTAL...	-	**10.1**	**9.4**	**12.8**	**12.8**	**4.5**	**0.7**	**-3.9**	**-5.5**	**-7.0**	**-8.3**	**49.6**	**25.5**

Quantria Strategies, LLC

NOTE: Details may not add to totals due to rounding.

Legend and footnotes for Table 1A

Legend for "Effective" column:

tyba = taxable years beginning after

[1] Assumes revenue neutral international tax reform is enacted.

[2] Only includes interaction with base broadening provisions.

Table 1. shows the estimate of a corporate-only tax reform plan that broadens the corporate tax base by eliminating certain deductions and credits to allow for a revenue-neutral corporate rate reduction. The analysis indicates that the maximum corporate tax rate could be reduced to 23 percent under this scenario. This reduction in the corporate tax rate is significantly less than the previous estimates, due mostly to the effect of the tax extenders enacted late last year. This had two related impacts: the revenue effect of lowering the top corporate

was reduced (because the current law baseline was lower) and the revenue increases from repealing certain corporate tax provisions raised significantly more revenue due the permanent extensions.

- American Action Forum -

Table 2. ESTIMATED REVENUE EFFECTS OF CORPORATE TAX REFORM

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
I. Repeal or Modify Tax Expenditures for All Corporations.........	tyba 12/31/15	129.5	192.3	203.0	205.7	205.2	205.0	200.1	200.6	202.1	205.2	935.7	1,948.7
II. International Tax Reforms [1]...	tyba 12/31/15	-	-	-	-	-	-	-	-	-	-	-	-
III. Reduction in Corporate Rate to 18 percent	tyba 12/31/15	-106.3	-165.7	-170.8	-173.3	-184.7	-189.9	-191.9	-194.5	-198.0	-202.8	-800.8	-1,777.9
IV. Interaction With Corporate Rate Change [2]......................	-	-66.6	-98.9	-104.4	-105.8	-105.5	-105.4	-102.9	-103.2	-103.9	-105.5	-481.2	-1,002.2
V. Impose a $20/ton Carbon Tax on Fossil Fuel Emissions [3]......	tyba 12/31/15	52.8	81.0	83.2	85.4	87.4	89.5	91.7	94.0	96.3	98.8	389.8	860.1
NET TOTAL...	-	**9.4**	**8.7**	**11.0**	**12.0**	**2.4**	**-0.9**	**-3.0**	**-3.1**	**-3.6**	**-4.3**	**43.5**	**28.7**

Quantria Strategies, LLC

NOTE: Details may not add to totals due to rounding.

Legend and footnotes for Table 1B

Legend for "Effective" column:

tyba = taxable years beginning after

[1] Assumes revenue neutral international tax reform is enacted.
[2] Only includes interaction with base broadening provisions.
[3] Estimate includes 25% excise tax offset.

Table 2. shows how this estimate would change if a $20/ton carbon tax is implemented as part of the reforms. The estimate indicates that the corporate tax rate could be lowered to 18 percent under this scenario.

American Action Forum

Table 3. Estimated Revenue Effects of Comprehensive Corporate Tax Reform Provisions

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
Corporate Provisions													
I. Research and Development													
1. Repeal expensing of research and development expenditures*	tyba 12/31/15	32.9	44.6	34.9	24.1	12.4	8.1	8.0	5.9	3.6	1.8	148.9	176.3
2. Repeal R&D credit	tyba 12/31/15	8.3	6.9	8.3	9.5	10.8	11.9	13.0	14.1	14.9	15.6	43.8	113.2
II. Energy													
1. Terminate clean renewable energy bonds and qualified energy conservation bonds (sec. 54C and 54D)*	bia 12/31/15	[2]	[2]	[2]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5
2. Repeal section 48 incremental energy credit*	ppisa 12/31/15	0.7	0.8	0.6	0.5	0.5	0.5	0.4	0.4	0.3	0.3	3.1	5.0
3. Repeal credit for electricity production from renewable resources (section 45)*	fpisa 12/31/15	0.0	0.6	1.9	2.5	3.0	3.4	3.5	2.9	3.0	2.9	8.1	23.9
4. Repeal credit for investment in advanced energy property (section 48C)*	tyba 12/31/15	IRS issues final rules for issuing remaining credits in 2012 and 2013; Credit expired 12/31/13											
5. Repeal deduction for expenditures on energy efficient commercial building property*	tyba 12/31/15	Provision expired 12/31/13											
6. Repeal expensing of oil and gas exploration and development costs*	cpoia 12/31/15	1.7	1.5	1.2	1.1	0.9	0.7	0.5	0.2	0.1	0.1	6.4	8.0
7. Repeal percentage depletion for oil and natural gas wells*	tyba 12/31/15	0.8	1.3	1.4	1.4	1.5	1.5	1.6	1.6	1.7	1.7	6.6	14.8
8. Repeal percentage depletion for coal and hard mineral fossil fuels*	tyba 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.8	1.3
9. Increase geological and small integrated geophysical amortization period for independent producers to seven years*	cpoia 12/31/15	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	1.0	1.2
10. Amortization of air pollution control facilities*	tyba 12/31/15	0.0	0.1	0.5	0.1	1.2	1.4	1.4	1.0	0.7	0.5	2.9	7.9
11. Repeal credits for alternative technology vehicles*	tyba 12/31/15	[1]	[1]	[1]	[1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
12. Repeal exclusion of energy conservation subsidies provided by public utilities	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.1	0.2
13. Repeal credit for plug-in electric vehicles	vsa 12/31/15	[1]	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.4	1.1

American Action Forum

Table 3. Estimated Revenue Effects of Comprehensive Corporate Tax Reform Provisions

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
III. Natural Resources and Environment													
1. Repeal expensing of exploration and development costs, nonfuel minerals*	cpoia 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.0
2. Excess of percentage over cost depletion, nonfuel minerals:	tyba 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.0
3. Repeal expensing of timber-growing and reforestation expenses	tyba 12/31/15	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	2.3	4.8
4. Special rules for mining reclamation reserves	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.2	0.4
5. Impose full tax on nuclear recommissioning reserve funds:	tyba 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.0
6. Repeal exclusion of contributions in aid of construction for water and sewer utilities	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.2	0.5
7. Repeal exclusion of earnings of certain environmental settlement funds	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.1	0.2
IV. Agriculture													
1. Repeal expensing of soil and water conservation expenditures, cost of raising dairy and breeding cattle, and costs of fertilizer and soil conditioner	tyba 12/31/15	0.2	0.2	0.3	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.4	0.9
2. Repeal exclusion from income for cost-sharing payments	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.1	0.2
3. Repeal exclusion for cancellation of indebtedness income of farmers	tyba 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.0
4. Repeal five-year carryback of net operating losses attributable to farming	tyba 12/31/15	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.8

American Action Forum

Table 3. Estimated Revenue Effects of Comprehensive Corporate Tax Reform Provisions

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
V. Commerce and Housing													
1. Repeal the credit for low-income housing*	caa 12/31/15	5.2	8.3	8.6	9.2	9.8	10.5	11.3	12.1	12.9	13.8	41.1	101.7
2. Repeal the rehabilitation credit*	caa 12/31/15	0.5	0.6	0.6	0.7	0.7	0.7	0.8	1.9	2.1	2.5	3.1	11.0
3. Repeal the deferral of gain for non-dealer installment sales	iaa 12/31/15	1.4	2.9	2.5	1.2	0.4	0.4	0.4	0.3	0.3	0.3	8.4	10.1
4. Repeal the deferral of gain on like-kind exchanges*	eca 12/31/15	0.5	1.0	1.7	2.0	2.2	2.7	3.0	3.4	4.0	4.5	7.4	25.0
5. Amortization of business start-up expenses		Not available											
6. Exemption from imputed interest rules		Not available											
7. Special rules for magazine, paperback book, and record returns		Not available											
8. Repeal the completed contract rule method*	sooda 12/31/15	1.4	2.5	1.5	0.7	0.7	0.8	0.8	0.9	1.0	1.2	6.8	11.5
9. Repeal cash accounting, other than agriculture	tyba 12/31/18	[1]	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.6	1.3	3.6
10. Repeal credit for employer-paid FICA on tips*	tyba 12/31/18	0.3	0.6	0.7	0.7	0.8	0.9	1.0	1.1	1.1	1.2	3.1	8.4
11. Repeal the deduction for income attributable to domestic production activities*	tyba 12/31/18	8.1	12.1	12.5	13.3	11.6	11.2	11.2	11.5	11.9	12.4	57.6	115.8
12. Credit for the cost of carrying tax-paid distilled spirits in wholesale inventories*		Not available											
13. Ordinary gain or loss treatment for sale or exchange of Fannie Mae and Freddie Mac preferred stock by certain financial institutions		Not available											
14. Inventory methods and valuation:													
a. Repeal last in, first out*	tyba 12/31/18	4.6	7.1	7.7	8.0	8.3	8.6	9.1	11.3	12.6	14.5	35.7	91.8
b. Repeal lower of cost method*	tyba 12/31/18	0.1	0.1	0.3	0.5	0.7	1.3	0.9	0.7	0.6	0.3	1.7	5.5
c. Specific identification for homogeneous products	tyba 12/31/18	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.2	0.4
15. Election of gain or loss on sale or exchange of Brownfield property	tyba 12/31/18	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.2	0.4
16. Income recognition rule for gain or loss from section 1256 contracts	tyba 12/31/18	[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.4
17. Inclusion of income arising from business indebtedness	tyba 12/31/18	Not available											
18. Expensing of Section 179 Property	tyba 12/31/15	11.2	11.0	8.7	7.0	5.6	4.8	4.1	4.1	4.7	4.8	43.5	66.0

American Action Forum

Table 3. Estimated Revenue Effects of Comprehensive Corporate Tax Reform Provisions

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
VI. Financial Institutions													
1. Tax income from credit unions	tyba 12/31/15	1.1	2.4	2.5	2.7	2.9	3.2	3.5	3.6	3.8	4.0	11.6	29.7
2. Expand pro-rata interest expense disallowance for company-owned life insurance*	cia 12/31/15	0.5	0.6	0.8	0.9	1.0	1.1	1.2	1.4	1.5	1.7	3.7	10.6
3. Repeal small life insurance company taxable income adjustment	tyea 12/31/15	[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.9
4. Repeal special deduction for Blue Cross and Blue Shield companies*	tyba 12/31/15	0.2	0.4	0.4	0.5	0.5	0.6	0.7	0.7	0.9	0.9	2.0	5.8
5. Repeal tax-exempt status and election to be taxed only on investment income for small property and casualty insurance companies	tyba 12/31/15	[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.9
6. Interest rate and discounting period assumptions for revenue of property and casualty insurance companies	tyba 12/31/15	1.7	2.6	2.6	2.7	2.7	2.7	2.8	2.9	3.0	3.2	12.3	26.9
7. Proration for property and casualty companies	tyba 12/31/15	0.1	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.5	0.6	1.2	3.7
VII. Transportation													
1. Deferral of tax on capital construction funds of shipping companies	tyba 12/31/15	[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.9
VIII. Community and Regional Development													
1. Repeal empowerment zone tax incentives	tyba 12/31/15	0.3	0.2	0.1	[1]	[1]	[1]	[1]	[1]	[1]	[1]	0.6	0.6
2. Repeal New Markets tax credit	tyba 12/31/15	[1]	0.1	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.6	1.2	3.6
3. Repeal District of Columbia tax incentives	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
4. Repeal credit for Indian reservation employment	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
5. Repeal rules for recovery zone economic development bonds (QZABs, QSCBs, and tribal economic development bonds)	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
6. Eliminate requirement that financial institutions allocate interest expense attributable to tax-exempt interest	tyba 12/31/15	0.2	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6	2.2	4.9

American Action Forum
Table 3. Estimated Revenue Effects of Comprehensive Corporate Tax Reform Provisions
Fiscal Years 2016 - 2025
(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
IX. Education, Training, Employment and Social Services													
1. Repeal deduction for charitable contributions of companies	tyba 12/31/15	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	1.3	3.0
2. Repeal provisions for employee stock ownership plans (ESOPs)	tyba 12/31/15	0.4	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.9	1.0	3.1	7.4
3. Deferral of taxation on spread on employee stock purchase plans	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
4. Credit for disabled access expenditures	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
X. Health													
1. Credit for orphan drug research	tyba 12/31/15	0.5	0.8	0.8	0.8	0.9	0.9	0.9	1.0	1.1	1.1	3.8	8.8
2. Premium subsidy on COBRA continuation coverage	tyba 12/31/15	[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.9
3. Tax credit for small business purchasing employee insurance	tyba 12/31/15	[1]	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.5	1.5
XI. Income Security													
1. Exclusion of disaster migration payments	tyba 12/31/15	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
XII Generally Purpose Rural Assistance													
1. Exclusion of interest on public purpose State and local government bonds		Not available											
XIII. General Corporate Provisions													
1. Repeal exclusion of interest on private activity bonds*	bia 12/31/15	0.1	0.2	0.4	0.7	1.1	1.4	1.7	2.0	2.2	2.5	2.5	12.4
2. Repeal MACRS and apply alternative depreciation system (ADS), other depreciation provisions*	ppisa 12/31/15	29.6	57.0	73.2	79.2	81.2	75.9	65.2	60.0	55.8	52.5	320.1	629.4
3. Repeal of expensing provisions (other than energy, natural resources, and agriculture)	tyba 12/31/15						Not available						
4. Repeal Corporate Interest Deduction	tyba 12/31/15	15.4	21.8	24.1	30.7	38.7	44.7	48.0	50.5	52.8	55.0	130.7	381.7
Net Total		129.5	192.3	203.0	205.7	205.2	205.0	200.1	200.6	202.1	205.2	936.6	1,950.3

*Estimates derived from available JCT estimates

Legend for Effective column:

apoia = annuities paid or incurred after

bia = bonds issued after

caa = credits allocated after

cpoia = costs paid or incurred after

cia = contracts issued after

DOE = date of enactment

dpa = deferrals paid after

eca = exchanges commencing after

fpisa = facilities placed in service after

isa = installment sales after

N/A = not applicable

ppisa = property placed in service after

saua = sales and uses after

sooda = sales or other distributions after

tyba = taxable years beginning after

tyea = taxable years ending after

vsa = vehicles sold after

[1] Gain of less than $50 million

[2] Loss of less than $50 million

Table 3. shows the detailed revenue estimates underlying the estimates in Tables 1. and 2. All of the estimates in Table 3. assume a maximum corporate tax rate of 35 percent, the current law rate. An additional line item reflects the interaction of the base-broadening provisions with the corporate tax rate reduction. (Generally, proposals that increase taxable income will raise less revenue under a reduced tax rate.)

Tax reform specifications:

In this option AAF estimated the maximum revenue-neutral reduction in the corporation income tax rate made possible by sweeping base-broadening. In dollar terms the three largest base-broadeners are the repeal of the Modified Accelerated Cost Recovery System (MACRS), which provides accelerated depreciation of investment; the deductibility of corporate interest; and the expensing of research and experimentation costs. See Table 3 for a complete list. Full repeal of these provisions would allow for a reduction in the current corporate rate of 35 percent to 23 percent (Table 1). Table 2 shows that including revenue from a new, $20 per ton carbon tax would allow the rate to be further reduced to 18 percent.

Questions and considerations:

- Should alternative revenue sources be considered?
- Is the corporate rate reduction sufficient?
- This reform contemplates moving towards a dividend exemption (territorial) tax system, with strict base erosion rules (modeled on former Ways & Means Chairman Camp's "option C.")
- Is a territorial system desirable?
- Are strict base erosion rules necessary?
- Many nations are providing preferential tax treatment of IP-derived income ("patent boxes"). Should a corporate-only reform provide for a similar policy?
- Many of the base-broadening provisions have a separate economic rationale (e.g., accelerated depreciation). Would the repeal some or all be economically counterproductive?

Option #2: Corporate and Individual Tax Reform.

(Enclosures: Table 4A: Revenue Effects for Corporate and Individual Tax Reform, Table 4B: Revenue Effects for Corporate and Individual Tax Reform w/ Carbon Tax Revenue, Table 5: Distributional Table, Table 6: Cost of Capital, Appendix A: Detailed Description of Plan Specifications)

American Action Forum

Table 4A. Estimated Revenue Effects of Growth and Investment Tax Reform Plan

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
III. Individual Savings and Retirement													
(a) Create Save at Work plans that rely on current 401(k) contribution limits; All accounts would be Roth accounts	tyba 12/31/15	18.9	32.0	32.8	33.6	34.4	35.3	36.2	37.1	38.0	39.0	**151.7**	**337.3**
(b) Retain current law for Defined Benefit Plans	tyba 12/31/15						No Revenue Effect						
(c) Replace all other retirement plans with Save for Retirement accounts ($10,000 annual limit) available to all taxpayers; All accounts would be Roth accounts	tyba 12/31/15	3.6	6.2	6.3	6.5	6.7	6.8	6.9	7.1	7.3	7.4	**29.3**	**64.8**
(d) Save for Family accounts ($10,000 annual limit) available to all taxpayers; all accounts would be Roth accounts	tyba 12/31/15	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	**-0.5**	**-1.4**
(e) Repeal Education savings plans	tyba 12/31/15	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	**0.5**	**1.5**
(f) Repeal Health savings plans	tyba 12/31/15	0.6	1.2	1.6	1.9	2.3	2.5	2.5	2.5	2.5	2.6	**7.6**	**20.2**
Subtotal, Individual Savings and Retirement		**23.2**	**39.4**	**40.7**	**42.0**	**43.4**	**44.7**	**45.6**	**46.7**	**47.8**	**49.0**	**188.7**	**422.4**
Total Growth and Investment Tax Package		**-341.7**	**-414.5**	**-342.3**	**-294.3**	**-259.1**	**-225.7**	**-201.9**	**-182.0**	**-166.7**	**-152.9**	**-1,651.8**	**-2,581.0**

Source: Quantria Strategies, LLC

tyba = tax year beginning after

(1) Proposals are estimated sequentially. I.e., each estimate assumes that the provisions above have been implemented.

(2) Dollar amounts have been indexed for inflation.

(3) Included in item I.b

(4) Estimate assumes individuals presently covered under employer-sponsored plans can deduct their employee share.

Table 4A. shows our estimate of the Growth and Investment Tax Plan presented in 2005 by President Bush's Advisory Panel on Federal Tax Reform. The plan was comprehensive, far reaching and would fundamentally change the U.S. tax system for both individuals and businesses. Among its most significant features include:

- A top tax rate of 30 percent for individuals and businesses. For individuals, the tax rate would be progressive with three brackets at 15 percent, 25 percent and 30 percent. Businesses would pay a flat rate of 30 percent.
- The Alternative Minimum Tax (AMT) for both individuals and businesses would be repealed.
- A new Family Tax Credit would replace personal exemptions, standard deduction and child credit.
- A Work Credit, integrated with the Family Tax Credit, would replace the Earned Income Tax Credit (EITC).
- Home mortgage interest deductions would be replaced with a 15 percent credit, available to all homeowners.
- Donations to charity would now be deductible for all taxpayers, not just those who itemize.
- Individuals who purchase health insurance would be able to deduct the cost of that insurance.
- Income from interest, dividends and capital gains would be taxed at 15 percent for individuals.
- For businesses (including sole proprietorships, S-Corporations, Partnerships and C-Corporations) would be able to expense the cost of all new investment.

Our estimates show that the individual tax provisions, including those for savings and retirement, raise substantial revenue over the 10-year budget horizon. However, this revenue gain is more than offset by revenue losses on the business side. The primary reason for this is the expensing provision for new investment.[1]

American Action Forum

Table 4B. Estimated Revenue Effects of Growth and Investment Tax Reform Plan

Fiscal Years 2016 - 2025

(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
I. Provisions Affecting Individuals (1), (2)													
(a) Tax Rates (15%, 25%, 30%) and AMT Repeal	tyba 12/31/15	-20.6	-32.3	-34.2	-35.7	-37.2	-39.0	-40.9	-42.9	-45.0	-47.3	**-160.0**	**-375.1**
(b) Repeal itemized deductions and certain adjustments to income	tyba 12/31/15	195.8	300.9	314.5	328.5	343.1	358.5	374.9	391.8	409.2	427.1	**1,482.8**	**3,444.2**
(c) Repeal deduction for state and local taxes	tyba 12/31/15	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	**(3)**	**(3)**
(d) 15% Tax Rate on Interest, Dividends and Capital Gains	tyba 12/31/15	-8.1	-54.4	-55.7	-57.1	-58.4	-60.3	-62.4	-64.8	-67.3	-69.9	**-233.7**	**-558.4**
(e) Deduction for charitable giving available for all taxpayers	tyba 12/31/15	-35.6	-54.8	-57.3	-59.8	-62.5	-65.3	-68.3	-71.3	-74.5	-77.8	**-270.0**	**-627.1**
(f) Replace three-tiered structure with a simple deduction for Social Security Benefits ($44,000 mfj; $22,000 single would pay no taxes; indexed for inflation)	tyba 12/31/15	-41.3	-64.7	-68.4	-71.4	-74.5	-78.1	-81.8	-85.8	-90.1	-94.6	**-320.3**	**-750.7**
(g) Deduction for purchasing health insurance (4)	tyba 12/31/15	-27.1	-48.9	-53.5	-54.0	-54.6	-55.2	-55.8	-56.3	-56.9	-57.4	**-238.1**	**-519.6**
(h) Replace home mortgage interest deduction with home	tyba 12/31/15	-47.6	-73.1	-76.3	-79.3	-82.3	-85.7	-89.2	-92.9	-96.7	-100.7	**-358.6**	**-823.6**
(h) Replace standard deduction, personal exemption and child credit with new Family Credit	tyba 12/31/15	39.9	61.3	63.9	66.4	69.0	71.8	74.8	77.8	81.0	84.4	**300.6**	**690.4**
(j) Replace EITC with Work Credit	tyba 12/31/15	-11.0	-16.8	-17.6	-18.2	-19.0	-19.7	-20.5	-21.4	-22.3	-23.2	**-82.6**	**-189.6**
Subtotal, Individual Provisions		**44.2**	**17.2**	**15.6**	**19.4**	**23.6**	**27.2**	**30.8**	**34.3**	**37.5**	**40.6**	**120.0**	**290.3**
II. Provisions Affecting Businesses													
(a) Flat tax rate of 30% and repeal corporate AMT	tyba 12/31/15	-31.3	-48.7	-50.2	-51.0	-54.3	-55.9	-56.4	-57.2	-58.2	-59.6	**-235.5**	**-522.9**
(b) Expensing of new investment	tyba 12/31/15	-391.0	-441.0	-369.0	-331.0	-305.0	-280.0	-263.0	-249.0	-239.0	-230.0	**-1,837.0**	**-3,098.0**
(c) Treatment of net interest	tyba 12/31/15	13.2	18.7	20.7	26.3	33.2	38.3	41.2	43.3	45.2	47.2	**112.1**	**327.2**
(d) International provisions (destination-basis with border tax adjustments	tyba 12/31/15	-	-	-	-	-	-	-	-	-	-	**-**	**-**
Subtotal, Business Provisions		**-409.1**	**-471.0**	**-398.6**	**-355.6**	**-326.1**	**-297.5**	**-278.3**	**-262.9**	**-252.0**	**-242.5**	**-1,960.5**	**-3,293.7**

American Action Forum
Table 4B. Estimated Revenue Effects of Growth and Investment Tax Reform Plan
Fiscal Years 2016 - 2025
(Billions of Dollars)

Provision	Effective	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
III. Individual Savings and Retirement													
(a) Create Save at Work plans that rely on current 401(k) contribution limits; All accounts would be Roth accounts	tyba 12/31/15	18.9	32.0	32.8	33.6	34.4	35.3	36.2	37.1	38.0	39.0	**151.7**	**337.3**
(b) Retain current law for Defined Benefit Plans	tyba 12/31/15						No Revenue Effect						
(c) Replace all other retirement plans with Save for Retirement accounts ($10,000 annual limit) available to all taxpayers; All accounts would be Roth accounts	tyba 12/31/15	3.6	6.2	6.3	6.5	6.7	6.8	6.9	7.1	7.3	7.4	**29.3**	**64.8**
(d) Save for Family accounts ($10,000 annual limit) available to all taxpayers; all accounts would be Roth accounts	tyba 12/31/15	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	**-0.5**	**-1.4**
(e) Repeal Education savings plans	tyba 12/31/15	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	**0.5**	**1.5**
(f) Repeal Health savings plans	tyba 12/31/15	0.6	1.2	1.6	1.9	2.3	2.5	2.5	2.5	2.5	2.6	**7.6**	**20.2**
Subtotal, Individual Savings and Retirement		**23.2**	**39.4**	**40.7**	**42.0**	**43.4**	**44.7**	**45.6**	**46.7**	**47.8**	**49.0**	**188.7**	**422.4**
IV. Impose a $60/Ton Carbon Tax on Fossil Fuel Emissions (5)	tyba 12/31/15	**150.0**	**228.4**	**235.3**	**242.4**	**249.8**	**257.3**	**265.1**	**273.1**	**281.3**	**289.8**	**1,106.0**	**2,472.6**
Total Growth and Investment Tax Package		**-191.7**	**-186.1**	**-106.9**	**-51.8**	**-9.3**	**31.6**	**63.2**	**91.1**	**114.6**	**136.9**	**-545.8**	**-108.4**

Source: Quantria Strategies, LLC

tyba = tax year beginning after
(1) Proposals are estimated sequentially. I.e., each estimate assumes that the provisions above have been implemented.
(2) Dollar amounts have been indexed for inflation.
(3) Included in item I.b
(4) Estimate assumes individuals presently covered under employer-sponsored plans can deduct their employee share.
(5) Estimate includes 25% excise tax offset.

Table 4B. shows the estimate if a $60 per ton carbon tax is included. We find this results in a plan that is essentially revenue neutral over the 10-year budget horizon. Significantly, the estimates show revenue losses in each of the first five years and increasingly growing revenue increases in the second half of the budget window. This is primarily due to the “front loading” of the revenue losses due to expensing.

Table 5. - Average Effective Tax Rates, by Income Class, Under Current Law an
Tax Growth and Investment Tax Plan

Income Class[1/]	Tax Year 2016 Average Effective Tax Rate[2/] Present Law (%)	Proposed Law (%)
Less Than $10,000	-8.2%	-9.1%
$10,000 to $20,000	-6.6%	-2.6%
$20,000 to $30,000	-1.4%	1.9%
$30,000 to $40,000	2.7%	5.4%
$40,000 to $50,000	5.8%	6.3%
$50,000 to $75,000	7.9%	7.9%
$75,000 to $100,000	9.0%	9.2%
$100,000 to $200,000	11.4%	12.2%
$200,000 to $500,000	16.8%	17.9%
$500,000 to $1 Million	23.5%	21.3%
$1 Million to $2 Million	26.8%	22.2%
$2 Million to $5 Million	27.6%	21.8%
$5 Million to $10 Million	27.6%	21.3%
$10 Million and Over	25.1%	19.2%
Total, All Taxpayers	**12.8%**	**12.7%**

Source: Quantria Strategies, LLC Individual Income Tax Simulation Model

[1/] The income concept used to classify taxpayers is total positive income.

[2/] Figures do not include certain provisions that were calculated independently of the simulation model.

Table 5. compares effective tax rates under present law and how they are likely to change under the Growth and Investment Tax Plan. The figures show that low-income taxpayers would be better off under the plan, due principally to the Family and Work Credit, but that this benefit declines as incomes reach about $200,000. Taxpayers with incomes above $200,000 see significant reductions in average tax rates due to the lower tax rates on interest, dividends and capital gains.

Table 6. - Change in the User Cost of Capital Under the Growth & Investment Plan

NAICS Code	Industry	User Cost of Capital (Present Law)	User Cost of Capital (Growth & Investment Plan)	Change from Present Law
11	Agriculture, forestry, fishing, and hunting	4.18%	3.63%	-13.16%
21	Mining	4.08%	3.58%	-12.25%
22	Utilities	4.29%	3.58%	-16.55%
23	Construction	3.96%	3.58%	-9.60%
31-33	Manufacturing	4.06%	3.58%	-11.82%
42	Wholesale trade	4.16%	3.60%	-13.46%
44-45	Retail trade	4.22%	3.61%	-14.45%
48-49	Transportation and warehousing	4.10%	3.59%	-12.44%
51	Information	4.83%	3.68%	-23.81%
52	Finance and insurance	4.22%	3.62%	-14.22%
53	Real estate and rental and leasing	4.11%	3.59%	-12.65%
54	Professional, scientific, and technical servic	4.35%	3.63%	-16.55%
55	Management of companies and enterprises	4.33%	3.63%	-16.17%
56	Administrative and waste management serv	4.25%	3.61%	-15.06%
61	Educational services	4.32%	3.62%	-16.20%
62	Health care and social assistance	4.24%	3.60%	-15.09%
71	Arts, entertainment, and recreation	4.21%	3.60%	-14.49%
72	Accommodation and food services	4.12%	3.59%	-12.86%
81	Other services, except government	4.19%	3.60%	-14.08%
	Total, All Industries	4.22%	3.61%	-14.45%

Source: Quantria Strategies, LLC

Table 6. shows how the business tax provisions would affect the user cost of capital under the Growth and Investment Tax Plan for equipment purchases. The estimates show significant reductions in the marginal cost of investment, about 15 percent, due primarily to the expensing provision and the reduction in the top rate for businesses to 30 percent. A reduction in the user cost of capital would result in more business investment

Tax reform specifications

For the purposes of providing a reference for an individual and corporate tax reform plan, AAF chose the President's Advisory Panel on Federal Tax Reform (2005) "Growth and Investment Plan" as a benchmark. This plan makes significant changes to existing tax law, including: implementing a progressive tax rate structure on wage income with a top rate at 30 percent; taxing income from capital (e.g., interest, dividends, capital gains) at 15 percent; repealing the Alternative Minimum Tax (AMT); replace the current system of exemptions and deductions with a Family Tax Credit; make far-reaching changes to our existing retirement, health and education tax incentives; and provide immediate expensing of capital expenditures for all businesses. Tables 4A provides detailed specifications and associated revenue effects. Table 4B moves the plan to revenue-neutrality by incorporating a $60 per ton carbon tax. (Note: this is much higher than any carbon tax proposal in the current environment.) Appendix A provides detailed specifications for the individual and corporate provisions of this plan.

Questions and Considerations:

- Unlike the corporate-only reform, this plan is well short of revenue neutrality. Is that an essential constraint?
- Should alternative revenue sources be considered?
- Is the rate structure (15, 25, 30 percent) appropriate?
- Is the treatment of savings and investment income appropriate? Should the tax on capital income be zero (i.e., a consumption tax base)?

These were initial questions that AAF hoped would jump-start a productive discussion.

APPENDIX A – DESCRIPTION OF PROVISIONS CONTAINED IN THE GROWTH AND INVESTMENT REVENUE TABLE

Individual Income Tax Provisions

I. Households and Families

1. Tax Compensation – The proposal would tax wages, compensation, and other compensation at three progressive tax rates (15, 25, and 30 percent). The following table summarizes the tax rates and income brackets for applying the tax rates. Generally, the provision would eliminate the marriage penalty (for the most part) by making the tax brackets and most other tax parameters double those for individual taxpayers. The provisions would apply to taxable years beginning after December 31, 2015.

Table A-1 – Tax Rates and Income Brackets		
Tax Rate	Married Taxpayers	Unmarried Taxpayers
15 percent	Up to $99,200	Up to $49,600
25 percent	$99,201 to $173,600	$49,601 to $86,800
30 percent	$173,601 or more	$86,001 or more

2. Alternative Minimum Tax – The proposal would repeal the current-law alternative minimum tax system. The provisions would apply to taxable years beginning after December 31, 2015.

3. Provide Family Credit – The proposal would create a family credit that would replace the personal exemption, standard deduction and child tax credit. The family credit would provide a $4,092 credit for married filing jointly taxpayers; $3,472 credit for unmarried taxpayers with a child; $2,046 credit for unmarried; and $1,426 credit for dependent taxpayers. Taxpayers would claim an additional credit for each dependent child of $1,860 and $620 credit for each additional dependent. The proposal would allow families to claim the family credit for some full-time students (not yet specified). The provisions would apply to taxable years beginning after December 31, 2015

4. Provide Work Credit – The proposal would create a new work credit that would replace the current-law earned income credit. These provisions would apply to taxable years beginning after December 31, 2015.

II. Other Major Credits and Deductions

1. Home Credit – The proposal would repeal the current-law mortgage interest deduction and replace it with a home credit equal to 15 percent of mortgage interest paid. The credit would apply to the average regional house price. Estimates suggest that average regional house prices would be limited to $227,000 to $412,000, depending upon the location. The provisions would apply to taxable years beginning after December 31, 2015.

2. Charitable Deduction – The proposal would repeal the current-law charitable deduction with a deduction that is available to all taxpayers that give 1 percent or more of income. The final proposal would include anti-abuse rules and require appropriate documentation. The provisions would apply to taxable years beginning after December 31, 2015.

3. Use Pre-tax Dollars for Health Insurance – Under this proposal, taxpayers would exclude amounts paid for health insurance from income (pre-tax dollars), up to the amount of the average premium (estimated at $5,000 individual and $11,500 for families). The provisions would apply to taxable years beginning after December 31, 2015.

4. Repeal Itemized Deductions – The proposal repeals specifically the itemized deduction for State and Local taxes. In addition, it is assumed that the itemized deductions for property taxes, businesses expenses, medical expenses, and other itemized deductions (not specifically addressed) are repealed. The

provisions would apply to taxable years beginning after December 31, 2015.

III. Individual Savings and Retirement

1. Create Save at Work Plans – The proposal would create the Save at Work Plan that would rely on the current-law 401(k) contribution limits. However, all contributions would be subject to tax and the accounts (prospectively) would receive tax treatment as current law Roth accounts (i.e., contributions are not deductible; interest earnings would not be subject to tax if they remain in the account for at least five years.) The provisions would apply to contributions made in taxable years beginning after December 31, 2015.

2. Other Defined Contribution Plans – The proposal would replace all other retirement plans (including individual retirement arrangements, and other cash or deferred arrangements) with Save for Retirement accounts. The accounts would be subject to a $10,000 annual limit and would be available to all taxpayers. The estimate assumes that the current-law provisions that limit contributions to total taxable compensation or the annual dollar limit amount would apply to these contributions. In addition, the estimate assumes that all retirement savings would receive the same tax treatment as Roth accounts. The provisions would apply to taxable years beginning after December 31, 2015.

3. Save for Family Accounts – In an effort to simplify and streamline the current tax –preferred savings opportunities, the proposal would create Save for Family Accounts. The accounts would be subject to a $10,000 annual limit and would be available to all taxpayers. The Save for Family Accounts would replace current-law education savings plans and health savings plans. The estimate assumes that all retirement savings would receive the same tax treatment as Roth accounts. The provisions would apply to taxable years beginning after December 31, 2015

4. Unify the tax treatment of capital income – Under the proposal, all capital income, including all dividends, capital gains and all taxable interest received would be subject to tax at a 15 percent tax rate. The provisions would apply to taxable years beginning after December 31, 2015.

5. Simplify and Limit Social Security Taxes – The proposal would replace the current-law three-tiered tax calculation with a simple deduction for Social Security Benefits. Married taxpayers would not be subject to tax on benefits up to $54,560 and unmarried taxpayers would not be subject to tax on benefits up to $27,280. The benefit threshold would be indexed for inflation. (The estimate assumes that the indexation calculation would apply the same CPI-W as that applied to annual benefit increases.) The provisions would apply to taxable years beginning after December 31, 2015.

Business Income Tax Provisions

I. Small Business

1. Small Business Tax Rates – Under the proposal, small businesses would be subject to a 30 percent tax rate on business income. Business income would be determined using the subtraction method. This method measures the difference between receipts and outlays, on a cash-flow basis. Sole proprietorships are subject to tax at the individual income tax rates. This strategy eliminates the potential for tax planning

strategies aimed at shifting income between the business activity and the individual income tax base. In addition, the proposal would repeal the alternative minimum tax for businesses. Under the tax plan, losses would not be refundable, but would allow the business taxpayer to carry forward the losses to apply to income earned in future periods. The provisions would apply to taxable years beginning after December 31, 2015.

2. Expensing – The proposal would allow businesses to deduct the cost of new investment in the year that the asset is placed in service. This would repeal the modified accelerated cost recovery system and would apply to property placed in service after December 31, 2015.

3. Large Business Tax Rates – Under the proposal, large businesses would be subject to a 30 percent tax rate on business income. Business income would be determined using the subtraction method. This method measures the difference between receipts and outlays, on a cash-flow basis. In addition, the proposal would repeal the alternative minimum tax for businesses. Under the tax plan, losses would not be refundable, but would allow the business taxpayer to carry forward the losses to apply to income earned in future periods. The provisions would apply to taxable years beginning after December 31, 2015.

4. Expensing – The proposal would allow businesses to deduct the cost of new investment in the year that the asset is placed in service. This would repeal the modified accelerated cost recovery system and would apply to property placed in service after December 31, 2015.

5. Consistent Treatment of Financial Transactions – The business income tax base would not include financial transactions. Under the proposal, with the exception of financial institutions, businesses would no longer deduct interest paid expenses and interest received would not be subject to tax. The provisions would apply to taxable years beginning after December 31, 2015

6. Foreign-Sourced Income – The proposal would reform international transaction to create a system of taxes based on a destination basis. This means that business tax would apply to all consumption, regardless of where the goods were produced. Income generated on the export of products produced domestically would be excluded from tax. The business would receive a tax rebate of the foreign taxes paid on the production costs (border tax adjustments). The provisions would apply to taxable years beginning after December 31, 2015.

[1] Our estimates do not include certain transition rules outlined in the Commission’s study. Including these would slightly increase the revenue losses of the business provisions.

Additional Sources:

TPC: An Analysis of Hillary Clinton’s Tax Proposals

CBO: The Distribution of Major Tax Expenditures in the Individual Tax System

OECD: Tax and Economic Growth

OECD: Tax Policy Reform and Economic Growth

RFF: Border Adjustments for Carbon Emissions

RFF:Comparing Policies to Combat Emissions Leakage

RFF: WTO Law Constraints on Border Tax Adjustment and Tax Credit Mechanisms to Reduce the Competitive Effects if Carbon Taxes

TPC: Integrating the Corporate and Individual Tax Systems: The Dividend Paid Deduction Considered

TPC: Curbing Tax Expenditures