

## OPPORTUNITIES AND RISKS IN INDIVIDUAL TAX REFORM

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Hearing on Individual Tax Reform

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Good morning, Mr. Chairman, Ranking Member Wyden, and Members of the Committee. My name is Lily Batchelder and I am a professor at NYU School of Law. Thank you for the opportunity to testify before you today on individual tax reform. It is a pleasure and honor to be back with the Committee.

There are three traditional goals of tax reform: greater equity, efficiency, and simplicity. Sometimes these goals are in tension; at other points, they can be furthered at the same time. In my view, individual tax reform should focus on areas where we are farthest from these goals, and where we can advance more than one simultaneously. My testimony makes five main points:

- The current tax reform effort is occurring at a time when low- and middle-income families are facing deep financial challenges. Economic disparities in the US are vast and have been widening for decades. The US also has one of the lowest levels of economic mobility among our competitors. Our debt as a share of GDP is projected to grow to unprecedented levels in coming decades, largely because of the retirement of the Baby Boom generation and increasing life expectancy. This growth in national debt will be a drag on economic growth. For all these reasons, tax reform should increase revenues and enhance progressivity. Doing so would boost economic growth and make the tax code fairer at the same time. At a bare minimum, tax reform should maintain the current level of revenues and progressivity, which should be measured consistently and without resort to budget gimmicks like a “current policy” baseline.
- Individual tax reform should focus on leveling the playing field for the next generation and supporting work. Doing so would blunt economic inequality, broaden economic opportunity, and increase efficiency and productivity by ensuring that jobs are awarded more often based on effort and talent, and less often based on connections and the luck of one’s birth. Some worthwhile proposals that would advance these goals are expanding the EITC, especially for workers without dependents; increasing refundability of the child tax credit, especially for young

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<sup>1</sup> I am grateful to Seth Hanlon, Chye-Ching Huang, David Kamin, and Greg Leiserson for helpful comments, and Cameron Williamson for excellent research assistance. All errors are my own.

children in the poorest families; and restructuring child care benefits so they provide the largest benefits to families for whom child care costs impose the greatest budgetary strain. These proposals could make significant headway in offsetting the much lower earnings growth experienced by low- and moderate-income families over the past few decades relative to those who are more affluent. They should be paid for by raising taxes on the most fortunate, including by strengthening, not repealing, wealth transfer taxes.

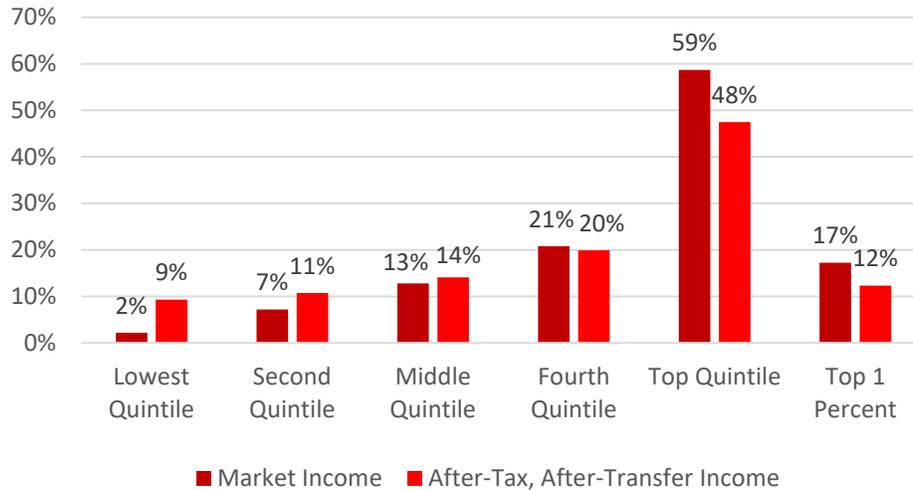
- Individual tax reform should also focus on reducing transactional complexity, which arises from taxpayers reorganizing their affairs to minimize taxes. Reducing transactional complexity essentially involves eliminating opportunities for savvy taxpayers to game the tax system and accomplishes the trifecta of tax reform: it makes the tax code fairer, more efficient, and simpler. To further this goal, Congress should consider proposals like rationalizing the NIIT and SECA taxes so all labor and capital income are subject to the Medicare tax on high incomes in some form, repealing stepped-up basis, narrowing the gap between the tax rates on ordinary income and capital gains, and taxing carried interest as ordinary income.
- Individual tax reform should further seek to make tax incentives more efficient and fair, generally by restructuring them into refundable tax credits and leveraging empirical insights from behavioral economics. Doing so could generate more social benefits at a lower cost. One particularly fruitful area for reform is tax incentives for retirement savings. By reducing tax benefits for the wealthy, increasing them for low- and middle-income workers, and ensuring that all workers have access to an easy way to save at their workplace through automatic IRAs, Congress could increase retirement security for millions of Americans while raising revenue at the same time.
- Unfortunately the tax plans offered to date by President Trump and the House GOP leadership move precisely in the opposite direction. Both lose massive amounts of revenue. The corresponding increase in debt would depress economic growth over time. They are also sharply regressive, providing vast tax cuts to the wealthy and a pittance to everyone else. They create a giant new loophole for the wealthy in the form of a special rate cap on pass-through business income, which tax experts on the left and right agree is a terrible idea. To the extent that they include proposals intended to support low- and middle-income households, they do so in relatively ineffective ways. Moreover, sooner or later, these plans' massive tax cuts for the wealthy will have to be paid for, and low- and middle-income families are likely to be left footing the bill. I urge you to consider a fundamentally different approach.

## I. Individual Tax Reform Should Enhance Progressivity and Increase Revenues

### A. The Context of Tax Reform

The current tax reform effort is occurring at time when low- and middle-income families are facing deep financial challenges. Economic disparities in the US are vast and have been widening for decades. As illustrated in Figure 1, the top 1% earns more than 17% of all market income.

**Figure 1: Shares of Market Income and After-Tax, After-Transfer Income, 2013**

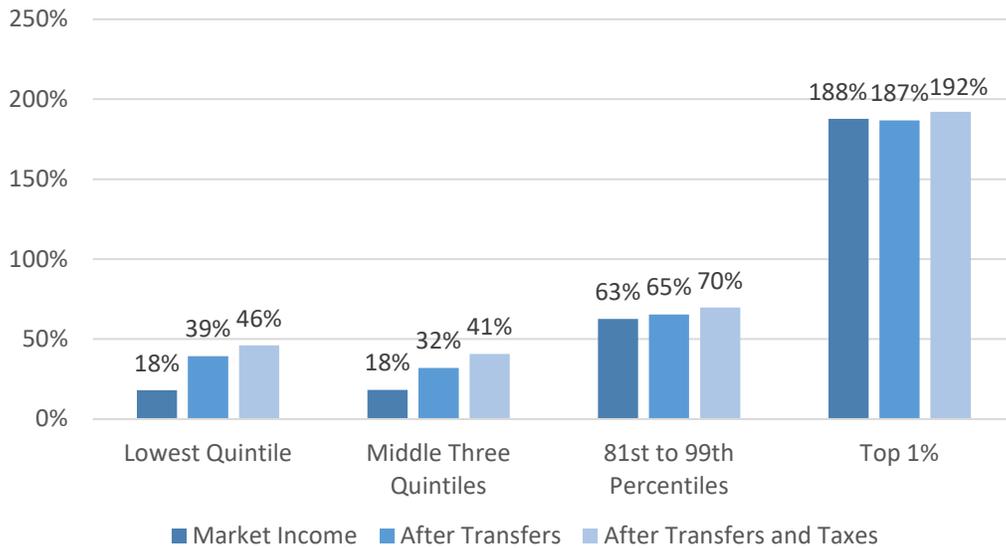


Source: CONG. BUDGET OFFICE, THE DISTRIBUTION OF HOUSEHOLD INCOME AND FEDERAL TAXES, 2013 (June 8, 2016).

Tax cuts and especially changes to direct spending programs have played an important role in boosting the incomes for low- and middle-income households over the past several decades. But the after-tax, after-transfer income of the top 1% has still grown about four times faster than it has for low- and middle-income households, as shown in Figure 2. The situation is even worse for working-class households, defined as those in which no one has a bachelor's degree. Real median after-tax, after-transfer income for a working-class household of three has only grown 3% since 1997.<sup>2</sup>

<sup>2</sup> Chuck Marr, Brandon DeBot, and Emily Horton, *How Tax Reform Can Raise Working-Class Incomes*, CTR. ON BUDGET AND POLICY PRIORITIES (Sept. 13, 2017).

**Figure 2: Cumulative Growth in Inflation-Adjusted Household Income from 1979 to 2013**



Source: CONG. BUDGET OFFICE, *THE DISTRIBUTION OF HOUSEHOLD INCOME AND FEDERAL TAXES*, 2013 (June 8, 2016).

These disparities might be justified if they purely reflected people’s efforts and choices. But the US actually has one of the lowest levels of intergenerational economic mobility among our competitors. In the US, a father on average passes on roughly half of his economic advantage or disadvantage to his son. Among our competitors, the comparable figure is less than one-third, and for several it is one-fifth.<sup>3</sup> This implies that, to an especially large extent in the US, economic disparities reflect the luck of one’s birth, not hard work.

Compounding these challenges, our national debt as a share of GDP is projected to grow to unprecedented levels in the coming decades, as shown in Figure 3. This is largely due to the retirement of the Baby Boom generation and increasing life expectancy—not policy choices. These demographic trends increase Medicare, Medicaid, and Social Security costs, contribute to health care costs rising more rapidly than inflation, and reduce the proportion of the population that contributes to the trust funds for these programs.

The solution will need to involve more revenues. As groups ranging from the National Academy of Sciences<sup>4</sup> to the Bipartisan Policy Center<sup>5</sup> to the American Enterprise Institute<sup>6</sup> have concluded, revenues will need to rise as a share of GDP and increase relative to current

<sup>3</sup> Miles Corak, *Income Inequality, Equality of Opportunity, and Intergenerational Mobility*, 27 J. OF ECON. PERSPECTIVES 3, 79 (2013).

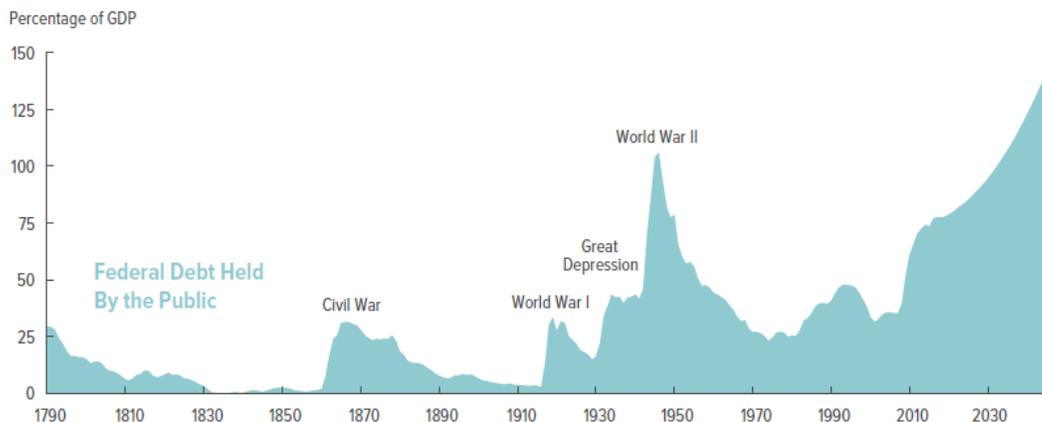
<sup>4</sup> National Research Council and National Academy of Public Administration, *CHOOSING THE NATION’S FISCAL FUTURE* (2010); *Setting and Meeting an Appropriate Target for Fiscal Sustainability: Hearing Before the S. Comm. on the Budget*, 111<sup>th</sup> Cong. (Feb. 11, 2010) (statement of Rudolph G. Penner, Institute Fellow, Urban Inst.).

<sup>5</sup> Bipartisan Policy Center, *A BIPARTISAN APPROACH TO AMERICA’S FISCAL FUTURE* (2015), [http://www.pgpf.org/sites/default/files/05122015\\_solutionsinitiative3\\_bpc.pdf](http://www.pgpf.org/sites/default/files/05122015_solutionsinitiative3_bpc.pdf).

<sup>6</sup> Joseph Antos, Andrew Biggs, Alex Brill, & Alan Viard, *A Balanced Plan for Fiscal Stability and Economic Growth*, AMERICAN ENTERPRISE INSTITUTE (2015), [http://www.pgpf.org/sites/default/files/05122015\\_solutionsinitiative3\\_aei.pdf](http://www.pgpf.org/sites/default/files/05122015_solutionsinitiative3_aei.pdf).

law. The later we act to stabilize our long-term fiscal outlook, the larger the costs will be, and the more likely it is that we will partially renege on fundamental commitments to low- and middle-income workers in their retirement through cuts to Social Security, Medicare, or Medicaid.<sup>7</sup>

**Figure 3: Historical and Projected Federal Debt as a Share of GDP**



Source: CONG. BUDGET OFFICE, THE LONG-TERM BUDGET OUTLOOK (March, 2017).

For all these reasons, I believe tax reform should enhance progressivity and increase revenues. Doing so would make the tax code fairer and boost economic growth at the same time. JCT and CBO have estimated that deficit-financed individual income tax cuts, including those disproportionately benefiting the wealthy, reduce growth by driving up private borrowing costs in the long-term.<sup>8</sup> This implies that progressive, revenue-enhancing reforms would increase economic growth. In addition, such reforms would strengthen the tax code’s ability to automatically stabilize the economy in recessions, potentially shortening downturns and mitigating their negative long-term effects on the economy.<sup>9</sup>

At a bare minimum, individual tax reform should do no harm: it should at least maintain the level of revenues and progressivity under current law. Revenue and distributional neutrality were the shared, bipartisan premises of the last major tax reform in 1986, and they are all the more critical basic standards today for the reasons laid out above.

<sup>7</sup> For further discussion of these issues, see Paul N. Van de Water, *Federal Spending and Revenues Will Need to Grow in Coming Years, Not Shrink*, CTR. ON BUDGET AND POLICY PRIORITIES (Sept. 6, 2017).

<sup>8</sup> CONG. BUDGET OFFICE, THE ECONOMIC OUTLOOK AND FISCAL POLICY CHOICES, *Hearing before the S. Comm. on the Budget*, 111<sup>th</sup> Cong. 8 (2010) (statement of Douglas W. Elmendorf, Director, Cong. Budget Office); J. COMM. ON TAXATION, MACROECONOMIC ANALYSIS OF VARIOUS PROPOSALS TO PROVIDE \$500 BILLION IN TAX RELIEF (Mar. 1, 2005), <http://www.jct.gov/x-4-05.pdf>.

<sup>9</sup> For discussions of the macroeconomic benefits of progressive taxes as automatic stabilizers, see Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23 (2006); Yair Listokin, *Stabilizing the Economy Through the Income Tax Code*, TAX NOTES (June 29, 2009); Douglas W. Elmendorf and Jason Furman, *If, When, How: A Primer on Fiscal Stimulus* (The Hamilton Project, Jan., 2008).

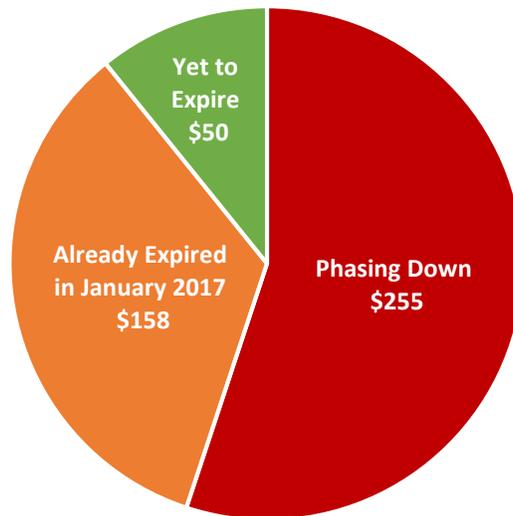
**B. The Importance of Accurately Measuring Revenues and Progressivity**

In determining whether tax reform maintains or increases revenues, it is critical that revenues are measured consistently and without resorting to budget gimmicks. This means first and foremost that revenues should be measured relative to current law, not so-called “current policy.”

At the end of 2015, Congress deliberately allowed many of the “tax extender” provisions to expire while making others permanent. The largest provision set to expire—bonus depreciation—was expressly intended as a temporary, stimulative policy when originally enacted.

Some have suggested adopting a current policy baseline for tax reform. Such a baseline would assume that all of these tax cuts currently set to expire—and potentially a host or provisions that have already expired—are actually permanent law, even though making them permanent would cost as much as \$450 billion over the next decade, as illustrated in Figure 4.<sup>10</sup> As a result, a bill that cuts taxes by \$450 billion could be treated as not cutting taxes at all. Adopting a current policy baseline for budget scoring purposes would be set a terrible precedent and would fundamentally undermine our system of budget enforcement.

**Figure 4: Components of Potential "Current Policy" Baseline**



Source: Committee for a Responsible Federal Budget, *Current Policy Gimmick Would Add Half-Trillion to Debt* (Aug. 30, 2017).

<sup>10</sup> CONG. BUDGET OFFICE, DETAILED REVENUE PROJECTIONS (June 2017), <https://www.cbo.gov/about/products/budget-economic-data#7>.

The problem with a current policy baseline is not strictly with treating temporary changes as permanent, but with doing so inconsistently.<sup>11</sup> To be sure, when some expiring spending programs are extended, their extension is treated as having no budgetary effect. But this is done consistently. Such a program is only treated as permanent in the baseline, and therefore having no budgetary effect when extended, if it was treated as permanent for budget scoring purposes when first enacted.

In contrast, Congress has traditionally applied a “current law baseline” when determining the budgetary effects of tax changes. When the tax extenders in place today were first enacted (or were extended), they were not treated as permanent tax cuts for budget scoring purposes. As a result, it would be fundamentally inconsistent to assume that making them permanent now has no budgetary cost. In fact, there is now some talk of both using a current policy baseline, which assumes that existing temporary provisions are permanent, and then scoring *new* temporary tax cuts as temporary all in the same bill—the ultimate fiscal shell game. By this logic, Congress could repeal all federal taxes for 2018 only and estimate the cost at the roughly \$3.6 trillion the federal government is expected to raise in 2018, using the current law baseline it has traditionally used for tax legislation. Then, in 2018, Congress could permanently repeal all federal taxes and, if the Budget Committee Chair declared that Congress was shifting to a current policy baseline for tax purposes, the permanent elimination of all federal taxes would be treated as having no budgetary effects whatsoever.

In determining the revenue effects of tax reform legislation, it is also critical for Congress to avoid timing gimmicks. To be sure, there are reasonable policy changes that have bigger or smaller budgetary effects within the budget window than they do outside it. But such changes should be enacted because they are substantive policy improvements, not as pretext to hide the cost of tax cuts. Congress should therefore be careful to consider the revenue effects both inside and outside the budget window.

In this respect, the Byrd rule serves as an important backstop. It provides that any tax legislation enacted through the reconciliation process (thereby avoiding a filibuster) cannot increase deficits in any year outside the budget window. But it is also important that any tax bill increases, or at a bare minimum maintains, the current law level of revenues within the budget window. The Byrd rule does not cover deficit increases within the budget window, but the Senate’s “pay-go” rule does, and that rule should not be discarded to allow for deficit-increasing tax cuts.<sup>12</sup>

In addition, tax reform legislation should respect the underlying intent of the Byrd rule (and the reconciliation process itself), which was to reduce deficits, not increase them. This is yet another argument for continuing to use a current law baseline for tax purposes. It also

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<sup>11</sup> For further discussion, see David Kamin and Rebecca Kysar, *All About that Base(line)* (Sept. 1, 2017) (working paper).

<sup>12</sup> See, e.g., Alan Cohen, *The Potential Impact of PAYGO Rules on Tax Legislation*, *CTR. FOR AM. PROGRESS* (Aug. 28, 2017), <https://www.americanprogress.org/issues/economy/reports/2017/08/28/437873/potential-impact-paygo-rules-tax-legislation/>.

means that if any bill includes provisions that raise more revenue within the budget window than outside it (such as the mandatory “Rothification” of all future contributions to retirement plans), the Senate should be absolutely sure to secure estimates of the revenue effects of the bill outside the budget window before voting. Such out-year estimates are necessary to ensure that any such bill complies with both the letter and spirit of the Byrd rule.

Turning to progressivity, there is broad agreement among tax experts that changes in progressivity should be measured by looking at the percent change in after-tax income for different income groups.<sup>13</sup> The progressivity measure should also incorporate all federal taxes, including the corporate income tax and wealth transfer taxes, and should distribute those taxes in line with the methodology adopted by the nonpartisan career staff at JCT, CBO and the Treasury Department. In this regard, recent suggestions that corporate income tax cuts should be distributed in a dramatically different manner from the consensus approach of these nonpartisan professionals are deeply disturbing.<sup>14</sup>

One alternative measure of progressivity that is particularly misleading is the percent change in tax liabilities. This measure makes regressive tax cuts look like progressive cuts. For example, it implies that if a minimum wage worker sees her income tax liability fall from \$100 to \$49, she is receiving a larger tax cut than a millionaire whose tax liability is cut from \$200,000 to \$100,000. Conversely, it is also misleading to look only at dollar changes in tax liability because this measure can make a progressive tax cut look like a regressive one. For example, it implies that if a family earning \$25,000 receives a \$1,000 tax cut and a family earning \$1 million receives a \$1,001 tax cut, this is a regressive tax change.

Continuing to use a current law baseline is also critical for measuring whether tax legislation maintains or increases progressivity. The tax cuts that have recently expired or are slated to expire disproportionately benefit the wealthy. They are mostly corporate tax cuts, and on average, they provide three times as large a tax cut for the top 1% as they do for the bottom four quintiles, when the tax cut is measured as a share of after-tax income.<sup>15</sup> Thus, assuming that these expired and expiring provisions are already permanent would involve assuming that the tax code is currently less progressive than it actually is.

If Congress increases or, at a bare minimum, maintains the current level of revenues and progressivity as defined here, any tax reform legislation will abide by the so-called Mnuchin principle, which I fully support. Treasury Secretary Steve Mnuchin has stated several times that “there will be no absolute tax cut for the upper class... any tax cuts we have for the upper class

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<sup>13</sup> See, e.g., Scott Greenberg, *Distributional Effects Should Be Measured in Percentages, Not Dollars*, TAX FOUNDATION (Nov. 5, 2015), <https://taxfoundation.org/distributional-effects-should-be-measured-percentages-not-dollars/>. For a detailed explanation of why this is the best measure of tax progressivity, see David Kamin, *What is a Progressive Tax Change?: Unmasking Hidden Values in Distributional Debates*, 83 NYU L. Rev. 241 (2008).

<sup>14</sup> Richard Rubin, *Who Ultimately Pays for Corporate Taxes? The Answer May Color the Republican Overhaul*, WALL ST. J. (Aug. 8, 2017).

<sup>15</sup> Chye-Ching Huang & Brandon DeBot, *“Current Policy” Baseline Would Hide \$439 Billion in Tax Cuts Worth at Least \$40,000 a Year for the Top 0.1 Percent*, CTR. ON BUDGET AND POLICY PRIORITIES (Aug. 16, 2017).

will be offset by less deductions that pay for it.”<sup>16</sup> In light of mounting inequality and deficits, tax reform should not provide a net tax cut to the wealthy. Instead, it should increase taxes on the wealthy and use some of the revenues raised for deficit reduction and some to boost the take-home pay of those who are less fortunate.

### ***C. Proposals to Date by the President and House Republicans Go in the Wrong Direction***

Unfortunately the proposals offered to date by President Trump and the House Republican Blueprint<sup>17</sup> move exactly in the wrong direction on revenues and progressivity. Both lose vast amounts of revenue. The Tax Policy Center has estimated that the President’s most recent plan would lose at least \$3.5 trillion over 10 years,<sup>18</sup> and that earlier, more detailed versions of his plan would lose \$6.2 trillion.<sup>19</sup> Just last month, the President said that he plans to enact the “biggest tax cut in the history of our country.”<sup>20</sup> The House GOP Blueprint would lose \$3.1 trillion over 10 years.<sup>21</sup>

Because of these massive revenue losses and the corresponding increase in deficits, the Tax Policy Center estimates that both plans would depress economic growth over time.<sup>22</sup> While JCT and CBO have not released estimates of either plan, their prior estimates imply that they would also find that both plans would reduce long-term economic growth.<sup>23</sup>

In addition, both plans are sharply regressive. Directly contradicting the Mnuchin principle, on average they provide massive tax cuts to the wealthiest Americans, including those who inherit vast sums of money, while providing a relative pittance to everyone else, as shown in Figure 5. The top 1% receives an average tax cut of 12-13% of their income under both plans, while the bottom four quintiles only receive average tax cuts of 0-2% of their after-tax

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<sup>16</sup> *Squawk Box* (CNBC television broadcast, Nov. 30, 2016), <http://www.cnbc.com/2016/11/30/cnbc-transcript-stein-mnuchin-and-wilbur-ross-speak-with-cnbc-squawk-box-today.html>. See also *Tucker Carlson Tonight* (Fox News television broadcast, Apr. 26, 2017), <http://www.foxnews.com/politics/2017/04/26/mnuchin-trumps-tax-plan-is-middle-income-tax-cut.html>.

<sup>17</sup> A BETTER WAY: TAX REFORM TASK FORCE REPORT 25–26 (June 24, 2016), [http://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf](http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf).

<sup>18</sup> TPC Staff, *The Implications of What We Know and Don’t Know about President Trump’s Tax Plan*, TAX POLICY CTR. (July 12, 2017).

<sup>19</sup> Jim Nunns et al., *An Analysis of Donald Trump’s Revised Tax Plan*, TAX POLICY CTR. (Oct. 18, 2016).

<sup>20</sup> Blair Guild, *Trump Lashes out during Combative Speech at Campaign-Style Rally in Phoenix*, CBS NEWS (Aug. 22, 2017), <https://www.cbsnews.com/news/trump-holds-make-america-great-again-rally-in-phoenix/>.

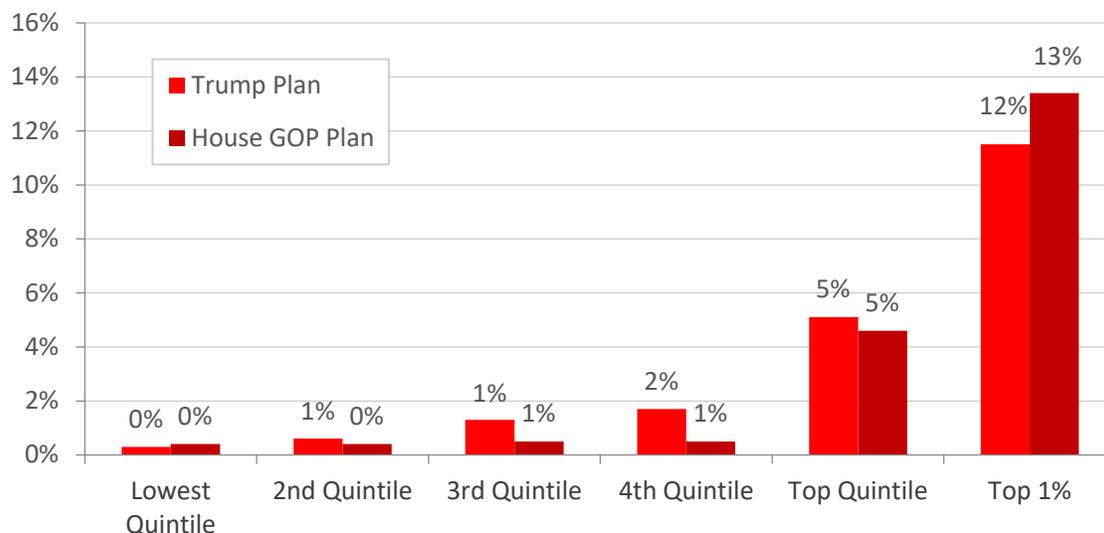
<sup>21</sup> Benjamin R. Page, DYNAMIC ANALYSIS OF THE HOUSE GOP TAX PLAN: AN UPDATE (June 30, 2017).

<sup>22</sup> *Id.* (estimating that the House GOP Blueprint would reduce GDP by 1% to 2.6% by 2036); TPC Staff, *The Implications of What We Know and Don’t Know about President Trump’s Tax Plan*, TAX POLICY CTR. (July 12, 2017).

<sup>23</sup> See CONG. BUDGET OFFICE, THE ECONOMIC OUTLOOK AND FISCAL POLICY CHOICES, *Hearing before the S. Comm. on the Budget*, 111<sup>th</sup> Cong. 8 (2010) (statement of Douglas W. Elmendorf, Director, Cong. Budget Office); J. COMM. ON TAXATION, MACROECONOMIC ANALYSIS OF VARIOUS PROPOSALS TO PROVIDE \$500 BILLION IN TAX RELIEF (Mar. 1, 2005).

income. Overall, the top 1% receives about half of the value of the tax cuts under the most recent Trump plan, and about three-quarters of the tax cuts under the House GOP Blueprint.<sup>24</sup>

**Figure 5: Percent Change in After-Tax Income under Trump Plan and House GOP Blueprint**



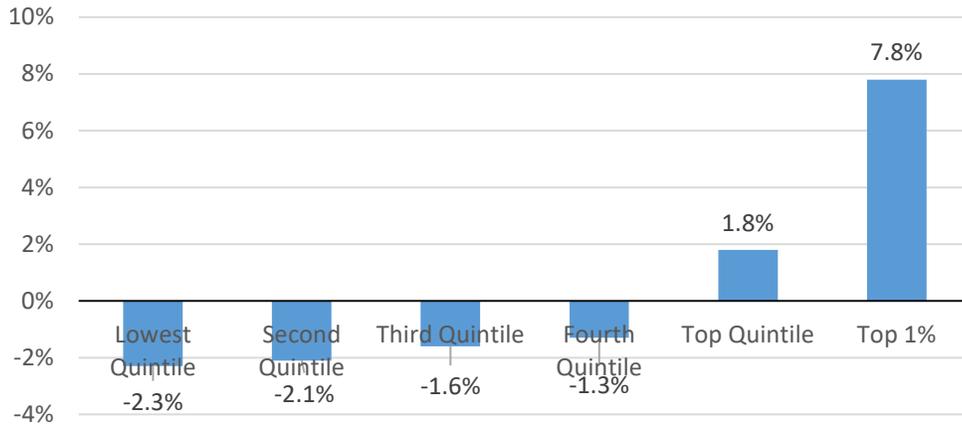
Sources: Tax Policy Center, *Table T17-0192* (July 12, 2017); Burman et al., *An Analysis of the House GOP Tax Plan*, COLUMBIA J. OF TAX L. (2017).

Sooner or later, these massive tax cuts for the wealthy will have to be paid for, and low- and middle-income families are likely going to be left paying the tab. As illustrated in Figure 6, if the President’s plan were eventually paid for by tax increases or spending cuts that were proportionate to income, 82% of households would be worse off—but not the most affluent.<sup>25</sup> And this outcome is probably less regressive than it would be if the tax cuts were paid for, either now or in the future, with the types of budget cuts called for in President Trump’s and the House Budget Committee’s budgets.

<sup>24</sup> Tax Policy Center, *T17-0192: Distributional Effects of Proposals Related to the Trump Administration’s 2017 Tax Plan; Tax Cut and Possible Revenue Raising Provisions, by Expanded Cash Income Percentile, 2018*, TAX POLICY CTR. (July 12, 2017), <http://www.taxpolicycenter.org/model-estimates/proposals-related-trump-administrations-2017-tax-plan-july-2017/t17-0192>; Burman et al., *An Analysis of the House GOP Tax Plan*, COLUMBIA J. OF TAX L. (2017).

<sup>25</sup> William Gale et al., *Cutting Taxes and Making Future Americans Pay for It: How Trump’s Tax Cuts Could Hurt Many Households*, TAX POLICY CTR. (Aug. 15, 2017).

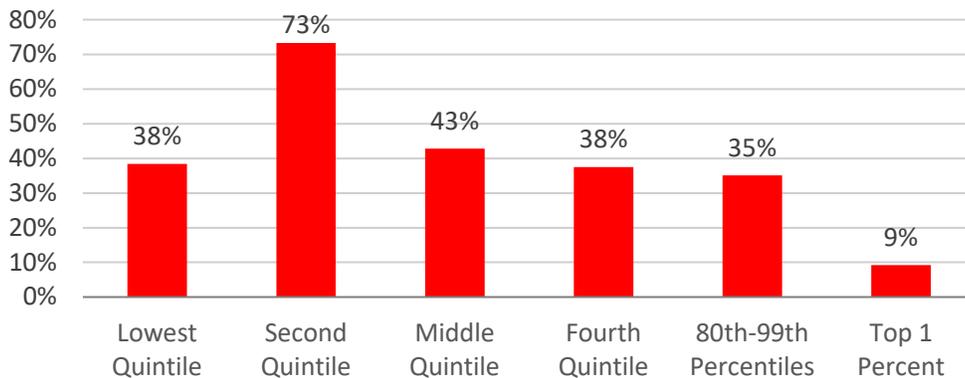
**Figure 6: Percent Change in After-Tax Income under Trump Plan if Eventually Paid for by Tax Increases or Spending Cuts Proportionate to Income**



Source: William Gale et al., *Cutting Taxes and Making Future Americans Pay for It: How Trump’s Tax Cuts Could Hurt Many Households*, TAX POLICY CTR. (Aug. 15, 2017).

Another possibility is that low- and middle income families will actually see their taxes immediately go up as part of tax reform, paying for tax cuts for the wealthy right away. Indeed, the Tax Policy Center estimates that an astonishing 45% of families with children—and 70% of single parents—would see their taxes go up in 2018 under the President’s most recent tax plan, as summarized in Figure 7.<sup>26</sup> This is all the more stunning when one considers that his plan reduces revenues by about \$3.5 trillion, and that he has had numerous opportunities to address these tax increases as his tax plan has evolved but has not even bothered.

**Figure 7: Share of Families with Children Facing Tax Increase under Trump Plan in 2018**



Source: Tax Policy Center, *Table T17-0192* (July 12, 2017).

<sup>26</sup> Tax Policy Center. *T17-0192: Distributional Effects of Proposals Related to the Trump Administration’s 2017 Tax Plan; Tax Cut and Possible Revenue Raising Provisions, by Expanded Cash Income Percentile, 2018*, TAX POLICY CTR. (July 12, 2017). This is largely due to his proposals to repeal personal exemptions and head of household filing status, and also because of the ways in which he proposes to consolidate the tax brackets. Using a slightly different methodology and focusing on his 2016 tax plan, I previously estimated that 21-28% of families with children and 51-61% of single parents would face a tax increase under the president’s plan. Lily L. Batchelder, *Families Facing Tax Increases under Trump’s Tax Plan*, TAX POLICY CTR. (Oct. 28, 2016).

The President and House GOP leadership have said that they intend for their tax plans to focus their benefits on middle-class families and, at times, that their tax plans will be revenue-neutral.<sup>27</sup> I very much hope this is the case. But it is deeply concerning that thus far they have proposed very specific and massive tax cuts for the wealthy, while being quite non-specific about how they would pay for these tax cuts or meaningfully invest in the middle class.

#### ***D. Better Approaches***

In contrast to the plans offered to date by President Trump and the House GOP Blueprint, I urge the Committee to consider raising more revenue through individual tax reform by increasing effective tax rates on the wealthy, including by adopting the revenue raising proposals discussed below.

Any tax cuts that are part of individual tax reform should be focused on low- and middle income households, and should therefore generally be structured as refundable tax credits. Cutting tax rates or increasing deductions and exemptions tends to disproportionately benefit the wealthy. This is because the value of a deduction or exemption is the amount deducted times the taxpayer's marginal tax rate, which tends to rise with income. This is also true of proposals to raise the income thresholds for the tax brackets—the value is the amount of the increase in the threshold times the taxpayer's marginal tax rate. Only a refundable tax credit de-links tax benefits from a household's marginal tax rate.

As an example of the problem with deductions and raising the thresholds for tax brackets, consider the proposal to substantially increase the standard deduction by President Trump and the House GOP leadership. Both have promoted this proposal as a core element of their plan for low- and moderate-income households.<sup>28</sup> But it is much less valuable for such households than a refundable credit of equivalent cost. Increasing the standard deduction is worth nothing to the 35% of households who already fall in the zero bracket (i.e., their income is less than the standard deduction and personal exemptions).<sup>29</sup> Among non-itemizers with income above the zero bracket, it is worth more to those in higher brackets, who tend to be higher income. To be sure, increasing the standard deduction also provides no benefit to households whose itemized deductions exceed the new, larger standard deduction, and these families tend to be wealthier. But the point remains that increasing the standard deduction is a

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<sup>27</sup> See, e.g., Donald Trump, "The Inaugural Address," The White House, January 20, 2017, <https://www.whitehouse.gov/inaugural-address> ("Every decision on...taxes...will be made to benefit American workers and American families."); Luca Gattoni-Celli, *Mnuchin Reaffirms Support for Revenue-Neutral Tax Reform*, TAX NOTES (June 14, 2017); Naomi Jagoda, *Brady Makes the Case for Revenue-Neutral Tax Reform*, THE HILL (Jan. 25, 2017).

<sup>28</sup> See, e.g., OFFICE OF THE PRESS SEC'Y, REMARKS BY PRESIDENT TRUMP ON TAX REFORM (Sept. 6, 2017), <https://www.whitehouse.gov/the-press-office/2017/09/06/remarks-president-trump-tax-reform> ("[W]e will provide tax relief to middle-income families through a combination of benefits, such as raising their standard deduction...").

<sup>29</sup> Tax Policy Center, *T16-0085: Number of Tax Units by Tax Bracket and Filing Status*, TAX POLICY CTR. (July 6, 2016), <http://www.taxpolicycenter.org/model-estimates/baseline-distribution-tax-units-tax-bracket-july-2016/t16-0085-number-tax-units-tax>.

poorly designed way to support low- and middle-income households, and provides little or no benefit to those who are financially struggling the most.

## **II. Individual Tax Reform Should Seek to Level the Playing Field and Support Work**

In addition to increasing revenues and progressivity, individual tax reform should focus on leveling the playing field for future generations and supporting work. Doing so would blunt economic inequality, broaden economic opportunity, and increase productivity by ensuring that jobs are awarded more often based on effort and talent, and less often based connections and the luck of one's birth. Reforms advancing these goals would make the tax code fairer and more efficient simultaneously. They could also be structured in ways that are relatively simple.

### **A. The First Goal: Do No Harm**

The first goal in this area should be to do no harm. Unfortunately, once again the proposals offered by President Trump and the House GOP Blueprint to date move in precisely the wrong direction. As discussed, their plans are sharply regressive. This means that they not only will exacerbate growing economic disparities, but also will probably reduce intergenerational economic mobility over time. Lower levels of income inequality are generally correlated with higher levels of intergenerational economic mobility.<sup>30</sup> Put differently, if tax reform raises taxes on the wealthy and uses part of the revenues raised to boost the living standards of low- and middle-income families, this doesn't just benefit such families now. It also means that their children are likely to do better because their economic success will be less heavily impacted by the economic status of their parents.

In addition to substantially reducing tax progressivity, both plans counterproductively repeal wealth transfer taxes, including the estate tax, when such taxes are actually one of the most important features of the tax system for making the economic playing field somewhat more level.<sup>31</sup> As discussed, the US has one of the highest levels of opportunity inequality among our competitors. The enormous inequality of financial inheritances worsens this inequality of life chances dramatically. Indeed, 30% of the correlation between parent and child incomes—and more than 50% of the correlation between the wealth of parents and their children—is attributable to financial inheritances.<sup>32</sup> This is far more than the impact of IQ, personality, and

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<sup>30</sup> Corak, *supra* note 3; Raj Chetty, et al., *Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility* 11 (Nat'l Bureau of Econ. Research, Working Paper No. 19844, 2014).

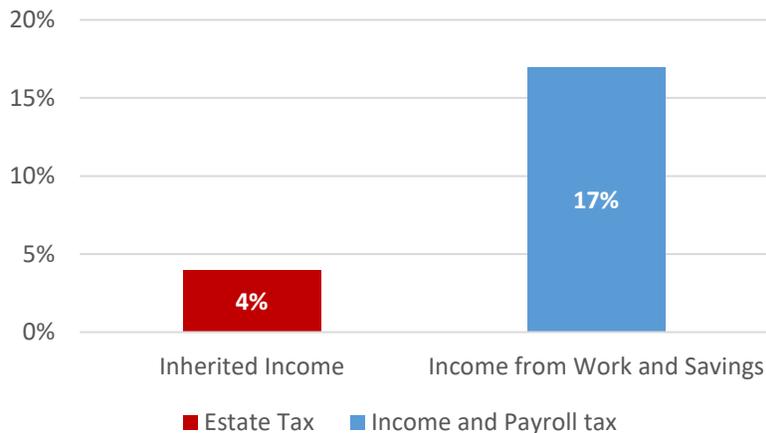
<sup>31</sup> This discussion of wealth transfer taxes draws on Lily L. Batchelder, *What Should Society Expect from Heirs? The Case for a Comprehensive Inheritance Tax*, 63 TAX L. REV. 1 (2009); Lily L. Batchelder, *The "Silver Spoon" Tax: How to Strengthen Wealth Transfer Taxation*, in DELIVERING EQUITABLE GROWTH: STRATEGIES FOR THE NEXT ADMINISTRATION (Washington Ctr. for Equitable Growth, 2016), and Lily L. Batchelder, *Fixing the Estate Tax*, 43 DEMOCRACY (Winter, 2017).

<sup>32</sup> Samuel Bowles, Herbert Gintis, & Melissa Osborne Groves, *Introduction to UNEQUAL CHANCES: FAMILY BACKGROUND AND ECONOMIC SUCCESS 18-19* (2005) (finding that financial inheritances account for 30% of the parent-child income correlation, while parent and child IQ, schooling, and personality combined account for only 18%); Adrian Adermon, Mikael Lindahl, & Daniel Waldenstrom, *Intergenerational Wealth Mobility and the Role of Inheritance: Evidence from Multiple Generations* (July 26, 2016) (working paper) (finding that bequests and gifts account for at least 50% of the parent-child wealth correlation, while earnings and education account for only 25%).

schooling combined. In short, when researchers have tried to boil down inequality of opportunity to one factor, it is about financial inheritances.

If financial inheritances drive economic opportunity this much, one would think the tax code would try to soften their effects. Instead, on average, we actually tax inheritances at only about one-quarter of the rate at which we tax income from work and savings, as summarized in Figure 8. If a wealthy individual bequeaths assets with \$100 million unrealized gains, neither that individual nor his heirs ever have to pay income or payroll tax on that \$100 million gain due to stepped-up basis. In addition, the recipients of such large inheritances never have to pay income or payroll tax on the total amount they inherit, whether attributable to unrealized gains or not. The only taxes that such lucky heirs may bear are wealth transfer taxes, which experts on the both sides of the aisle agree are largely borne by the heirs of large estates, not the decedent.<sup>33</sup>

**Figure 8: Average Tax Rate on Inherited Income versus Income from Work and Saving, 2009**



Source: Lily L. Batchelder, *What Should Society Expect from Heirs? The Case for a Comprehensive Inheritance Tax*, 63 TAX L. REV. 1 (2009).

Wealth transfer taxes are not only essential to leveling the playing field, but they are also the most progressive component of the federal tax system. Currently they only apply to the top 0.2% of estates<sup>34</sup> because the exemption is extremely high: \$11 million per couple in 2017, and probably more than \$16 million if a couple takes full advantage of the annual gift exclusion,<sup>35</sup> not to mention other planning opportunities. Contrary to the talking points of estate tax opponents, neither the American Farm Bureau nor the New York Times have been

<sup>33</sup> See, e.g., N. Gregory Mankiw, Remarks at the National Bureau of Economic Research Tax Policy and the Economy Meeting from Council of Economic Advisers (Nov. 4, 2003) (“As a first approximation, it would make more sense to distribute the burden of the tax to the estate’s beneficiaries rather than to the decedent”). For an explanation of why this is the case, see Lily L. Batchelder & Surachai Khitatrakun, *Dead or Alive: An Investigation of the Incidence of Estate Taxes and Inheritance Taxes* (2008) (working paper).

<sup>34</sup> J. COMM. ON TAXATION, HISTORY, PRESENT LAW, AND ANALYSIS OF THE FEDERAL WEALTH TRANSFER TAX SYSTEM (Mar. 16, 2015), <https://www.jct.gov/publications.html?func=startdown&id=4744>.

<sup>35</sup> This assumes that a couple makes annual gifts equal to the annual exclusion for 50 years, the annual exclusion is constant (although it is actually inflation-adjusted) and the interest rate is 5%.

able to identify a single case of a farm actually being sold to pay the estate tax, even when the exemption was one-sixteenth of the current level and the rate was 55%.<sup>36</sup> The estate tax also has strong positive effects on charitable giving. When the estate tax was repealed for one year in 2010, charitable bequests fell by 37%.<sup>37</sup> Moreover, repeal would cost \$270 billion over 10 years, further jeopardizing our long-term fiscal outlook.<sup>38</sup>

By dramatically cutting taxes for the most affluent and repealing wealth transfer taxes, the plans advanced by President Trump and the House GOP Blueprint therefore fail to level the playing field at the top, instead magnifying the advantages of the most fortunate. At the same time, to the extent that these plans include proposals intended support low- and middle-income households, they do so in relatively ineffective ways.

For example, President Trump's proposals in 2016 to expand tax benefits for child care disproportionately benefit higher-income families.<sup>39</sup> They increase tax complexity by increasing the number of child-care-related tax benefits from two to five. And they provide benefits to higher-income working families with a stay-at-home parent, while arbitrarily excluding similar families who are lower-income.<sup>40</sup>

As discussed, the President's and House GOP's proposals to increase the standard deduction benefits higher-income non-itemizers more than lower-income non-itemizers, and doesn't benefit the lowest-income workers at all. This is despite the fact that low-income workers face some of the highest implicit marginal tax rates, meaning that after taxes, transfers, and work-related costs like child care, it may not pay for them to work at all.<sup>41</sup>

Others have proposed eliminating personal exemptions and/or the head of household filing status in order to pay for a larger child tax credit. But as explained by my fellow witness Ramesh Ponnuru, this may well hurt many low- and middle-income families, rather than helping them.<sup>42</sup> This is especially true if the refundability of the child tax credit were not increased substantially so that more families could claim the full credit.

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<sup>36</sup> David Cay Johnston, *Talk of Lost Farms Reflects Muddle of Estate Tax Debate*, N.Y. TIMES (Apr. 8, 2001).

<sup>37</sup> Sahil Kapur, *GOP Plan to Kill Estate Tax Sets Up Charitable Giving Conflict*, BLOOMBERG (Aug. 25, 2017). This is consistent with estimates that permanent estate tax repeal would reduce charitable bequests (which represent 8% of all charitable giving) by 22-37%. Jon M. Bakija & William G. Gale, *Effects of Estate Tax Reform on Charitable Giving*, TAX POLICY CTR. (July, 2003).

<sup>38</sup> J. COMM. ON TAXATION, DESCRIPTION OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE PROVISIONS OF H.R. 1105, THE "DEATH TAX REPEAL ACT OF 2015" (Mar. 24, 2015), <https://www.jct.gov/publications.html?func=startdown&id=4761>.

<sup>39</sup> Lily L. Batchelder, Elaine Maag, Chye-Ching Huang, & Emily Horton, *Who Benefits from President Trump's Child Care Proposals*, TAX POLICY CTR. RESEARCH REP. (Feb. 28, 2017) (estimating that the average tax cut for families with income under \$40,000 would be less than \$20, about 3% of all benefits, while about 70% of the benefits would go to families with income over \$100,000, and about 25% to families with income over \$200,000).

<sup>40</sup> *Id.*

<sup>41</sup> See, e.g., CONG. BUDGET OFFICE, EFFECTIVE MARGINAL TAX RATES FOR LOW- AND MODERATE-INCOME WORKERS IN 2016 (Nov., 2015) (finding that some households earning 100-149% of the poverty line face implicit marginal tax rates of more than 65% when accounting for taxes and some transfers, but not other transfers and work-related costs).

<sup>42</sup> Ramesh Ponnuru, *GOP's Pro-Family Tax Reform Might Have a Catch*, BLOOMBERG VIEW (Aug. 28, 2017).

Finally, recent proposals to double the child tax credit and make it fully refundable against payroll taxes would provide much smaller benefits to lower-income families than higher-income families because they would leave the rate at which low earnings count toward earning the credit virtually unchanged.

### ***B. Reforms Worth Considering***

Instead of pursuing the counterproductive or relatively ineffective proposals described above, Congress should instead consider reforms that would meaningfully level the playing field and support work. While there are a host of possibilities, I would like to highlight four options that are especially promising.

The first is expanding the Earned Income Tax Credit (EITC), especially for workers without dependents (sometimes called childless workers). The EITC and child tax credit (CTC) are some of our most effective policies for reducing poverty and increasing employment. In 2013, they kept 8.8 million people out of poverty, including 4.7 million children.<sup>43</sup> The EITC results in about 1 in 10 parents entering the labor force who otherwise would not do so.<sup>44</sup> In addition, mounting evidence suggests that the EITC and CTC improve health outcomes, school performance, educational attainment, and long-term earnings, including for the next generation.<sup>45</sup>

Tax reform should build on the success of these programs. To start, it should address the fact that, as illustrated in Figure 9, childless workers are the only group that is currently taxed into poverty.<sup>46</sup>

Senator Brown and Representative Neal have proposed increasing the maximum EITC for childless workers to \$1,400, phasing it in and out more rapidly, and making it available to younger workers.<sup>47</sup> A similar proposal was advanced by former President Obama and endorsed by Speaker Ryan, though it was not included in the House GOP Blueprint.<sup>48</sup> This proposal would subsidize the wages of groups with low or declining labor force participation rates, including men without a college education, young adults not enrolled in school, workers with disabilities,

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<sup>43</sup> EXEC. OFFICE OF THE PRESIDENT AND US TREASURY DEP'T, THE PRESIDENT'S PLAN TO HELP MIDDLE-CLASS AND WORKING FAMILIES GET AHEAD 2 (Apr., 2015).

<sup>44</sup> *Id.*, citing Bruce D. Meyer and Dan T. Rosenbaum, *Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers*, 116 Q. J. ECON. 1063 (2014).

<sup>45</sup> Chuck Marr, Chye-Ching Huang, Arloc Sherman, & Brandon DeBot, *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds*, CTR. ON BUDGET AND POLICY PRIORITIES (Oct. 1, 2015).

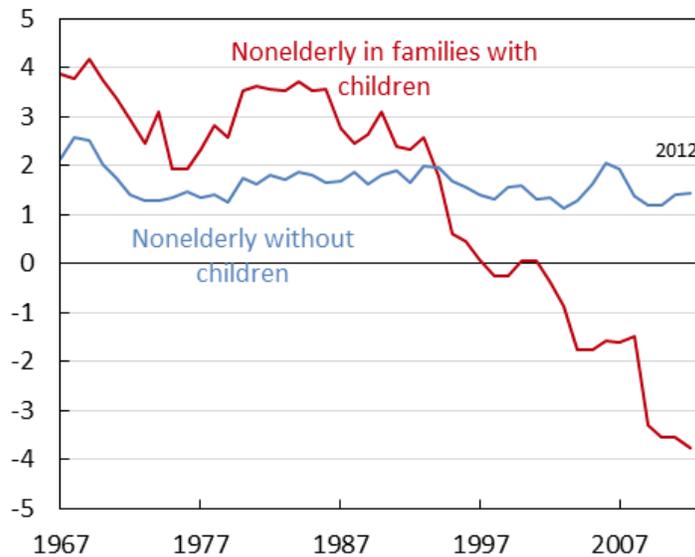
<sup>46</sup> Each year, about 7.5 million working-age adults in the group are taxed into or deeper into poverty. Chuck Marr, Chye-Ching Huang, Cecile Murray, and Arloc Sherman, *Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty*, CTR. ON BUDGET AND POLICY PRIORITIES (Apr. 11, 2016).

<sup>47</sup> S. 1012, 114<sup>th</sup> Cong. (2015); H.R. 902, 114<sup>th</sup> Cong. (2015). Senators Baldwin and Booker have proposed a similar expansion of the EITC for childless workers in S. 3231, 114<sup>th</sup> Cong. (2016).

<sup>48</sup> NBC News, MEET THE PRESS TRANSCRIPT – FEBRUARY 1, 2015. <http://www.nbcnews.com/meet-the-press/meet-press-transcript-february-1-2015-n302111>.

and older workers.<sup>49</sup> As a result, it could meaningfully boost labor force participation. It would lift 600,000 workers out of poverty and lessen the severity of poverty for another 8.7 million.<sup>50</sup> Moreover, the Brown-Neal proposal would essentially ensure that the federal tax code no longer taxes childless workers into poverty.<sup>51</sup>

**Figure 9: Percent Increase (+) or Decrease (-) in Poverty Rate Due to Taxes**



Source: EXECUTIVE OFFICE OF THE PRESIDENT AND THE U.S. TREASURY DEPARTMENT, THE PRESIDENT'S PROPOSAL TO EXPAND THE EARNED INCOME TAX CREDIT (March, 2014).

A much more ambitious approach would be to expand the EITC for workers with children as well. For example, Senator Brown and Representative Khanna are proposing a major expansion to the EITC that would roughly double the maximum credit for all groups.<sup>52</sup> Such an expansion would make significant headway toward offsetting the much lower earnings growth that working-class households have experienced over the past few decades relative to comparable families with a bachelor's degrees.<sup>53</sup> While this proposal would cost over \$1 trillion,<sup>54</sup> it could be more than paid for by tax increases on the wealthy discussed here and

<sup>49</sup> EXEC. OFFICE OF THE PRESIDENT AND US TREASURY DEP'T, THE PRESIDENT'S PROPOSAL TO EXPAND THE EARNED INCOME TAX CREDIT (March, 2014).

<sup>50</sup> Chuck Marr, Brandon DeBot, and Emily Horton, *How Tax Reform Can Raise Working-Class Incomes*, CTR. ON BUDGET AND POLICY PRIORITIES (Sept. 13, 2017).

<sup>51</sup> Chuck Marr, Chye-Ching Huang, Cecile Murray, and Arloc Sherman, *Strengthening the EITC for Childless Workers Would Promote Work and Reduce Poverty*, CTR. ON BUDGET AND POLICY PRIORITIES (Apr. 11, 2016).

<sup>52</sup> Casey Tolan, *Progressive Democrats' Counter-Argument to Trump Tax Plan: a \$1.4 Trillion Tax Credit for the Working Class*. MERCURY NEWS (Sept. 12, 2017).

<sup>53</sup> Chuck Marr, Brandon DeBot, and Emily Horton, *How Tax Reform Can Raise Working-Class Incomes*, CTR. ON BUDGET AND POLICY PRIORITIES (Sept. 13, 2017). A working-class household is defined here as one in which no one has a bachelor's degree. See also Neil Irwin, *What Would It Take to Replace the Pay Working-Class Americans Have Lost?*, N.Y. TIMES (Dec. 9, 2016).

<sup>54</sup> Tolan, supra note 52.

elsewhere. And its cost pales in comparison to the tax cuts for the wealthy contained in President Trump's plan and the House GOP Blueprint.

A second proposal worth considering is strengthening the child tax credit (CTC), especially for low-income families with young children. Currently, the CTC excludes almost 11 million children with working parents because their earnings are too low.<sup>55</sup> One way to build on the benefits of the CTC for future generations is to eliminate the threshold that currently excludes the first \$3,000 of earnings from being counted towards earning the credit and to increase the rate at which the credit can be earned, especially for families with young children, similar to proposals by Senators Baldwin, Bennet, Brown, and Booker.<sup>56</sup> These reforms would target benefits on young children in the poorest households. Children under age 6 are much more likely to live in poverty than other children or adults. Moreover, the evidence that the CTC and similar programs boost children's health, educational and lifetime earning outcomes is especially strong for the poorest children.<sup>57</sup> For them, more income makes a much bigger difference.

An even more ambitious approach would be to make the CTC fully refundable so that the poorest children could fully benefit even if their parents' have no income, similar to a proposal by Rep. DeLauro.<sup>58</sup>

A third reform worth considering is replacing the current law child and dependent care tax benefits with a single refundable tax credit that is larger for families for whom such expenses represent the largest budgetary strain.<sup>59</sup> Child and dependent care costs are a significant financial burden on working families, especially those with low and moderate incomes. On average, the median single mother with children under five spends 15% of her earnings on child care, and the median analogous married couple spends 6%.<sup>60</sup> Child care costs

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<sup>55</sup> Elaine Maag & Julia B. Isaacs, *Analysis of a Young Child Tax Credit*, URBAN INST. (Sept., 2017).

<sup>56</sup> See S.2264, 114<sup>th</sup> Cong. (2015); S.3231, 114<sup>th</sup> Cong. (2016). For further discussion of these proposals and similar ones, see Chuck Marr, Chloe Cho, & Arloc Sherman, A TOP PRIORITY TO ADDRESS POVERTY: STRENGTHENING THE CHILD TAX CREDIT FOR VERY POOR YOUNG CHILDREN (Aug. 10, 2016); Maag and Isaacs, *supra*.

<sup>57</sup> See, e.g., Gordon B. Dahl & Lance Lochner, *The Impact of Family Income on Child Achievement: Evidence from the Earned Income Tax Credit*, 102 AM. ECON. REV. 5, 1927–56 (May 2012); Kerris Cooper & Kitty Stewart, *Does Money Affect Children's Outcomes? A Systematic Review*, JOSEPH ROWNTREE FOUND. (Oct. 22, 2013), <https://www.jrf.org.uk/report/does-money-affect-children%E2%80%99s-outcomes>.

<sup>58</sup> H.R. 4693, 114<sup>th</sup> Cong. (2016).

<sup>59</sup> For further discussion of this idea, see Lily L. Batchelder, Elaine Maag, Chye-Ching Huang & Emily Horton, *Who Benefits from President Trump's Child Care Proposals*, TAX POLICY CTR. RESEARCH REP. (Feb. 28, 2017); Katie Hamm & Carmel Martin, *A New Vision for Child Care in the United States*, CTR. FOR AM. PROGRESS (Sept., 2015), <https://cdn.americanprogress.org/wp-content/uploads/2015/08/31111043/Hamm-Childcare-report.pdf>; James P. Ziliak, *Supporting Low-Income Workers through Refundable Child-Care Credits*, HAMILTON PROJECT: IMPROVING SAFETY NET AND WORK SUPPORT (2014), [http://www.hamiltonproject.org/assets/legacy/files/downloads\\_and\\_links/child\\_care\\_credit\\_ziliak.pdf](http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/child_care_credit_ziliak.pdf); Elaine Maag, *Simplifying Child Care Tax Benefits*, TAX POLICY CTR. (2013), <http://www.taxpolicycenter.org/taxvox/simplifying-child-care-tax-benefits>.

<sup>60</sup> Ziliak, *supra*.

have grown dramatically over time, rising 70% in inflation-adjusted terms from 1985 to 2001.<sup>61</sup> Reducing child care costs increases labor force participation by ensuring that caretakers who prefer to engage in market work actually benefit financially from doing so.<sup>62</sup>

One drawback of this proposal is that it would not provide financial support to such families when they need it most: when their child care bills are due. Therefore, while not strictly a tax proposal, an even better reform would be to fully fund child care assistance programs, which provide direct subsidies for child care for low-wage working families.<sup>63</sup> Currently only 15% of families eligible for these subsidies actually receive them because of under-funding; the remaining 85% of families are put on waiting lists.<sup>64</sup> Fully funding this program could be combined with a tax credit for families above the eligibility threshold, as proposed by former President Obama and other researchers.<sup>65</sup>

Finally, these proposals could be paid for by raising taxes on the most fortunate, including by strengthening, not repealing, wealth transfer taxes. There are at least three ways to strengthen the taxation of financial inheritances that are worth considering. The first is to raise the wealth transfer tax rate above 40%. A second, more fundamental reform would be to replace our current wealth transfer taxes with a direct tax on the recipients of large inheritances. Effectively, the exemption from wealth transfer taxes would then be based on how much an individual inherited, not how much a donor bequeathed. If individuals who inherit more than \$2.1 million over their lifetime had to pay income tax plus a 15% surcharge (roughly equivalent to the payroll tax rate) on their inheritances above this threshold, this proposal would raise roughly \$200 billion more over 10 years than our current wealth transfer taxes.<sup>66</sup> Lastly, either of these reforms could be coupled with repealing stepped-up basis, which is discussed in more detail in the next section.

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<sup>61</sup> Drew DeSilver, *Rising Cost of Child Care May Help Explain Recent Increase in Stay-At-Home Moms*, FACTTANK BLOG (Apr. 18, 2014), <http://www.pewresearch.org/fact-tank/2014/04/08/rising-cost-of-child-care-may-help-explain-increase-in-stay-at-home-moms/>.

<sup>62</sup> COUNCIL OF ECON. ADVISERS, *THE ECONOMICS OF EARLY CHILDHOOD INVESTMENTS* (2014), [https://obamawhitehouse.archives.gov/sites/default/files/docs/the\\_economics\\_of\\_early\\_childhood\\_investments.pdf](https://obamawhitehouse.archives.gov/sites/default/files/docs/the_economics_of_early_childhood_investments.pdf) (reviewing the literature and concluding that a 10% reduction in child care costs increases maternal employment by 0.5% to 4%).

<sup>63</sup> Currently, the federal government provides states funding for child care assistance programs through the Child Care and Development Fund and the Temporary Assistance for Needy Families block grant.

<sup>64</sup> Matthews and Walker, 2016.

<sup>65</sup> OFFICE OF MGMT. AND BUDGET, *BUDGET OF THE US GOV'T: FISCAL YEAR 2017* (2016), <https://www.gpo.gov/fdsys/pkg/BUDGET-2017-BUD/pdf/BUDGET-2017-BUD.pdf>; AJAY CHAUDRY, TARYN MORRISSEY, CHRISTINA WEIL, & HIROKAZU YOSHIKAWA, *CRADLE TO KINDERGARTEN: A NEW PLAN TO COMBAT INEQUALITY* (2017).

<sup>66</sup> Lily L. Batchelder, *The "Silver Spoon" Tax: How to Strengthen Wealth Transfer Taxation*, in *DELIVERING EQUITABLE GROWTH: STRATEGIES FOR THE NEXT ADMINISTRATION* (Washington Ctr. for Equitable Growth, 2016)

### III. Simplifying the Tax Code by Reducing Opportunities for Gaming

The third traditional goal of tax reform is simplification. Simplification should certainly be part of individual tax reform, but the policies that meaningfully simplify the tax system are often misunderstood.

David Bradford, the intellectual father of the 1986 Tax Reform Act, distinguished three types of tax complexity: compliance complexity, rule complexity, and transactional complexity.<sup>67</sup> Compliance complexity includes things like how long it takes to prepare one's tax return and how many records taxpayers have to keep. Rule complexity is how difficult it is to understand what the law is, and can be the result of the tax code being unclear, or unclear administrative guidance and case law. Transactional complexity arises from taxpayers organizing their affairs to minimize their tax liability.

Often transactional complexity is actually the most costly type of tax complexity. But many proposals to simplify the tax code focus on compliance complexity in ways that provide little or no practical benefits for taxpayers. For example, tax plans (including the President's and the House GOP Blueprint) often promise to reduce the number of tax brackets or the number of taxpayers who itemize deductions, heralding these changes as major simplifications. But virtually no taxpayer would notice if there were fewer tax brackets because 90% prepare their returns with computer software or the help of a third party (who generally uses such software).<sup>68</sup> The 10% who still complete their tax returns by hand are instructed by Form 1040 to look up their taxable income on a tax table in order to apply the tax rates, so they are not supposed to do the arithmetic to apply the tax brackets in the first place. Similarly, taxpayers who do not itemize still need to keep records of their state and local taxes, charitable contributions, mortgage interest payments, medical expenses, and the like in order to determine whether they are better off itemizing or claiming the standard deduction. The only way to eliminate these record keeping burdens is to eliminate itemized deductions altogether, which these tax plans do not propose.

Instead, simplification efforts in individual tax reform should focus on reducing transactional complexity, which essentially arises from opportunities for savvy taxpayers to game the tax system. Some tax provisions are meant to change behavior, like the charitable deduction. But other tax provisions sometimes create large, unintended opportunities to reduce or avoid taxes by structuring a transaction or activity in one way, rather than in another, economically identical form. These are what the press frequently refers to as "loopholes".

Reducing such transactional complexity accomplishes the trifecta of tax reform: it makes the tax code fairer, more efficient, and simpler at the same time. It is fairer because generally only taxpayers who can afford high-priced tax advice learn about opportunities to structure their affairs in ways that are economically identical but reduce their taxes. It is more efficient

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<sup>67</sup> DAVID BRADFORD, UNTANGLING THE INCOME TAX 266-67 (1986).

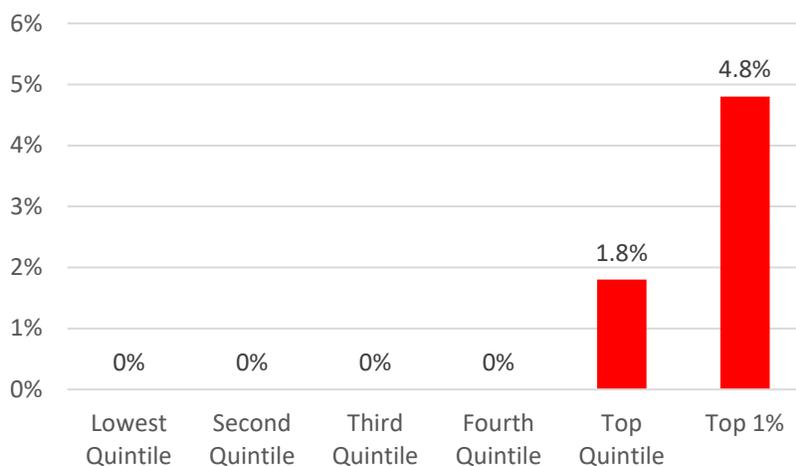
<sup>68</sup> Susan Jones, *IRS: 90% of Taxpayers Seek Help in Preparing Their Returns*, *cnsnews.com* (Apr. 9, 2014), <https://www.cnsnews.com/news/article/susan-jones/irs-90-taxpayers-seek-help-preparing-their-returns>.

and simpler because taxpayers spend less time trying to figure out how to arrange their affairs to reduce their tax liability, and change their behavior less in response to the tax system.

**A. The First Goal (Again): Do No Harm**

Unfortunately several current proposals would dramatically increase transactional complexity. The most alarming is the proposal to apply a new, special cap on the tax rate for pass-through business income.<sup>69</sup> Pass-through business income has always been taxed on individual income tax returns at the same rates as other income. But President Trump has proposed cutting the top rate on pass-through income (and only pass-through income) from 39.6% to 15%, while cutting the top rate on all other ordinary income to 35%. The House GOP Blueprint cuts the top rate on pass-through income to 25%, while cutting the top rate on other ordinary income to 33%.

**Figure 10: Percent Change in After-Tax Income under Trump’s Proposed Pass-through Rate Cap**



Source: Tax Policy Center, *Table T17-0164* (May 15, 2017).

Proponents of this rate cap argue that it would benefit small businesses and rectify the over-taxation of pass-through businesses compared to C corporations. But nothing could be further from the truth. The Tax Policy Center estimates that a full 77% of the benefits of the President’s proposal would go to the top 1%,<sup>70</sup> who currently earn more than half of all pass-through income.<sup>71</sup> As illustrated in Figure 10, the average tax cut for the top 1% would amount

<sup>69</sup> This discussion draws on Lily Batchelder, *Trump’s Giant Loophole*, N.Y. TIMES (May 30, 2017).

<sup>70</sup> Urban-Brookings Tax Policy Ctr. Microsimulation Model, *T17-0164 - Distributional Effect of a 15-Percent Top Rate on a Broad Definition of Pass-Through Income, Baseline: Current Law with AMT Repealed and 12/25/33 Rate Structure, by Expanded Cash Income Percentile, 2018* (May 15, 2017), <http://www.taxpolicycenter.org/model-estimates/options-taxing-pass-through-income-preferential-rates-may-2017/t17-0164-distributional>.

<sup>71</sup> Urban-Brookings Tax Policy Ctr. Microsimulation Model, *T17-0080 - Sources of Flow-Through Business Income by Expanded Cash Income Percentile; Current Law, 2017* (Mar. 20, 2017), <http://www.taxpolicycenter.org/model-estimates/distribution-business-income-march-2017/t17-0080-sources-flow-through-business>.

to 5% of their after-tax income, while the average tax cut for the bottom four quintiles would be zero.

Moreover, the effective marginal tax rate on pass-through businesses is currently about 5 percentage points lower than that on C corporations after accounting for investor-level taxes. This is part of the reason why the share of all business income earned by pass-throughs has risen precipitously, from less than one-quarter in 1980 to 60% today.<sup>72</sup>

A pass-through rate cap would dramatically increase the incentive to characterize income, including compensation for services, as pass-through business income. This is already a significant problem under the current tax code because certain types of pass-through business income are not subject to either payroll or self-employment tax. But it would become much worse. For example, under the President's plan, if a wealthy executive sets up an LLC to receive his \$10 million salary, he could save \$2 million in taxes. Few middle-class workers have the resources to set up such vehicles—and the vast majority would not benefit if they did because they are already in the 15% rate bracket or below.<sup>73</sup> Indeed, the Tax Policy Center and Goldman Sachs estimate that the tax avoidance response would be staggering, accounting for 30-50% of the sizeable cost of the proposal.<sup>74</sup>

For these reasons, tax experts on the left and right agree that it is a terrible idea. For example, experts at the Tax Foundation, which traditionally supports business tax cuts, argue that “the pass-through carve-out primarily incentivizes tax avoidance, not job creation.”<sup>75</sup>

## **B. Reforms Worth Considering**

Instead of dramatically increasing transactional complexity, Congress should consider several proposals that would substantially reduce it. The first is reforming the self-employment tax (SECA) and net investment income tax (NIIT) to ensure that all labor and capital income are subject to the Medicare tax on high incomes in some form.

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<sup>72</sup> THE WHITE HOUSE AND THE U.S. TREASURY DEP'T, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM: AN UPDATE (Apr., 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf>.

<sup>73</sup> Tax Policy Center, *T16-0085: Number of Tax Units by Tax Bracket and Filing Status*, TAX POLICY CTR. (July 6, 2016), <http://www.taxpolicycenter.org/model-estimates/baseline-distribution-tax-units-tax-bracket-july-2016/t16-0085-number-tax-units-tax> (estimating that 79% of taxpayers are in the 15% bracket or below, and 95% are in the 25% bracket or below).

<sup>74</sup> Urban-Brookings Tax Policy Ctr. Microsimulation Model, “*T17-0162 - Revenue Effect of Options for Taxing Pass-Through Income at Preferential Rates, Baseline: Current Law with Individual AMT Repealed and 12/25/33 Percent Individual Income Tax Rate Structure, 2018-27*,” TAX POLICY CTR. (May 15, 2017), <http://www.taxpolicycenter.org/model-estimates/options-taxing-pass-through-income-preferential-rates-may-2017/t17-0162-revenue-effect>; Robert Schroeder, *Trump Proposal to Lower Pass-through Tax Rate Could Cost \$2 Trillion, Goldman Finds*, MARKETWATCH (May 3, 2017), <http://www.marketwatch.com/story/trump-proposal-to-lower-pass-through-tax-rate-could-cost-2-trillion-goldman-finds-2017-05-03>.

<sup>75</sup> Kyle Pomerleau, Scott Drenkard, & John Buhl, *What Trump can Learn from Kansas' Tax Troubles*, POLITICO (May 4, 2017), <http://www.politico.com/magazine/story/2017/05/04/what-trump-can-learn-from-kansas-tax-troubles-215103>.

Currently the NIIT and SECA apply a 3.8% to income above \$200,000 for single filers and \$250,000 for married filers in some cases but not others. They do apply the tax to all employees, owners of sole proprietorships, and “passive” owners of businesses. However, they only apply it in part to “active” owners of S corporations, and often do not apply it at all to “active” owners of LLCs and limited partners.<sup>76</sup> Many high earners (including Newt Gingrich and John Edwards historically) avoid this 3.8% Medicare tax—and sometimes Social Security tax as well—by claiming that their labor income is instead pass-through business income that falls into one of these tax-exempt or tax-preferred buckets.

The different treatment of some pass-through business income from other economically-identical types of such income is a classic example of transactional complexity. It creates traps for the unwary, enabling savvy taxpayers to avoid the tax by changing the legal form of their ownership or the payments they receive. Less savvy taxpayers, all wage earners, and all sole proprietors are left footing the bill.

Former President Obama’s final budget proposed rationalizing these taxes so that all income above these thresholds was subject to the 3.8% tax either through the NIIT or SECA<sup>77</sup>. It also proposed treating eliminating differences in how professional services income is taxed depending on whether it is paid by an S corporation or partnership. Together, these proposals would raise \$272 billion over 10 years. In addition, all NIIT revenue would be redirected from the General Fund to the Medicare trust fund, extending its solvency by more than 15 years.<sup>78</sup>

A second reform worth serious consideration is repealing stepped-up basis. Sometimes called the single biggest loophole in the individual income tax,<sup>79</sup> stepped-up basis refers to the fact that capital gains on assets held until death are never taxed—instead the tax on such gains is forgiven forever. Stepped-up basis creates a large incentive for investors to hold on to underperforming assets purely for tax reasons (the so-called lock-in effect), resulting in resources being misallocated throughout the economy. It also creates traps for the unwary who do not realize how much tax they can save by holding on to their assets even if they are underperforming.

Former President Obama proposed repealing stepped-up basis subject to several exclusions, including an exemption for the first \$100,000 in accrued gains (\$200,000 per couple).<sup>80</sup> Together with raising the capital gains rate to 28 percent (an idea discussed next), this proposal would raise \$210 billion over 10 years and significantly more over time as it fully

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<sup>76</sup> DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2017 REVENUE PROPOSALS 169 (Feb., 2016).

<sup>77</sup> *Id.*

<sup>78</sup> OFFICE OF MGMT. AND BUDGET, MEETING OUR GREATEST CHALLENGES: OPPORTUNITY FOR ALL (2016), (<https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/opportunity.pdf>).

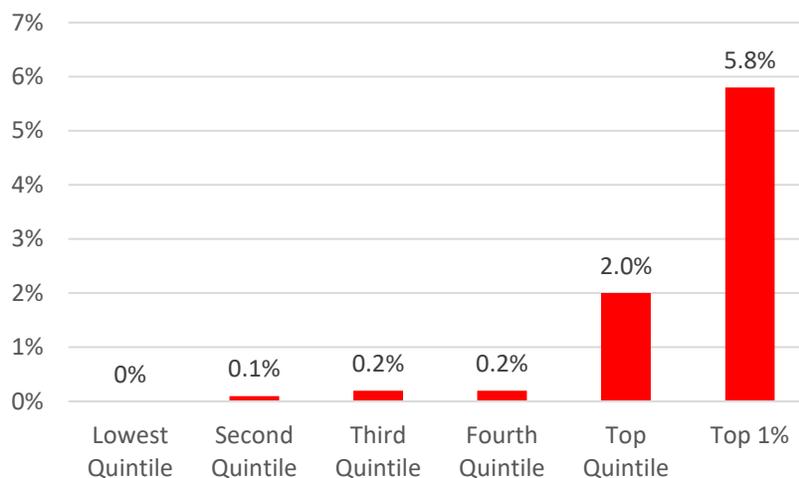
<sup>79</sup> See, e.g., Len Burman, *President Obama Targets The 'Angel Of Death' Capital Gains Tax Loophole*, FORBES (Jan. 18, 2015).

<sup>80</sup> DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2017 REVENUE PROPOSALS, 156, (Feb., 2016). The proposal would also exempt all gains on the sale of tangible personal property, and would effectively establish a \$500,000 per-couple exemption for gains on residences.

phased in.<sup>81</sup> The proposal would also be extraordinarily progressive because inheritances are distributed so unequally and accrued gains are even more concentrated among the rich.<sup>82</sup> It would further help ensure that those who inherit large sums are taxed at a rate closer to those who earn their income from working. A full 99% of the revenue raised would come from the top 1%, and 80% would come from the top 0.1%.<sup>83</sup>

A third, related reform is narrowing the gap between the tax rates on ordinary income and capital gains. This gap creates a large incentive for taxpayers to try to recharacterize ordinary income as capital gain, with carried interest a prime example. In addition to treating carried interest as ordinary income to the extent that it represents compensation for services,<sup>84</sup> Congress should consider raising the capital gains rates to reduce this incentive in the first place.

**Figure 11: Percent Change in After-Tax Income from Preferential Rates for Capital Gains and Dividends**



Source: Tax Policy Center, *Table T17-0137* (Apr. 18, 2017).

Capital gains are highly concentrated among the wealthy. As a result, the preferential rates for capital gains and dividends very disproportionately benefit them. As illustrated in Figure 11, these preferential rates provide the top 1% with a tax cut that is 29 times larger than that for the middle quintile, even when measured as a share of after-tax income.<sup>85</sup> Indeed the

<sup>81</sup> *Id.*

<sup>82</sup> James Poterba & Scott Weisbenner, *The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death*, in *RETHINKING ESTATE AND GIFT TAXATION* 439-40 (William G. Gale et al. eds., 2001). Untaxed accrued gains compose 36 percent of the value of all bequests, but 56 percent of bequests over \$10 million.

<sup>83</sup> EXEC. OFFICE OF THE PRESIDENT AND U.S. TREASURY DEP'T, *THE PRESIDENT'S PLAN TO HELP MIDDLE-CLASS AND WORKING FAMILIES GET AHEAD*, 35 (Apr., 2015).

<sup>84</sup> Sen. Baldwin and Rep. Levin have introduced bills to address this issue. See S. 1020, 115<sup>th</sup> Cong. (2017); H.R. 2889, 114<sup>th</sup> Cong. (2015).

<sup>85</sup> Tax Policy Center, *Table T17-0137* (Apr. 18, 2017), <http://www.taxpolicycenter.org/model-estimates/individual-income-tax-expenditures-april-2017/t17-0137-tax-benefit-preferential>.

top 0.1% of taxpayers, earning over \$3 million per year, receive more than 55% of the benefits.<sup>86</sup> Raising these preferential rates could help curb rising economic inequality, making the tax code fairer. But it would also reduce transaction complexity by reducing one of the biggest incentives for tax planning in the income tax.

#### **IV. Individual Tax Reform Should Make Tax Incentives Fairer and More Efficient**

A final area on which individual tax reform should focus is reforming tax incentives to make them more efficient and fair. As just discussed, some tax provisions create opportunities for gaming that Congress did not intend. But many other tax provisions, which I will call tax incentives, are explicitly intended to change behavior, for example by encouraging people to attend college or purchase health insurance. In such cases, it is not a problem if people respond to the tax incentive; in fact, that is the whole purpose. But many such tax incentives are poorly designed to achieve their own goals. Restructuring them to get more bang-for-the-buck could simultaneously improve social outcomes and raise revenue, which could be used to reduce our mounting debt, address rising inequality, and broaden opportunity. One could spend a whole hearing on each individual tax incentive, so I will instead highlight a few general principles and case studies here.

First, the most efficient type of tax incentive is generally a refundable tax credit. As Fred Goldberg, Peter Orszag, and I have explained, deductions can be efficient if they are designed to measure income or ability to pay.<sup>87</sup> Deductions for business expenses are one such example. But where, as with tax incentives, the goal is to promote socially valued activities or investments, the most efficient default structure is a uniform incentive—unless there is evidence that certain households are more responsive to the incentive or generate larger social benefits from engaging in the activity. Such uniform benefits can only be accomplished through a refundable tax credit.

Even when there is evidence that responsiveness or social benefits vary by household income or other characteristics, the most efficient incentive is almost certainly still some type of refundable credit. It is extremely unlikely that there is a sharp break in social benefits or responsiveness to a tax incentive exactly at the point of no income tax liability or the rate bracket thresholds. But these types of discontinuities are inherent in all other types of tax incentives. For example, preferential rates and non-refundable credits do not benefit taxpayers in the zero bracket, while the value of above-the-line deductions and exclusions intrinsically rises with the taxpayer's marginal tax rate.

Congress should therefore consider restructuring all tax expenditures that are intended to change behavior into refundable tax credits, designing them based on evidence of how to get the most bang-for-the-buck. In all likelihood, this will also make the tax code more progressive. Even if, for example, higher-income households are more responsive to a tax incentive, it is

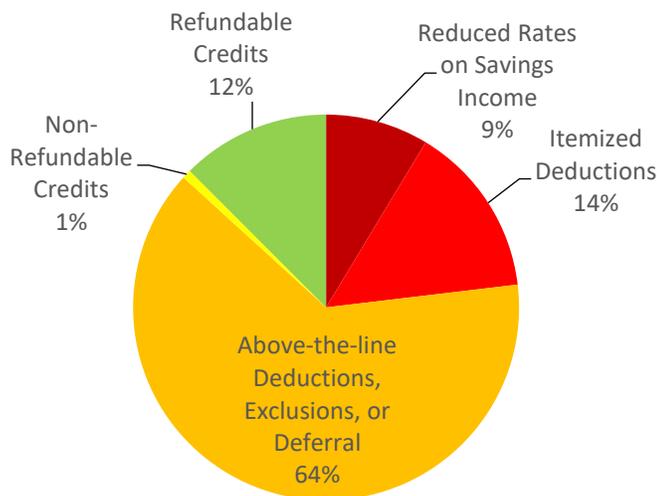
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<sup>86</sup> *Id.*

<sup>87</sup> Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23 (2006).

unlikely that the optimal tax incentive will be as regressive as many of the deductions, exclusions, and preferential rates that we have today. Restructuring tax incentives into refundable tax credits will, however, be a major undertaking. Currently, only about 12% of tax expenditures are structured as refundable credits, as illustrated in Figure 12.

**Figure 12: Share of Cost of Tax Expenditures by Form, 2016**



Source: Author's calculations based on OMB, Analytic Perspectives FY2017, tbl. 14-2, Year 2016 (2016).

Second, wherever possible, Congress should leverage the insights of behavioral economics when redesigning tax incentives. Doing so can also generate more social benefits at a lower cost.

To provide one example, tax incentives for retirement savings are a particularly fruitful area for reform. Though we currently spend more than \$80 billion per year on retirement savings incentives, the median household nearing retirement has only \$14,500 in retirement savings.<sup>88</sup> About one-third of workers do not have access to an employer-sponsored retirement plan, even though middle-class workers are 15 times more likely to save for retirement if they are covered by an employer plan.<sup>89</sup>

Low- and middle-income families are generally the least prepared for retirement,<sup>90</sup> but the lion's share of tax incentives for retirement savings go to the wealthy. Households in the top income quintile receive two-third of the benefit of retirement savings incentives and those

<sup>88</sup> Keith Miller et al., *The Reality of the Retirement Savings Crisis*, CTR. FOR AM. PROGRESS (Jan. 26, 2015) (figure is for households age 55 to 64, and excludes Social Security).

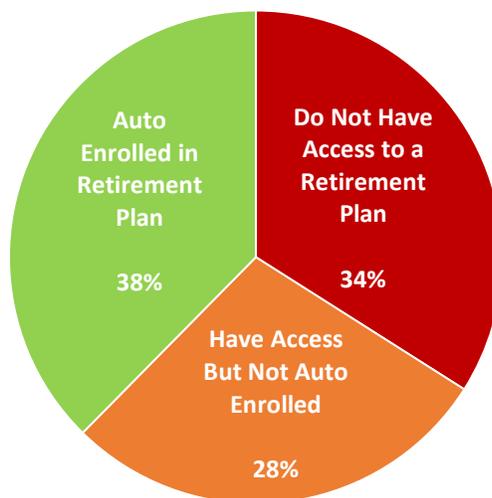
<sup>89</sup> *Retirement Savings 2.0: Updating Savings Policy for the Modern Economy: Hearing Before the S. Comm. on Finance*, 113<sup>th</sup> Cong. 9-10 (2014) (statement of Scott Betts, Senior Vice President of National Benefits Services, LLC).

<sup>90</sup> Alicia Munnell et al., *NRRI Update Shows Half Still Falling Short* (Ctr. for Retirement Research Brief No. 14-20, Dec., 2014)

in the top 5% receive more than one-third of the benefits.<sup>91</sup> In contrast, the bottom two quintiles only receive 7% of the benefits.

In addition, there is extensive empirical evidence that retirement savings choices are heavily influenced by how easy it is to save principally as a result of defaults. For example, new hires are about 50 percentage points more likely to participate in their employer’s retirement plan if they are automatically enrolled.<sup>92</sup> There have been several positive reforms in response to this research. For example, the Pension Protection Act of 2006 and Treasury Department guidance issued before and after it contributed to a large rise in automatic enrollment.<sup>93</sup> But the default retirement savings rate is still zero for roughly 62% of workers, as illustrated in Figure 13.

**Figure 13: Share of Workers with Default to Save for Retirement**



Source: Author’s calculations based on PLAN SPONSOR COUNCIL OF AMERICA, 58<sup>TH</sup> ANNUAL SURVEY (2016); BUREAU OF LABOR STATISTICS, NATIONAL COMPENSATION SURVEY, tbl.2 (2016).

As part of individual tax reform, Congress should therefore consider a number of ways to improve retirement savings incentives. These include restructuring the tax incentives so that a larger share of the benefits go to low- and middle-income workers,<sup>94</sup> directly depositing the

<sup>91</sup> CONG. BUDGET OFFICE, THE DISTRIBUTION OF MAJOR TAX EXPENDITURES IN THE INDIVIDUAL INCOME TAX SYSTEM tbl.2 (May, 2013).

<sup>92</sup> Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001). While many of these workers would eventually join the plan if enrollment were voluntary, accelerating participation through auto enrollment substantially boosts the overall retirement savings of most workers.

<sup>93</sup> In 2014, 57% of 401(k) plans auto enrolled their workers compared to less than 10% in 2000. PLAN SPONSOR COUNCIL OF AM., 58<sup>TH</sup> ANNUAL SURVEY (2016).

<sup>94</sup> See, e.g., William G. Gale et al., *Improving Opportunities and Incentives for Saving by Middle- and Low-Income Households* (The Hamilton Project, Discussion Paper 2006-02, 2006), [https://www.brookings.edu/wp-content/uploads/2016/06/200604hamilton\\_2.pdf](https://www.brookings.edu/wp-content/uploads/2016/06/200604hamilton_2.pdf); Christian E. Weller & Sam Ungar, *The Universal Savings Credit*

incentive into the taxpayer's account,<sup>95</sup> requiring employers offering retirement plans to automatically enroll their workers, and enacting automatic IRAs at a federal level so that every worker has access to an easy way to save for retirement.<sup>96</sup> Such reforms could substantially boost retirement security while saving revenue. Automatic IRAs alone would give 30 million more workers access to a workplace savings opportunity.<sup>97</sup>

To provide another example, many would argue that the purpose of the tax exemption for state and local bonds is to support investments by state and local governments, effectively devolving federal revenue to them. But about 20% of the value of the exemption goes to high-bracket investors in the form of above-market after-tax interest rates, rather than to state and local governments in the form of lower interest costs.<sup>98</sup> If Congress replaced the exemption with a refundable tax credit, as was the case with Build America Bonds, we could deliver the same amount of aid to state and local governments at a much lower budgetary cost.

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(Ctr. for Am. Progress, July, 2012), <https://cdn.americanprogress.org/wp-content/uploads/2013/07/UniversalSavingsCredit-report.pdf>.

<sup>95</sup> Emmanuel Saez, *Details Matter: The Impact of Presentation and Information on the Take-up of Financial Incentives for Retirement Saving*, 1 AM. ECON. J.: ECON. POLICY 204 (2009).

<sup>96</sup> Senator Whitehouse and Rep. Neal have introduced federal automatic IRA legislation. S. 245, 114<sup>th</sup> Cong. (2015); H.R. 2499, 115<sup>th</sup> Cong. (2017). For more details on auto-IRA proposals, see, e.g., Mark Iwry & David C. John, *Pursuing Universal Retirement Security Through Automatic IRAs*, THE RET. SEC. PROJECT (2009), <http://www.brookings.edu/research/papers/2009/07/automatic-ira-iwry>; DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2016 REVENUE PROPOSALS, 134, (Feb., 2015).

<sup>97</sup> EXEC. OFFICE OF THE PRESIDENT AND US TREASURY DEP'T, THE PRESIDENT'S PLAN TO HELP MIDDLE-CLASS AND WORKING FAMILIES GET AHEAD 5 (Apr., 2015).

<sup>98</sup> CONG. BUDGET OFFICE & J. COMM. ON TAXATION, SUBSIDIZING INFRASTRUCTURE INVESTMENT WITH TAX-PREFERRED BONDS 34 (Oct., 2009). CBO and JCT estimate that state and local governments are able to pay interest at a rate that is 21% below that of comparable taxable bonds because of the exemption. This implies that investors in tax brackets above 21% benefit from the exemption by an amount equal to their marginal tax rate minus 21% multiplied the amount of tax-exempt interest they receive. *Id.*, at 31-33.