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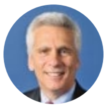
Real tax reform



By **Jared Bernstein** August 7 Follow @econjared

Jared Bernstein, a former chief economist to Vice President Biden, is a senior fellow at the Center on Budget and Policy Priorities and author of the new book 'The Reconnection Agenda: Reuniting Growth and Prosperity.'

Now that the health-care debate is at least temporarily resolved, the Trump administration and congressional Republicans are pivoting to tax reform. Given that tax policy is far more familiar to Republican policymakers than health care, there's more confidence in their caucus that they might be able to actually legislate something.

That may or may not be true. Thus far, the administration has shown neither skill nor interest in the work of legislating, which requires analysis, organizing stakeholders and close work with your congressional partners.

But while much of the focus will be on the process of tax reform, it's essential to recognize that there is as yet no tax reform. There are only highly regressive, revenue-losing tax cuts. Real tax reform, meaning tax changes responsive to the needs of the majority of the American people now and in the future, would push back on, instead of exacerbate, market-driven inequalities and raise the necessary revenue to meet the many challenges we face.

Conservatives have yet to settle on a specific plan, so it's possible that some genuine reform could be forthcoming. But the plans they've surfaced thus far, from which the numbers below are drawn, push hard in the wrong direction. Unless they sharply change course, here's what we're likely to see.

— ***Tax cuts that largely accrue to wealthy households.*** Lowering personal rates, cutting the corporate tax rate by more than half, ending the estate tax, and getting rid of the alternative minimum tax (which enforces higher tax liabilities among those, like President Trump himself, who have high incomes but scads of deductions) would make federal taxes fall about $175,000 for the richest 1 percent of households (8 percent of their pretax income), $940,000 for the top 0.1 percent (9 percent) and $760 for the middle class (1 percent), according to the nonpartisan Tax Policy Center (TPC). Looking across various proposals, tax/budget analyst Seth Hanlon finds that between 50 percent and 100 percent of the share of these tax cuts either immediately or eventually accrue to the top 1 percent.

— ***Tax cuts that lose somewhere between $3 trillion and $5 trillion over 10 years.*** Look for Team Trump to try to make those losses look smaller by using "dynamic scoring" — i.e., adding in revenue allegedly spun off by tax-induced growth effects. But both the TPC and the Congressional Budget Office show that, absent statistical abuse, such effects are minimal or go the wrong way (i.e., the dynamic score loses more than the static score). TPC finds the dynamic effects reduce the revenue loss from $3.5 trillion to $3.4 trillion in the first decade but then raise it from $5.7 trillion to $5.9 trillion in the second decade.

— Tax cuts that open up a big fat new tax loophole. A common element of these "reform" plans is a much-reduced top tax rate for "pass-through" businesses. About half of business income now shows up in the personal tax liabilities of people who form entities such as partnerships, LLCs and S-corporations. Under the rubric — one that has long wreaked much havoc in the tax code — of helping small businesses, Trump's team wants to lower the top rate on this income to 15 percent.

Once again, this is a giveaway to the rich and an invitation to them to define their income to take advantage of the new, reduced rate. The vast majority of pass-through filers already pay 15 percent or less, such that, according to CC Huang, "68 percent of the tax cut on existing pass-through income would flow to millionaires, including real estate investors, hedge fund managers, investment bankers, and the like." Moreover, 30 percent of the predicted revenue loss from this change comes from tax avoiders redefining their income to take advantage of the change.

The ideas above aren't anything close to "reform," which is often described as revenue-neutral tax changes that pay for a few points off marginal tax rates by closing loopholes. But based on our aging population, climate change, the rise of inequality, and geopolitical realities, revenue neutrality is an insufficient goal for true tax reform.

Between now and 2040, the share of our population over 65 is expected to rise by more than a third (from 15 percent to 20 percent), generating pressure on both the spending and revenue sides of the budget. Global warming, rising sea levels and weather changes will require investments in infrastructure and science. Increased inequality leads to stickier poverty rates, diminished mobility, and the need for increased investment in children's education and their parents' well-being.

Politicians, and not just conservatives, are in denial about much of the above. Even many Democrats fear that to come clean on the need for ample revenue to meet these needs would lead to defeat at the polls. Maybe they're right, but while Republicans make empirically indefensible growth predictions to pretend to offset their tax cuts, Democrats have long been reluctant to explain to constituents that the necessary role of government they represent will require more tax revenue than we can raise from solely the top 1 percent (though that's the right place to start).

Progressives cannot beat Republicans in a fight over tax reform as currently defined — i.e., if tax reform means tax cuts, we've already lost. As their health plans revealed, Republicans' goal is to shrink government and give the proceeds to the rich. Democrats' response cannot be that they'll instead cut taxes for the middle class.

Instead, they should explain what true tax reform is, why it is so necessary and how it must support a robust role for a government that is amply funded to meet the steep challenges we face.

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