

VIEWPOINT

## **Realistic Definition Of Tax Reform Will Help In Getting The Job Done**

*Seventh In A Series*

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The President's Tax Reform Advisory Panel is about to complete the first phase of its work.

In a kind of Tax Law 101 tutorial, it has been traveling the country listening to experts describe operational details and characteristics of the current federal income tax. It's heard from economists, academics and former Treasury Department officials, as well as from beleaguered taxpayers.

As a result, panel members have a more than ample catalogue of the many ways in which the tax code harms the economy and frustrates taxpayers.

The next step is for the panel to figure out how best to cure the code's most damaging defects in a way that can actually get enacted into law. There's no need for another round of "virtual" tax reform — as has occurred in the past, when reformers sought to make the code conform to some academic notion of perfection outside the realm of practical political reality.

President Bush has defined tax reform in realistic terms: make the tax code simpler and more conducive to economic growth. To that end, he selected an advisory panel that is, by leadership and composition, well-suited for the job of making tax reform a practical success.

There's no reason for the panel to be constrained by the politics or ideologies of the past. It has the strong backing of the president. His political party controls both houses of Congress, and the anti-growth biases of the tax code are intellectually discredited and short on political support.

### **Get Rid Of The Bias**

In the past, some people sought to excuse those biases in the name of "fairness." But there's nothing fair about tax policies that destroy jobs and lower living standards. And today, just about all members of Congress in both political parties understand that fact.

The panel can accomplish the goal of removing the existing tax barriers to economic growth in two ways. It can remove the offending provisions from the current income tax or it can replace the current income tax with a new tax system that does not have those anti-capital, anti-growth biases to start with. In neither case is it necessary to reinvent the wheel.

If the decision is to repair the income tax, a few familiar amendments to the tax code would do the job. Dozens of bills have been introduced in Congress that would accomplish major tax reform within the framework of the

current income tax: Personal savings would no longer be double taxed. Business investment in capital equipment would be expensed in the year purchased. American companies would be allowed a better opportunity to compete in global markets. And if they win, they could bring their profits home for investment in America, instead of being forced by the tax code to reinvest their money abroad.

The statutory language to make these changes is already drafted and available. The economic consequences are well known and salutary.

### **Hybrid System**

If the panel opts to recommend “big bang” tax reform — by replacing the current tax code with a new one — here again they do not have to start from zero. The plausible replacements for the current income tax are available “off the shelf” — most of them having been worked out in detail by countless congressional hearings, Treasury studies and academic colloquia over many decades.

In the 1950s, the focus was on a “cash flow tax.” In the 1970s, the favorite was either a consumed-income tax or a value added tax. In the last two decades, several combinations and permutations have been crafted in an effort to make the tax code simpler and less destructive of economic growth.

Most recently, one such hybrid, an unusual bipartisan effort with its own brand name — the Simplified USA Tax — came exceedingly close to achieving the ultimate goal of “taxing all income alike and only once.” It did so in a statutory framework that resembled a plain-English version of the current income tax reduced in size by about 50%. It preserved deductions for home mortgage interest and charitable giving. And it provided a way of equalizing the treatment of all international trade income — including removal of the double tax on U.S. exports.

Despite their different structures and terminologies, most of the plausible alternatives to the income tax tend to produce bottom-line economic results not greatly different from the economic results of a “reformed” income tax — one that’s been amended to eliminate double taxation of savings and investment and to allow U.S. firms a fair chance to compete globally.

Most of the alternatives suffer from two fundamental defects.

First, they are inconsistent with some of the president’s instructions to the panel. Second, they are not politically viable.

When he created the panel, Bush instructed it to develop recommendations that preserve tax benefits for home mortgage interest and charitable giving. Except for the Simplified USA Tax, none of the alternatives being discussed is structured to make retention of these deductions feasible.

Furthermore, there is little realistic chance that any of the big-bang alternatives could be enacted into law right now. Fact is, neither the public nor Congress understands any of them well enough to be comfortable with the idea of taking the plunge into an unfamiliar tax system. Americans may love to hate the income tax they know, but they are unlikely to trade it for something that to them is a mystery.

Two key amendments to the current tax code — elimination of the double taxation of savings and allowing first-year expensing of business equipment — would achieve 70% to 80% of the economic benefits of even the best of the big-bang replacements. And the benefits of these straightforward amendments can be understood — and accepted — by the American public and Congress.

These two critical changes to the current income-tax code should thus be the linchpin of the panel's recommendations for immediate enactment.

The panel should not stop there. Recognizing that tax reform is not a one-time-only event, the panel should also recommend the creation of a task force to begin its work after the first two linchpin amendments to the current code have been enacted.

The mission of the task force would be twofold. First, focus on making the code simpler and more understandable. Second, develop additional reform proposals in the international tax area that would further enhance the ability of U.S. companies to compete in foreign trade.

### **Foundation In Place**

In this additional round of tax reform, there would be no need for the task force to start with a blank slate. Indeed, the panel should include in its report the recommendation that the starting point be the Simplified USA Tax — a fully developed proposal that not only simplifies the tax code, but also contains the key ingredients of a vastly improved international tax regime.

With respect to both aspects of tax reform — economic reform and simplification — the panel should keep in mind the words of professor James Eustice and not lose sight of the fact “that there are people out there . . . (who must) function under this system.”

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