Presentation to

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**** prepared remarks ****

Hello and thank you for the opportunity to speak with you today. My name is John Irons, I am currently the research director at the economic policy institute where I work on a range of economic issues, including tax policy. I am a PhD. economist by training, and taught economics at Amherst College for 3 years before coming to DC back in 2002.

The mission of the board, as I understand it, is to provide the President with options and recommendation to promote economic growth, create jobs, and improve long-term prosperity. And this sub-committee is charged with addressing tax policy in that context.

I salute your courage and your fortitude in this endeavor – as you've almost certainly found out, tax reform is a something of a cottage industry here in DC.

Before diving into a couple specific policy areas, let me step back for a moment to make some more general points about tax policy and prosperity.

First, tax policy is just one tool that can be used to promote long-term prosperity, and it's certainly not the most important. Public investments in areas such as education, basic research, and national infrastructure play vital roles. Not to mention labor market policy, trade policy, and many others. It is all too easy to fall into a trap that places the tax code at the center of economic policy – it is not.

We also need to remember that the prime purpose of tax policy is to raise adequate revenue to finance public investments and other national priorities. And, at the same time, the tax code should for the most part, get out of the way of economic activities.

Having said that, tax policy, because of its reach into individual and business decision-making can influence for better or worse, long-term economic outcomes.

My understanding was that this committee was charged with addressing 3 areas, including simplicity, enforcement, and corporate taxes. Let me address each in turn, but I want also to challenge you to think beyond this framework—competiveness and growth is not just about corporations and physical capital. It is also about individuals and human capital; and about innovation and efficiency.

Let me turn to these three areas. I'm not going to delve too deeply into any one area given time limitations, but rather I will raise a set of issues that I think are important. I'm happy to address specific issues in more detail if you have questions.

On Simplicity

First, you should take Austan Goolsbee's advice on the Simple Return, which allows the IRS to fill out tax returns and mail them to taxpayers who could then simply sign and return.[1]

[1] http://www.brookings.edu/papers/2006/07useconomics_goolsbee.aspx

Second, what makes that tax code complex is not the number of tax brackets, but rather the myriad deductions, credits, and special provisions—all of which come with various eligibility criterion, phase-out rates, and supplemental worksheets.

There isn't time to go into every area that can be simplified but let me flag several.

- *The earned income tax credit.* Nearly 3 out of 4 EITC recipients used a paid tax return preparer. Reconciling and unifying the child tax credit, the dependent care credit, and the EITC, for example, would help streamline the credit.
- *The AMT.* The Alternative Minimum Tax adds an unneeded layer to tax filing. Given the growing cost of annual extensions to AMT thresholds, AMT reform will need to be addressed at some point. In my opinion, reform efforts should aim to incorporate AMT preference items into the standard code when appropriate.
- *Savings incentives.* Incentives for retirement, education, etc., are too complicated and should be consolidated where possible.
- *Tax deductions.* In my view deductions should generally be turned into credits so the tax savings are not dependent on income levels and marginal tax brackets. Right now higher-income taxpayers get a larger tax benefit – while lower income taxpayers may get very little.

That's really just scratching the surface. I would direct you to other sources, including the final report from prior administration's tax reform panel, and various tax expenditure reports from the JCT for more issues.

On enforcement

I am an economist, not a tax lawyer. I know this is a distinction without a difference to many. The first difference is of course that the lawyers are paid much better than us economists. The second is that tax lawyers will know where the bodies are buried – how people and corporations avoid and evade taxes, so I won't say much here, but I do support the president's recommendations on closing off-shore avoidance schemes for corporations and individuals.

The corporate tax

It is tempting to think about corporate taxation in isolation. As others have already noted to this board, the statutory marginal tax rates that businesses pay is on the high end compared to other countries, but due to a wide variety of deductions, credits, preferences, etc, the actual tax bills that many corporations face is substantially lower.

Thus a 1986-style reform—with a broader tax base and lower marginal rates—would seem to be called for.

Aside on 1986

Let me take a brief detour on the 1986 reform efforts.

You've probably already heard a lot about it, since it's often held up as a gold standard in tax reform. The 1986 reform aimed to broaden the base, lower rates, and to do so in a way that was both revenue and distributionally neutral. The idea that you can broaden the base and lower marginal rates fits many principles of good tax design—in particular the idea that economic inefficiencies are dependent on marginal tax rates.

However, not all the guidelines that drove the 1986 reform are as relevant today. The current situation is different in at least two ways.

First, the long-term budget outlook is unlikely to be sustainable under current policy. Health care reform may improve the outlook somewhat if cost savings materialize, however, adjustments to revenue and spending levels may be necessary to bring us closer to a sustainable deficit path. Tax reform efforts should thus consider higher revenues as part of their mandate. This can be done either in the context of the current income tax code, or one could look to augment the code with other revenue streams such as a VAT, revenue from carbon permits or carbon taxes, or a financial transactions tax.

Second, changes to the tax code since 2000 have primarily benefited high-income and high-wealth individuals. Further, we also know that income inequality has grown since this time.

Future tax reforms efforts should also look to lean against the wind of increases in income inequality.

I don't disagree that a 1986-style reform would be a step in the right direction—on the corporate side, Representative Rangle has proposed this kind of reform, which would remove special provisions and bring the corporate tax rate from 35% to 30.5%. I would urge you to review the proposal for specific items that could be reformed.

However, I believe that given the interconnectedness of the tax code, corporate taxation should be considered together with the broader tax code. For example, small business owners and those who are self-employed often report their income on a standard individual income tax return and thus pay rates according to the individual rate structure. Lowering the corporate rate without making other changes would thus have additional implications for taxes across business types.

Finally, many view reducing or eliminating the corporate tax as a desirable step towards a consumption tax, which, they argue, would lead to greater capital formation and higher levels of long-run growth. Other steps would include eliminating the tax on other forms of capital income, including taxes on capital gains, dividends, and estates.

However, as a replacement for progressive income taxes generally or corporate taxes, a flat-rate consumption tax (e.g. the Flat tax, or the so-called "fair tax") would likely entail significant tax increases on low- and moderate income taxpayers. A reduction in taxes on physical capital would also mean a relatively higher burden would be placed on human capital and wages. Further, the potential economic gains of a shift to a consumption base are uncertain, and, at best, very small. And, more likely, the gains would be nonexistent if transition assistance were given to existing wealth holders.

Beyond Corporate Taxes

As I said earlier, I want to urge the board to consider tax reform options outside of the corporate tax that would help generate economic growth and broadly shared prosperity. To reiterate, competiveness and growth is not just about corporations and physical capital. It is also about individuals, human capital, innovation, and economic efficiency.

Here are five issues I think you need to consider in your deliberations:

- *Human Capital.* Given the obvious importance of education in the modern economy, we should make sure that the tax code supports education at all levels. For example, savings incentives for higher education are insufficient for many families, and overly complex. Navigating the options including state 529 plans, Coverdells, etc. is not easy. For continuing education there are many programs that should be examined to ensure that they provide adequate incentives, including the Hope credit, life-long learning credit, and section 127 employer education assistance.

- *Low-income supports.* We all work in an interdependent labor market – my productivity depends on the skills of my colleagues and coworkers. Further we can't afford to waste any resources in a globally competitive environment. Supports for low-income families help them develop and pursue opportunities and build skills, and are thus essential for achieving our nation's long-run potential. Many have offered various proposals to increase EITC for e.g. childless workers and families with more than 2 children; address marriage penalties, etc. Other efforts to support wealth building would also help support individual opportunity, and thus long-run growth.

- *The financing of infrastructure projects.* Our nation's economy depends on a safe and efficient infrastructure. Adequate financing for our nation's roads, bridges, waterways, and airports is essential. For example, consider the surface transportation bill that is due for reauthorization: Is dedicated financing only through the gas tax optimal? Are the formulas and allocations across transportation modes optimal? Some have proposed other financing mechanisms, including a reinvestment bank, which could be part of the mix as well.

- *Innovation and R&D*. Innovation today is not done just by corporations,[2] and the tax code should realize that as well. For example, Carl Malamud and I have proposed an Open Source Tax Credit which would provide a 20% tax credit for the out-of-pocket expenses of open-source software developers to encourage software innovation and dissemination.[3] On the corporate side, I assume you've already been told that R&E tax credit needs to be revamped – I agree.

- *Energy and climate change*. I know that the board has already communicated with the president on this issue, but this should also be done by the tax committee. You should address, for example, credits for energy efficiency improvements and renewable energy development and deployment.

These issues—human capital, low-income supports, infrastructure, innovation, and energy policy—should all be part of the mix.

Thank you for the opportunity to speak with you today.

[2] C.f. Democratizing Innovation by Eric Von Hippel, 2005, MIT Press.
[3] http://www.americanprogress.org/kf/OS_CREDIT.PDF