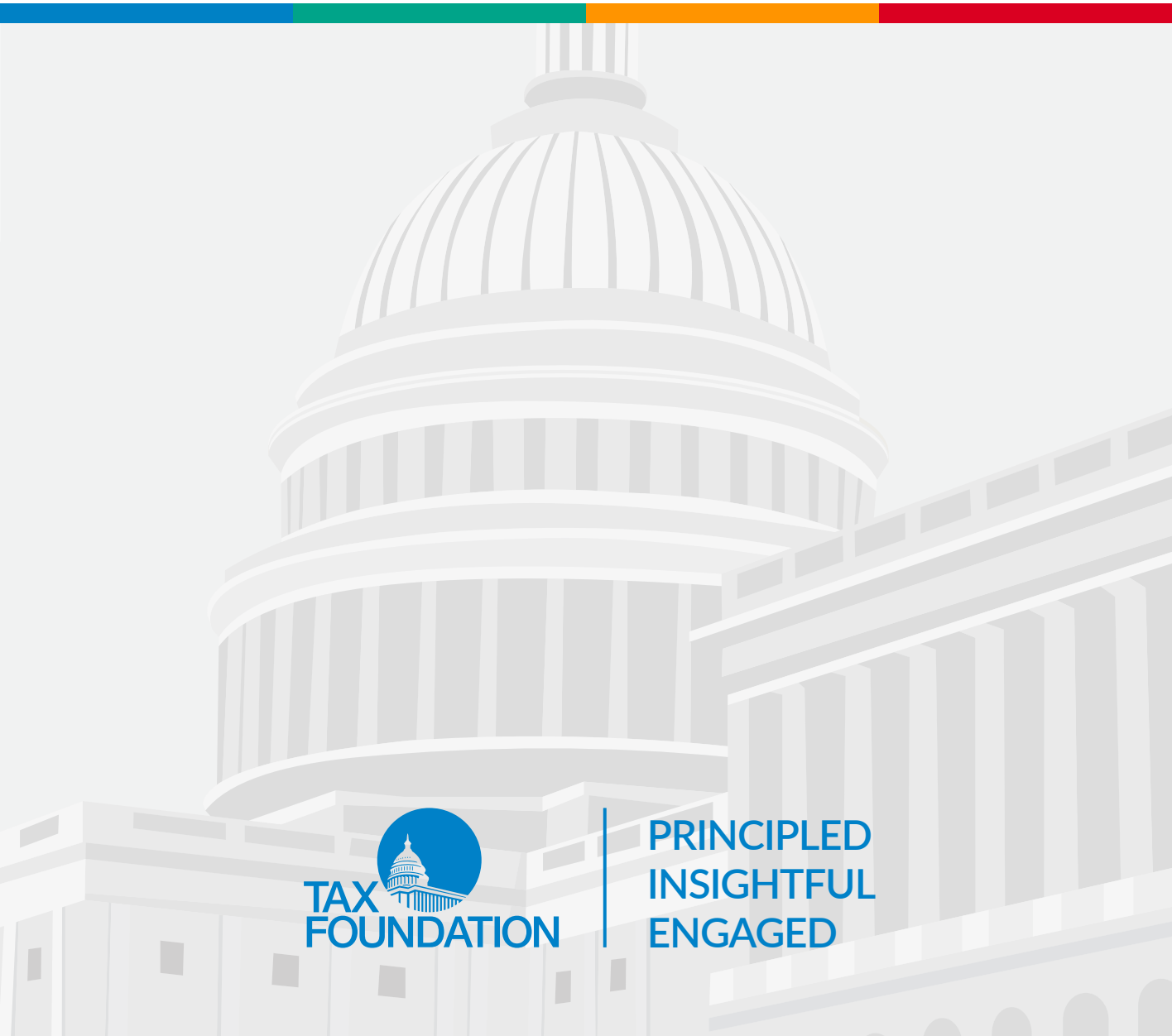
OPTIONS FOR REFORMING AMERICA'S TAX CODE 2.0



TAX FOUNDATION

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OPTIONS FOR REFORMING AMERICA'S TAX CODE 2.0

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TABLE OF CONTENTS

INTRODUCTION

The economic crisis caused by the coronavirus pandemic poses a triple challenge for tax policy in the United States. Lawmakers are tasked with crafting a policy response that will accelerate the economic recovery, reduce the mounting deficit, and protect the most vulnerable populations.

To help lawmakers navigate the triple challenge and design an appropriate tax policy response, we have assembled this book. *Options for Reforming America's Tax Code* describes 70 changes to the U.S. tax code that may be considered, organized under the following categories:

- Options for Promoting a Rapid Return to Growth
- Options for Reducing the Deficit
- Options for Protecting the Vulnerable
- Options for Simplifying the Tax Code

Each option would have a different impact on the U.S. economy, the distribution of the tax burden, and federal revenue. Armed with the information in this book, policymakers can debate the relative merits and trade-offs of each policy.

THEMES OF THIS BOOK

Every option in this book tells a separate story. However, a few themes do emerge throughout the following pages.

Tax Policy Is About Trade-Offs

A famous economist once said, "There are no solutions, there are only trade-offs." That lesson is especially true in tax policy.

The scales of justice may have two trays, but tax policy has three that lawmakers must balance—revenue, equity, and economic growth.

In other words, in tax policy there is an ever-present trade-off among (1) how much revenue a tax will raise, (2) progressivity, or who bears the burden of a tax, and (3) what impact a tax change will have on economic growth.

After modeling 70 changes to the tax code, we've found that it is nearly impossible to balance all three equally. Lawmakers will have to decide which of the three is most important based on their values and priorities.

For example, if lawmakers want to make the tax code more progressive and raise revenues, our model shows that they will likely have to give up some economic output, because higher tax rates dampen economic activity, especially higher taxes on capital and labor.

And less growth raises less revenue.

If lawmakers want to generate more economic output, our model shows that they will likely have to give up some progressivity, and maybe some tax revenue—although, all things being equal, a larger economy will tend to generate more tax revenue than the baseline.

But contrary to popular belief, few, if any, tax cuts pay for themselves.

Some Tax Changes Impact the Economy More Than Others

The willingness of people to work and deploy capital drives economic growth. Changes in the tax treatment of capital and labor change the cost of capital and the cost of labor and therefore affect the size of the capital stock and the supply of labor. Taxes influence people's decisions about joining the workforce and how many hours to work.

Taxes also influence decisions about how much people are willing to invest in new plant and equipment and where they decide to locate new investment. How much the capital stock and the labor supply expand, or contract, largely determines the level of output and income in the economy.

Importantly, under standard economic theory, taxes only affect behavior when they apply "on the margin"—when they affect a person's decision about his next hour of labor or her next dollar of investment.

For instance, changes in marginal tax rates affect people's incentives differently than lump-sum tax credits. Imagine a policy that cut the bottom tax bracket from 10 percent to 5 percent. Currently, households that fall into the bottom bracket keep 90 cents of every additional dollar they earn working. Under this proposed policy, households in the bottom bracket would keep 95 cents of every additional dollar they earn working. Thus, this policy would give low-income households a stronger incentive to increase their supply of labor, because they would be able to keep more of their additional earnings.

On the other hand, imagine a policy that gave a fully refundable $2,000 tax credit to every individual. That policy would cut taxes significantly for every single taxpayer. However, it would not have any effect on households' supply of labor. Households in the 10 percent bracket would still only receive 90 cents of each additional dollar they earn working. Because this policy would not change households' marginal tax rates, it would not alter incentives to change labor supply.

Empirical evidence demonstrates that capital is far more sensitive to changes in tax policy than labor is primarily because capital is far more mobile than labor. Capital can move quickly from jurisdiction to jurisdiction in search of lower tax costs, but it is more difficult for workers to move their families from place to place to lower their tax bills.

So, changes in the taxation of capital have a larger effect on the economy than changes in the taxation of the labor. To illustrate, compare the following two options:

Making 100 percent bonus depreciation a permanent part of the tax code (Option #7) and reducing the employer-side and employee-side payroll tax by a half a percentage point each (Option #4).

	Make 100% Bonus Depreciation Permanent	Reduce Both the Employer-side and Employee-side Payroll Tax by Half a Percentage Point Each
GDP	+0.5%	+0.2%
GNP	+0.4%	+0.2%
Capital Stock	+0.9%	+0.2%
Wage Rate	+0.4%	+0.0%
Full-Time Equivalent Jobs	+86,000	+179,000
Conventional Revenue (10 years)	-$213.4 billion	-$651.8 billion
Dynamic Revenue (10 years)	-$110.2 billion	-$545.4 billion

Source: Tax Foundation General Equilibrium Model, March 2021.

100 percent bonus depreciation allows businesses to immediately deduct the full cost of short-lived investments like machinery and equipment, which increases the return to capital. Reducing the payroll tax by 1 percentage point increases the return to labor, as both sides of the payroll tax are fully borne by workers.

As compared to the payroll tax cut, permanent 100 percent bonus depreciation would have a substantially larger positive effect on output (GDP, the final value of goods and services produced in America) as well as national income (GNP, the final value of goods and services owned by Americans) and yet would cost substantially less in terms of reduced federal revenue. Bonus depreciation offers more “bang for the buck” than reducing the payroll tax because bonus depreciation reduces taxes on capital, while the payroll tax falls squarely on labor.

The Economic Effects of a Tax Change Matter

The theme that some tax changes produce more economic growth than others moves the tax debate past a simple argument over *how much* revenue ought to be raised to a deeper discussion about *how* revenue ought to be raised.

One way to think about it is as a hierarchy in which taxes are ranked most and least harmful for long-term economic growth. The hierarchy is determined in part by which factors are most mobile, and thus most sensitive to high tax rates.

Taxes on the most mobile factors in the economy, such as capital, cause the most distortions and have the most negative impact on the economy. Taxes on factors that cannot easily be moved are more stable and less distortive.

Accounting for the different economic effects of different tax changes ensures a more accurate revenue estimate. Tax changes can grow GDP or shrink GDP, and the resulting larger (smaller) economy generates more (less) revenue. Dynamic revenue scores take such feedback effects into account, providing a fuller picture of how tax changes will impact revenue.

The Tax Base Is Just as Important as the Tax Rate

Changing a tax rate might seem to be the most straightforward way to provide tax relief or increase revenue, but the tax rate only matters because there is a tax base to which it applies.

Currently, numerous deductions, exclusions, and exemptions narrow the size of the U.S. tax base and reduce the amount of economic activity subject to tax. A broader tax base could result in additional tax revenue without rate changes.

Broader tax bases and lower tax rates tend to be more economically efficient than systems with narrow tax bases and high tax rates. While the rule holds in general, not all measures to broaden the tax base are good tax policy. For instance, broadening the business tax base by lengthening depreciation schedules would cause significant economic harm.

Changing tax rates is a simple endeavor but defining the tax base is a complex and nuanced task that hinges on one's view of an ideal tax base. Two primary approaches compete for this ideal: an income tax base and a consumption tax base.

Under an income tax base, individuals pay taxes on their consumption plus their change in wealth. Under a consumption tax base, individuals pay taxes only on their consumption.

To illustrate the difference between an income-based tax and a consumption-based tax, imagine a small business owner who earns $250,000 in net income, spends $200,000 of it on an investment, and consumes the remaining $50,000.

- Under an income-based tax, the business owner would pay taxes on both the $50,000 of consumption and the $200,000 increase in wealth.
- Under a consumption-based tax, the business owner would only pay taxes on the $50,000 of consumption and would not pay taxes on the investment until it yields a profit in the future.

A consumption-based tax avoids the double taxation of saving and investment. For instance, in the example above, the income-based tax would apply to both the principal of the investment (the $200,000 spent today) and the profits of the investment (the profit that the investment would yield in the future). As a result, this double tax would make the business owner less likely to invest.

Income-based taxes often cause several layers of tax on the same investment. For instance, an individual's investment in a U.S. corporation may be subject to four layers of taxation: once when the income is initially earned, through the individual income tax; a second time when the corporation earns a profit, through the corporate income tax; a third time when the profit is distributed to shareholders, through the individual income tax on dividends; and a fourth time when the individual dies, through the estate tax.

Supporters of income-based taxes argue they are more progressive than consumption-based taxes. Because high-income taxpayers are more likely to save and invest than low-income taxpayers, placing several layers of taxes on investment increases the tax burden on the wealthy. However, it is also possible to make consumption-based taxes progressive without imposing a higher tax burden on saving and investment, thus avoiding the distortions caused by higher marginal tax rates on investment.

Under current law, the U.S. tax system is a hybrid between a pure income-based tax and a pure consumption-based tax. For instance, capital gains are included in the tax base (income feature) but taxed at a lower rate (consumption feature). Another example: businesses are unable to deduct the full cost of their capital investments immediately (income feature) but the tax code allows for accelerated depreciation schedules (consumption feature).

Some of the options in this book would move the U.S. tax system further toward an income tax base while others would move it further toward a consumption tax base. Lawmakers should consider which direction they wish to move toward and the trade-offs involved with each approach.

HOW TO USE THIS BOOK

The figures reported in this book were estimated using the Tax Foundation's General Equilibrium Model[1] with the goal of providing a comprehensive picture of how different tax changes would affect the U.S. economy, federal tax revenue, and distribution of the tax burden. Each option described in this book is accompanied by several statistics that summarize the projected long-run economic effects, 10-year revenue effects (calendar years), and distributional effects of the tax change relative to a current law baseline (unless otherwise noted).

Long-run change in Gross Domestic Product: This statistic conveys how much larger or smaller the U.S. economy would be in the long run if a particular tax change were adopted. It measures the final value of goods and services produced within the United States (by Americans and foreigners) within a given time frame. For instance, if an option results in a 1 percent change in long-run GDP, this means that adopting the option would make the U.S. economy 1 percent larger than otherwise. This statistic does not convey any information about how annual GDP growth would change along the adjustment path to the new level because of an option.

Long-run change in Gross National Product: This statistic conveys how much larger or smaller American incomes would be because of a particular tax change. It is related to GDP but differs because it only measures the final value of goods and services owned by Americans (within the United States and abroad) within a given time frame.

Some tax changes can create a wedge between GDP (American output) and GNP (American incomes). Taxes levied on domestic saving, such as capital gains taxes, would reduce the return to saving and may reduce the ownership of American investment by domestic residents. Because the U.S. economy is open to international investment, foreign investors who are not subject to the tax may provide additional funds to finance domestic investments.

While increased international investment helps reduce the effect of the tax change on domestic output, it would change the composition of ownership, resulting in less ownership of U.S. assets by Americans and a decrease in national income as the returns to the investments would flow to foreign owners rather than Americans.

Capital Stock: This statistic conveys how much larger or smaller the U.S. capital stock would be in the long run if a particular tax change were adopted. The capital stock is a measure of the level of fixed assets in the economy, including government-owned and private-owned. The private stock consists of four main asset types: equipment and software, nonresidential structures, residential structures, and intellectual property. An increase (or decrease) in the after-tax rate of return to capital will drive an increase (or decrease) in the capital stock. A change in the level of the capital stock permanently changes output, which increases (or decreases) the incomes for both owners of capital and workers.

1 William McBride, Cody Kallen, and Huaqun Li, "The Tax Foundation's Taxes and Growth Model," Forthcoming, Tax Foundation.

Wages: This statistic conveys how much larger or smaller the level of real average hourly earnings for employees in all sectors would be in the long run if a particular tax change were adopted.

Full-Time Equivalent Jobs: This statistic conveys how much larger or smaller the labor supply would be if a particular tax change were adopted. The labor supply response is measured in hours worked, which is then converted into a measure of full-time equivalent jobs. For example, in 2019, the United States had roughly 155 million employees but some of them worked part-time jobs. Converted to full-time equivalent employees, which expresses how many employees there would be if Americans worked the same total number of hours but only in full-time jobs, the United States had roughly 139 million full-time equivalent employees in 2019. Many of the options in this book would increase or decrease the capacity of the economy to employ labor, leading to additional or fewer full-time equivalent jobs.

Conventional 10-Year Revenue: Between 2022 and 2031 the federal government is expected to raise nearly $49 trillion in revenue. This statistic conveys how much a tax policy change would raise or lower revenue if it has no macroeconomic effect (in other words, holding the size of the economy constant). In some cases, the change in revenue over the first 10 years may differ from the long-run change in revenue. This could be due to tax changes that "frontload" or "backload" the revenue impact or due to changes with other timing-related impacts, such as phaseouts or expirations that are scheduled to occur under current law.

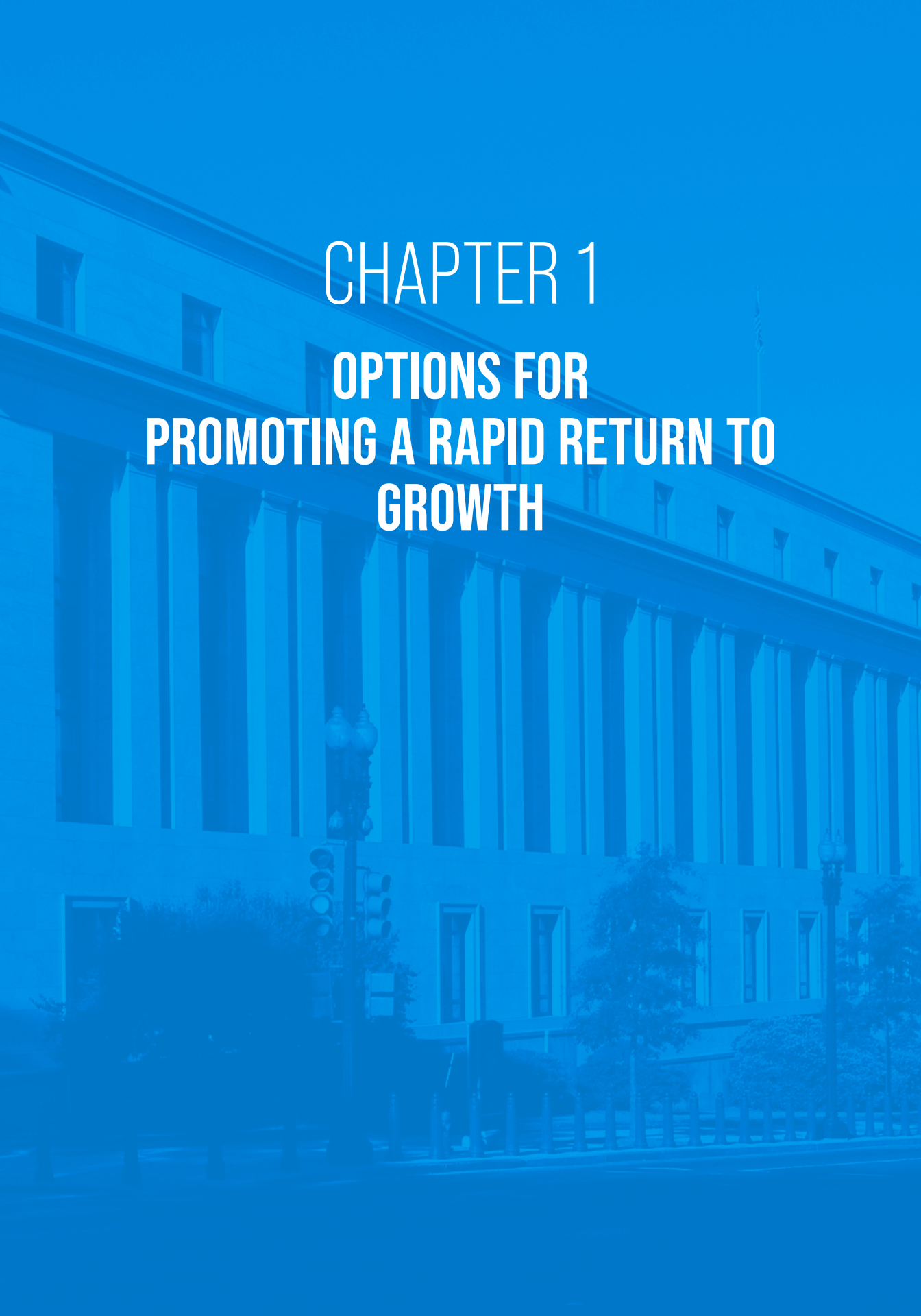
Dynamic 10-Year Revenue: This statistic expresses the change in federal revenue resulting from each option after considering its economic effects. For instance, if cutting the income tax would lead to more jobs, thus in turn higher payroll tax revenue, it would make up for some of the revenue lost from the income tax cut. Dynamic revenue scores offer a more complete picture of how much federal revenue would actually change as a result of a tax change. Note that the long-run revenue change after all adjustments have occurred may be considerably different from the revenue change over the 10-year budget window because economic effects build over time.

Conventional Change in After-Tax Income, 2022 and 2031: Most tax changes deliver differing costs and benefits to different groups of taxpayers. The conventional distributional table at the bottom of each option shows how after-tax income changes across the income scale, holding the size of the economy constant. To produce these tables, we rank each household that pays income tax by adjusted gross income, from lowest to highest, and divide taxpayers into five groups of equal size, known as quintiles. To show how much an option would raise or lower taxes on each group, we calculate the tax change as a percentage of the group's after-tax income (adjusted gross income minus taxes paid). For some options, we show the conventional distribution in the first and last year of the 10-year budget window to illustrate how the provision would impact taxpayer incomes over the budget window.

Dynamic Change in After-Tax Income, Long-Run: In addition to benefiting or harming households through higher or lower taxes, the options in this book would also benefit and harm households through their economic effects. The dynamic distributional tables at the bottom of each page show how the after-tax incomes of each group of taxpayers would change due to both direct tax changes and indirect economic effects.

WARNING: Readers should not attempt to combine the revenue, economic, or distributional figures from multiple options. For instance, if Option A would raise $100 billion and Option B would raise $200 billion, it is not necessarily the case that implementing both Option A and Option B would raise $300 billion. The U.S. tax system contains many components which interact with each other in complex ways.

If you are interested in assembling a tax plan of your own, please feel free to contact the Tax Foundation for assistance and model results, at (202) 464-6200. Priority will be given to members of Congress and their staff.



CHAPTER 1

OPTIONS FOR PROMOTING A RAPID RETURN TO GROWTH

INTRODUCTION

If lawmakers solely rely on policies designed to stimulate short-run economic growth and provide liquidity to households and businesses, they risk producing only short-term results and an anemic long-term recovery. While immediate relief is warranted, permanent improvements to tax policy offer an effective means for promoting work, investment, and capital formation over the long term.

To be effective in promoting economic recovery, federal tax policy changes must be made on a permanent basis to improve long-term incentives. Temporary improvements would not provide adequate time to recoup the cost of major investments nor the certainty needed to engage in long-term decision-making. Moreover, short-term policy changes can increase uncertainty—undermining capital spending and new investment as a general matter.

Broadly speaking, permanent improvements to the tax code can clear the path to economic recovery through one of two main channels. First, tax policy can change people's incentives to work, affecting the supply of labor. Second, tax policy can change people's incentives to save and invest, affecting the supply of capital. Higher supplies of labor and capital lead to a larger economy.

In most cases, such improvements would not require a new set of policies—just the removal of obstacles that stand in the way of work and investment. Chapter 1 outlines 13 options lawmakers might consider for improving policies across individual, business, payroll, and excise taxes.[1]

1 Under the current structure of the federal income tax, cutting the top ordinary income rate would not lead to a much lower tax bill for many high-income households because if the top rate were lowered significantly, many households would fall into the alternative minimum tax (AMT), particularly after 2025, when the AMT is scheduled to change and impact more households. To reflect the full revenue impact of cutting the top tax rate, all the options in this book that change the top individual income tax rate were modeled against a baseline which does not have the AMT.

01. LOWER INDIVIDUAL INCOME TAX RATES ACROSS THE BOARD BY 10 PERCENT

GDP	+0.9%
GNP	+1.0%
Capital Stock	+1.0%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+975,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$172.2	-$181.0	-$187.8	-$198.1	-$216.6	-$238.6	-$249.0	-$259.4	-$269.8	-$284.8	-$2,257.3
Dynamic	-$135.2	-$140.8	-$145.8	-$153.8	-$162.2	-$179.6	-$187.0	-$194.4	-$201.8	-$213.2	-$1,713.8

This option would reduce all seven income tax rates by 10 percent, resulting in a new top rate of 33.3 percent in years 2022 through 2025 and 35.6 percent in 2026 through 2031. The bottom rate would be 9 percent. Rates in between would also be reduced by 10 percent.

Reducing individual income tax rates would increase long-run GDP by 0.9 percent by increasing the incentives for individuals to work, save, and invest, including through ownership of pass-through businesses, such as sole proprietorships, partnerships, and S corporations. The larger economy would offset some of the revenue loss from the broad tax cuts, but even so, the policy would still reduce federal revenues by $1.7 trillion.

Higher-income taxpayers receive the largest increase in after-tax income because the individual income tax is progressive and high-income taxpayers benefit from the lower tax rates all the way up the income tax brackets. On a dynamic basis, after-tax incomes would increase for all taxpayers.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.7%
20% to 40%	0.2%	0.2%	1.0%
40% to 60%	0.6%	0.7%	1.4%
60% to 80%	0.9%	1.0%	1.7%
80% to 100%	1.8%	2.0%	2.7%
80% to 90%	1.2%	1.3%	2.0%
90% to 95%	1.4%	1.6%	2.3%
95% to 99%	1.8%	2.0%	2.8%
99% to 100%	2.8%	3.0%	3.7%
TOTAL	**1.3%**	**1.4%**	**2.2%**

02. LOWER THE TOP MARGINAL INCOME TAX RATE ON INDIVIDUAL INCOME TO 35 PERCENT

GDP	+0.2%
GNP	+0.3%
Capital Stock	+0.3%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+199,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$17.3	-$18.1	-$18.9	-$19.7	-$48.9	-$53.8	-$56.2	-$58.6	-$60.9	-$64.4	-$416.7
Dynamic	-$14.1	-$14.6	-$15.1	-$15.6	-$36.9	-$40.4	-$42.0	-$43.5	-$45.0	-$47.4	-$314.5

This option would reduce the top marginal individual income tax rate to 35 percent. The top rate is currently 37 percent, through 2025; beginning in 2026 it is scheduled to increase to 39.6 percent.

Reducing the top rate would increase the incentive for individuals in the top bracket to work, save, and invest, including through ownership of pass-through businesses. The response to the greater incentives would increase long-run GDP by 0.2 percent and reduce the revenue cost of the policy from $417 billion to $315 billion over 10 years. The boost in after-tax income would be concentrated among earners in the top quintile, particularly on a conventional basis, but on a dynamic basis, after-tax incomes would increase for all taxpayers.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.2%
20% to 40%	0.0%	0.0%	0.2%
40% to 60%	0.0%	0.0%	0.2%
60% to 80%	0.0%	0.0%	0.2%
80% to 100%	0.2%	0.6%	0.8%
80% to 90%	0.0%	0.0%	0.2%
90% to 95%	0.0%	0.0%	0.2%
95% to 99%	0.0%	0.0%	0.2%
99% to 100%	0.9%	2.1%	2.3%
TOTAL	**0.1%**	**0.3%**	**0.5%**

03. CONSOLIDATE CURRENT BRACKETS INTO THREE: 10 PERCENT, 25 PERCENT, AND 35 PERCENT

GDP	+1.3%
GNP	+1.4%
Capital Stock	+1.4%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+1.3 million

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$77.5	-$81.6	-$84.9	-$89.6	-$336.8	-$371	-$387.1	-$403.3	-$419.7	-$443.1	-$2,694.5
Dynamic	-$70.2	-$73.6	-$76.2	-$80.0	-$265.8	-$294.4	-$306.6	-$318.9	-$331.4	-$350.1	-$2,167.2

Under this option, individual income that is currently taxed at 12 percent would be taxed at 10 percent; 22, 24, or 32 percent would be taxed at 25 percent; and 37 percent would be taxed at 35 percent. Many taxpayers would face a lower marginal tax rate, boosting the supply of labor and reducing the cost of capital for businesses that pay the individual income tax, resulting in a 1.3 percent increase in long-run GDP. After considering the effects on the economy, the option would reduce federal revenue by $2.2 trillion over a 10-year period.

The bottom two quintiles would see little change in after-tax income because many already fall into the 10 percent tax bracket or use the standard deduction to reduce their taxable income to zero. Some upper-income taxpayers in the new 25 percent bracket would initially see slight tax increases but would receive a tax cut after the 2017 tax law changes expires. On a dynamic basis, after-tax income would rise for every group.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	1.0%
20% to 40%	< +0.05%	0.1%	1.2%
40% to 60%	0.5%	1.2%	2.4%
60% to 80%	0.8%	2.3%	3.4%
80% to 100%	0.6%	2.8%	3.9%
80% to 90%	0.3%	2.3%	3.4%
90% to 95%	-0.4%	1.9%	3.0%
95% to 99%	-0.3%	2.4%	3.6%
99% to 100%	2.5%	4.2%	5.4%
TOTAL	**0.6%**	**2.2%**	**3.3%**

04. REDUCE EMPLOYER- AND EMPLOYEE-SIDE PAYROLL TAX BY 1 PERCENTAGE-POINT SPLIT

GDP	+0.2%
GNP	+0.2%
Capital Stock	+0.2%
Wage Rate	+0.0%
Full-Time Equivalent Jobs	+179,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$50.6	-$58.8	-$60.9	-$62.4	-$64.9	-$66.2	-$68.6	-$70.9	-$73.2	-$75.4	-$651.8
Dynamic	-$42.6	-$50.1	-$51.8	-$52.9	-$54.7	-$55.1	-$57.0	-$58.7	-$60.5	-$62.2	-$545.4

The employee-side and employer-side payroll tax would decrease by 1 percentage point, split between the two sides, making each drop from 6.2 percent to 5.7 percent for a combined Social Security payroll tax rate of 11.4 percent. The payroll tax applies to the first $142,800 of wages and is indexed to wage growth.

The economic incidence of both sides of the payroll tax is fully borne by workers in the form of lower wages over the long run. Because labor is less responsive to taxation than capital, the payroll tax is a relatively efficient tax.

Reducing both sides of the payroll tax would increase the return to labor. It would lead to an immediate increase in after-tax income for taxpayers as the wedge between the total amount employers pay their workers and what the workers receive as pretax taxable income shrinks.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.4%	0.4%	0.5%
20% to 40%	0.6%	0.7%	0.8%
40% to 60%	0.8%	0.8%	0.9%
60% to 80%	0.8%	0.8%	0.9%
80% to 100%	0.5%	0.6%	0.7%
80% to 90%	0.8%	0.8%	0.9%
90% to 95%	0.8%	0.8%	0.9%
95% to 99%	0.6%	0.6%	0.7%
99% to 100%	0.1%	0.2%	0.3%
TOTAL	**0.7%**	**0.7%**	**0.8%**

05. LOWER THE TOP RATE ON CAPITAL GAINS AND DIVIDENDS TO 15 PERCENT

GDP	< +0.05%
GNP	+0.1%
Capital Stock	< +0.05%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+7,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$13.1	-$13.5	-$13.8	-$14.3	-$14.2	-$15.3	-$15.7	-$16.4	-$17.0	-$18.0	-$151.1
Dynamic	-$13.0	-$13.4	-$13.6	-$14.1	-$13.9	-$15.0	-$15.4	-$16.1	-$16.7	-$17.6	-$148.7

Long-term capital gains and qualified dividends are taxed at lower rates than ordinary income, facing a top rate of 20 percent (in addition to the 3.8 percent NIIT). Though the Treasury Department and the Joint Committee on Taxation categorize the separate rate schedule for capital gains and dividends as a tax expenditure, the lower rates offset some of the double taxation of corporate income and saving.

Lowering the top rate from 20 to 15 percent would have a larger effect on national incomes than economic output by reducing the tax burden on saving. This would increase American ownership of U.S. assets, reducing foreigners' net claims on U.S. assets and therefore reducing U.S. payments to the rest of the world, while slightly increasing economic output. This option would primarily affect the top 1 percent of U.S. taxpayers, though all groups would benefit to some degree due to economic growth

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.0%
20% to 40%	0.0%	0.0%	0.0%
40% to 60%	0.0%	0.0%	0.0%
60% to 80%	0.0%	0.0%	0.0%
80% to 100%	0.1%	0.2%	0.2%
80% to 90%	0.0%	0.0%	0.0%
90% to 95%	0.0%	0.0%	0.0%
95% to 99%	0.0%	< +0.05%	< +0.05%
99% to 100%	0.7%	0.6%	0.6%
TOTAL	**0.1%**	**0.1%**	**0.1%**

06. INDEX CAPITAL GAINS REALIZATIONS TO INFLATION

GDP	< +0.05%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+9,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$6.9	-$4.3	-$15.8	-$16.2	-$17.0	-$18.2	-$18.5	-$19.3	-$20.1	-$21.3	-$143.7
Dynamic	$6.9	-$4.3	-$15.8	-$16.2	-$17.0	-$18.2	-$18.4	-$19.2	-$20.0	-$21.2	-$143.4

Under the current U.S. tax code, capital gains are only taxed when the underlying asset is sold (or "realized"). As the taxes are not adjusted for inflation, some portion of the capital gain that is taxed is not actually real growth in the value of the asset. Short-term capital gains are taxed at ordinary income tax rates, while long-term capital gains are taxed at lower rates.

Indexing capital gains realizations for inflation would reduce federal revenues by $144 billion over the next 10 years. Federal revenue would actually increase in the first year due to increased realizations but drop in subsequent years. Relative to other pro-growth tax changes, the economic effects would be small. While indexing capital gains to inflation would increase the domestic capital stock slightly, investment is only partially constrained by the domestic saving rate, as foreigners also provide large amounts of capital to the U.S. firms. On a distributional basis, this option would mainly benefit the top quintile, increasing their after-tax incomes by 0.2 percent, though all groups would benefit to a small degree due to economic growth.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	< +0.05%	< +0.05%
20% to 40%	< -0.05%	< +0.05%	< +0.05%
40% to 60%	< -0.05%	0.1%	0.1%
60% to 80%	< -0.05%	0.1%	0.1%
80% to 100%	-0.1%	0.2%	0.2%
80% to 90%	-0.1%	0.2%	0.2%
90% to 95%	-0.1%	0.2%	0.2%
95% to 99%	-0.1%	0.4%	0.4%
99% to 100%	-0.1%	0.3%	0.3%
TOTAL	**-0.1%**	**0.2%**	**0.2%**

07. MAKE 100 PERCENT BONUS DEPRECIATION PERMANENT

GDP	+0.5%
GNP	+0.4%
Capital Stock	+0.9%
Wage Rate	+0.4%
Full-Time Equivalent Jobs	+86,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$0.0	-$9.8	-$18.1	-$25.3	-$31.5	-$37.0	-$29.5	-$24.1	-$20.3	-$17.8	-$213.4
Dynamic	$0.0	-$9.3	-$15.1	-$20.1	-$22.8	-$24.2	-$14.5	-$6.9	-$1.1	$3.8	-$110.2

The 2017 tax reform introduced temporary 100 percent bonus depreciation, allowing businesses to immediately deduct the full cost of investments in short-lived investments like machinery and equipment. Under current law, bonus depreciation is scheduled to start phasing out in 2023 until it fully expires at the end of 2026, which would increase the cost of capital for investing in the United States.

Permanence would reduce the tax code's bias against capital investment, reduce the cost of capital, and boost economic output by encouraging marginal investment. When accounting for the increase in economic activity, the 10-year cost of the policy falls to $110 billion. Higher levels of investment, productivity, and output mean that taxpayers across the income spectrum would see an increase in their after-tax income on a long-run dynamic basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.4%
20% to 40%	0.0%	0.0%	0.4%
40% to 60%	0.0%	0.0%	0.4%
60% to 80%	0.0%	0.0%	0.4%
80% to 100%	0.0%	0.1%	0.5%
80% to 90%	0.0%	0.0%	0.4%
90% to 95%	0.0%	0.1%	0.4%
95% to 99%	0.0%	0.1%	0.5%
99% to 100%	0.0%	0.3%	0.6%
TOTAL	**0.0%**	**0.1%**	**0.4%**

08. IMPLEMENT NEUTRAL COST RECOVERY FOR STRUCTURES

GDP	+1.2%
GNP	+1.0%
Capital Stock	+2.3%
Wage Rate	+1.0%
Full-Time Equivalent Jobs	+231,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$0.0	-$0.1	-$0.2	-$0.3	-$0.6	-$0.9	-$1.2	-$1.7	-$2.4	-$3.1	-$10.4
Dynamic	$5.0	$9.9	$14.7	$19.5	$27.4	$33.8	$39.4	$45.0	$50.3	$56.1	$301.0

Under current law, when a business invests in building a factory, it is not recognized as an expense on a business's tax return in the same year. Instead, the business deducts a share of its cost each year over multiple decades. Due to inflation and the time value of money, the present value of the deductions is worth less than the original investment's cost.

A neutral cost recovery system (NCRS) would adjust deductions by inflation and a real rate of return to maintain their value over time. The cost of NCRS is backloaded, so that it would only slightly reduce revenues in the first 10 years, while costing more in the out years as adjustments to deductions compound. Switching to NCRS would significantly boost the capital stock and economic output. Part of the reason for particularly strong economic growth for such a low revenue cost is that revenue costs of NCRS are higher outside the 10-year budget window. NCRS would have no effect on incomes in 2022 on a conventional basis, as the adjustments to the deductions begin in the second year. On a long run-dynamic basis, it would have a positive effect across the entire income distribution.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	< +0.05%	1.1%
20% to 40%	0.0%	< +0.05%	1.1%
40% to 60%	0.0%	< +0.05%	1.1%
60% to 80%	0.0%	< +0.05%	1.1%
80% to 100%	0.0%	< +0.05%	1.5%
80% to 90%	0.0%	< +0.05%	1.1%
90% to 95%	0.0%	< +0.05%	1.2%
95% to 99%	0.0%	< +0.05%	1.4%
99% to 100%	0.0%	0.1%	2.1%
TOTAL	**0.0%**	**< +0.05%**	**1.3%**

09. CANCEL THE AMORTIZATION OF RESEARCH AND DEVELOPMENT EXPENSES

GDP	+0.1%
GNP	+0.1%
Capital Stock	+0.2%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+20,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$38.6	-$27.5	-$18.8	-$13.5	-$7.4	-$4.5	-$4.9	-$5.1	-$5.3	-$5.6	-$131.3
Dynamic	-$38.4	-$27.1	-$18.2	-$12.8	-$6.6	-$1.5	-$1.3	-$0.9	-$0.7	-$0.4	-$107.9

Beginning in 2022, businesses will be required to switch from immediately deducting, or expensing, their costs of research and development to amortizing the costs over five years. The switch will mark the first time since 1954 that companies will not be able to deduct their full R&D costs immediately, and it will increase the cost of capital.

Canceling the amortization requirement and allowing businesses to continue expensing research and development costs would reduce the cost of capital and boost investment and economic output. The revenue effect is frontloaded, meaning it costs much more in its first years than in subsequent years. When factoring in higher levels of output from canceling the switch, taxpayers across the income spectrum would see an increase in after-tax income over the long term.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.2%	0.0%	0.1%
20% to 40%	0.1%	0.0%	0.1%
40% to 60%	0.2%	0.0%	0.1%
60% to 80%	0.2%	0.0%	0.1%
80% to 100%	0.5%	0.1%	0.1%
80% to 90%	0.2%	0.0%	0.1%
90% to 95%	0.2%	0.0%	0.1%
95% to 99%	0.4%	0.0%	0.1%
99% to 100%	1.1%	0.1%	0.2%
TOTAL	**0.4%**	**< +0.05%**	**0.1%**

10. MAKE THE SECTION 199A DEDUCTION PERMANENT

GDP	+0.2%
GNP	+0.2%
Capital Stock	+0.3%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+58,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$0.0	$0.0	$0.0	$0.0	-$64.6	-$70.5	-$72.4	-$74.6	-$76.7	-$79.9	-$438.7
Dynamic	$0.0	$0.0	$0.0	$0.0	-$59.0	-$63.6	-$64.9	-$66.2	-$67.5	-$70.0	-$391.2

The 2017 tax reform created a temporary deduction for households with income from pass-through businesses—such as partnerships, S corporations, and sole proprietorships—that is scheduled to expire after 2025. The deduction allows taxpayers to exclude up to 20 percent of their pass-through business income from federal income tax. Higher-income taxpayers face several limits to the deduction, which contribute to the complexity and non-neutrality of the deduction.

Permanence would reduce the cost of capital for the pass-through sector and boost economic output by 0.2 percent. Revenues in the latter half of the budget window would fall by $439 billion on a conventional basis and $391 billion on a dynamic basis. While the immediate benefits of permanence would flow primarily to higher-income earners, higher economic output would benefit taxpayers across the income spectrum.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.2%
20% to 40%	0.0%	0.1%	0.2%
40% to 60%	0.0%	0.1%	0.3%
60% to 80%	0.0%	0.2%	0.4%
80% to 100%	0.0%	0.6%	0.8%
80% to 90%	0.0%	0.4%	0.5%
90% to 95%	0.0%	0.7%	0.8%
95% to 99%	0.0%	1.1%	1.2%
99% to 100%	0.0%	0.5%	0.6%
TOTAL	**0.0%**	**0.4%**	**0.6%**

11. LOWER THE CORPORATE TAX RATE TO 15 PERCENT

GDP	+0.5%
GNP	+0.5%
Capital Stock	+1.0%
Wage Rate	+0.4%
Full-Time Equivalent Jobs	+101,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$66.9	-$82.6	-$91.1	-$99.1	-$100.6	-$101.7	-$105.1	-$108.0	-$110.6	-$113.2	-$978.9
Dynamic	-$66.4	-$79.2	-$85.6	-$91.1	-$89.2	-$86.4	-$87.4	-$87.6	-$87.6	-$87.4	-$847.7

The 2017 tax reform brought the statutory corporate income tax rate down from among the highest in the world at 35 percent to 21 percent, nearer the middle of the pack when factoring in state and local corporate income taxes. Economists generally find that corporate taxes are more economically harmful than other taxes because they discourage business investment, a central determinant of the long-run size of the economy.

This option would reduce the tax burden on old capital—leading to higher profits on existing investments—and on new capital—incentivizing businesses to make new investments. Additionally, it could induce corporations to report more of their earnings in the United States by making it less profitable to shift earnings abroad. While initially the benefits would flow to higher-income taxpayers, in the long run we estimate the benefit is split between workers and shareholders.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.4%	0.5%	1.2%
20% to 40%	0.3%	0.4%	1.0%
40% to 60%	0.4%	0.4%	1.1%
60% to 80%	0.4%	0.5%	1.1%
80% to 100%	0.7%	0.9%	1.7%
80% to 90%	0.4%	0.5%	1.1%
90% to 95%	0.5%	0.6%	1.2%
95% to 99%	0.7%	0.8%	1.6%
99% to 100%	1.3%	1.6%	2.6%
TOTAL	**0.6%**	**0.7%**	**1.4%**

12. LOWER THE ESTATE TAX RATE TO 30 PERCENT

GDP	< +0.05%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+7,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$0.8	-$5.6	-$5.9	-$6.2	-$6.4	-$9.5	-$10.6	-$11.4	-$12.3	-$13.4	-$81.9
Dynamic	-$0.8	-$5.5	-$5.8	-$6.0	-$6.2	-$9.2	-$10.2	-$11.0	-$11.8	-$12.9	-$79.5

In 2021, the federal estate tax exemption is $11.7 million (doubled for married filers, both indexed to inflation) and will drop by half beginning in 2026. One way to reduce estate tax burdens would be to reduce the tax rate estates face. Under current law, the top marginal rate on estates is 40 percent. This option would reduce it to 30 percent.

This option would reduce federal revenue from the estate tax by $82 billion over 10 years, on a conventional basis. In the first year, the revenue effect is lower because we assume estate tax returns for those who died in year one will only account for a limited amount of total estate returns filed in year one. The change would only apply to a small portion of tax filers who end up having estate tax liability. The positive economic effect from this option is mainly seen in higher GNP, as American saving and incomes would increase. The change in after-tax income is larger in 2031 than in 2022 due to the expiration of the 2017 tax law's higher estate tax exemption. The estate tax only applies to deceased individuals with more than $11.7 million in assets (the exemption is scheduled to shrink by half in 2026), and as such we assume most of the tax cut would flow to high-income households, as we have insufficient data on heirs.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	< +0.05%
20% to 40%	0.0%	0.0%	< +0.05%
40% to 60%	0.0%	0.0%	< +0.05%
60% to 80%	0.0%	0.0%	< +0.05%
80% to 100%	0.0%	0.2%	0.2%
80% to 90%	0.0%	0.0%	< +0.05%
90% to 95%	0.0%	0.0%	< +0.05%
95% to 99%	0.0%	0.0%	< +0.05%
99% to 100%	0.1%	0.8%	0.8%
TOTAL	**0.0%**	**0.1%**	**0.1%**

13. REPEAL ALL SECTION 232, 201, AND 301 TARIFFS

GDP	+0.1%
GNP	+0.2%
Capital Stock	+0.1%
Wage Rate	+0.5%
Full-Time Equivalent Jobs	+83,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$79.5	-$79.1	-$78.7	-$78.0	-$76.3	-$74.9	-$74.3	-$73.5	-$72.8	-$71.8	-$759.0
Dynamic	-$72.2	-$71.2	-$70.1	-$69.5	-$67.2	-$65.1	-$64.1	-$63.0	-$61.8	-$60.3	-$664.9

In 2018, President Trump imposed a variety of tariffs on U.S. imports ranging from steel and aluminum, washers and solar panels, Chinese goods, and various imports of EU products. The largest section of tariffs was on Chinese goods, ranging from 10 percent to 25 percent on approximately $475 billion worth of Chinese goods.

Tariffs are equivalent to an excise tax on certain goods. Repealing all the newly imposed tariffs would reduce federal revenues by $759 billion over the next 10 years. However, as tariffs increase the costs of imports to both consumers and producers, repealing them would increase long-run GDP by 0.1 percent. After accounting for macroeconomic effects, revenues would only fall by about $665 billion.

On a distributional basis, all income quintiles would be impacted, but the bottom quintile would experience the largest change in after-tax income from repealing the tariffs, as their incomes would rise by 0.4 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.3%	0.3%	0.4%
20% to 40%	0.3%	0.3%	0.4%
40% to 60%	0.3%	0.3%	0.4%
60% to 80%	0.3%	0.3%	0.4%
80% to 100%	0.3%	0.3%	0.3%
80% to 90%	0.3%	0.3%	0.4%
90% to 95%	0.3%	0.3%	0.4%
95% to 99%	0.3%	0.3%	0.4%
99% to 100%	0.2%	0.3%	0.3%
TOTAL	**0.3%**	**0.3%**	**0.4%**

CHAPTER 2

OPTIONS FOR REDUCING THE DEFICIT

INTRODUCTION

Prior to the pandemic-induced recession, the federal budget faced structural deficits that would become unsustainable over the long term. The fiscal response to the pandemic and recession drastically increased the budget deficit in 2020 and 2021. Even after the fiscal response and short-term effects of the pandemic fade, spending growth is set to well outpace revenue growth due to structural deficits driven by demographics, entitlement spending, and interest costs.

While the nascent recovery is not the appropriate time to engage in deficit-reduction efforts, particularly given that low interest rates imply ample room for a continuing fiscal policy response, lawmakers will eventually turn their attention toward addressing deficits.

It will be important that if, or more likely when, lawmakers look for ways to raise tax revenues, they keep in mind that tax increases come with trade-offs in terms of effects on economic output and revenue-raising potential.

Once the public health threat is mitigated and the economy has recovered, considering such trade-offs will help lawmakers avoid tax increases that would cause undue harm to the economy by reducing incentives to work and invest. In general, taxes on more mobile factors of production, such as capital, cause more distortions to economic incentives than taxes on less mobile factors, such as labor.

This chapter compares 37 changes to federal taxes on individual income, business income, payroll, select sales (excises), and estates and gifts.

14. RAISE INDIVIDUAL INCOME TAX RATES BY 10 PERCENT

GDP	-0.9%
GNP	-1.0%
Capital Stock	-1.0%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-961,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$171.9	$180.7	$187.6	$198.0	$194.5	$214.6	$223.9	$233.4	$242.8	$256.4	$2,103.8
Dynamic	$131.3	$136.6	$141.3	$149.5	$136.2	$151.2	$157.1	$163.4	$169.4	$179.0	$1,515.0

Under this option, all seven individual income tax rates would increase by 10 percent. Under the current baseline, the top marginal rate would rise from 37 percent to 40.7 percent through 2025, and from 39.6 percent to 43.7 percent when the 2017 tax reform expires after 2025.

On a conventional basis, this change would increase federal revenue over a 10-year period by $2.1 trillion. It would reduce the supply of labor and increase the cost of capital for businesses that pay the individual income tax, leading to a 0.9 percent decrease in long-run GDP and 961,000 fewer full-time equivalent jobs. After considering the economic effects, it would increase federal revenue by $1.5 trillion over a 10-year period.

On a conventional basis, the tax increase would primarily affect the top four quintiles because many lower-income households use the standard deduction to reduce their taxable income to zero. On a dynamic basis, after-tax income would drop for every group.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.7%
20% to 40%	-0.2%	< -0.05%	-0.8%
40% to 60%	-0.6%	-0.4%	-1.1%
60% to 80%	-0.9%	-0.8%	-1.4%
80% to 100%	-1.8%	-1.9%	-2.6%
80% to 90%	-1.2%	-1.1%	-1.9%
90% to 95%	-1.4%	-1.4%	-2.1%
95% to 99%	-1.8%	-2.0%	-2.6%
99% to 100%	-2.8%	-3.0%	-3.7%
TOTAL	**-1.3%**	**-1.3%**	**-2.0%**

15. REPEAL THE 2017 TAX LAW INDIVIDUAL TAX CHANGES

GDP	0.0%
GNP	0.0%
Capital Stock	0.0%
Wage Rate	0.0%
Full-Time Equivalent Jobs	0

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$195.6	$204.1	$210.4	$219.6	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$829.7
Dynamic	$153.3	$159.8	$164.3	$171.4	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$648.8

The 2017 tax reform made significant changes to the individual income tax, but most of the changes are temporary and will expire after 2025. Under this option, the following reforms would immediately revert to their pre-law levels: income tax rate brackets; modified standard deduction, personal exemption, and child tax credit; 20 percent deduction for qualified business income; changes to deductions for state and local taxes, home mortgage interest, and certain other deductions; and changes to the alternative minimum tax.

This option does not affect long-term conditions as it does not deviate from long-term law. In years which the provisions would otherwise be in effect, this option would increase revenue and decrease after-tax incomes.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.9%	0.0%	0.0%
20% to 40%	-1.5%	0.0%	0.0%
40% to 60%	-1.4%	0.0%	0.0%
60% to 80%	-1.5%	0.0%	0.0%
80% to 100%	-1.6%	0.0%	0.0%
80% to 90%	-1.5%	0.0%	0.0%
90% to 95%	-1.5%	0.0%	0.0%
95% to 99%	-2.8%	0.0%	0.0%
99% to 100%	-0.8%	0.0%	0.0%
TOTAL	**-1.6%**	**0.0%**	**0.0%**

16. REVERT TO PRE-2018 INDIVIDUAL INCOME TAX RATES ON INCOME OVER $400,000

GDP	0.0%
GNP	0.0%
Capital Stock	0.0%
Wage Rate	0.0%
Full-Time Equivalent Jobs	0

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$25.1	$26.4	$27.1	$28.7	$0	$0	$0	$0	$0	$0	$107.3
Dynamic	$20.3	$21.1	$21.4	$22.6	$0	$0	$0	$0	$0	$0	$85.4

This option would raise individual income tax rates for those earning over $400,000 in taxable income to rates that prevailed prior to the 2017 tax reform, i.e., the 33 percent, 35 percent, and 39.6 percent tax brackets. This would be a tax increase from 2022 to 2025, until conforming with current law tax rates from 2026 to 2031.

This tax change would reduce after-tax incomes for higher earners while raising about $107 billion over 10 years. From 2022 to 2025, it would raise the marginal tax rate on labor, slightly reducing labor supply among high-income taxpayers. This would also reduce revenue collected over those years on a dynamic basis by reducing individual income tax revenue. The long-run economic effect is zero because the option changes the timing of the expiration of the 2017 tax law's rate reductions, and long-run tax rates remains the same as under current law.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.0%
20% to 40%	0.0%	0.0%	0.0%
40% to 60%	0.0%	0.0%	0.0%
60% to 80%	0.0%	0.0%	0.0%
80% to 100%	-0.3%	0.0%	0.0%
80% to 90%	0.0%	0.0%	0.0%
90% to 95%	0.0%	0.0%	0.0%
95% to 99%	-0.1%	0.0%	0.0%
99% to 100%	-1.2%	0.0%	0.0%
TOTAL	**-0.2%**	**0.0%**	**0.0%**

17. ADD A NEW 45% TAX BRACKET FOR INCOME ABOVE $750,000

GDP	-0.2%
GNP	-0.2%
Capital Stock	-0.3%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-166,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$60.6	$63.9	$71.6	$69.9	$44.5	$48.8	$50.9	$53.0	$55.1	$58.2	$576.2
Dynamic	$49.1	$51.0	$56.2	$54.8	$33.6	$36.5	$37.9	$39.1	$40.4	$42.5	$441.1

This option would add a new 45% tax bracket for income above $750,000. On a conventional basis, this change would increase federal revenue over a 10-year period by $576 billion.

A new, higher bracket would make the tax code more progressive, but would discourage labor supply among high-income individuals and increase the cost of capital for businesses that pay the individual income tax. This would reduce long-run GDP by 0.2 percent and cost 166,000 full-time equivalent jobs. After considering the effects on the economy, this change would increase federal revenue by $441 billion over a 10-year period.

On a conventional basis, this option reduces the after-tax incomes of the top quintile by 0.8 percent in 2022. On a dynamic basis, after-tax incomes would drop by a small amount for all quintiles.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.2%
20% to 40%	0.0%	0.0%	-0.2%
40% to 60%	0.0%	0.0%	-0.2%
60% to 80%	0.0%	0.0%	-0.2%
80% to 100%	-0.8%	-0.5%	-0.7%
80% to 90%	0.0%	0.0%	-0.2%
90% to 95%	0.0%	0.0%	-0.2%
95% to 99%	0.01%	0.0%	-0.2%
99% to 100%	-3.0%	-1.9%	-2.1%
TOTAL	**-0.5%**	**-0.3%**	**-0.5%**

18. CREATE AN ADDITIONAL FLAT INDIVIDUAL INCOME TAX OF 5%

GDP	-2.1%
GNP	-2.3%
Capital Stock	-2.3%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-2.2 million

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$538.5	$565.5	$585.8	$617.1	$598.0	$657.5	$684.6	$713.4	$741.8	$782.8	$6,485.0
Dynamic	$427.6	$445.6	$460.5	$485.1	$455.9	$503.7	$523.0	$544.2	$565.1	$596.52	$5,007.2

This option would introduce an additional individual income tax of 5 percent, which would apply to all taxable income.

As the tax would apply to a broad base of income, including income that has already been taxed, it would generate nearly $6.5 trillion in revenue on a conventional basis, but have an outsized negative impact on long-term GDP. After accounting for the 2.1 percent reduction in economic output, the option would raise $5 trillion over the budget window.

On a conventional basis, the bottom quintile would only see a small decrease in after-tax income because the tax would be largely offset by tax credits. All income quintiles would experience declines in their income on a dynamic basis, due to the broad base of the tax.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	< -0.05%	-0.1%	-1.7%
20% to 40%	-1.2%	-1.2%	-2.8%
40% to 60%	-2.9%	-2.8%	-4.4%
60% to 80%	-3.8%	-3.6%	-5.1%
80% to 100%	-5.1%	-4.9%	-6.4%
80% to 90%	-4.3%	-4.1%	-5.6%
90% to 95%	-4.6%	-4.4%	-5.9%
95% to 99%	-5.0%	-5.0%	-6.4%
99% to 100%	-6.4%	-6.2%	-7.6%
TOTAL	**-4.1%**	**-4.0%**	**-5.5%**

19. ELIMINATE THE CHILD TAX CREDIT (CTC)

GDP	+0.1%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	0.0%
Full-Time Equivalent Jobs	+100,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$131.0	$133.4	$134.7	$138.1	$58.5	$59.9	$59.5	$59.0	$58.4	$58.3	$890.7
Dynamic	$127.7	$130.0	$131.3	$134.7	$64.3	$66.1	$66.0	$65.9	$65.4	$65.8	$917.2

This option would eliminate the CTC. It provides $2,000 for each qualifying child under age 17 ($1,000 after 2025), reduced by $50 for every $1,000 of adjusted gross income above $200,000 for single parents and $400,000 for married jointly filing couples ($75,000 and $110,000 after 2025). Families that owe little to no income tax can get refundable credits of up to $1,400 per child ($1,000 after 2025). The refundable portion of the credit, also called the additional child tax credit (ACTC), phases in at 15 percent of earned income above $2,500 ($3,000 after 2025).

The credit incentivizes work along the phase-in and disincentivizes work along the phaseout because it changes marginal tax rates. Eliminating the credit would have nearly offsetting economic effects along the two margins. The option would raise more revenue in early years when the credit is scheduled to be larger. Lower-income households would see a substantial decrease in their after-tax income.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-4.3%	-3.2%	-3.1%
20% to 40%	-4.1%	-1.9%	-1.8%
40% to 60%	-2.2%	-0.9%	-0.8%
60% to 80%	-1.2%	-0.2%	-0.2%
80% to 100%	-0.4%	0.0%	0.1%
80% to 90%	-0.7%	0.0%	0.1%
90% to 95%	-0.5%	0.0%	0.1%
95% to 99%	-0.2%	0.0%	0.1%
99% to 100%	0.0%	0.0%	0.1%
TOTAL	**-1.2%**	**-0.4%**	**-0.4%**

20. REDUCE THE CTC TO $500

GDP	< +0.05%
GNP	< +0.05%
Capital Stock	< +0.05%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+44,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$100.9	$102.7	$103.6	$106.1	$29.6	$30.4	$30.2	$30.1	$29.9	$29.9	$593.4
Dynamic	$97.6	$99.2	$100.1	$102.7	$30.4	$31.2	$31.2	$31.1	$30.9	$30.9	$585.2

This option would reduce the CTC to $500. Currently, it provides $2,000 for each qualifying child under age 17 ($1,000 after 2025), reduced by $50 for every $1,000 of adjusted gross income above $200,000 for single parents and $400,000 for married jointly filing couples ($75,000 and $110,000 after 2025). Families that owe little to no income tax can get refundable credits of up to $1,400 per child ($1,000 after 2025). The refundable portion of the credit, also called the additional child tax credit (ACTC), phases in at 15 percent of earned income above $2,500 ($3,000 after 2025).

This option would reduce taxpayer exposure to both the phase-in and the phaseout ranges of the credit, reducing both the positive and negative work incentives from changing marginal tax rates. After-tax incomes would drop primarily for lower- and middle-income filers.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-4.2%	-1.4%	-1.4%
20% to 40%	-3.3%	-1.0%	-1.0%
40% to 60%	-1.6%	-0.5%	-0.5%
60% to 80%	-0.9%	-0.2%	-0.2%
80% to 100%	-0.3%	0.0%	0.0%
80% to 90%	-0.5%	0.0%	0.0%
90% to 95%	-0.4%	0.0%	0.0%
95% to 99%	-0.2%	0.0%	0.0%
99% to 100%	0.0%	0.0%	0.0%
TOTAL	**-1.0%**	**-0.2%**	**-0.2%**

21. ELIMINATE THE EARNED INCOME TAX CREDIT (EITC)

GDP	+0.2%
GNP	+0.3%
Capital Stock	+0.3%
Wage Rate	+0.0%
Full-Time Equivalent Jobs	+273,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$51.4	$51.9	$52.5	$52.6	$65.0	$65.7	$66.2	$66.9	$67.5	$68.0	$607.8
Dynamic	$64.0	$65.5	$66.5	$67.2	$81.0	$83.0	$84.3	$85.7	$87.1	$88.6	$773.0

The EITC is a targeted subsidy for low-income working families. The value of the EITC is a fixed percentage of a household's earned income until the credit reaches its maximum. The EITC stays at its maximum value as a household's earned income continues to increase, until earnings reach a phaseout threshold, above which the credit drops by a fixed percentage for each additional dollar of income over the phaseout threshold. The EITC is a fully refundable credit. The EITC's rates and thresholds depend on a household's filing status and number of qualifying children.

Eliminating the EITC would increase federal revenue by $608 billion over the next decade, on a conventional basis. Elimination would reduce work incentives for certain low-income workers over the phase-in range but increase incentives for others as they would no longer face higher marginal tax rates as the credit phases out. Consequently, the long-run effect on GDP would be positive at 0.2 percent. On a dynamic basis, this option would reduce the after-tax income of the bottom quintile by 10.5 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-10.6%	-10.7%	-10.5%
20% to 40%	-3.9%	-3.9%	-3.7%
40% to 60%	-0.1%	-0.1%	0.1%
60% to 80%	0.0%	0.0%	0.2%
80% to 100%	0.0%	0.0%	0.2%
80% to 90%	0.0%	0.0%	0.2%
90% to 95%	0.0%	0.0%	0.2%
95% to 99%	0.0%	0.0%	0.2%
99% to 100%	0.0%	0.0%	0.2%
TOTAL	**-0.7%**	**-0.7%**	**-0.5%**

22. ELIMINATE THE FEDERAL INCOME TAX DEDUCTION FOR STATE AND LOCAL TAXES

GDP	-0.7%
GNP	-0.6%
Capital Stock	-1.3%
Wage Rate	-0.3%
Full-Time Equivalent Jobs	-492,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$32.5	$33.5	$34.1	$35.4	$204.0	$224.7	$234.2	$243.9	$253.5	$267.7	$1,563.6
Dynamic	$28.3	$28.4	$28.4	$29.0	$169.4	$185.9	$192.4	$199.2	$205.7	$216.4	$1,283.2

The deduction for state and local tax (SALT) is one of the largest itemized deductions. Taxpayers who choose to itemize can reduce their taxable incomes by the amount they paid in certain state and local taxes, i.e., property taxes and either income or sales taxes. The 2017 tax law capped the total amount of state and local taxes that can be deducted from taxable income at $10,000 between 2018 and 2025.

This option eliminates entirely the SALT deduction starting in 2022, which raises marginal tax rates on filers that itemize, reducing economic output by 0.7 percent in the long run. It would primarily reduce the after-tax incomes of higher-income earners, reducing after-tax income for the top 1 percent by 3.4 percent in the long run.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.6%
20% to 40%	< -0.05%	-0.1%	-0.6%
40% to 60%	< -0.05%	-0.2%	-0.8%
60% to 80%	-0.2%	-0.6%	-1.1%
80% to 100%	-0.4%	-2.2%	-2.7%
80% to 90%	-0.3%	-1.3%	-1.8%
90% to 95%	-0.5%	-1.8%	-2.3%
95% to 99%	-0.5%	-2.6%	-3.1%
99% to 100%	-0.2%	-2.9%	-3.4%
TOTAL	**-0.3%**	**-1.4%**	**-1.9%**

23. LOWER THE HOME MORTGAGE INTEREST DEDUCTION CAP TO $500,000 IN PRINCIPAL

GDP	-0.1%
GNP	< -0.05%
Capital Stock	-0.2%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-30,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$7.4	$7.9	$8.5	$9.1	$15.1	$17.1	$18.4	$19.8	$21.2	$23.0	$147.5
Dynamic	$7.2	$7.6	$8.1	$8.7	$14.4	$16.3	$17.4	$16.5	$17.4	$18.7	$132.2

The home mortgage interest deduction allows taxpayers who itemize their deductions to deduct interest paid on their home mortgage from their taxable incomes. Under current law, taxpayers who itemize can deduct interest paid on their mortgage up to $750,000 worth of principal. This cap on mortgage principal was reduced from $1 million after the 2017 tax law. The $750,000 cap will sunset after 2025 and revert to pre-TCJA levels. This option will instead reduce this cap to $500,000 of home mortgage debt beginning in 2022.

This option would raise $147.5 billion over 10 years on a conventional basis. It would reduce long-term GDP by about 0.1 percent because it would push more taxpayers into higher brackets by raising taxable income, thus raising the marginal tax rate on labor, and it would increase the cost of capital for the homeowner-occupied housing sector. As higher-income households are the most likely to itemize, they would be the most impacted by this option on a distributional basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.1%
20% to 40%	0.0%	0.0%	-0.1%
40% to 60%	0.0%	0.0%	-0.1%
60% to 80%	0.0%	0.0%	-0.1%
80% to 100%	-0.1%	-0.2%	-0.3%
80% to 90%	0.0%	-0.1%	-0.2%
90% to 95%	-0.1%	-0.2%	-0.3%
95% to 99%	-0.2%	-0.3%	-0.4%
99% to 100%	-0.1%	-0.2%	-0.2%
TOTAL	**-0.1%**	**-0.1%**	**-0.2%**

24. ELIMINATE THE HOME MORTGAGE INTEREST DEDUCTION

GDP	-0.7%
GNP	-0.5%
Capital Stock	-1.9%
Wage Rate	-0.4%
Full-Time Equivalent Jobs	-367,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$43.2	$44.7	$45.6	$47.5	$128.1	$140.8	$146.6	$152.4	$158.1	$166.6	$1,073.5
Dynamic	$38.1	$38.1	$37.8	$38.4	$101.3	$110.1	$112.7	$115.4	$118.0	$123.0	$832.8

The mortgage interest deduction is an itemized deduction for interest paid on home mortgages. It is limited to interest paid on the first $750,000 ($1 million after 2025) in principal value of a home and it is limited indirectly by the expansion of the standard deduction, which is scheduled to revert to a smaller level after 2025.

Eliminating the deduction would raise taxes on debt-financed, owner-occupied housing, and in some cases result in a double tax on such capital investment. It would also increase marginal tax rates on labor by pushing households into higher tax brackets. Higher taxes on capital and labor would reduce economic output and the smaller economy would offset some of the revenue raised by eliminating the deduction. As higher-income households are the most likely to itemize, they would be the most impacted by this option on a distributional basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.6%
20% to 40%	< -0.05%	-0.1%	-0.7%
40% to 60%	-0.1%	-0.3%	-0.9%
60% to 80%	-0.2%	-0.7%	-1.3%
80% to 100%	-0.6%	-1.3%	-1.8%
80% to 90%	-0.5%	-1.3%	-1.9%
90% to 95%	-0.7%	-1.7%	-2.2%
95% to 99%	-0.8%	-1.7%	-2.2%
99% to 100%	-0.4%	-0.6%	-1.1%
TOTAL	**-0.4%**	**-0.9%**	**-1.5%**

25. ELIMINATE THE CHARITABLE DEDUCTION

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.2%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-90,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$44.7	$46.7	$48.3	$51.0	$79.6	$87.7	$91.3	$95.1	$98.8	$104.4	$747.4
Dynamic	$42.5	$44.1	$45.4	$47.8	$73.8	$81.2	$84.4	$87.9	$91.2	$96.2	$694.5

Under current law, taxpayers may deduct their charitable contributions from their taxable income if they itemize their deductions. The 2017 tax reform allows taxpayers to deduct up to 60 percent of their adjusted gross income in charitable contributions, up from 50 percent previously. Due to the large expansion of the standard deduction in the 2017 tax reform, fewer taxpayers overall itemize and thus most do not use the charitable deduction.

Repealing the charitable interest deduction would raise $747 billion on a conventional basis over the next 10 years. The option would raise more revenue starting in 2026, as the expiration of the 2017 tax reform would lead more taxpayers to itemize. It would reduce GDP by 0.1 percent because of higher marginal tax rates. As high-income taxpayers itemize disproportionately, it would primarily impact them, causing after-tax income of the top 1 percent to drop by 1.4 percent on a dynamic basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	-0.1%
20% to 40%	< -0.05%	< -0.05%	-0.1%
40% to 60%	< -0.05%	-0.1%	-0.2%
60% to 80%	-0.1%	-0.2%	-0.3%
80% to 100%	-0.6%	-0.8%	-0.9%
80% to 90%	-0.2%	-0.5%	-0.6%
90% to 95%	-0.3%	-0.6%	-0.7%
95% to 99%	-0.5%	-0.8%	-0.9%
99% to 100%	-1.2%	-1.4%	-1.4%
TOTAL	**-0.3%**	**-0.5%**	**-0.6%**

26. LIMIT TAX SAVINGS FROM ITEMIZED DEDUCTIONS TO 28 PERCENT OF VALUE

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.1%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-64,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$11.7	$12.3	$12.8	$13.5	$23.3	$25.6	$26.6	$27.8	$28.9	$30.6	$213.0
Dynamic	$11.3	$11.8	$12.2	$12.8	$19.6	$21.5	$22.3	$23.2	$24.1	$25.4	$184.2

Tax deductions reduce households' taxable incomes. The tax saving that a deduction generates depends on the top marginal rate at which a household is taxed. For example, if the household is in the 37 percent tax bracket, a $1 deduction would reduce tax liability by 37 cents. This option would cap the tax savings from itemized deductions to no more than 28 percent.

This option would increase federal revenue by $213 billion over 10 years, on a conventional basis. The limitation would subject some households in the top three brackets to higher marginal tax rates and would reduce their willingness to work and invest. As a result, the economy would shrink by around 0.1 percent. High-income households would primarily be affected, and after-tax incomes would drop more in 2031 than in 2022 due to scheduled changes in the tax code from the 2017 tax law.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.1%
20% to 40%	0.0%	0.0%	-0.1%
40% to 60%	0.0%	0.0%	-0.1%
60% to 80%	0.0%	0.0%	-0.1%
80% to 100%	-0.2%	-0.3%	-0.4%
80% to 90%	0.0%	0.0%	-0.1%
90% to 95%	0.0%	0.0%	-0.1%
95% to 99%	-0.1%	0.0%	-0.1%
99% to 100%	-0.5%	-1.0%	-1.1%
TOTAL	**-0.1%**	**-0.2%**	**-0.2%**

27. ELIMINATE THE TAX EXCLUSION FOR MUNICIPAL BOND INTEREST

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-11,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$2.0	$6.1	$10.2	$13.9	$18.0	$21.9	$25.3	$28.7	$31.9	$35.0	$192.8
Dynamic	$2.0	$6.1	$10.1	$13.8	$17.9	$21.8	$25.2	$28.5	$31.7	$34.8	$191.8

The tax exclusion of municipal bond interest was designed so that investors would accept lower interest returns on tax-exempt bonds, to reduce borrowing costs for state and local governments and incentivize them to invest in public educational facilities and transportation infrastructure. As owners of municipal bonds, some people in high tax brackets and some corporations benefit from the tax exemption of municipal bond interest income.

Eliminating the exemption for municipal bond interest for new bond purchases would increase federal revenue by about $193 billion over the next 10 years. Some taxpayers would be pushed into higher tax brackets, resulting in a slight increase in marginal tax rates and decrease in GDP. The effect would be primarily felt by taxpayers in the top quintile.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	< -0.05%	< -0.05%	< -0.05%
20% to 40%	< -0.05%	< -0.05%	< -0.05%
40% to 60%	< -0.05%	< -0.05%	< -0.05%
60% to 80%	< -0.05%	< -0.05%	< -0.05%
80% to 100%	< -0.05%	-0.3%	-0.3%
80% to 90%	< -0.05%	-0.1%	-0.1%
90% to 95%	< -0.05%	-0.1%	-0.2%
95% to 99%	< -0.05%	-0.3%	-0.3%
99% to 100%	-0.1%	-0.5%	-0.6%
TOTAL	**< -0.05%**	**-0.2%**	**-0.2%**

28. TAX CARRIED INTEREST AS ORDINARY INCOME

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-9,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$1.6	$1.7	$1.7	$1.8	$2.0	$2.1	$2.2	$2.3	$2.4	$2.5	$20.3
Dynamic	$1.5	$1.5	$1.6	$1.7	$1.8	$2.0	$2.0	$2.1	$2.2	$2.3	$18.5

Investment managers at private equity firms and hedge funds are often compensated according to a "two and twenty" arrangement: they are automatically paid 2 percent of all assets invested and earn an additional 20 percent of additional profits they bring in ("carried interest"). The proper taxation of carried interest depends on whether it should be treated as labor income or capital income. Under current law, it is treated as capital income and receives the same preferential treatment as long-term capital gains if an investment fund holds assets for more than three years.

This option would tax carried interest as ordinary income, which would raise $20 billion over the next decade, on a conventional basis. As carried interest represents a narrow portion of all employee compensation, the economic impact would be small. On both a static and dynamic basis, the negative effects on after-tax income would fall on taxpayers in the top quintile.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	0%
20% to 40%	0%	0%	0%
40% to 60%	0%	0%	0%
60% to 80%	0%	0%	0%
80% to 100%	< -0.05%	< -0.05%	< -0.05%
80% to 90%	0%	0%	0%
90% to 95%	0%	0%	0%
95% to 99%	0%	0%	0%
99% to 100%	-0.1%	-0.1%	-0.1%
TOTAL	**< -0.05%**	**< -0.05%**	**< -0.05%**

29. RAISE THE TOP CAPITAL GAINS AND DIVIDEND TAX RATE TO 30 PERCENT

GDP	< -0.05%
GNP	-0.1%
Capital Stock	-0.1%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-10,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$4.8	$5.2	$5.3	$5.8	$6.5	$7.3	$7.5	$7.9	$8.2	$8.6	$67.0
Dynamic	$4.6	$4.9	$5.0	$5.3	$6.1	$6.7	$6.9	$7.2	$7.4	$7.9	$61.8

Under the current U.S. tax code, long-term capital gains and qualified dividends are taxed at a top rate of 20 percent (in addition to the 3.8 percent Net Investment Income Tax). Lower rates on long-term capital gains and qualified dividends offset some of the double taxation of corporate income and savings.

Raising the tax rate on long-term capital gains and qualified dividends to 30 percent would discourage saving and investment and exacerbate the existing bias toward debt-financed investment over equity-financed investment. A higher capital gains rate would shrink domestic incomes more than it would reduce domestic output as it would encourage foreign investment over investment by U.S. residents. Taxpayers would realize fewer gains, reducing the revenue raised by the tax increase. Accounting for the economic effects, after-tax incomes would drop across the income scale.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	< -0.05%
20% to 40%	0%	0%	< -0.05%
40% to 60%	0%	0%	-0.1%
60% to 80%	0%	0%	< -0.05%
80% to 100%	-0.1%	-0.1%	-0.1%
80% to 90%	0%	0%	< -0.05%
90% to 95%	0%	0%	< -0.05%
95% to 99%	0%	< -0.05%	-0.1%
99% to 100%	-0.2%	-0.3%	-0.3%
TOTAL	**-0.1%**	**< -0.05%**	**-0.1%**

30. RAISE TOP CAPITAL GAINS RATE TO 39.6 PERCENT ON INCOME OVER $1 MILLION

GDP	-0.1%
GNP	-0.2%
Capital Stock	-0.1%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-15,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$10.1	-$9.9	-$9.5	-$9.5	-$13.4	-$13.9	-$13.7	-$14.1	-$14.3	-$14.9	-$123.5
Dynamic	-$10.4	-$10.3	-$10.1	-$10.1	-$14.1	-$14.6	-$14.5	-$15.1	-$15.4	-$18.5	-$132.9

Under the current tax code, long-term capital gains and qualified dividends are taxed at lower rates than ordinary income (which includes wages, interest, and most other sources of income). This option would raise the long-term capital gains and qualified dividends tax rate to 39.6 percent for income earned over $1 million, up from a top rate of 20 percent under current law.

This tax increase would raise the service price of capital and reduce the after-tax return to saving. It would reduce domestic incomes (GNP) to a greater extent than domestic output (GDP) by encouraging foreign investment in the United States over investment by residents in the United States. Taxpayers would realize fewer gains to such an extent that revenue would decrease by $123 billion on a conventional basis and by $133 billion after accounting for a smaller economy. After-tax incomes would increase for the top 1 percent and on a dynamic basis, after-tax incomes would drop for each quintile overall.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	-0.1%
20% to 40%	0%	0%	-0.1%
40% to 60%	0%	0%	-0.1%
60% to 80%	0%	0%	-0.1%
80% to 100%	+0.1%	+0.1%	-0.1%
80% to 90%	0%	0%	-0.1%
90% to 95%	0%	0%	-0.1%
95% to 99%	0%	0%	-0.1%
99% to 100%	+0.5%	+0.5%	+0.5%
TOTAL	**+0.1%**	**+0.1%**	**< +0.05%**

31. ELIMINATE THE EXCLUSION OF CAPITAL GAINS ON A PRINCIPAL RESIDENCE

GDP	-0.3%
GNP	-0.2%
Capital Stock	-0.4%
Wage Rate	-0.3%
Full-Time Equivalent Jobs	-65,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$50.3	$52.6	$55.1	$57.7	$64.8	$70.0	$73.1	$76.2	$79.4	$82.7	$661.9
Dynamic	$50.1	$50.2	$54.3	$55.0	$60.8	$64.1	$67.2	$69.5	$71.9	$74.2	$617.3

A taxpayer who sells an asset is typically required to pay capital gains taxes on the profit from the sale. However, the Taxpayer Relief Act of 1997 created an exception for taxpayers who sell homes that they have owned and lived in for at least two years, excluding up to $250,000 (for single homeowners) or $500,000 (for married homeowners) of the gains from tax.

Repealing the exclusion would raise the cost of capital in the housing sector by subjecting a significant portion of investment returns to additional taxation, reducing long-run GDP by 0.3 percent. It would have the largest impact on high-income taxpayers, as most homeowners in the United States face no capital gains taxes on their home sales.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	-0.3%
20% to 40%	-0.1%	-0.1%	-0.4%
40% to 60%	-0.1%	-0.1%	-0.5%
60% to 80%	-0.3%	-0.3%	-0.6%
80% to 100%	-0.5%	-0.6%	-0.9%
80% to 90%	-0.4%	-0.5%	-0.8%
90% to 95%	-0.5%	-0.7%	-0.9%
95% to 99%	-0.7%	-0.8%	-1.1%
99% to 100%	-0.5%	-0.5%	-0.8%
TOTAL	**-0.4%**	**-0.4%**	**-0.7%**

32. INSTITUTE A WEALTH TAX

GDP	-0.8%
GNP	-1.5%
Capital Stock	-2.0%
Wage Rate	-0.7%
Full-Time Equivalent Jobs	-149,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$205.9	$208.6	$211.4	$214.5	$217.7	$220.8	$224.0	$227.2	$230.5	$233.7	$2,194.4
Dynamic	$203.0	$202.0	$200.7	$199.1	$197.0	$193.8	$190.7	$187.3	$183.6	$179.0	$1,936.4

Wealth taxes are imposed on the market value of total assets minus the market value of total liabilities owned by households on an annual basis. This option models Sen. Elizabeth Warren's 2020 presidential campaign proposal: a 2 percent tax rate on every dollar of net wealth between $50 million and $1 billion, and a 6 percent tax rate on net wealth over $1 billion.

We estimate the proposal would raise nearly $2.2 trillion during the next decade on a dynamic basis. It would reduce the after-tax return to saving, ultimately reducing American incomes by 1.5 percent. It would shrink American output by 0.8 percent in the long run due to a decrease in investment, especially in the pass-through business and homeowner-occupied housing sectors that are more dependent on domestic saving. On a dynamic basis, after-tax incomes would drop across the income scale but most severely for the top 1 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.6%
20% to 40%	0.0%	0.0%	-0.7%
40% to 60%	0.0%	0.0%	-0.6%
60% to 80%	0.0%	0.0%	-0.6%
80% to 100%	-3.8%	-3.7%	-3.4%
80% to 90%	0.0%	0.0%	-0.6%
90% to 95%	0.0%	0.0%	-0.6%
95% to 99%	0.0%	0.0%	-0.6%
99% to 100%	-13.8%	-13.5%	-11.0%
TOTAL	**-2.1%**	**-2.0%**	**-2.2%**

33. INCREASE EMPLOYER- AND EMPLOYEE-SIDE PAYROLL TAX BY 1 PERCENTAGE-POINT SPLIT

GDP	-0.2%
GNP	-0.2%
Capital Stock	-0.2%
Wage Rate	0.0%
Full-Time Equivalent Jobs	-180,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$52.2	$60.4	$62.5	$64.2	$67.0	$68.5	$70.9	$73.3	$75.7	$78.0	$672.7
Dynamic	$44.0	$51.4	$53.2	$54.4	$56.4	$57.1	$58.9	$61.0	$62.7	$64.3	$563.4

This option would increase both the employee and employer Social Security payroll tax from 6.2 percent to 6.7 percent, yielding a combined Social Security payroll tax rate of 13.4 percent on the first $142,800 of wages and indexed to wage growth.

Though employers are legally responsible for paying their portion of the payroll tax, the long-term burden of both sides of the payroll tax falls on employees in the form of lower wages. As such, this option would reduce the incentive to work, thereby reducing economic output and after-tax incomes. Compared to other tax types, the payroll tax is relatively efficient in that the entire burden falls on labor, which is less responsive to taxation than capital.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.5%	-0.7%	-0.8%
20% to 40%	-0.7%	-0.7%	-0.9%
40% to 60%	-0.8%	-0.8%	-1.0%
60% to 80%	-0.8%	-0.8%	-0.9%
80% to 100%	-0.6%	-0.6%	-0.7%
80% to 90%	-0.8%	-0.8%	-0.9%
90% to 95%	-0.8%	-0.8%	-0.9%
95% to 99%	-0.6%	-0.6%	-0.7%
99% to 100%	-0.1%	-0.2%	-0.3%
TOTAL	**-0.7%**	**-0.7%**	**-0.8%**

34. ELIMINATE THE SOCIAL SECURITY PAYROLL TAX CAP

GDP	-1.1%
GNP	-1.2%
Capital Stock	-1.3%
Wage Rate	0.00%
Full-Time Equivalent Jobs	-1.3 million

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$121.0	$139.8	$144.9	$148.4	$152.8	$156.8	$162.4	$168.1	$173.7	$179.2	$1,546.6
Dynamic	$100.7	$116.4	$120.7	$123.6	$127.2	$130.6	$135.3	$140.0	$144.6	$149.3	$1,288.3

Under current law, individuals are subject to the Social Security payroll tax and self-employment tax on their first $142,800 of labor income (indexed to wage growth). Under this option, this tax base would be expanded by eliminating the Social Security payroll wage cap and taxing all labor income. It assumes no change to Social Security benefits compared to current law.

This tax change would discourage work among high-income individuals, leading to a 1.1 percent smaller economy and 1.3 million fewer full-time equivalent jobs in the long run. It would be concentrated on those earning over $142,800 and would raise $1.5 trillion over 10 years on a conventional basis. However, when considering economic effects, the revenue raised drops to $1.3 trillion over 10 years.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.9%
20% to 40%	0.0%	0.0%	-1.0%
40% to 60%	0.0%	0.0%	-0.9%
60% to 80%	0.0%	0.0%	-0.9%
80% to 100%	-1.6%	-1.7%	-2.5%
80% to 90%	< -0.05%	< -0.05%	-0.9%
90% to 95%	-0.3%	-0.3%	-1.1%
95% to 99%	-1.9%	-1.9%	-2.7%
99% to 100%	-4.0%	-4.1%	-4.9%
TOTAL	**-0.9%**	**-0.9%**	**-1.8%**

35. APPLY THE SOCIAL SECURITY PAYROLL TAX TO WAGES ABOVE $400,000

GDP	-0.2%
GNP	-0.2%
Capital Stock	-0.2%
Wage Rate	0.00%
Full-Time Equivalent Jobs	-226,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$64.3	$73.9	$76.6	$78.5	$81.1	$83.5	$86.6	$89.7	$92.7	$95.8	$822.3
Dynamic	$54.2	$62.9	$65.1	$66.6	$67.8	$69.1	$71.6	$74.0	$76.3	$78.6	$686.0

While the most straightforward way to expand the Social Security payroll tax base is to raise the cap on taxable wages, some policymakers have proposed a different option: applying the Social Security payroll tax to income above $400,000. Under this option, individuals would be subject to the Social Security payroll tax and self-employment tax on their first $142,800 of labor income, as well as on all labor income above $400,000, but not any labor income in between these thresholds (creating a so called “donut hole”). This option assumes no change to Social Security benefits compared to current law.

On a conventional basis, this tax change would raise $822 billion over the 10-year budget window. It would discourage work among high-income individuals, leading to a 0.2 percent smaller economy and 226,000 fewer full-time equivalent jobs in the long run. It would primarily raise its revenue from a small number of high-income Americans, but all income groups would see some reduction in after-income due to a smaller economy. On a dynamic basis, it would raise $686 billion over the 10-year budget window.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	-0.2%
20% to 40%	0%	0%	-0.2%
40% to 60%	0%	0%	-0.2%
60% to 80%	0%	0%	-0.2%
80% to 100%	-0.5%	-0.5%	-0.7%
80% to 90%	0%	0%	-0.2%
90% to 95%	0%	0%	-0.2%
95% to 99%	< -0.05%	< -0.05%	-0.2%
99% to 100%	-1.9%	-2.0 %	-2.1%
TOTAL	**-0.3%**	**-0.3%**	**-0.5%**

36. RAISE THE CORPORATE INCOME TAX RATE TO 28 PERCENT

GDP	-0.7%
GNP	-0.7%
Capital Stock	-1.4%
Wage Rate	-0.6%
Full-Time Equivalent Jobs	-138,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$60.5	$74.8	$82.5	$89.8	$91.0	$92.1	$95.2	$97.8	$100.1	$102.5	$886.3
Dynamic	$58.4	$69.7	$74.2	$77.7	$74.5	$70.1	$69.4	$68.2	$66.7	$65.0	$693.9

This option would increase the corporate income tax rate from 21 percent to 28 percent, as proposed in President Biden's initial Made in America Tax Plan in April 2021. A higher corporate income tax rate would hinder capital formation by increasing the cost of capital.

A higher cost of capital would make some investments unviable as they would no longer meet the required after-tax rate of return. Investment would drop, leading to a 0.7 percent reduction in GDP and 138,000 fewer full-time equivalent jobs. A higher corporate tax rate would also lead to increased profit shifting, reducing the amount of revenue raised by the tax increase to about $886 billion on a conventional basis.

Over the long term, the burden of a corporate tax increase falls on workers and shareholders, leading to a reduction in after-tax income of at least 1.3 percent across income levels on a dynamic basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.5%	-0.6%	-1.5%
20% to 40%	-0.4%	-0.5%	-1.3%
40% to 60%	-0.4%	-0.5%	-1.4%
60% to 80%	-0.5%	-0.5%	-1.3%
80% to 100%	-0.9%	-1.0%	-2.0%
80% to 90%	-0.5%	-0.6%	-1.4%
90% to 95%	-0.6%	-0.7%	-1.6%
95% to 99%	-0.8%	-0.9%	-1.9%
99% to 100%	-1.5%	-1.8%	-3.1%
TOTAL	**-0.7%**	**-0.8%**	**-1.7%**

37. INSTITUTE A CORPORATE SURTAX OF 5 PERCENT

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.2%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-16,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$9.6	$11.9	$13.1	$14.3	$14.5	$14.7	$15.2	$15.6	$15.9	$16.3	$141.1
Dynamic	$9.5	$11.6	$12.7	$13.7	$13.7	$11.7	$11.7	$11.6	$11.5	$11.3	$119.0

This option would create a corporate surtax of 5 percent, which would increase a corporation's tax liability by 5 percent. It is equivalent to changing the current tax rate on a corporation's net income from 21 percent to 22.05 percent.

The higher marginal tax rate would raise the cost of capital for businesses, which would reduce long-run economic output by 0.1 percent. On a conventional basis, the surtax would increase federal revenue over a 10-year period by $141 billion, but incorporating the negative effect of the surtax, on a dynamic basis, it would only raise $119 billion. Because the corporate income tax falls on both shareholders and workers, the surtax would reduce after-tax incomes for taxpayers at all income levels.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.1%	-0.1%	-0.2%
20% to 40%	-0.1%	-0.1%	-0.2%
40% to 60%	-0.1%	-0.1%	-0.2%
60% to 80%	-0.1%	-0.1%	-0.2%
80% to 100%	-0.1%	-0.2%	-0.3%
80% to 90%	-0.1%	-0.1%	-0.2%
90% to 95%	-0.1%	-0.1%	-0.2%
95% to 99%	-0.1%	-0.1%	-0.3%
99% to 100%	-0.2%	-0.3%	-0.5%
TOTAL	**-0.1%**	**-0.1%**	**-0.3%**

38. ELIMINATE THE SECTION 199A DEDUCTION

GDP	0.0%
GNP	0.0%
Capital Stock	0.0%
Wage Rate	0.0%
Full-Time Equivalent Jobs	0.0%

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$49.5	$51.3	$52.6	$54.9	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$208.2
Dynamic	$48.9	$50.5	$49.7	$51.2	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$200.3

The 2017 tax reform created a temporary deduction for households with income from pass-through businesses—such as partnerships, S corporations, and sole proprietorships—that is scheduled to expire after 2025. This option would move the expiration sooner, to 2022. The deduction allows taxpayers to exclude up to 20 percent of their pass-through business income from federal income tax, but higher-income taxpayers face many limitations.

Eliminating the deduction beginning in 2022 does not affect long-term economic output or incomes because the deduction is a temporary policy. Over the budget window in years when the provisions would otherwise be in effect, elimination would increase the cost of capital for pass-through businesses, reducing after-tax income primarily for high-income earners.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.0%
20% to 40%	< -0.05%	0.0%	0.0%
40% to 60%	-0.1%	0.0%	0.0%
60% to 80%	-0.2%	0.0%	0.0%
80% to 100%	-0.6%	0.0%	0.0%
80% to 90%	-0.3%	0.0%	0.0%
90% to 95%	-0.6%	0.0%	0.0%
95% to 99%	-1.0%	0.0%	0.0%
99% to 100%	-0.4%	0.0%	0.0%
TOTAL	**-0.4%**	**0.0%**	**0.0%**

39. REQUIRE AMORTIZATION OF ADVERTISING EXPENSES OVER 10 YEARS

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.3%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-18,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$35.3	$32.1	$29.1	$26.2	$23.4	$20.8	$18.3	$16.0	$13.7	$11.6	$226.5
Dynamic	$35.0	$31.5	$28.3	$25.3	$22.3	$17.4	$14.9	$12.6	$10.5	$8.6	$206.4

Under current law, businesses can immediately deduct the cost of advertising. Lawmakers have considered broadening the tax base by allowing businesses to fully deduct 50 percent of their advertising costs, with the remaining 50 percent amortized over 10 years.

Requiring advertising expenses to be amortized would make advertising more expensive, meaning it would increase the cost of capital for businesses and reduce long-run economic output by 0.1 percent. The smaller economy would ultimately reduce the amount of revenue this option would raise in the budget window from $227 billion on a conventional basis to $206 billion on a dynamic basis. In years outside of the budget window, it would raise less revenue due to timing effects of amortization. On a conventional basis, it would reduce after-tax income by at least 0.1 percent for each income group. After taking economic effects into account, each income group would see at least a 0.2 percent decrease in after-tax income.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.1%	-0.1%	-0.2%
20% to 40%	-0.1%	-0.1%	-0.2%
40% to 60%	-0.1%	-0.1%	-0.2%
60% to 80%	-0.1%	-0.1%	-0.2%
80% to 100%	-0.1%	-0.2%	-0.3%
80% to 90%	-0.1%	-0.1%	-0.2%
90% to 95%	-0.1%	-0.1%	-0.2%
95% to 99%	-0.1%	-0.2%	-0.3%
99% to 100%	-0.3%	-0.3%	-0.5%
TOTAL	**-0.1%**	**-0.1%**	**-0.3%**

40. RETURN TO ALTERNATIVE DEPRECIATION SCHEDULE (ADS)

GDP	-0.6%
GNP	-0.5%
Capital Stock	-1.1%
Wage Rate	-0.5%
Full-Time Equivalent Jobs	-109,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$127.6	$119.6	$95.3	$67.0	$41.2	$11.3	$27.0	$36.8	$39.7	$37.9	$603.4
Dynamic	$120.5	$107.5	$80.5	$50.6	$23.6	-$5.5	$7.2	$14.1	$14.0	$9.0	$421.3

Currently, businesses deduct the cost of their investments according to the Modified Accelerated Cost Recovery System (MACRS), which allows larger depreciation deductions in the early years of an asset's life. Returning to the Alternative Depreciation Schedule (ADS) would require businesses to take depreciation deductions in equal increments under the straight-line method.

Lengthening depreciation schedules would worsen the tax bias against investment, because inflation and the time value of money erode the real value of future deductions. It would significantly increase the cost of capital, reducing long-run economic output (GDP) by 0.6 percent. After accounting for the negative effects, the estimated federal revenue gain would drop from $603 billion on a conventional basis to $421 billion on a dynamic basis over the next decade. It raises more in its first decade than in subsequent decades because it primarily changes the timing of deductions. On a conventional basis, it would primarily impact high-income taxpayers who are shareholders, while on a dynamic basis all quintiles would see a substantial decline in income.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.4%	-0.1%	-0.6%
20% to 40%	-0.3%	-0.1%	-0.6%
40% to 60%	-0.3%	-0.1%	-0.6%
60% to 80%	-0.4%	-0.1%	-0.6%
80% to 100%	-1.6%	-0.3%	-0.8%
80% to 90%	-0.4%	-0.1%	-0.6%
90% to 95%	-0.6%	-0.2%	-0.7%
95% to 99%	-1.4%	-0.3%	-0.8%
99% to 100%	-3.5%	-0.7%	-1.3%
TOTAL	**-1.0%**	**-0.2%**	**-0.7%**

41. REPEAL LAST-IN, FIRST-OUT (LIFO) INVENTORY ACCOUNTING

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	-0.1%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-5,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$6.7	$13.5	$13.5	$13.5	$7.3	$1.1	$1.1	$1.1	$1.2	$1.2	$60.2
Dynamic	$6.6	$13.3	$13.3	$13.2	$6.9	$0.7	$0.6	$0.5	$0.5	$0.5	$56.0

Businesses cannot immediately deduct inventories from taxable income. Instead, they must deduct when they are sold. Under current law, businesses can use three major assumptions to calculate the cost of inventories sold: first-in, first-out (FIFO), last-in, first-out (LIFO), and weighted-average cost. Some policymakers propose eliminating LIFO because it allows businesses to defer a significant amount of tax, while others believe it should remain because it better reflects the true cost of inventory investments.

Repealing LIFO would raise $60 billion over a decade, on a conventional basis. However, this would increase the cost of capital for businesses, causing a slight reduction in long-run GDP. Repealing LIFO would generate more revenue in the first half of the decade compared to subsequent years because firms would have to revalue their current inventories, increasing their taxable incomes. Going forward, the revenue impact would be minimal as firms could only use FIFO or weighted-average cost. As a result, in the long run, the negative economic impact of LIFO repeal is relatively large compared to the revenue it would raise. On a dynamic basis, taxpayers at all income levels would see a slight reduction in after-tax income.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	< -0.05%	< -0.05%	< -0.05%
20% to 40%	< -0.05%	< -0.05%	< -0.05%
40% to 60%	< -0.05%	< -0.05%	< -0.05%
60% to 80%	< -0.05%	< -0.05%	< -0.05%
80% to 100%	-0.1%	< -0.05%	< -0.05%
80% to 90%	< -0.05%	< -0.05%	< -0.05%
90% to 95%	-0.1%	< -0.05%	< -0.05%
95% to 99%	-0.1%	< -0.05%	< -0.05%
99% to 100%	-0.1%	< -0.05%	< -0.05%
TOTAL	**-0.1%**	**< -0.05%**	**< -0.05%**

42. ELIMINATE 1031 LIKE-KIND EXCHANGES

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-3,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$1.0	$1.1	$1.1	$1.3	$1.4	$1.5	$1.5	$1.6	$1.7	$1.8	$13.8
Dynamic	$1.0	$1.1	$1.1	$1.3	$1.3	$1.5	$1.5	$1.6	$1.6	$1.7	$13.6

When a business sells an asset, such as a piece of real estate, it is generally required to pay taxes on the capital gain resulting from the sale. However, in the 1920s, Congress made several changes to the tax code that allowed businesses to defer paying capital gains taxes on the sale of an asset if the asset is exchanged for a similar one.

The rules of section 1031 like-kind exchanges are complex, but the section exists to avoid taxing companies on gains that are tied up in illiquid assets and have not yet been realized. The provision helps mitigate the double taxation of saving that results from the current treatment of capital gains. Because section 1031 does not apply to all investments, it can distort investment and lead to a misallocation of capital across economic sectors. However, eliminating section 1031 would reduce the after-tax return on many investments, slightly reducing GDP and after-tax incomes.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	< -0.05%
20% to 40%	0%	0%	< -0.05%
40% to 60%	0%	0%	< -0.05%
60% to 80%	0%	0%	< -0.05%
80% to 100%	< -0.05%	< -0.05%	< -0.05%
80% to 90%	0%	0%	< -0.05%
90% to 95%	< -0.05%	< -0.05%	< -0.05%
95% to 99%	< -0.05%	< -0.05%	< -0.05%
99% to 100%	< -0.05%	< -0.05%	< -0.05%
TOTAL	**< -0.05%**	**< -0.05%**	**< -0.05%**

43. ENACT A 5 PERCENT VALUE-ADDED TAX (VAT)

GDP	-1.2%
GNP	-1.3%
Capital Stock	-0.9%
Wage Rate	-4.0%
Full-Time Equivalent Jobs	-931,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$514.6	$528.5	$552.3	$576.3	$594.6	$615.0	$640.2	$664.5	$689.8	$715.9	$6,091.7
Dynamic	$447.4	$456.3	$477.2	$498.1	$510.3	$524.9	$546.1	$566.5	$587.9	$609.0	$5,223.6

The United States is one of the few countries in the world without a VAT, which can be thought of as an ideal sales tax in that it is designed to tax all consumption without taxing business inputs. Typically, VATs are administered through a credit-invoice system, in which companies at every step of the supply chain charge VAT to their customers and receive a credit for VAT paid on business inputs. Because the VAT is a very broad-based tax, even a low-rate tax could raise a substantial amount of revenue.

A 5 percent VAT would raise about $6.1 trillion over a decade, on a conventional basis. A VAT would primarily increase marginal tax rates on labor. As a result, it would lower incentives to work, reducing GDP by 1.2 percent in the long run and result in 931,000 fewer full-time equivalent jobs. Accounting for the smaller economy in the long run, this option would raise $5.2 trillion over a decade on a dynamic basis. Enacting a VAT would be regressive in terms of income but neutral in terms of consumption.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-3.3%	-3.2%	-4.2%
20% to 40%	-3.0%	-2.9%	-4.0%
40% to 60%	-3.0%	-2.9%	-4.0%
60% to 80%	-2.9%	-2.8%	-3.7%
80% to 100%	-2.6%	-2.6%	-3.4%
80% to 90%	-2.7%	-2.6%	-3.6%
90% to 95%	-2.8%	-2.7%	-3.6%
95% to 99%	-2.8%	-2.7%	-3.6%
99% to 100%	-2.3%	-2.3%	-3.0%
TOTAL	**-2.8%**	**-2.8%**	**-3.7%**

44. RETURN THE ESTATE TAX TO CLINTON-ERA LEVELS

GDP	-0.2%
GNP	-0.4%
Capital Stock	-0.6%
Wage Rate	-0.2%
Full-Time Equivalent Jobs	-41,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$13.7	$96.4	$101.2	$106.0	$110.8	$76.2	$85.1	$91.9	$98.6	$107.5	$887.4
Dynamic	$13.7	$93.8	$97.4	$101.0	$105.2	$69.3	$77.0	$82.6	$88.1	$95.7	$823.9

Under this option (using the estate tax law of 2000 to represent the Clinton-era estate tax), the estate tax per-person exemption, now $11.7 million, would be cut to $675,000, and the exemption would no longer be indexed for inflation. The top tax rate, currently 40 percent, would be increased to 55 percent for taxable estates and gifts.

On a conventional basis, this option would almost triple revenue from the federal estate tax—raising about $887 billion over the next decade. The increase in estate tax would reduce the after-tax return to saving and raise the cost of capital particularly in the pass-through business and housing sectors that are dependent on domestic saving. Economic output would drop by 0.2 percent and national income drop by 0.4 percent. After accounting for economic effects, after-tax income would drop at all income levels, with the largest effects felt by the top 1 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.2%
20% to 40%	0.0%	0.0%	-0.2%
40% to 60%	0.0%	0.0%	-0.2%
60% to 80%	0.0%	0.0%	-0.2%
80% to 100%	-0.3%	-1.7%	-1.7%
80% to 90%	0.0%	0.0%	-0.2%
90% to 95%	0.0%	0.0%	-0.2%
95% to 99%	-0.1%	-0.3%	-0.5%
99% to 100%	-0.9%	-5.9%	-5.5%
TOTAL	**-0.1%**	**-0.9%**	**-0.8%**

45. ELIMINATE STEP-UP IN BASIS ON CAPITAL GAINS

GDP	-0.1%
GNP	-0.2%
Capital Stock	-0.1%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-8,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$11.0	$11.3	$11.4	$11.8	$11.6	$12.6	$12.8	$13.3	$13.9	$14.6	$124.2
Dynamic	$10.9	$11.0	$11.1	$11.3	$11.1	$11.9	$12.1	$12.5	$12.9	$13.6	$118.5

Under current law, the tax basis of property transferred to an heir at death is "stepped up" to its current market value, such that only the asset appreciation after the inheritance faces capital gains tax. Stepped-up basis has been critiqued for discouraging taxpayers from realizing capital gains, and for benefiting only high-income households. However, the step-up in basis ensures that when an asset is passed to an heir, the value of the asset is not subject to both the estate tax and the capital gains tax.

Under this option, property transferred at death would receive a "carryover basis," meaning the original owner's original cost basis is carried over to the heir. Repealing step-up in basis would increase revenue on a conventional basis. The option has a larger negative effect on national income (GNP) than output (GDP) since the resulting reduction in domestic saving would attract inflow of foreign investment. After accounting for economic effects, after-tax income would drop at all income levels, with the largest effects felt by the top 1 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.1%
20% to 40%	0.0%	0.0%	-0.1%
40% to 60%	0.0%	0.0%	-0.1%
60% to 80%	0.0%	0.0%	-0.1%
80% to 100%	-0.2%	-0.1%	-0.2%
80% to 90%	0.0%	0.0%	-0.1%
90% to 95%	0.0%	0.0%	-0.1%
95% to 99%	0.0%	0.0%	-0.1%
99% to 100%	-0.5%	-0.5%	-0.5%
TOTAL	**-0.1%**	**-0.1%**	**-0.1%**

46. LOWER THE ESTATE AND GIFT TAX EXEMPT AMOUNT TO $2 MILLION

GDP	< -0.05%
GNP	-0.1%
Capital Stock	-0.1%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-6,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$6.5	$45.5	$47.7	$50.0	$18.9	$28.0	$31.3	$33.7	$36.2	$39.5	$337.2
Dynamic	$6.5	$45.1	$47.3	$49.4	$18.5	$27.5	$30.7	$33.1	$35.5	$38.7	$332.1

Under current law, the unified estate and gift tax has exemptions of $11.7 million (indexed for inflation) for individuals and $23.4 million for couples, resulting in about 5,000 estates subject to tax each year.

This option would decrease the exemption to $2 million for individuals ($4 million for joint filers), which was the exempt amount from 2006 to 2008. It would increase federal revenue by $337 billion over the 10-year budget window, on a conventional basis. It would slightly shrink economic output (GDP) and national income (GNP) after considering the marginal effect of subjecting more estates to the tax on investment and saving. After-tax incomes would drop primarily for the top 1 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	< -0.05%
20% to 40%	0.0%	0.0%	< -0.05%
40% to 60%	0.0%	0.0%	< -0.05%
60% to 80%	0.0%	0.0%	< -0.05%
80% to 100%	-0.1%	-0.6%	-0.7%
80% to 90%	0.0%	0.0%	< -0.05%
90% to 95%	0.0%	0.0%	< -0.05%
95% to 99%	0.0%	0.0%	< -0.05%
99% to 100%	-0.4%	-2.3%	-2.3%
TOTAL	**-0.1%**	**-0.3%**	**-0.4%**

47. INCREASE THE GAS TAX BY 15 CENTS PER GALLON AND INFLATION-ADJUST GOING FORWARD

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.1%
Wage Rate	-0.2%
Full-Time Equivalent Jobs	-50,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$28.1	$28.9	$30.1	$31.6	$32.5	$33.6	$34.9	$36.3	$37.6	$39.0	$332.6
Dynamic	$24.6	$25.0	$26.1	$27.3	$28.0	$28.8	$29.9	$31.1	$32.2	$33.3	$286.2

The gas tax is the primary funding source for the Highway Trust Fund (HTF)—the channel the federal government uses to provide revenue for state and local government highway spending. The HTF is projected to run out of money by the end of 2021. Currently at 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel, this option would increase the tax by 15 cents per gallon and inflation-adjust it going forward.

Increasing the gas tax by 15 cents per gallon would raise about $332 billion on a conventional basis. Overall, the gas tax increase would lead to a small negative impact on long-run GDP, relative to revenue raised. A portion of the gas tax increase would fall on production processes, as some businesses purchase gasoline as an input, leading to a slight increase in the cost of capital. However, most of the burden would fall on consumer purchases, resulting in a small decrease in the labor supply and a regressive decrease in after-tax income. On a dynamic basis, it would increase federal revenue by $286 billion over the 10-year budget window.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.2%	-0.2%	-0.2%
20% to 40%	-0.2%	-0.2%	-0.2%
40% to 60%	-0.2%	-0.2%	-0.2%
60% to 80%	-0.2%	-0.1%	-0.2%
80% to 100%	-0.1%	-0.1%	-0.2%
80% to 90%	-0.1%	-0.1%	-0.2%
90% to 95%	-0.1%	-0.1%	-0.2%
95% to 99%	-0.1%	-0.1%	-0.2%
99% to 100%	-0.1%	-0.1%	-0.2%
TOTAL	**-0.1%**	**-0.1%**	**-0.2%**

48. INCREASE THE GAS TAX BY 35 CENTS PER GALLON AND INFLATION-ADJUST GOING FORWARD

GDP	-0.1%
GNP	-0.1%
Capital Stock	-0.1%
Wage Rate	-0.5%
Full-Time Equivalent Jobs	-103,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$64.1	$65.8	$68.8	$71.7	$74.0	$76.6	$79.7	$82.7	$85.8	$89.1	$758.3
Dynamic	$55.9	$57.0	$59.6	$62.3	$63.9	$65.6	$68.2	$70.9	$73.5	$76.2	$653.1

The gas tax is the primary funding source for the Highway Trust Fund (HTF)—the channel the federal government uses to provide revenue for state and local government highway spending. The HTF is projected to run out of money by the end of 2021. Currently at 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel, this option would increase the tax by 35 cents per gallon and adjust it for inflation going forward.

Increasing the gas tax by 35 cents per gallon would raise $758 billion on a conventional basis. Overall, the gas tax increase would lead to a small negative impact on long-run GDP, relative to revenue raised. A portion of the gas tax increase would fall on production processes, as some businesses purchase gasoline as an input, leading to a slight increase in the cost of capital. However, most of the burden would fall on consumer purchases, resulting in a small decrease in the labor supply and a regressive decrease in after-tax income. On a dynamic basis, it would increase federal revenue by about $653 billion over the 10-year budget window.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.4%	-0.4%	-0.5%
20% to 40%	-0.3%	-0.3%	-0.4%
40% to 60%	-0.3%	-0.3%	-0.4%
60% to 80%	-0.3%	-0.3%	-0.4%
80% to 100%	-0.3%	-0.3%	-0.4%
80% to 90%	-0.3%	-0.3%	-0.4%
90% to 95%	-0.3%	-0.3%	-0.4%
95% to 99%	-0.3%	-0.3%	-0.4%
99% to 100%	-0.2%	-0.3%	-0.3%
TOTAL	**-0.3%**	**-0.3%**	**-0.4%**

49. REINSTATE THE CADILLAC TAX

GDP	< -0.05%
GNP	-0.1%
Capital Stock	< -0.05%
Wage Rate	-0.2%
Full-Time Equivalent Jobs	-38,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$21.0	$21.7	$22.8	$23.7	$24.5	$25.3	$26.3	$27.3	$28.3	$29.4	$250.2
Dynamic	$18.5	$18.9	$19.8	$20.7	$21.3	$22.0	$22.9	$23.8	$24.7	$25.6	$218.4

Originally part of the Patient Protection and Affordable Care Act in 2009 but now repealed, the Cadillac Tax would require employers to pay a 40 percent tax on the "excess benefit" of each health-care plan—the portion of annual premium that exceeds $11,200 for individuals and $30,150 for families. Because the thresholds would be adjusted for overall inflation, rather than health-care inflation, more and more health-care plans would be subject to the Cadillac Tax over time.

This option would reinstate the tax and raise $250 billion over the next decade on a conventional basis. It would slightly raise the cost of labor, reducing labor supply and long-run economic output by 0.1 percent. After accounting for economic effects, it would raise $218 billion in revenue on a dynamic basis. Middle- and upper-middle income taxpayers would face the largest tax increases, experiencing declines in their after-tax incomes of at least 0.3%.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.1%	-0.9%	-0.2%
20% to 40%	-0.2%	-0.2%	-0.3%
40% to 60%	-0.4%	-0.5%	-0.6%
60% to 80%	-0.3%	-0.5%	-0.4%
80% to 100%	-0.2%	-0.3%	-0.4%
80% to 90%	-0.2%	-0.3%	-0.4%
90% to 95%	-0.2%	-0.3%	-0.4%
95% to 99%	-0.1%	-0.2%	-0.2%
99% to 100%	-0.1%	-0.1%	-0.2%
TOTAL	**-0.2%**	**-0.3%**	**-0.4%**

50. ENACT A $25 PER TON CARBON TAX

GDP	-0.2%
GNP	-0.2%
Capital Stock	-0.1%
Wage Rate	-0.7%
Full-Time Equivalent Jobs	-149,000

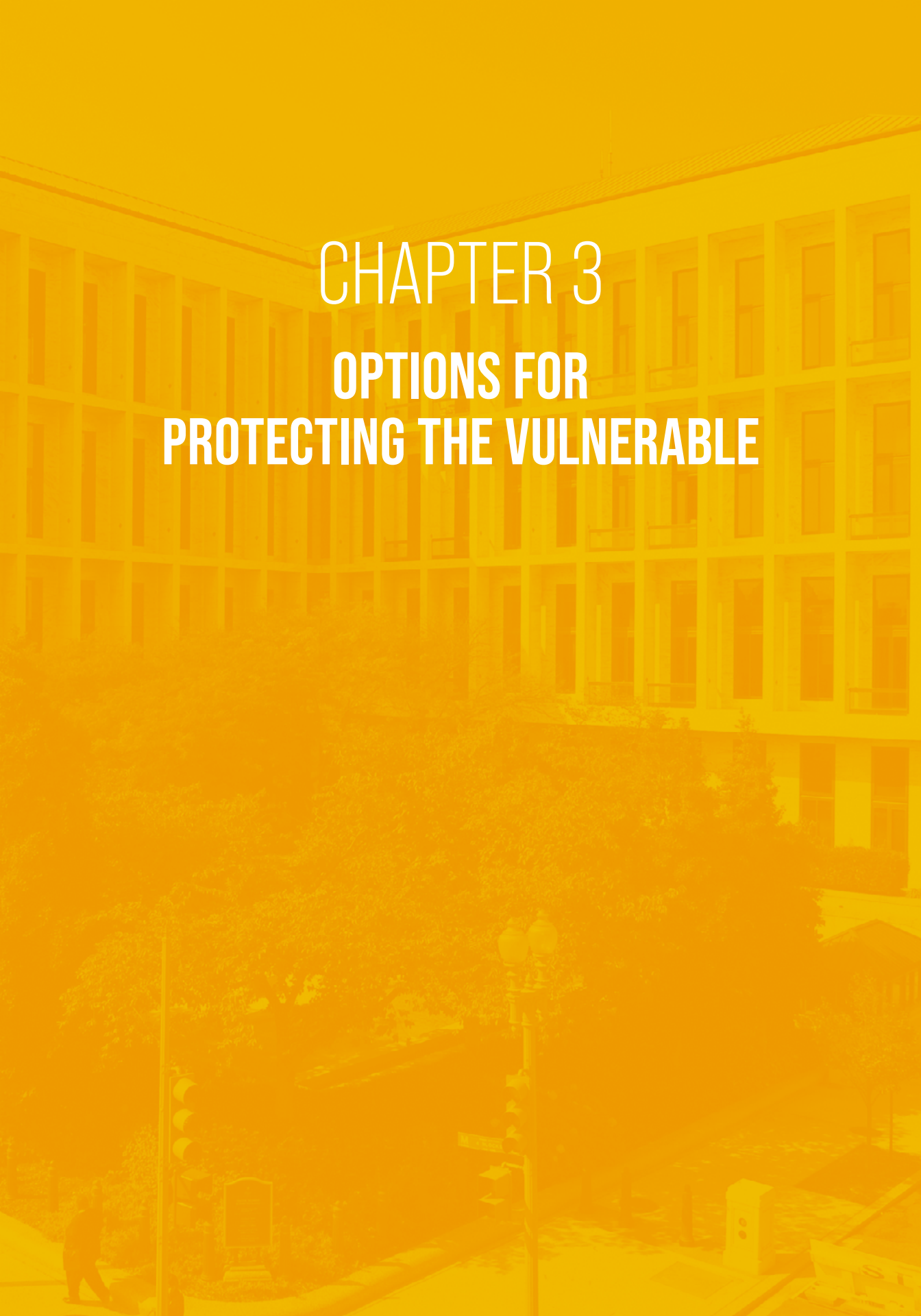
Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$84.4	$86.7	$90.5	$94.5	$97.5	$100.9	$105.0	$109.0	$113.1	$117.3	$998.9
Dynamic	$73.6	$75.1	$78.6	$82.1	$84.2	$86.4	$90.0	$93.5	$96.8	$100.4	$860.5

Due to concerns about government deficits and climate change, some lawmakers have proposed enacting a carbon tax. Such a tax mainly targets fossil fuels—such as oil, gas, and coal—used for heating purposes, as well as motor fuels. As a "Pigouvian tax," the carbon tax is designed to make business and individuals that benefit from burning fossil fuels shoulder the social cost of environmental damage. Taxing carbon emissions would raise the price of fossil fuels and any resulting goods or services, thus serving as an incentive for producers and consumers to use less carbon-intensive goods.

This option would enact a carbon tax of $25 per metric ton of carbon produced through fossil fuels combustion, increasing at 5 percent annually to $38.78 per metric ton by 2031. This option would raise $998.9 billion over the next decade, on a conventional basis, and reduce GDP by 0.2 percent, resulting in a slightly regressive reduction in after-tax income.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.5%	-0.5%	-0.7%
20% to 40%	-0.4%	-0.4%	-0.6%
40% to 60%	-0.5%	-0.4%	-0.6%
60% to 80%	-0.4%	-0.4%	-0.6%
80% to 100%	-0.4%	-0.4%	-0.5%
80% to 90%	-0.4%	-0.4%	-0.6%
90% to 95%	-0.4%	-0.4%	-0.6%
95% to 99%	-0.4%	-0.4%	-0.6%
99% to 100%	-0.3%	-0.3%	-0.5%
TOTAL	**-0.4%**	**-0.4%**	**-0.6%**



CHAPTER 3

OPTIONS FOR PROTECTING THE VULNERABLE

INTRODUCTION

While recessions usually hurt a broad swath of households, the pandemic-induced shutdowns and recession hit lower-income households disproportionately when compared to previous recessions, especially those with school-age children. At its height, approximately 20 million workers lost their jobs with losses heavily concentrated in tourism, food service, and related sectors. Though the ongoing recovery has seen more than half of jobs return, the gains have not been proportional across the income scale.

Concerns about protecting low-income or other vulnerable populations are often conflated with broader concerns about increasing the overall progressivity of the tax code or raising the tax burden on wealthy households. Rather than take that approach, the options here outline changes to provisions targeted to populations in need.

For many low-income households, payroll taxes comprise a larger share of their tax burden than individual income taxes do. Further, many lower-income households face negative effective income tax rates, as refundable tax credits such as the Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) fully offset tax liability and result in tax refunds. In tax year 2018, more than 39 million tax returns claimed the CTC and more than 26 million returns claimed the EITC.

While strong economic growth—fueled by higher levels of investment, productivity, and jobs—will lift after-tax incomes over time, policies that provide relief by immediately boosting after-tax incomes of lower-income households are also available. To that end, the following chapter illustrates the economic, revenue, and distributional implications of eight changes to tax provisions that affect vulnerable populations.

51. DOUBLE EITC FOR WORKERS WITHOUT QUALIFYING CHILDREN TO $1,075

GDP	< +0.05%
GNP	< +0.05%
Capital Stock	< +0.05%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	6,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$3.0	-$3.0	-$3.1	-$3.1	-$3.8	-$3.8	-$3.9	-$3.9	-$3.9	-$4.0	-$35.5
Dynamic	-$2.9	-$2.9	-$3.0	-$3.0	-$3.7	-$3.7	-$3.8	-$3.8	-$3.8	-$3.8	-$34.3

The earned income tax credit (EITC) is a targeted subsidy for low-income working families. The value of the EITC is a fixed percentage of a household's earned income until the credit reaches its maximum. The EITC stays at its maximum value as a household's earned income continues to increase, until earnings reach a phaseout threshold, above which the credit drops by a fixed percentage for each additional dollar of income over the phaseout threshold. The EITC is a fully refundable credit. The EITC's rates and thresholds depend on a household's filing status and number of qualifying children.

This option would double the phase-in rate of EITC for childless filers from its current 7.65 percent to 15.3 percent, increasing the maximum EITC for households without qualifying children to $1,075. The change would decrease marginal tax rates on households in the EITC phase-in range but increase marginal tax rates on households in the phaseout range, resulting in a negligible impact on GDP. This would reduce federal revenue by $35.5 billion over the next decade on a conventional basis and increase after-tax income of the bottom quintile by 1 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	1.0%	1.0%	1.0%
20% to 40%	0.1%	0.1%	0.1%
40% to 60%	0%	0%	0%
60% to 80%	0%	0%	0%
80% to 100%	0%	0%	0%
80% to 90%	0%	0%	0%
90% to 95%	0%	0%	0%
95% to 99%	0%	0%	0%
99% to 100%	0%	0%	0%
TOTAL	**< +0.05%**	**< +0.05%**	**< +0.05%**

52. REFORM THE EITC FOR MARRIED AND UNMARRIED WORKERS, WITH AND WITHOUT CHILDREN

GDP	+0.1%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	+0.0%
Full-Time Equivalent Jobs	+97,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$13.9	-$14.1	-$14.2	-$14.2	-$17.7	-$17.8	-$17.9	-$18.0	-$18.1	-$18.2	-$164.0
Dynamic	-$9.4	-$9.3	-$9.3	-$9.2	-$12.0	-$11.6	-$11.5	-$11.3	-$11.2	-$11.0	-$105.7

The rates and thresholds of the EITC depend on a household's filing status and number of children. Under current law, households without qualifying children are eligible for a relatively small EITC, with a phase-in rate of 7.65 percent. Phaseout thresholds differ between single/head of households and married joint filers in a way that makes joint filers eligible for a smaller credit than when the two people would file their taxes individually.

This option aims to expand the EITC for workers without qualifying children by increasing their phase-in and phaseout rates to the level faced by heads of households with one child. At the same time, this option reduces the marriage penalty by increasing the phaseout threshold for married joint filers to double the threshold for non-married filers.

The changes would reduce the federal revenue by $164 billion over the next decade, on a conventional basis, and would slightly decrease the aggregate marginal tax rate on labor due to the offsetting effect between phase-in and phaseout changes.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	3.0%	3.0%	3.1%
20% to 40%	1.0%	1.0%	1.1%
40% to 60%	0.0%	0.0%	0.1%
60% to 80%	0.0%	0.0%	0.1%
80% to 100%	0.0%	0.0%	0.1%
80% to 90%	0.0%	0.0%	0.1%
90% to 95%	0.0%	0.0%	0.1%
95% to 99%	0.0%	0.0%	0.1%
99% to 100%	0.0%	0.0%	0.1%
TOTAL	**0.2%**	**0.2%**	**0.3%**

53. MAKE THE CHILD TAX CREDIT FULLY REFUNDABLE

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	-16,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$15.1	-$14.6	-$14.1	-$12.8	-$3.0	-$2.8	-$2.7	-$2.6	-$2.4	-$2.3	-$72.3
Dynamic	-$19.5	-$19.2	-$18.9	-$17.9	-$3.5	-$3.3	-$3.2	-$3.0	-$2.9	-$2.8	-$94.2

This option would make the full amount of the child tax credit (CTC) refundable, eliminating the 15 percent phase-in and the $1,400 refundability limit that applies through 2025. Currently, taxpayers may claim a maximum CTC of $2,000 for each qualifying child under age 17 ($1,000 after 2025), reduced by $50 for every $1,000 of adjusted gross income above $200,000 for single parents and $400,000 for married jointly filing couples ($75,000 and $110,000 after 2025). Families that owe little to no income tax can get refundable credits of up to $1,400 per child ($1,000 after 2025). The refundable portion of the credit, also called the additional child tax credit (ACTC), phases in at 15 percent of earned income above $2,500 ($3,000 after 2025).

Under this option, some households would see slight increases in their marginal tax rates due to the eliminated phase-in and the longer phaseout, resulting in a slightly negative effect on GDP. This option would reduce federal revenue by $72 billion over the next decade, on a conventional basis, with most of the cost in years 2022 through 2025 when the higher CTC is in effect.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	4.7%	0.6%	0.6%
20% to 40%	0.5%	< +0.05%	< +0.05%
40% to 60%	< +0.05%	0%	0%
60% to 80%	< +0.05%	0%	0%
80% to 100%	0%	0%	0%
80% to 90%	0%	0%	0%
90% to 95%	0%	0%	0%
95% to 99%	0%	0%	0%
99% to 100%	0%	0%	0%
TOTAL	**0.2%**	**< +0.05%**	**< +0.05%**

54. MAKE THE CHILD TAX CREDIT FIRST DOLLAR REFUNDABLE

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	0.0%
Full-Time Equivalent Jobs	-15,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$5.5	-$5.3	-$5.0	-$5.3	-$3.1	-$2.9	-$2.7	-$2.6	-$2.4	-$2.3	-$37.0
Dynamic	-$6.2	-$6.0	-$5.8	-$6.0	-$3.8	-$3.6	-$3.4	-$3.2	-$3.1	-$2.8	-$43.9

Under current law taxpayers may claim a maximum CTC of $2,000 for each qualifying child under age 17 ($1,000 after 2025), reduced by $50 for every $1,000 of adjusted gross income above $200,000 for single parents and $400,000 for married jointly filing couples ($75,000 and $110,000 after 2025). Families that owe little to no income tax can get refundable credits of up to $1,400 per child ($1,000 after 2025). The refundable portion of the credit, also called the additional child tax credit (ACTC), phases in at 15 percent of earned income above $2,500 ($3,000 after 2025).

This option would reduce the refundability threshold for the CTC so that the credit phases in from the first dollar of earnings, instead of phasing in at $2,500 of earned income through 2025 and $3,000 after 2025. It would primarily increase after-tax income for taxpayers in the bottom quintile.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	2.0%	0.7%	2.0%
20% to 40%	0.1%	0.0%	0.1%
40% to 60%	0.0%	0.0%	0.0%
60% to 80%	0.0%	0.0%	0.0%
80% to 100%	0.0%	0.0%	0.0%
80% to 90%	0.0%	0.0%	0.0%
90% to 95%	0.0%	0.0%	0.0%
95% to 99%	0.0%	0.0%	0.0%
99% to 100%	0.0%	0.0%	0.0%
TOTAL	**0.1%**	**0.0%**	**0.1%**

55. RESTRUCTURE THE CTC AND EITC

GDP	+0.1%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	+0.0%
Full-Time Equivalent Jobs	+87,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$86.3	-$85.4	-$84.0	-$82.8	-$172.0	-$178.9	-$179.6	-$180.4	-$181.2	-$184.0	-$1,414.4
Dynamic	-$86.6	-$86.0	-$84.7	-$83.7	-$165.4	-$172.2	-$173.1	-$174.1	-$175.2	-$178.1	-$1,379.0

This option to simplify the CTC and EITC is based on the Family Security Act (FSA) proposed by Sen. Mitt Romney in February 2021.

The child tax benefit would increase to $4,200 per child under age 6 and $3,000 per child ages 6 to 17. It would be fully refundable with no minimum income requirement. It would still phase out at $50 for every $1,000 in income above $200,000 for single filers and $400,000 for joint filers. The EITC would be restructured to have a maximum credit of $1,000 per adult and an extra $1,000 for households with dependents.

This option would expand the benefits across quintiles, with the largest increases going to the bottom income quintiles. It would also significantly increase the revenue cost of the work- and child-related benefits in the tax code, while increasing the tax code's progressivity. It would slightly increase the size of the economy mainly due to how the phase-in and phaseout changes would alter marginal tax rates on labor.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	5.5%	3.2%	3.3%
20% to 40%	1.7%	1.7%	1.8%
40% to 60%	1.6%	2.2%	2.3%
60% to 80%	0.9%	1.5%	1.6%
80% to 100%	0.3%	0.5%	0.6%
80% to 90%	0.5%	1.0%	1.1%
90% to 95%	0.4%	0.7%	0.8%
95% to 99%	0.2%	0.3%	0.3%
99% to 100%	0.0%	0.0%	0.1%
TOTAL	**0.9%**	**1.2%**	**1.2%**

56. INCREASE THE STANDARD DEDUCTION BY 25% FOR ALL FILING GROUPS

GDP	< +0.05%
GNP	+0.1%
Capital Stock	-0.1%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	+70,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$80.7	-$85.0	-$88.4	-$93.6	-$39.4	-$43.3	-$45.1	-$47.0	-$48.9	-$51.4	-$622.7
Dynamic	-$70.6	-$74.4	-$77.9	-$82.8	-$35.9	-$39.5	-$41.4	-$43.2	-$45.2	-$47.7	-$558.5

The standard deduction is the alternative to itemized deductions and simplifies tax filing for taxpayers and administrators. The 2017 tax law nearly doubled the standard deduction through 2025, such that nine out of 10 taxpayers take the standard deduction rather than itemize. The standard deduction (2021) is currently $12,550 for single filers, $25,100 for joint filers, and $18,800 for heads of household.

This option would increase the baseline current law standard deduction in each year by 25 percent. Increasing the standard deduction would bump some taxpayers into lower brackets, decreasing marginal tax rates on labor and business income, but could increase marginal tax rates on filers no longer able to take itemized deductions. Taxpayers in the bottom quintile would see only a small benefit as they already have little taxable income from which to deduct. Many taxpayers at the top would remain better off itemizing; they too see little benefit from the policy.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.1%	0.1%
20% to 40%	0.8%	0.6%	0.6%
40% to 60%	1.1%	0.7%	0.7%
60% to 80%	0.9%	0.4%	0.4%
80% to 100%	0.4%	0.1%	0.1%
80% to 90%	0.8%	0.2%	0.2%
90% to 95%	0.5%	0.1%	0.1%
95% to 99%	0.3%	0.0%	0.0%
99% to 100%	0.1%	0.0%	0.0%
TOTAL	**0.6%**	**0.3%**	**0.3%**

57. RESTORE THE PERSONAL EXEMPTION

GDP	0.0%
GNP	0.0%
Capital Stock	0.0%
Wage Rate	0.0%
Full-Time Equivalent Jobs	0

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$180.4	-$189.6	-$196.6	-$207.8	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	-$774.4
Dynamic	-$154.5	-$161.4	-$167.3	-$177.3	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	-$660.5

Prior to the 2017 tax reform, a personal exemption was allowed against the federal income tax. It effectively adjusted income taxes for household size by exempting $4,050 in income per person. The 2017 tax reform set the personal exemption to $0 in exchange for a larger standard deduction and expanded CTC, all of which revert to prior law after the end of 2025. This option would reinstate the personal exemption for years 2022 through 2025, as it would have been in the absence of the 2017 tax law.

Because the personal exemption is already scheduled to come back in 2026, the option does not have a long-run effect. Instead, it only affects years 2022 through 2025, reducing revenue and moving some taxpayers into lower tax brackets. Reinstating the personal exemption would provide the largest boost in after-tax income to the middle quintile of taxpayers, because personal exemptions are phased out for higher-income earners and lower-income earners have little taxable income to offset.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.0%
20% to 40%	1.2%	0.0%	0.0%
40% to 60%	2.2%	0.0%	0.0%
60% to 80%	1.9%	0.0%	0.0%
80% to 100%	1.2%	0.0%	0.0%
80% to 90%	1.9%	0.0%	0.0%
90% to 95%	1.5%	0.0%	0.0%
95% to 99%	1.0%	0.0%	0.0%
99% to 100%	0.3%	0.0%	0.0%
TOTAL	**1.4%**	**0.0%**	**0.0%**

58. MAKE CHARITABLE DEDUCTION "ABOVE-THE-LINE"

GDP	< -0.05%
GNP	< +0.05%
Capital Stock	< -0.05%
Wage Rate	< -0.05%
Full-Time Equivalent Jobs	+16,000

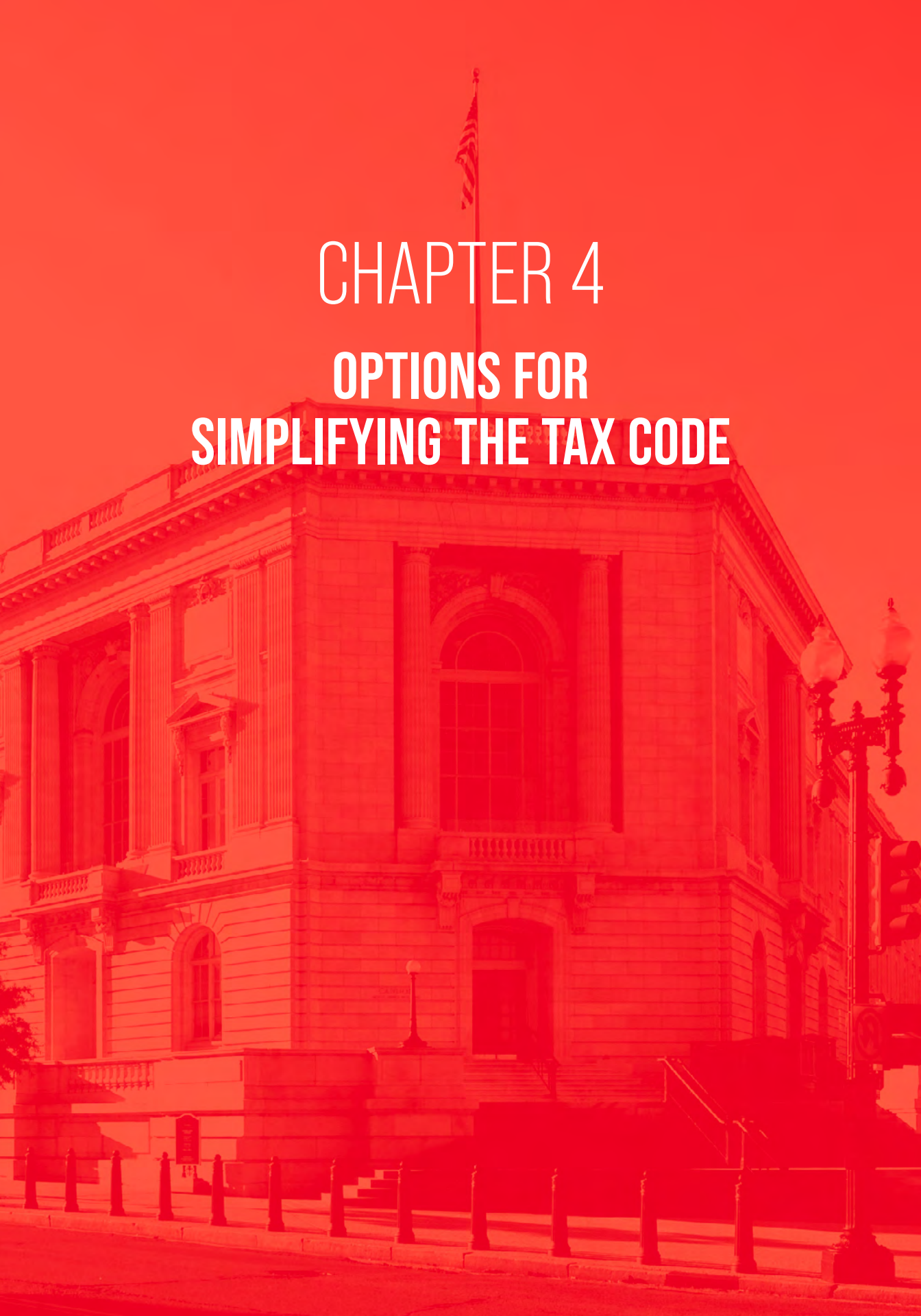
Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$32.5	-$34.4	-$36.0	-$38.1	-$21.0	-$23.2	-$24.4	-$25.4	-$26.5	-$27.9	-$289.3
Dynamic	-$31.8	-$33.7	-$35.3	-$37.4	-$20.8	-$23.0	-$24.2	-$25.2	-$26.4	-$27.8	-$285.4

The charitable contribution deduction is an itemized deduction for donations to certain nonprofit enterprises. The 2017 tax law significantly reduced the number of taxpayers who itemize, decreasing the number that take the charitable deduction. The tax benefits for charitable giving are largely limited to high-income households because these taxpayers are more likely to itemize.

Making the charitable deduction an above-the-live deduction would make it available to all taxpayers, instead of just itemizers. The option would reduce federal revenue because more taxpayers would be able to take this deduction. The economic effect of this option is muted by two opposing effects: it would decrease marginal tax rates on labor for those non-itemizers who get a reduction in taxable income, but it would cause fewer households to itemize, leading to an increase in marginal tax rates on labor.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	< +0.05%	< +0.05%
20% to 40%	0.1%	0.1%	0.1%
40% to 60%	0.2%	0.2%	0.2%
60% to 80%	0.2%	0.2%	0.2%
80% to 100%	0.3%	0.1%	0.1%
80% to 90%	0.3%	0.2%	0.1%
90% to 95%	0.3%	0.1%	0.1%
95% to 99%	0.3%	0.1%	0.0%
99% to 100%	0.3%	0.1%	0.1%
TOTAL	**0.3%**	**0.1%**	**0.1%**



CHAPTER 4

OPTIONS FOR SIMPLIFYING THE TAX CODE

INTRODUCTION

Outside of changes aimed at returning to growth, reducing budget deficits, and aiding vulnerable households, the tax code could be simplified and improved. Major, structural tax reform does not happen often and tends to be a once-in-a-generation event. Between major reforms, the tax code tends to get more complex, not less.

Some of the changes in this chapter would improve the horizontal equity of the tax code, moving towards applying the same set of rules for taxpayers that are in similar situations. For example, repealing the individual alternative minimum tax (AMT) would eliminate a second structure under which certain taxpayers face different rules. Implementing full expensing for all capital investments would equalize tax treatment of the different types of costs businesses incur.

The tax code also contains many temporary provisions, which requires taxpayers to frequently check the tax code for changes. Some of the changes in this chapter would improve the stability of the tax code by eliminating temporary tax expenditures and making other components of the tax code permanent.

This chapter illustrates the economic, revenue, and distributional effects of 12 simplifications to the tax code that lawmakers could consider.

59. TAX INDIVIDUAL INCOMES AT A FLAT 30 PERCENT RATE

GDP	-2.9%
GNP	-3.1%
Capital Stock	-3.0%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-3.3 million

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$1,201.1	$1,264.9	$1,313.7	$1,386.5	$1,130.9	$1,244.7	$1,297.8	$1,351.9	$1,405.1	$1,481.7	$13,078.2
Dynamic	$956.4	$1,001.1	$1,039.8	$1,099.9	$915.4	$1,013.6	$1,056.7	$1,100.8	$1,144.6	$1,208.5	$10,536.9

This option would replace the current bracket structure for individual income taxes with a flat 30 percent rate. It would reduce taxes for the top 1 percent of earners, while raising taxes on many middle-income and upper-middle income taxpayers.

As there are many more middle-income taxpayers than high-income ones, the net effect of a flat tax of 30 percent would be to grow tax revenue—boosting federal revenue over a 10-year period by $13.1 trillion on a conventional basis. This would reduce the supply of labor and increase the cost of capital for businesses that pay the individual income tax. It would also reduce long-run GDP by 2.9 percent and cost 3.3 million full-time equivalent jobs. After including the effects on the economy, this change would increase federal revenue by $10.5 trillion over a 10-year period. On a static basis, this option would have little effect on the bottom 20 percent of taxpayers, because many use the standard deduction to reduce their taxable income to zero. On a dynamic basis, after-tax income would fall for every group, from 2.6 percent for the lowest quintile to 7.9 percent for the highest quintile.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.1%	-0.4%	-2.6%
20% to 40%	-5.1%	-4.9%	-6.8%
40% to 60%	-10.8%	-9.9%	-11.8%
60% to 80%	-13.3%	-11.6%	-13.4%
80% to 100%	-8.0%	-5.8%	-7.9%
80% to 90%	-13.1%	-11.0%	-13.0%
90% to 95%	-11.9%	-9.7%	-11.7%
95% to 99%	-9.4%	-6.7%	-9.0%
99% to 100%	1.2%	3.3%	0.9%
TOTAL	**-9.2%**	**-7.4%**	**-9.4%**

60. ELIMINATE THE INDIVIDUAL ALTERNATIVE MINIMUM TAX (AMT)

GDP	-0.1%
GNP	-0.1%
Capital Stock	0.0%
Wage Rate	0.0%
Full-Time Equivalent Jobs	-113,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$13.8	-$14.5	-$15.0	-$15.8	-$48.5	-$53.2	-$55.2	-$57.3	-$59.3	-$62.6	-$395.1
Dynamic	-$14.1	-$14.9	-$15.4	-$16.3	-$54.6	-$59.6	-$61.8	-$63.9	-$66.1	-$69.6	-$436.2

The alternative minimum tax (AMT) is a separate set of rules that causes some households to calculate their tax liability twice: once under the normal rules and once under the AMT. The AMT rules provide a larger exemption amount but fewer tax preferences than the ordinary income tax system, which allows the AMT to capture more income tax from households that would otherwise claim large deductions under the normal system. The 2017 tax law temporarily increased the AMT exemption and phaseout threshold through 2025, resulting in smaller AMT liabilities and fewer households incurring any AMT liability at all.

Repealing the AMT would reduce federal revenue, but counterintuitively, it would increase the marginal tax rate on some households even as it reduces average tax rates, resulting in a small reduction in GDP. The estimates do not account for the compliance costs of the AMT or the elaborate planning some households undertake to avoid the AMT altogether.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	-0.1%
20% to 40%	0.0%	0.0%	-0.1%
40% to 60%	0.0%	0.0%	-0.1%
60% to 80%	0.0%	0.0%	-0.1%
80% to 100%	0.2%	0.6%	0.5%
80% to 90%	0.0%	0.0%	0.0%
90% to 95%	0.0%	0.1%	0.1%
95% to 99%	0.1%	1.1%	1.1%
99% to 100%	0.6%	1.0%	0.9%
TOTAL	**0.1%**	**0.3%**	**0.3%**

61. PERMANENTLY ELIMINATE THE PEASE LIMITATION ON ITEMIZED DEDUCTIONS

GDP	+0.1%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+78,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$0	$0	$0	$0	-$22.9	-$25.1	-$26.4	-$27.5	-$28.6	-$30.2	-$160.8
Dynamic	$0	$0	$0	$0	-$18.0	-$19.6	-$20.7	-$21.5	-$22.3	-$23.5	-$125.6

The Pease limitation on itemized deductions, named after the late U.S. Congressman Donald Pease, reduces the value of a taxpayer's itemized deductions by 3 percent of every dollar of taxable income above a certain threshold. The 2017 tax reform temporarily eliminated the Pease limitation, but it is set to return in 2026.

Permanently eliminating the Pease limitation would reduce federal revenue by $161 billion over the next decade on a conventional basis. As it would reduce marginal income tax rates, long-run GDP would increase by 0.1 percent. On a dynamic basis, this option would mainly affect top earners, increasing the after-tax incomes of the top quintile by 0.4 percent.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	0.1%
20% to 40%	0.0%	0.0%	0.1%
40% to 60%	0.0%	0.0%	0.1%
60% to 80%	0.0%	0.0%	0.1%
80% to 100%	0.0%	0.3%	0.4%
80% to 90%	0.0%	0.0%	0.1%
90% to 95%	0.0%	0.0%	0.1%
95% to 99%	0.0%	0.1%	0.2%
99% to 100%	0.0%	1.0%	1.0%
TOTAL	**0.0%**	**0.2%**	**0.2%**

62. MAKE THE 2017 TAX LAW STANDARD DEDUCTION, PERSONAL EXEMPTION, AND CTC PERMANENT

GDP	-0.3%
GNP	-0.2%
Capital Stock	-0.6%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-168,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$0.0	$0.0	$0.0	$0.0	$18.5	$22.5	$24.8	$26.2	$28.4	$34.6	$154.9
Dynamic	$0.0	$0.0	$0.0	$0.0	$7.9	$10.4	$11.5	$12.0	$12.7	$17.1	$71.6

The 2017 tax law nearly doubled the standard deduction, eliminated the personal exemption, and increased the child tax credit. The three changes have important implications for the structure of the tax code, such as simplification, as more taxpayers are better off taking the larger standard deduction instead of itemizing their deductions. The changes are scheduled to expire after 2025; this option would make them permanent.

Permanence for the changes would decrease marginal tax rates for some taxpayers but increase marginal tax rates for others. The option would increase revenue and reduce long-run economic output. Taxpayers in the bottom two quintiles would still see their after-tax incomes increase due to the larger standard deduction and child tax credit, even when factoring in reduced economic output.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	1.4%	1.2%
20% to 40%	0.0%	1.3%	1.0%
40% to 60%	0.0%	0.2%	0.0%
60% to 80%	0.0%	-0.2%	-0.4%
80% to 100%	0.0%	-0.5%	-0.7%
80% to 90%	0.0%	-0.7%	-0.9%
90% to 95%	0.0%	-0.9%	-1.1%
95% to 99%	0.0%	-0.4%	-0.6%
99% to 100%	0.0%	0.0%	-0.2%
TOTAL	**0.0%**	**-0.1%**	**-0.3%**

63. IMPLEMENT $2,500 PER YEAR ROTH-STYLE UNIVERSAL SAVINGS ACCOUNTS (USAS)

GDP	< +0.05%
GNP	< +0.05%
Capital Stock	< +0.05%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	0

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$1.3	-$1.3	-$1.4	-$1.4	-$1.4	-$1.5	-$1.6	-$1.7	-$1.8	-$1.9	-$15.1
Dynamic	-$1.3	-$1.3	-$1.4	-$1.4	-$1.4	-$1.5	-$1.6	-$1.7	-$1.7	-$1.8	-$15.0

This option would establish a universal savings account (USA) that would allow taxpayers to contribute up to $2,500 per year in after-tax dollars. Returns to the account would not be subject to tax, mirroring the treatment of Roth plans. The USAs would have no income limitations or withdrawal rules associated with contributions.

This option would reduce federal revenue by about $15.1 billion from 2022 to 2031 on a conventional basis, a relatively small amount compared to other options, due to the $2.500 contribution limit. It would slightly increase the after-tax return to saving, leading to small increases in output and after-tax incomes.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	0%
20% to 40%	0%	0%	0%
40% to 60%	0%	0%	0%
60% to 80%	0%	0%	0%
80% to 100%	< +0.05%	< +0.05%	< +0.05%
80% to 90%	0%	0%	0%
90% to 95%	< +0.05%	< +0.05%	< +0.05%
95% to 99%	< +0.05%	< +0.05%	< +0.05%
99% to 100%	< +0.05%	< +0.05%	< +0.05%
TOTAL	**< +0.05%**	**< +0.05%**	**< +0.05%**

64. ELIMINATE THE NET INVESTMENT INCOME TAX (NIIT)

GDP	< +0.05%
GNP	+0.1%
Capital Stock	+0.1%
Wage Rate	< +0.05%
Full-Time Equivalent Jobs	+9,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$22.3	-$23.5	-$24.3	-$25.6	-$25.4	-$28.0	-$29.1	-$30.6	-$32.1	-$34.2	-$275.1
Dynamic	-$22.3	-$23.3	-$24.1	-$25.3	-$25.1	-$27.6	-$28.6	-$30.0	-$31.4	-$33.5	-$271.2

This option would eliminate the Net Investment Income Tax (NIIT), which was created by the Patient Protection and Affordable Care Act of 2010 as an additional 3.8 percent income tax on certain net investment income, such as dividends, capital gains, interest, estates, and trusts. The tax occurs when modified adjusted gross income rises above $200,000 for singles or $250,000 for couples. Those thresholds are not indexed for inflation, so this tax would affect more taxpayers with each passing year.

Eliminating the NIIT increases the after-tax return to saving, resulting in a slight increase in economic output and a 0.1 percent increase in domestic incomes. After-tax incomes increase mainly for high-income households, but all groups benefit to some degree after accounting for economic growth.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.0%	0.0%	< +0.05%
20% to 40%	0.0%	0.0%	< +0.05%
40% to 60%	0.0%	0.0%	< +0.05%
60% to 80%	0.0%	0.0%	< +0.05%
80% to 100%	0.3%	0.3%	0.4%
80% to 90%	0.0%	0.0%	< +0.05%
90% to 95%	0.0%	0.0%	0.1%
95% to 99%	0.2%	0.3%	0.3%
99% to 100%	0.9%	0.9%	1.0%
TOTAL	**0.2%**	**0.2%**	**0.2%**

65. ENACT FULL EXPENSING FOR ALL CAPITAL INVESTMENT

GDP	+2.3%
GNP	+1.9%
Capital Stock	+4.3%
Wage Rate	+1.9%
Full-Time Equivalent Jobs	+442,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$142.8	-$156.6	-$166.8	-$182.0	-$190.5	-$202.3	-$183.7	-$169.9	-$159.5	-$153.4	-$1,707.4
Dynamic	-$136.3	-$142.4	-$144.3	-$149.3	-$143.1	-$141.0	-$111.5	-$86.4	-$65.2	-$47.2	-$1,166.7

Businesses are permitted to deduct ordinary business costs from revenue to determine taxable income and tax owed. But when a business makes a capital investment, like building a factory, it can only deduct a share of the cost immediately, with the rest deducted over future years on future tax returns. Delaying deductions prevents businesses from fully recovering investment costs because inflation and the time value of money erode the real value of the deductions.

This option would allow businesses to fully expense short- and long-lived investments and research and development costs, reducing the cost of capital. Economic output would expand by 2.3 percent and employment would rise by 442,000 full-time equivalent jobs. When first moving to full expensing, businesses can immediately deduct the cost of their new investments while they continue taking depreciation deductions for their old investments, leading to a large 10-year revenue cost of $1.7 trillion that would drop over time. On a dynamic basis, the revenue cost of the policy is reduced to $1.2 trillion, and after-tax incomes are substantially higher at all income levels.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0.5%	0.4%	2.1%
20% to 40%	0.4%	0.3%	2.2%
40% to 60%	0.4%	0.3%	2.2%
60% to 80%	0.4%	0.3%	2.1%
80% to 100%	1.7%	1.3%	2.9%
80% to 90%	0.5%	0.4%	2.1%
90% to 95%	0.7%	0.6%	2.3%
95% to 99%	1.4%	1.1%	2.8%
99% to 100%	4.0%	2.9%	4.3%
TOTAL	**1.2%**	**0.9%**	**2.6%**

66. MAINTAIN LIMITATION ON INTEREST DEDUCTIBILITY AT 30 PERCENT OF EBITDA

GDP	+0.1%
GNP	< +0.05%
Capital Stock	+0.2%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+19,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$1.7	-$6.0	-$7.8	-$6.3	-$6.6	-$6.9	-$7.2	-$7.5	-$7.8	-$8.1	-$65.8
Dynamic	-$1.5	-$5.7	-$7.3	-$5.7	-$5.8	-$5.9	-$3.8	-$3.6	-$3.4	-$3.2	-$45.9

Under current law, businesses that pay interest on loans can deduct the amount of interest paid as a business expense on their tax returns. The 2017 tax reform limited the deductibility of interest expenses to 30 percent of a business's earnings before interest, taxes, depreciation, and amortization (EBITDA). The cap was temporarily raised to 50 percent of EBITDA for 2019 and 2020 in response to the COVID-19 pandemic. Starting in 2022, interest deductibility would be further limited to 30 percent of a business's earnings before interest and taxes (EBIT).

This option would maintain the limitation at 30 percent of EBITDA rather than EBIT. This would reduce federal revenues over the next decade by $66 billion on a conventional basis. By reducing the cost of debt-financed investments, it would increase long-run GDP by 0.1 percent, reducing the federal revenue cost to $46 billion over the decade. All income quintiles would experience at least a 0.1 percent increase in income on a long-run dynamic basis.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	< +0.05%	0.1%	0.1%
20% to 40%	< +0.05%	< +0.05%	0.1%
40% to 60%	< +0.05%	0.1%	0.1%
60% to 80%	< +0.05%	0.1%	0.1%
80% to 100%	< +0.05%	0.1%	0.1%
80% to 90%	< +0.05%	0.1%	0.1%
90% to 95%	< +0.05%	0.1%	0.1%
95% to 99%	< +0.05%	0.1%	0.1%
99% to 100%	< +0.05%	0.2%	0.1%
TOTAL	**< +0.05%**	**0.1%**	**0.1%**

67. ELIMINATE VARIOUS BUSINESS TAX EXPENDITURES

GDP	-0.2%
GNP	-0.2%
Capital Stock	-0.4%
Wage Rate	-0.2%
Full-Time Equivalent Jobs	-33,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$114.6	$119.8	$126.0	$120.2	$83.1	$72.7	$78.9	$86.8	$90.0	$93.7	$985.6
Dynamic	$114.0	$116.3	$120.6	$112.5	$78.9	$67.1	$72.3	$79.2	$81.5	$84.1	$926.4

Tax expenditures are provisions that deviate from a "normal income tax structure" and generally favor a specific industry or activity. This option would broaden the tax base by repealing most business tax expenditures, but it would retain expenditures related to deferral, cost recovery, and foreign income.

The economic impact of repeal is limited by two factors: some expenditures incentivize switching from one activity to another, rather than increasing the overall level of activity, and some are temporary, so bringing forward their scheduled expiration does not deviate from long-term law. Some expenditures, though, do have effects on long-term marginal tax rates, and so eliminating them would increase marginal tax rates on corporate and noncorporate businesses.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.9%	-0.7%	-1.1%
20% to 40%	-0.7%	-0.6%	-0.9%
40% to 60%	-0.8%	-0.6%	-1.0%
60% to 80%	-0.8%	-0.6%	-1.0%
80% to 100%	-1.6%	-1.2%	-1.8%
80% to 90%	-0.9%	-0.7%	-1.1%
90% to 95%	-1.0%	-0.8%	-1.3%
95% to 99%	-1.4%	-1.1%	-1.7%
99% to 100%	-2.7%	-2.1%	-3.1%
TOTAL	**-1.2%**	**-1.0%**	**-1.4%**

68. REPLACE THE CORPORATE INCOME TAX WITH A 5 PERCENT VALUE-ADDED TAX (VAT)

GDP	+0.4%
GNP	+0.2%
Capital Stock	+2.0%
Wage Rate	+0.5%
Full-Time Equivalent Jobs	+122,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$288.2	$248.6	$243.1	$239.8	$253.1	$269.3	$283.6	$298.6	$315.5	$332.8	$2,772.6
Dynamic	$229.1	$191.0	$189.6	$190.9	$208.4	$228.8	$247.4	$266.9	$288.1	$309.4	$2,349.3

This option would repeal the current corporate income tax (and its attendant complexities in defining domestic and foreign income) and replace it with a 5 percent Value-Added Tax (VAT), which is a broad-based tax on consumption.

Because the VAT allows businesses to immediately deduct the cost of their investments, this swap would reduce the cost of capital and lead to a larger economy. The option would raise substantial revenue because the VAT has a broader base than the current corporate income tax, covering approximately 63 percent of GDP. Exempting sectors of the economy from the VAT would reduce its revenue-raising potential.

Replacing the corporate income tax with a VAT would be regressive. Over the long term, some of the reductions in after-tax income would be offset by the increase in economic output, but households in the bottom four quintiles would still see a reduction in incomes.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-1.5%	-1.1%	-0.2%
20% to 40%	-1.5%	-1.3%	-0.6%
40% to 60%	-1.5%	-1.2%	-0.4%
60% to 80%	-1.3%	-1.0%	-0.2%
80% to 100%	+0.2%	+0.7%	+2.1%
80% to 90%	-1.0%	-0.7%	+0.1%
90% to 95%	-0.8%	-0.5%	+0.5%
95% to 99%	-0.3%	0.3%	+1.6%
99% to 100%	+2.5%	+3.3%	+5.7%
TOTAL	**-0.6%**	**-0.2%**	**+1.0%**

69. ELIMINATE ESTATE AND GIFT TAXES

GDP	+0.1%
GNP	+0.2%
Capital Stock	+0.3%
Wage Rate	+0.1%
Full-Time Equivalent Jobs	+22,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	-$2.9	-$20.0	-$21.0	-$22.0	-$23.0	-$34.0	-$38.0	-$41.0	-$44.0	-$48.0	-$293.9
Dynamic	-$2.8	-$19.8	-$20.6	-$21.5	-$20.2	-$30.5	-$34.0	-$36.4	-$38.9	-$42.3	-$267.1

Federal estate and gift taxes generate a small portion of federal revenue compared to other taxes. In 2018, only roughly 13,000 estate tax returns were filed and less than half were taxable. In 2019, estate and gift taxes only raised $19 billion, accounting for about 0.5 percent of total federal revenue receipts. Since 2000, the estate tax has played a decreasing role due to a higher exemption and a lower rate.

Repealing the federal estate and gift taxes would cost $294 billion over the next decade, on a conventional basis. Furthermore, eliminating the taxes would lower the combined tax rate on savings and investment. This would lead to a 0.1 percent increase in economic output and a 0.2 percent increase in national income. The estate tax only applies to deceased individuals with more than $11.7 million in assets (the exemption is scheduled to shrink by half in 2026), and as such we assume most of the tax cut would flow to high-income households, as we have insufficient data on heirs.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	0%	0%	0.1%
20% to 40%	0%	0%	0.1%
40% to 60%	0%	0%	0.1%
60% to 80%	0%	0%	0.1%
80% to 100%	0.1%	0.8%	0.8%
80% to 90%	0.0%	0.0%	0.1%
90% to 95%	0.0%	0.0%	0.1%
95% to 99%	0.0%	0.0%	0.1%
99% to 100%	0.2%	2.8%	2.6%
TOTAL	**< +0.05%**	**0.4%**	**0.4%**

70. INCREASE ALCOHOL EXCISE TAXES TO $16 PER PROOF GALLON AND INDEX TO INFLATION

GDP	< -0.05%
GNP	< -0.05%
Capital Stock	< -0.05%
Wage Rate	-0.1%
Full-Time Equivalent Jobs	-23,000

Billions of Dollars	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total
Conventional	$11.5	$11.8	$12.4	$12.9	$13.3	$13.7	$14.3	$14.9	$15.4	$16.0	$136.1
Dynamic	$11.0	$11.2	$11.7	$12.3	$12.6	$13.0	$13.5	$14.1	$14.6	$15.1	$129.1

Alcohol excise taxes are levied on manufacturers and importers of beer, wine, and distilled spirits. The alcohol content of different beverages is taxed at different rates, and smaller producers face lower rates for some beverages. Excise taxes are sometimes used to address societal costs or discourage bad behavior, but alcohol excise taxes have not historically fulfilled that role. Instead, they have been used as a source of revenue.

This option would uniformly tax the alcohol content of all beverages at $16 per proof gallon, including for small producers, and index the tax for inflation going forward. The increase would have a slightly negative effect on the economy and a regressive impact on after-tax incomes. In the long term, consumers would bear the burden of an alcohol excise tax increase through increased prices.

CHANGE IN AFTER-TAX INCOME

Income Quintile	Conventional 2022	Conventional 2031	Long-Run Dynamic
0% to 20%	-0.1%	-0.1%	-0.1%
20% to 40%	-0.1%	-0.1%	-0.1%
40% to 60%	-0.1%	-0.1%	-0.1%
60% to 80%	-0.1%	-0.1%	-0.1%
80% to 100%	-0.1%	-0.1%	-0.1%
80% to 90%	-0.1%	-0.1%	-0.1%
90% to 95%	-0.1%	-0.1%	-0.1%
95% to 99%	-0.1%	-0.1%	-0.1%
99% to 100%	-0.1%	-0.1%	< -0.05%
TOTAL	**-0.1%**	**-0.1%**	**-0.1%**

ABOUT THE TAX FOUNDATION

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and global levels. Our Center for Federal Tax Policy's research and outreach highlight our tax code's strengths and weaknesses and show how tax policy impacts taxpayers, the government, and the economy at large.

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Acknowledgments

The Tax Foundation would like to thank the work of Kyle Pomerleau, Stephen J. Entin, Gary Robbins, and Karl Smith.

The economic crisis caused by the coronavirus pandemic poses a triple challenge for tax policy in the United States. Lawmakers are tasked with crafting a policy response that will accelerate the economic recovery, reduce the mounting deficit, and protect the most vulnerable.

To assist lawmakers in navigating the challenge, and to help the American public in understanding the tax changes being proposed, we've assembled a collection of 70 potential changes to the U.S. tax code. Our team of economists has modeled the effects of each option on the U.S. economy, the distribution of the tax burden, and federal revenue.

In tax policy there is an ever-present trade-off among how much revenue a tax will raise, who bears the burden of a tax, and what impact a tax will have on economic growth. Armed with the information in this book, policymakers can debate the relative merits and trade-offs of each option to improve the tax code in a post-pandemic world.

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