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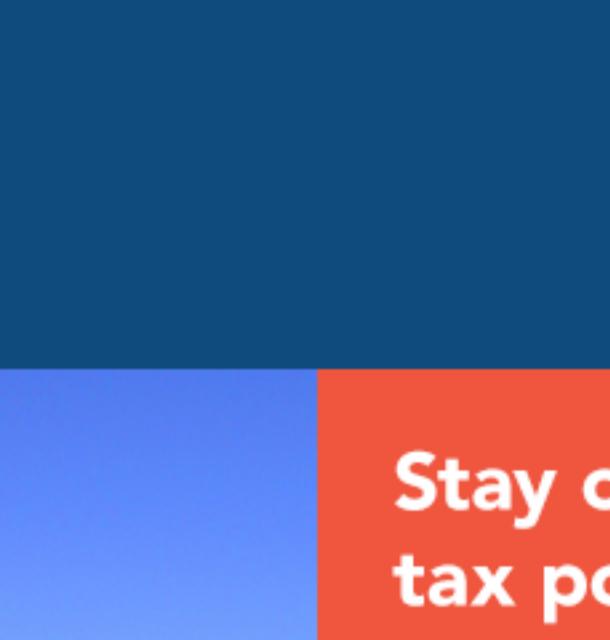


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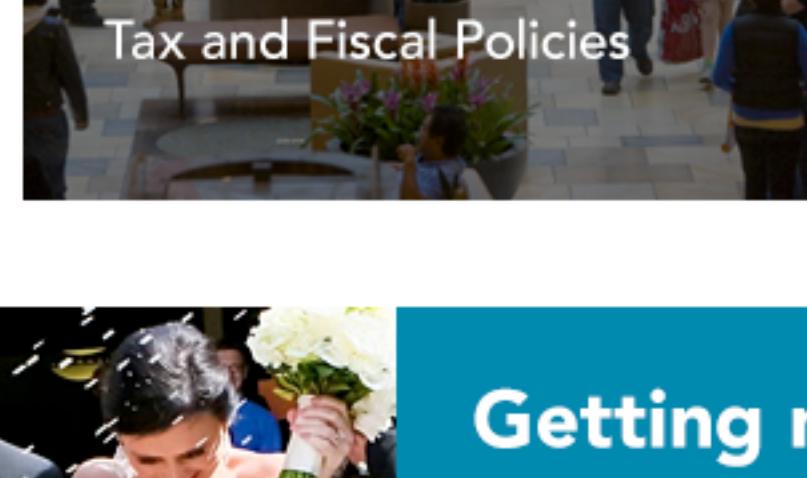
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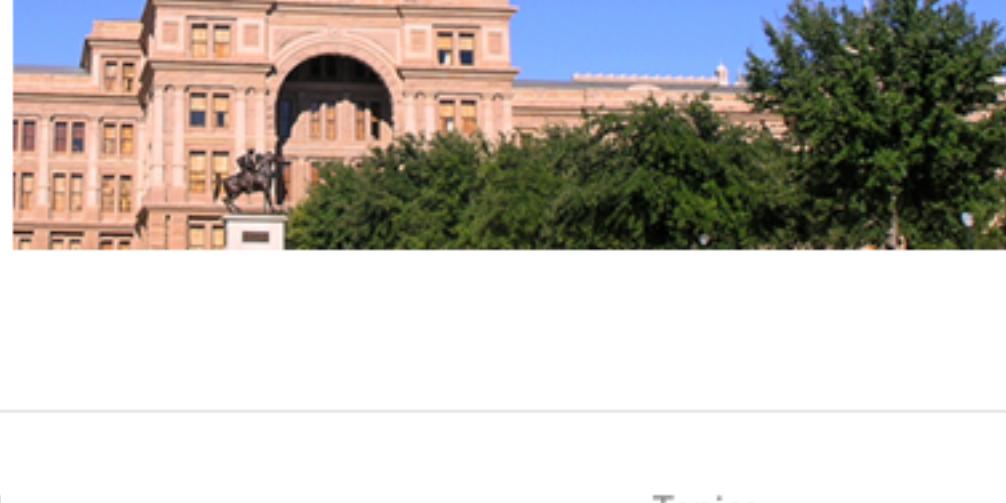
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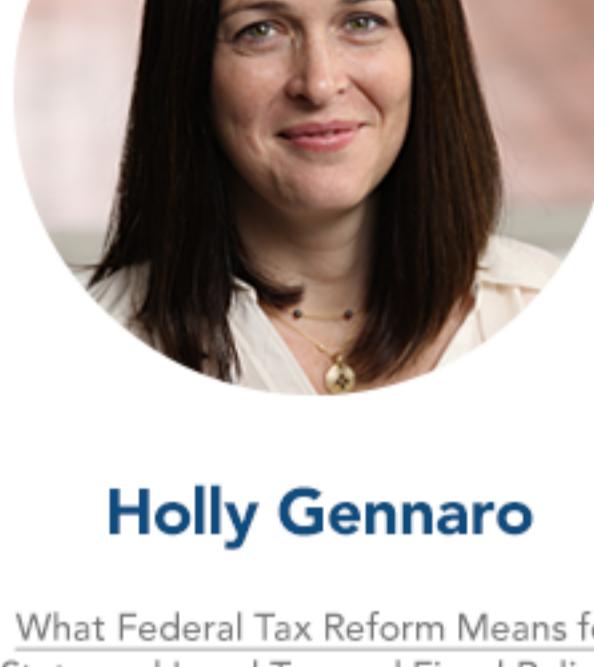
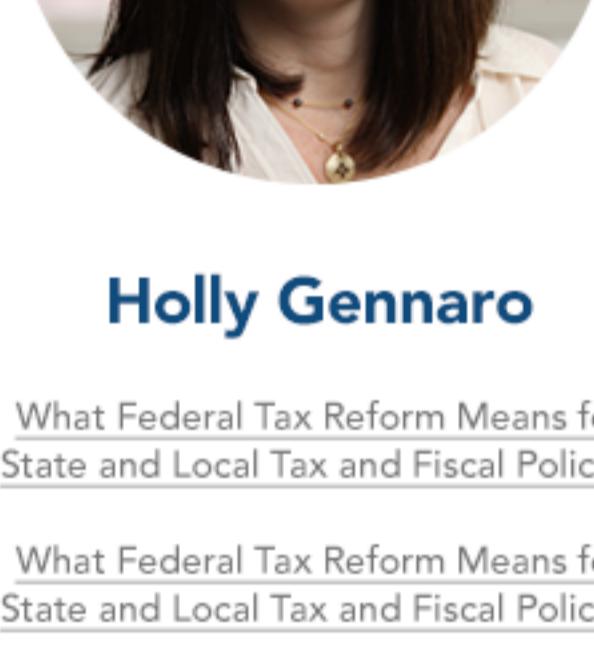
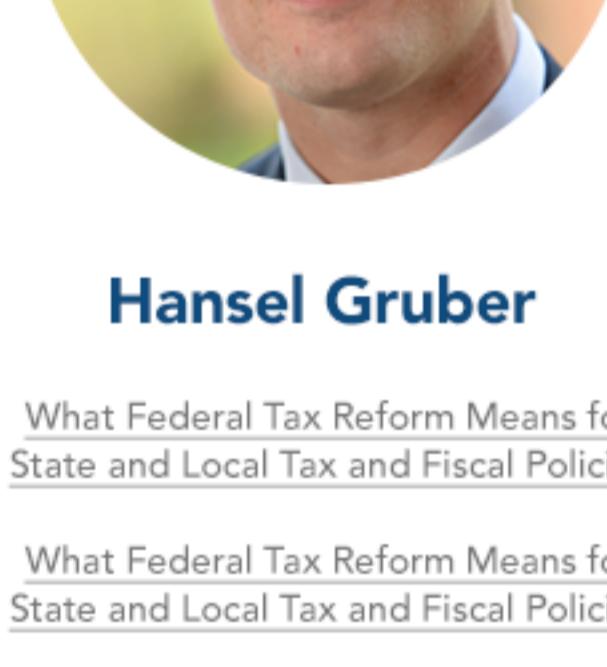
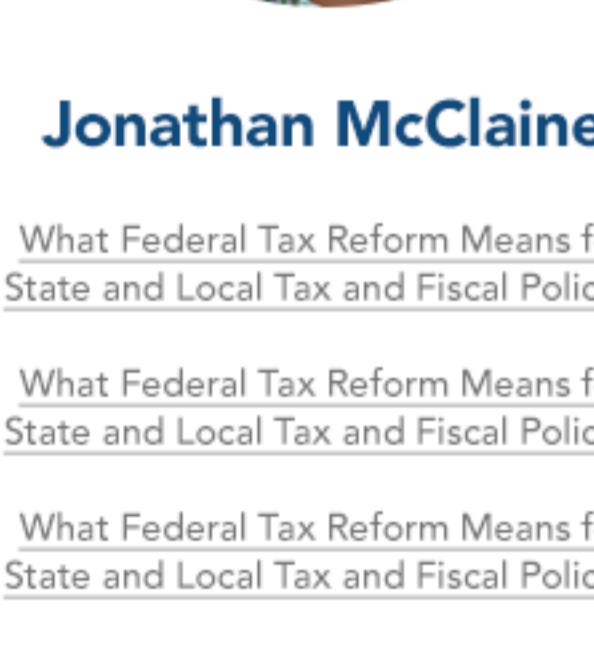
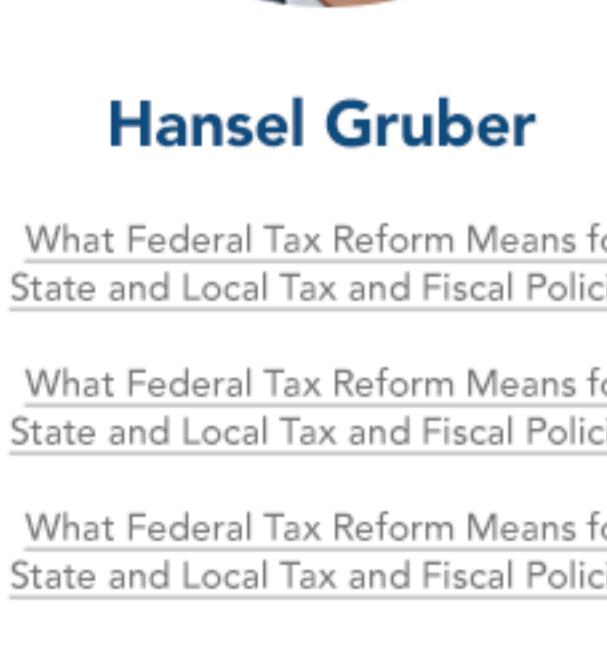
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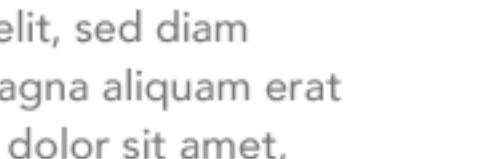
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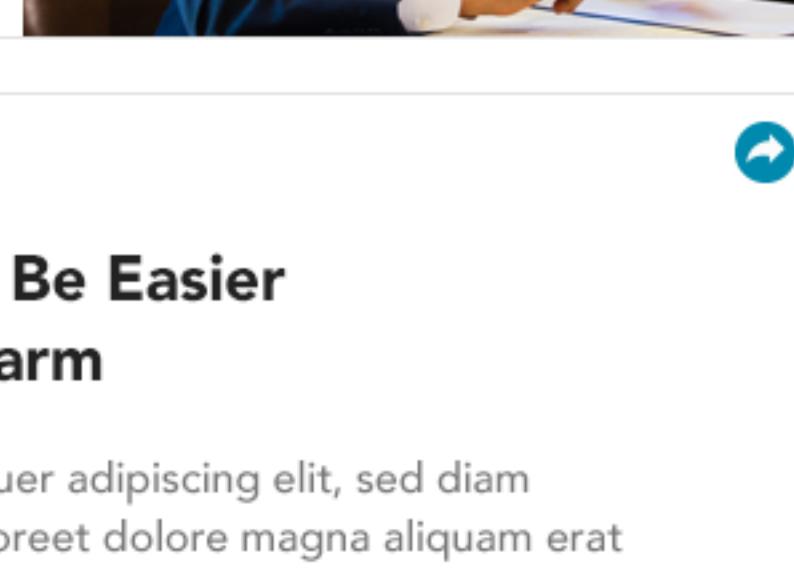
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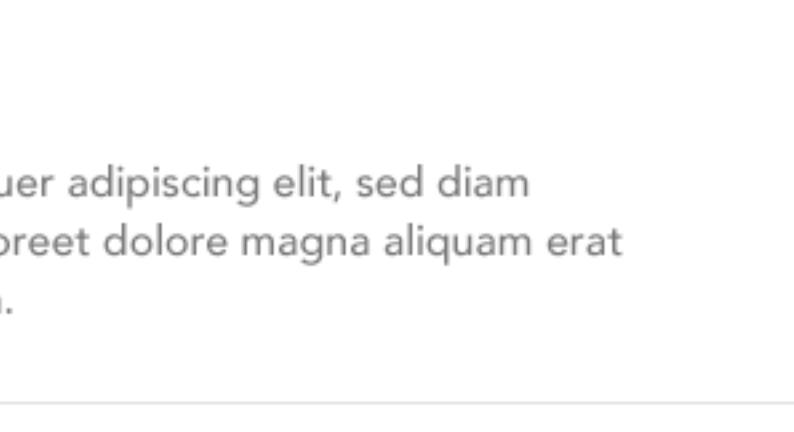
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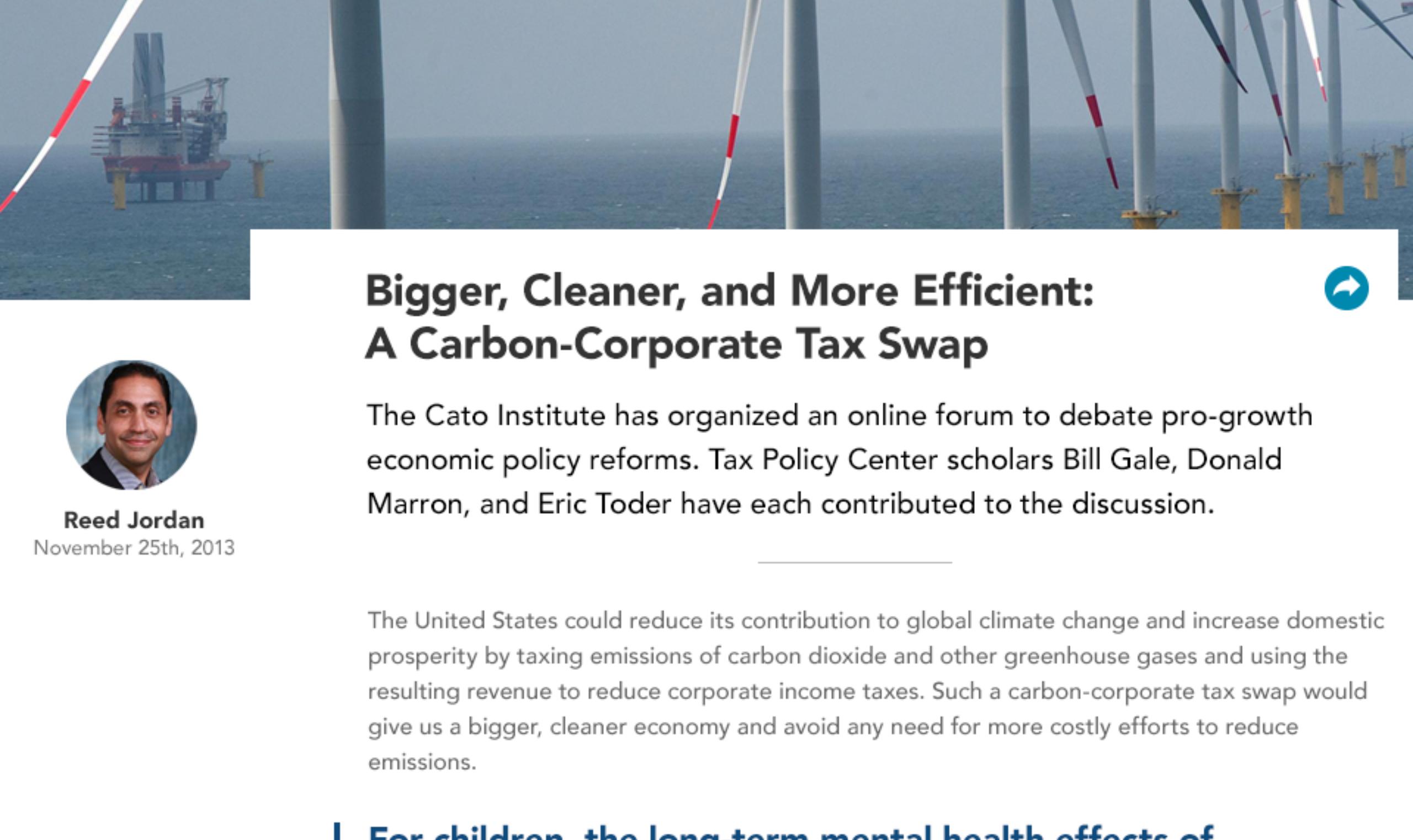
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Bigger, Cleaner, and More Efficient: A Carbon-Corporate Tax Swap



Reed Jordan

November 25th, 2013

The Cato Institute has organized an online forum to debate pro-growth economic policy reforms. Tax Policy Center scholars Bill Gale, Donald Marron, and Eric Toder have each contributed to the discussion.

For children, the long-term mental health effects of poverty are even more alarming.

Second, putting a price on carbon is the most efficient way to reduce carbon emissions. In the absence of a national carbon price, as from a carbon tax or a cap-and-trade system, policymakers will likely continue to pursue piecemeal regulations and subsidies. Indeed, we see that today in heightened fuel economy standards and state-by-state electric power plant regulations.

These regulatory efforts can reduce emissions, but at greater cost per ton than a national carbon price.

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Even the best-intentioned regulations treat emissions sources differently, over-controlling some and under-controlling others. They overlook some of the least costly ways to reduce emissions and do little to reward innovation beyond regulatory minimums. Subsidies, through both spending programs and tax incentives, suffer similar problems, offering incentives that are only loosely related to potential environmental gains and often omitting potential methods for reducing emissions. Far more efficient would be a single price that uniformly encourages emissions reductions from all sources and by any means.

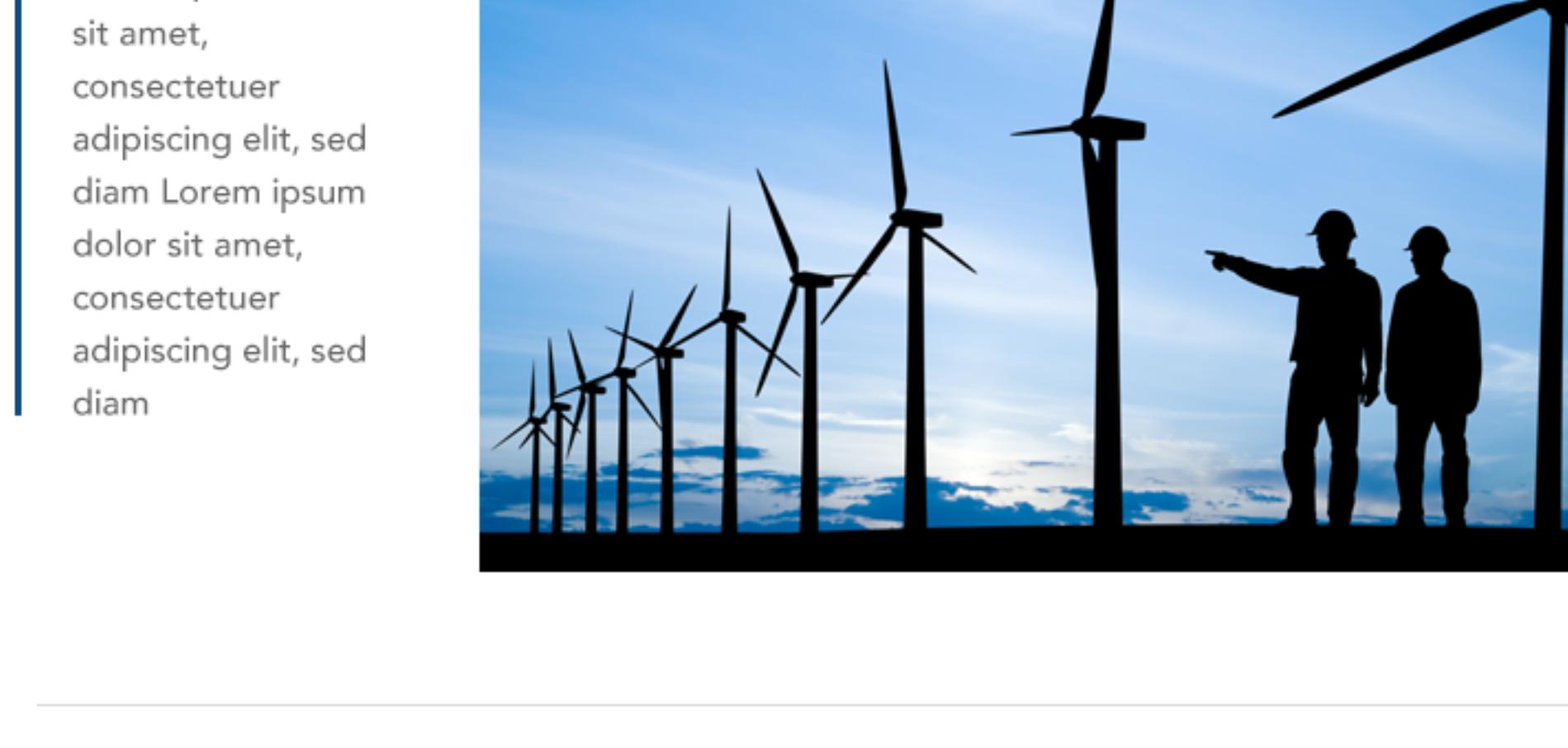
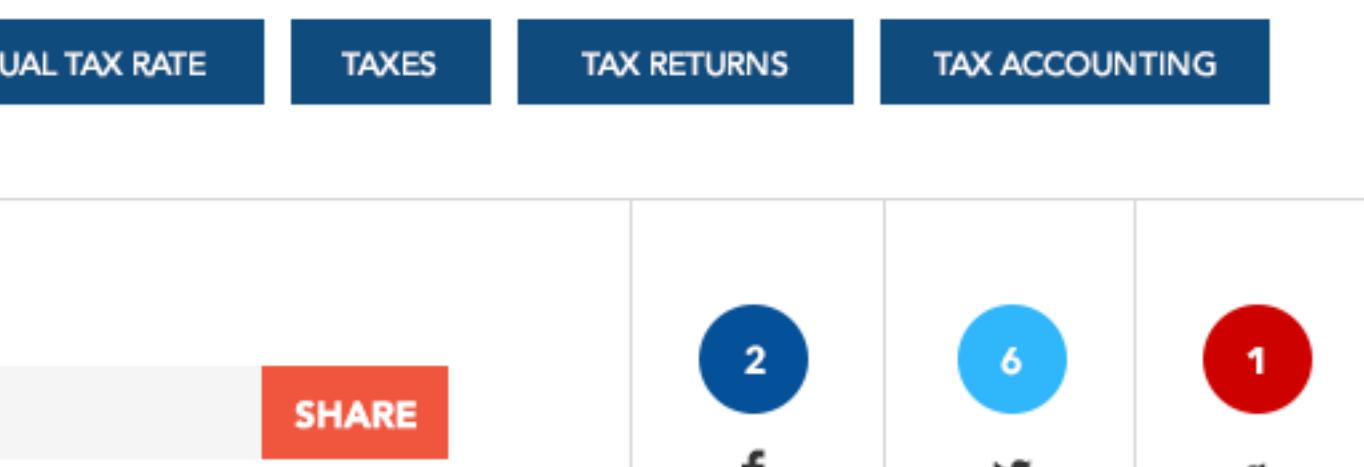


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Abstract

Our tax system imposes widely varying tax rates on investments in different activities, favors debt over equity, and favors pass-throughs over corporations. Targeted tax incentives can lower the cost of capital for small businesses, startups, and those that invest in intellectual property. But those advantages are weakened, and sometimes eliminated, because businesses that invest in new ideas rely more on higher-taxed equity than do firms that focus on tangible investment and because startups are often limited in their ability to use tax deductions and credits. These limits can more than offset the benefit from tax incentives.

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America's long journey to end housing discrimination remains unfinished.

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Introduction

New investment, whether in software, factories, or innovative ideas, is a key driver of productivity growth and rising living standards. America's future prosperity depends, in significant measure, on the amount and type of investments that existing businesses and new entrepreneurs make today and in coming years.

Taxes are one factor influencing their investment decisions. High taxes can discourage some investments, while tax incentives can encourage others. Wide differences in effective tax rates, moreover, alter the composition of investment, boosting it in some areas while reducing it in others. Some differences in tax treatment across forms of investment might be warranted on policy grounds (for example, encouraging investments that produce extra societal benefits), but differential tax incentives usually inefficiently distort investment decisions and reduce total economic output.

Policymakers should therefore give careful attention to those incentives and disincentives and their effects on investment and innovation.

Such attention is particularly important given recent interest in tax reform. Policymakers from across the political spectrum have recently proposed major rewrites of business and corporate taxation. Last year, for example, then-House Ways and Means Chairman Dave Camp offered a far-reaching plan that attempts to address many of the problems and tradeoffs in our current system of business taxation. The Senate Finance Committee and the Obama Administration have also offered business tax proposals, suggesting there might be bipartisan interest in pursuing reform. At the same time, the influence of tax considerations on a wave of expatriation transactions (so-called inversions) by U.S. multinational corporations has further focused attention on the way we tax businesses.

Given that context, it is a propitious time to examine how the current U.S. tax system affects incentives to invest and how those might change under various tax reforms. Of particular interest is how the tax system affects the most innovative parts of our economy, including entrepreneurial ventures and firms large and small that invest in new ideas.

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In section 3, we apply that framework to today's federal tax code. Like prior studies, we find that debt-financed investments enjoy a significant advantage over equity-financed ones, and that pass-through entities face lower effective tax rates than C corporations. We also find that investments in intellectual property, especially research and development, face significantly lower effective taxes than do tangible investments in equipment, structures, and inventory. Favorable depreciation rules reduce effective tax rates for startups and other small businesses that invest in equipment. Favorable capital gains treatment for investors can also help startups, but the effect is small compared to other tax provisions. Tax benefits for innovative businesses are partly offset, however, by their greater reliance on higher-taxed equity.

In section 4, we examine an important tax disadvantage facing many startups: limits on their ability to receive the full benefit of tax deductions and credits. If a company is making losses during its initial years of operation, it may not receive any immediate benefit from write-offs or credits resulting from new investment; instead, those benefits are in many circumstances delayed until the company becomes profitable. That delay, along with rules that reduce the value of accrued tax losses if a company is acquired, increases the effective tax rate on startup investment. We extend our framework to account for these limitations, and find that they have a substantial effect. In some cases, the reduction in benefits from these loss limitations more than offsets the benefit provided by tax incentives aimed at small and new businesses.

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Percentage of live births to unmarried mothers

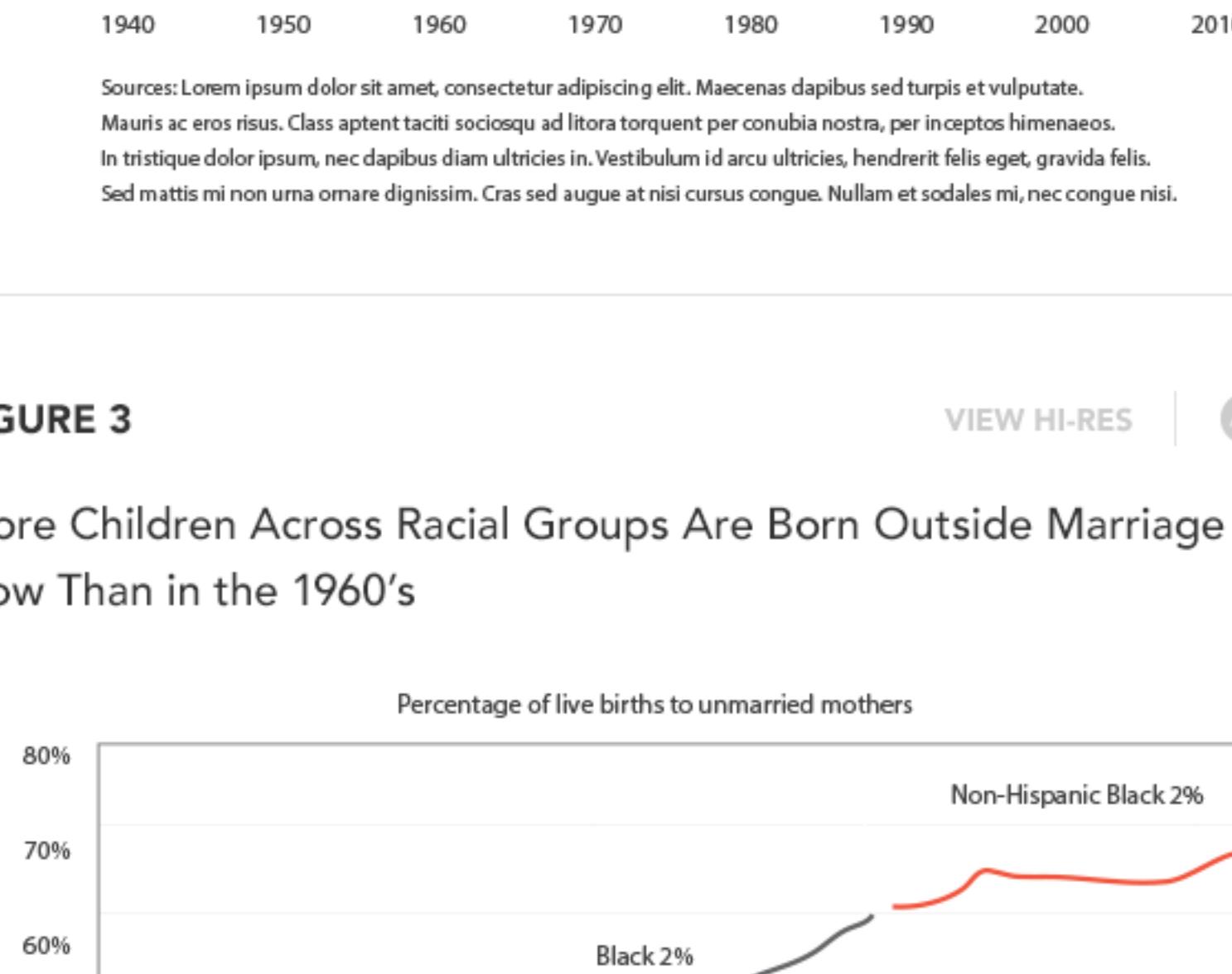


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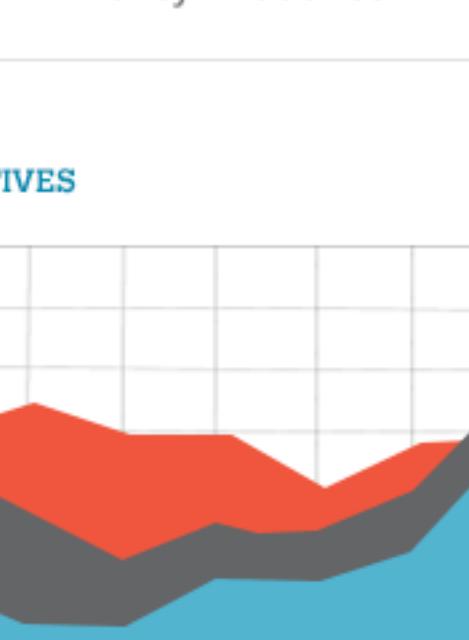
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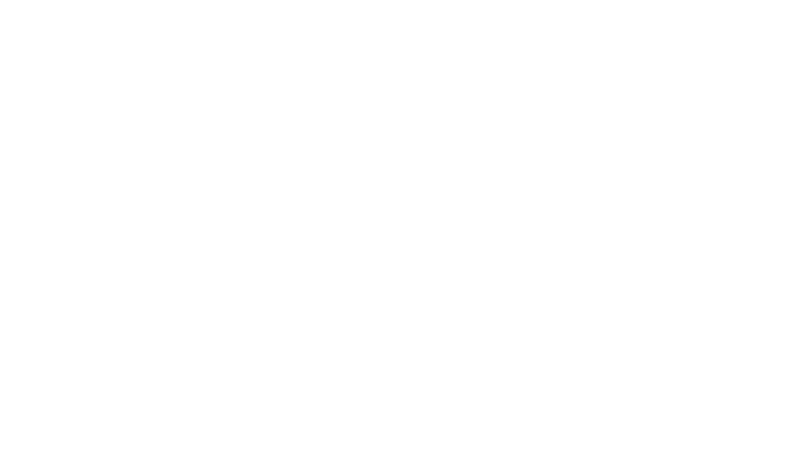


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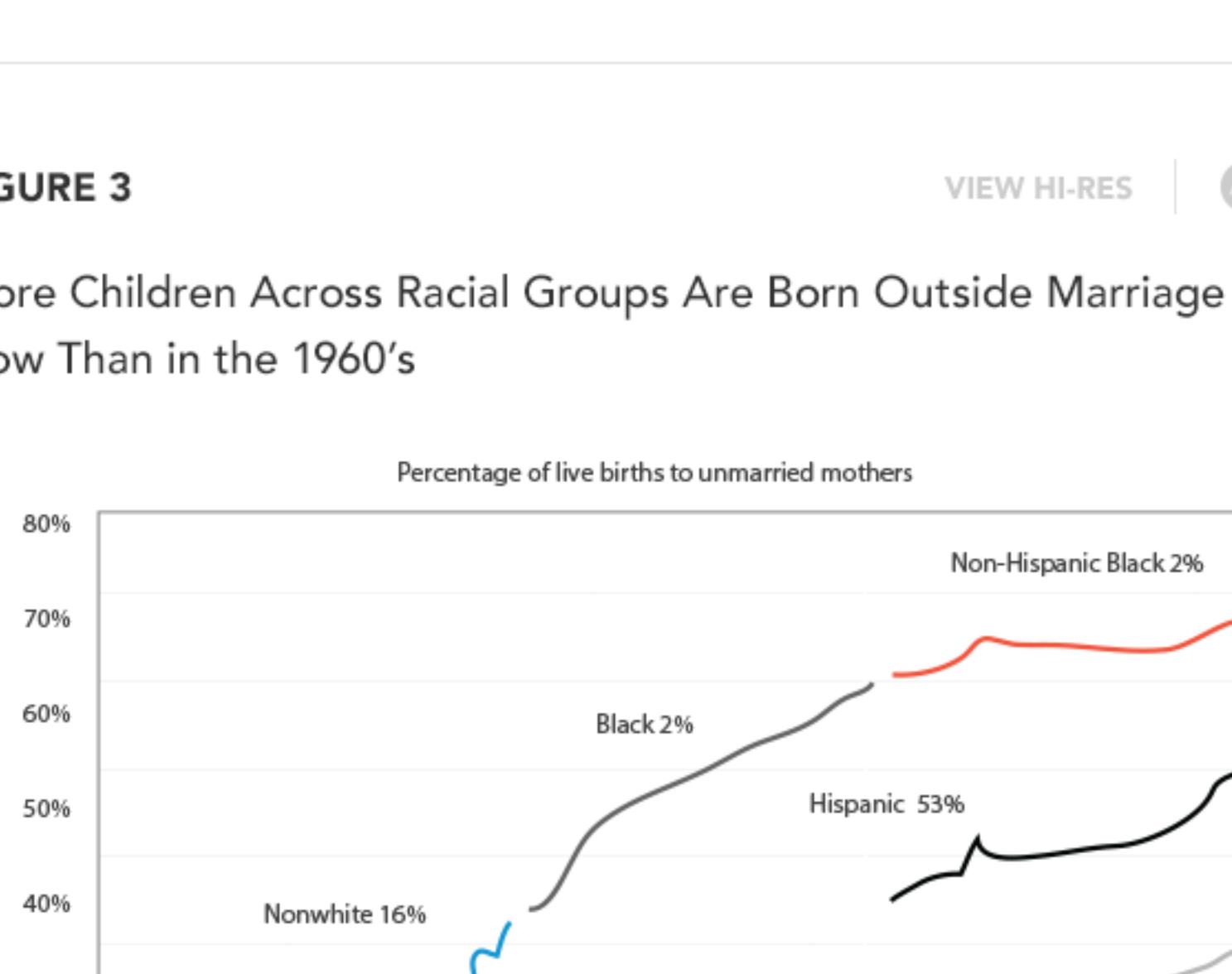
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FIGURE 3

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More Children Across Racial Groups Are Born Outside Marriage Now Than in the 1960's

Percentage of live births to unmarried mothers



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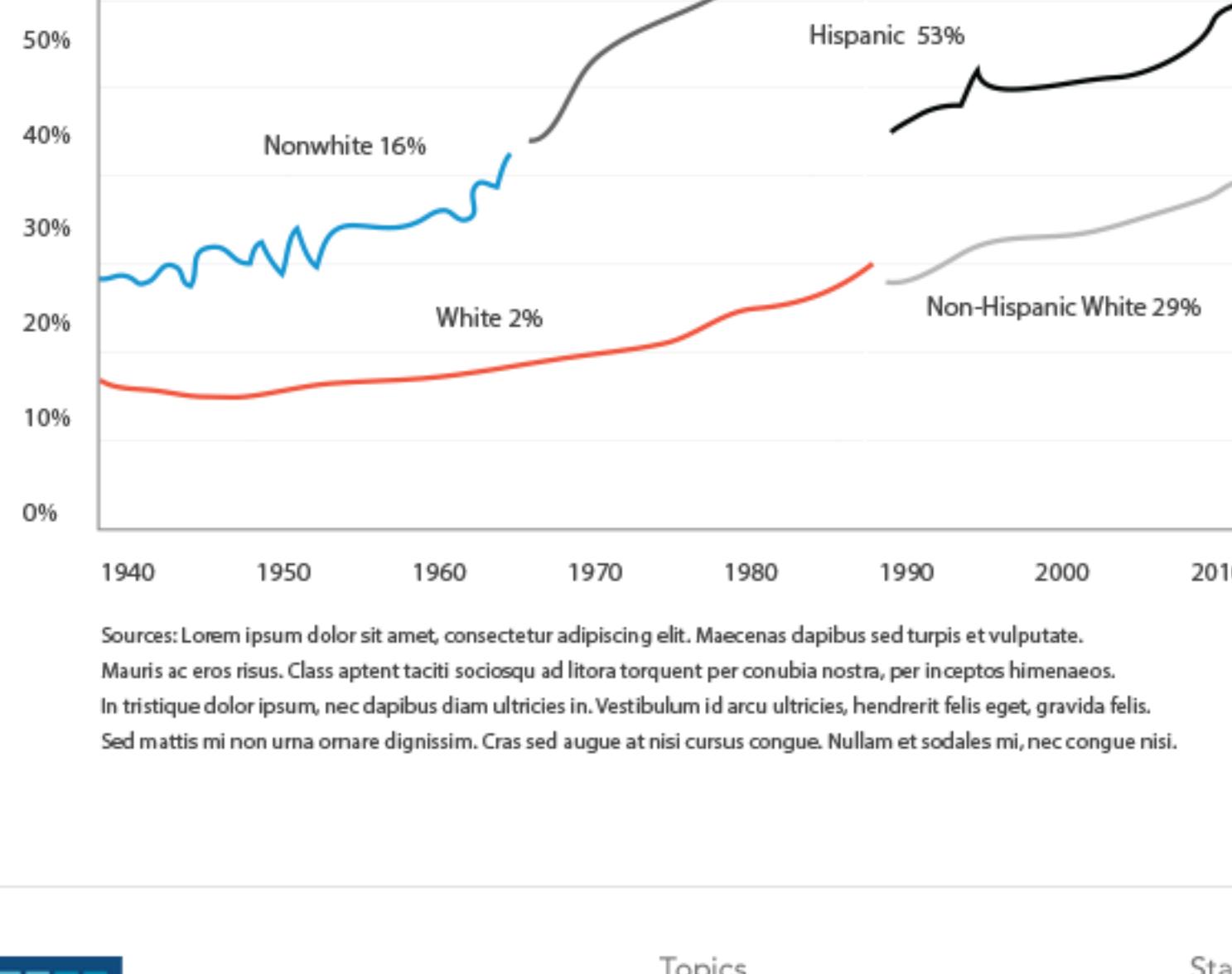
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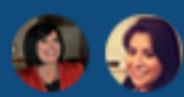
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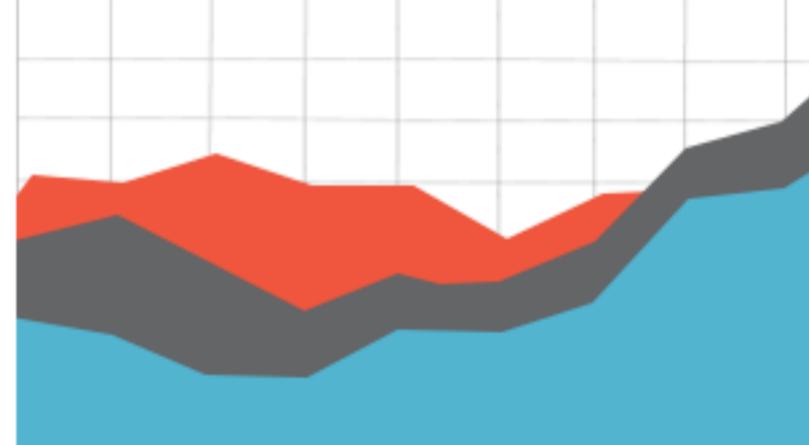
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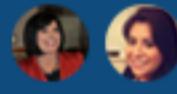




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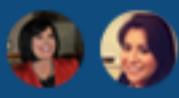


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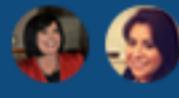
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22-Aug-03

Nonfilers and Filers With Modest Tax Liabilities, 2003

| Family Status | Tax Units | | Nonfilers | | Nontaxable Returns (including those with net refunds)* | | Income Tax of \$500 or Less | |
|--------------------------|--------------------|------------------|--------------------|-------------------|---|-------------------|-----------------------------|-------------------|
| | Number (thousands) | Percent of Total | Number (thousands) | Percent of Column | Number (thousands) | Percent of Column | Number (thousands) | Percent of Column |
| Single | 59,108 | 42.5 | 11,345 | 62.6 | 10,098 | 30.1 | 4,949 | 59.1 |
| Single head of household | 21,242 | 15.3 | 1,533 | 8.5 | 13,036 | 38.9 | 966 | 11.5 |
| Married without children | 30,992 | 22.3 | 4,681 | 25.8 | 3,548 | 10.6 | 1,461 | 17.4 |
| Married with children | 27,617 | 19.9 | 573 | 3.2 | 6,861 | 20.5 | 996 | 11.9 |
| All | 138,959 | 100 | 18,131 | 100 | 33,544 | 100 | 8,372 | 100 |

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0503-1).
Peter Orszag and Matthew Hall, "Nonfilers and Filers With Modest Tax Liabilities" Tax Facts column in Tax Notes magazine, August 4, 2003.
Note: Excludes dependent filers.

* Income tax liability net of refundable credits.

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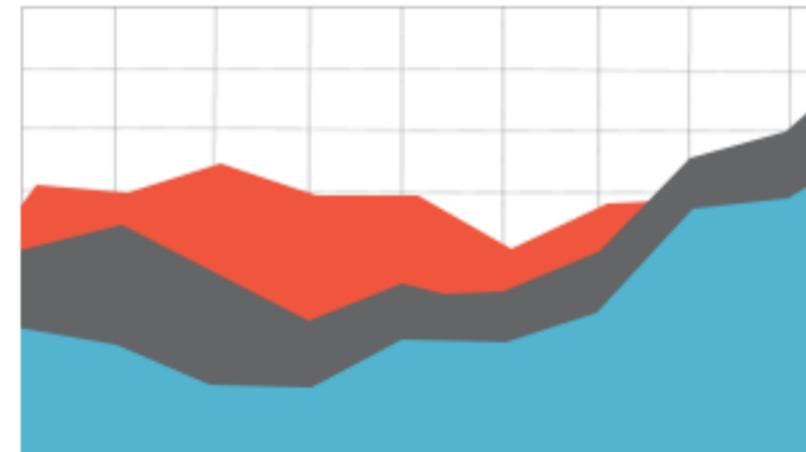
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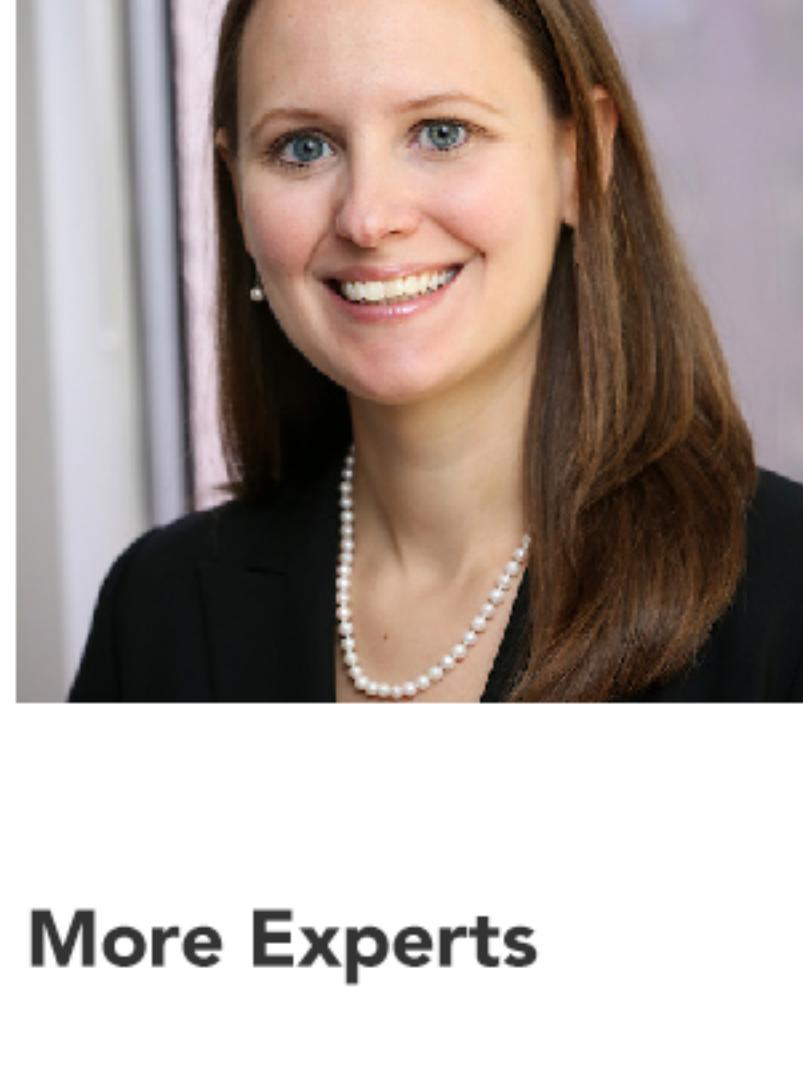
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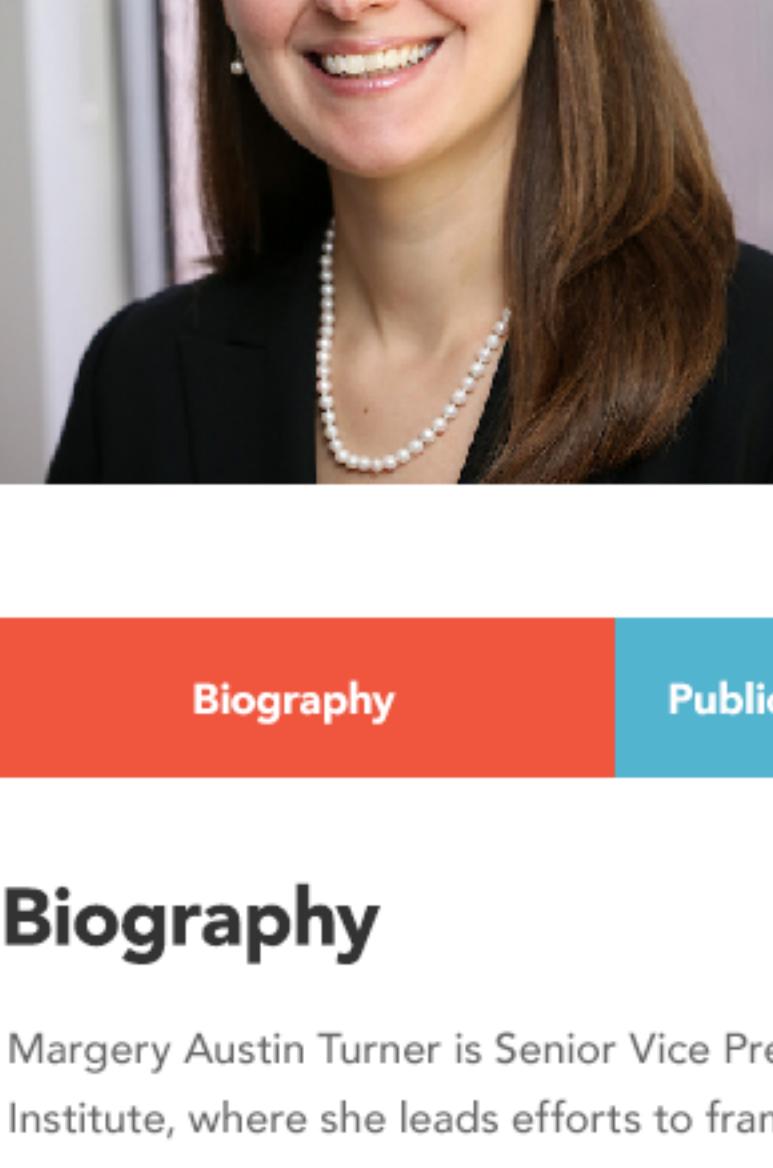
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Margery Austin Turner is Senior Vice President for Program Planning and Management at the Urban Institute, where she leads efforts to frame and conduct a forward-looking agenda of policy research. A nationally recognized expert on urban policy and neighborhood issues, Ms. Turner has analyzed issues of residential location, racial and ethnic discrimination and its contribution to neighborhood segregation and inequality, and the role of housing policies in promoting residential mobility and location choice. Among her recent publications is *Public Housing and the Legacy of Segregation* (2009).

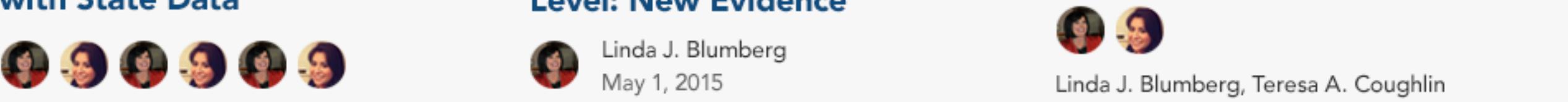
Ms. Turner served as Deputy Assistant Secretary for Research at the Department of Housing and Urban Development from 1993 through 1996, focusing HUD's research agenda on the problems of racial discrimination, concentrated poverty, and economic opportunity in America's metropolitan areas. During her tenure, HUD's research office launched three major social science demonstration projects to test different strategies for helping families from distressed inner-city neighborhoods gain access to opportunities through employment and education.

To contact this expert, call the Office of Public Affairs at (202) 261-5709 or email them directly at publicaffairs@urban.org.

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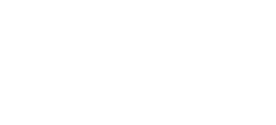


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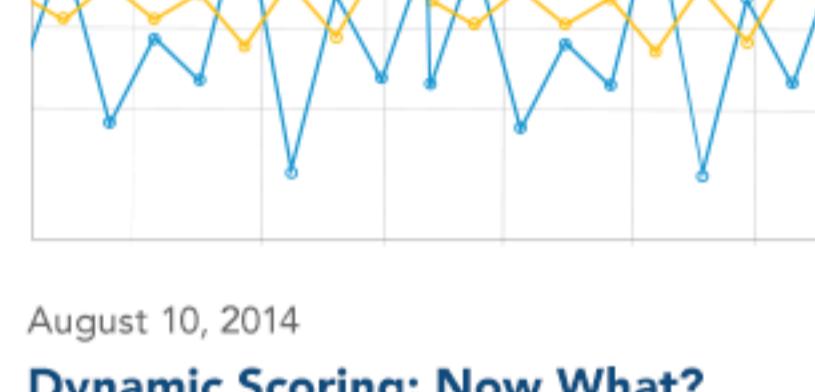
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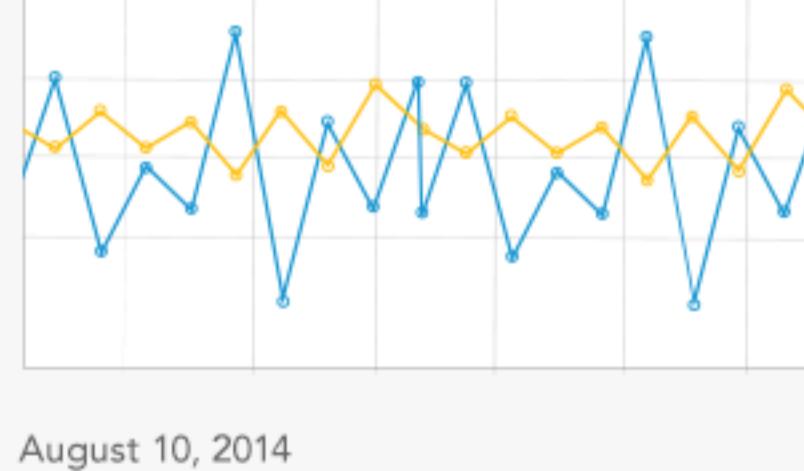
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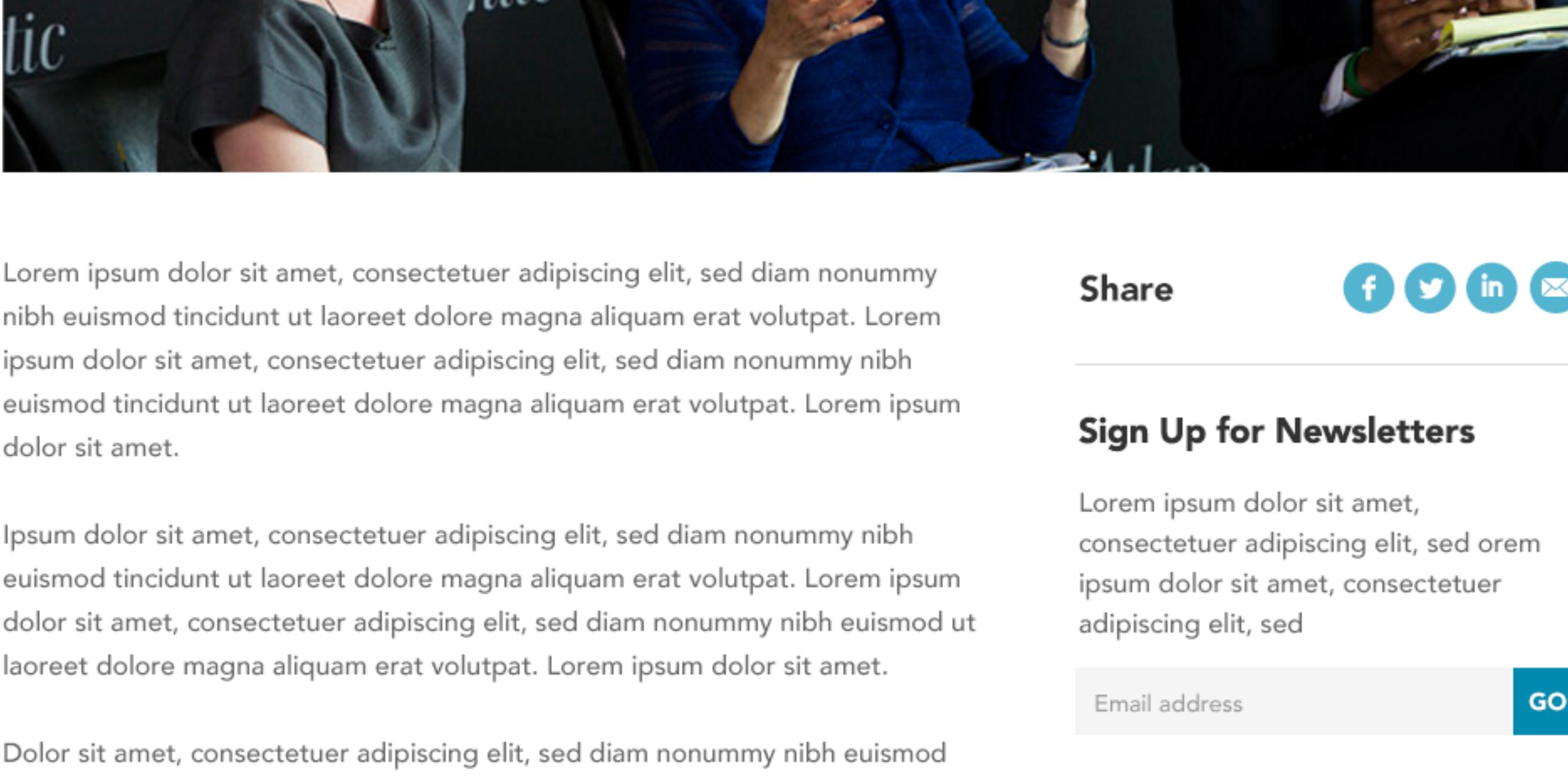
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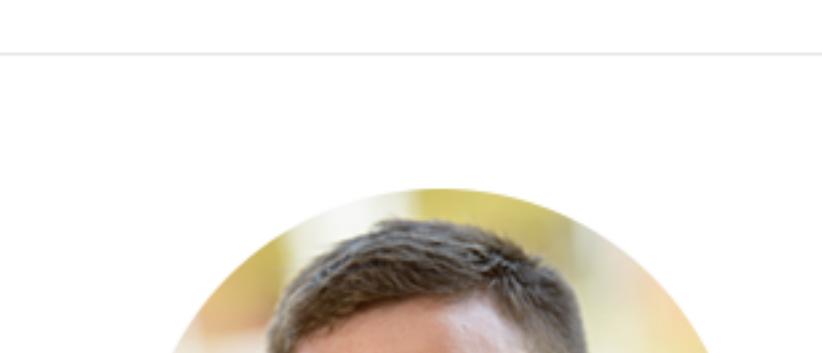
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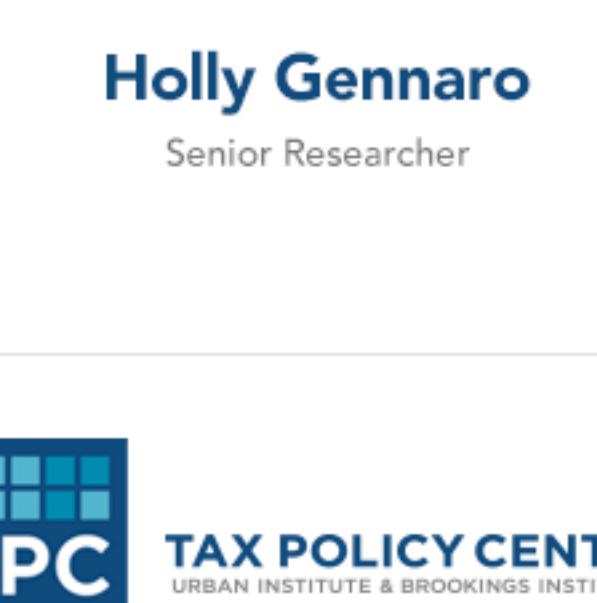
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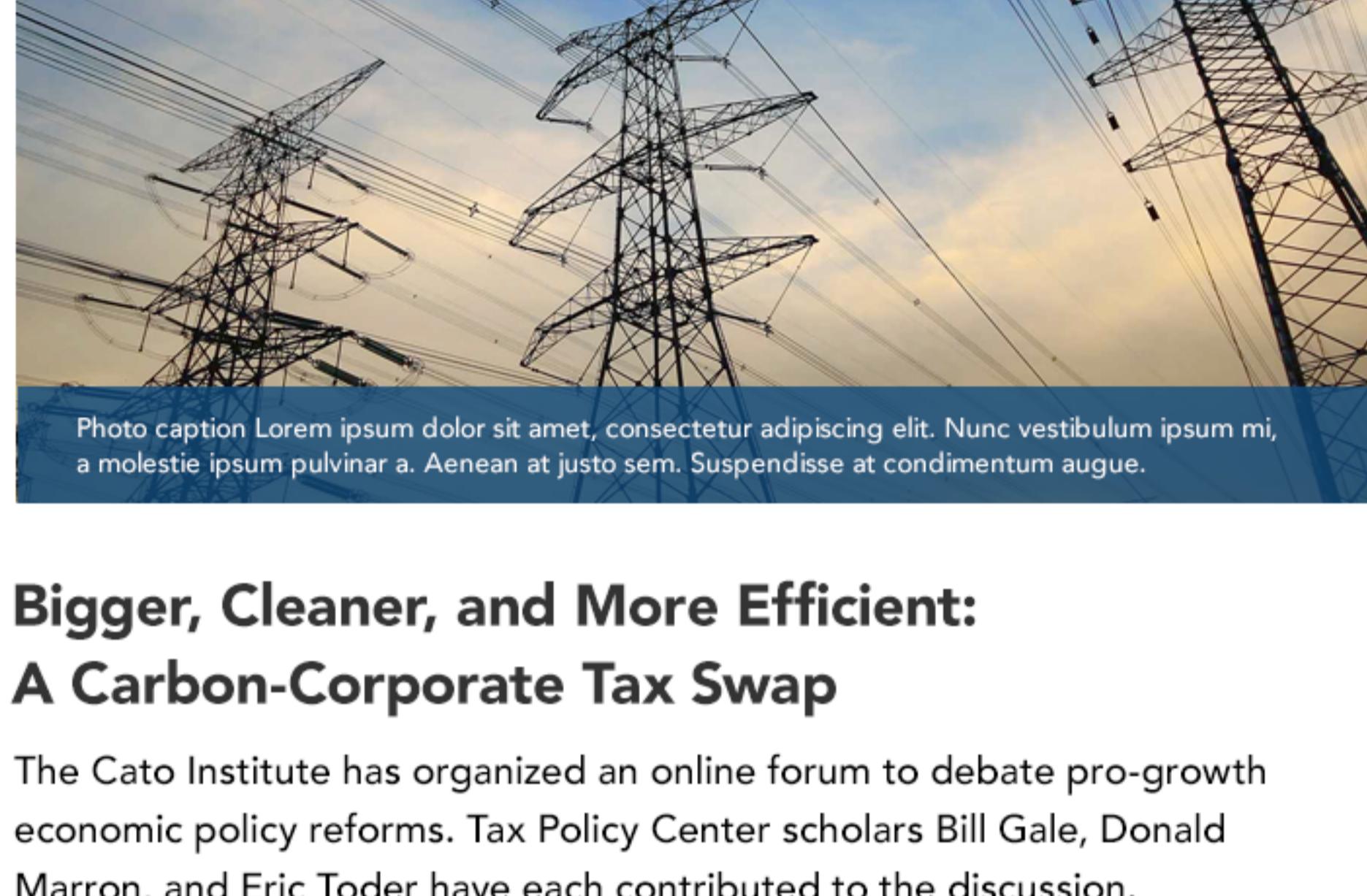


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Bigger, Cleaner, and More Efficient: A Carbon-Corporate Tax Swap

The Cato Institute has organized an online forum to debate pro-growth economic policy reforms. Tax Policy Center scholars Bill Gale, Donald Marron, and Eric Toder have each contributed to the discussion.

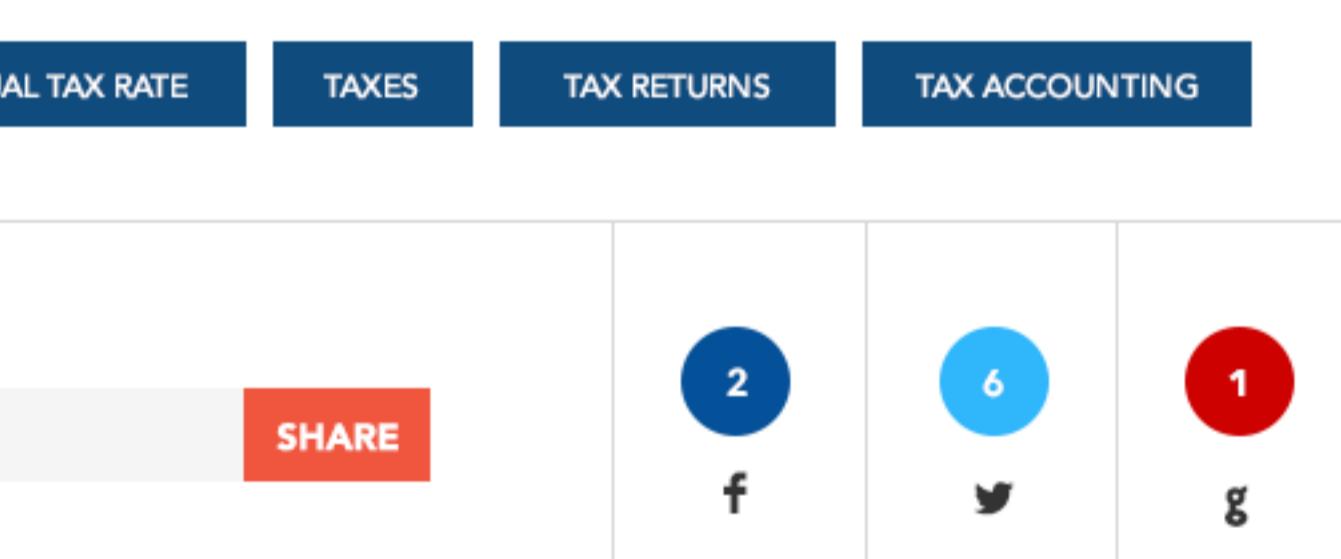
The United States could reduce its contribution to global climate change and increase domestic prosperity by taxing emissions of carbon dioxide and other greenhouse gases and using the resulting revenue to reduce corporate income taxes. Such a carbon-corporate tax swap would give us a bigger, cleaner economy and avoid any need for more costly efforts to reduce emissions.

Second, putting a price on carbon is the most efficient way to reduce carbon emissions. In the absence of a national carbon price, as from a carbon tax or a cap-and-trade system, policymakers will likely continue to pursue piecemeal regulations and subsidies. Indeed, we see that today in heightened fuel economy standards and state-by-state electric power plant regulations. These regulatory efforts can reduce emissions, but at greater cost per ton than a national carbon price.

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Even the best-intentioned regulations treat emissions sources differently, over-controlling some and under-controlling others. They overlook some of the least costly ways to reduce emissions and do little to reward innovation beyond regulatory minimums. Subsidies, through both spending programs and tax incentives, suffer similar problems, offering incentives that are only loosely related to potential environmental gains and often omitting potential methods for reducing emissions. Far more efficient would be a single price that uniformly encourages emissions reductions from all sources and by any means.

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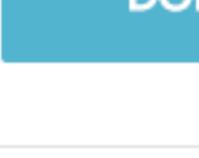
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Tax Policy and Investment by Startups and Innovative Firms

Our tax system imposes widely varying tax rates on investments in different activities, favors debt over equity, and favors pass-throughs over corporations.

February 10th, 2015 | Sharon K. Long

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How could we improve the federal tax system?



Child Tax Credit

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Q. Can poor families benefit from the child tax credit?

A. The child tax credit (CTC) provides a credit of up to \$1,000 per child under age 17. If the CTC exceeds taxes owed, families may receive some or all of the credit as a refund, known as the additional child tax credit (ACTC) or refundable CTC. Families can receive an ACTC of 15 cents for every dollar of earnings in excess of \$3,000 until the sum of the ACTC and taxes owed equals a family's total allowable CTC. The lower the refundability threshold is set, the more likely poor families can benefit from the CTC. After 2017, the refundability threshold is set to rise to \$14,600. At that point, fewer very low-income families will benefit from the CTC than under the current policy.

Highlights

- Families can receive a Child Tax Credit of up to \$1,000 per child. The credit is available to workers with at least \$3,000. It starts to phase out for single parents once adjusted gross income reaches \$75,000 (\$110,000 for married couples). After 2017, workers must have at least \$14,600 to receive the credit.
- Families may exempt a base amount of income from the income tax as a result of the personal exemption and standard deduction. Most poor families only benefit from the refundable portion of the CTC.

How the CTC Works Today

Taxpayers can claim a child tax credit (CTC) of up to \$1,000 per child under age 17. The credit is reduced by 5 percent of adjusted gross income over \$110,000 for married couples (\$75,000 for single parents).

If the credit exceeds taxes owed, taxpayers can receive some or all of the balance as a refund, known as the additional child tax credit (ACTC) or refundable CTC.

The ACTC is limited to 15 percent of earnings above a threshold that is indexed to inflation. Starting in 2011, the threshold was temporarily

reduced to \$3,000. The American Taxpayer Relief Act of 2012 (ATRA) extended the temporary reduction through 2017.

How the CTC Will Change After 2017

After 2017, ATRA is set to expire, and the credit phase-in will jump from \$3,000 to \$14,600. As a result of this change, a family with one child and income below \$21,667 (the point at which a family can receive the full \$1,000 credit) will see their credit reduced or eliminated. At that point, workers with children in the lowest income quintile will see their benefits reduced, and many will no longer qualify for a CTC.

TPC estimates that in 2018, if the ARRA refundability threshold were extended for the CTC, 69.3 percent of tax units with children in the lowest income quintile would

receive a higher CTC than they will under current law. Almost a quarter of tax units with children in the second income quintile will qualify for a higher CTC if the ARRA

refundability provisions are extended.

Families with children in the lowest income quintile will receive average CTCs worth \$611 after 2018, significantly reducing the impact of the CTC on poor families. If, however, ARRA is extended, average benefits for families with children will be about 965.

FIGURE 1
Average CTC Benefit for Families with Children under Current Law and \$3,000 refundability threshold extended, 2018



See Also

Data Sources

Further Reading

Center on Budget and Policy Priorities, 2014. "Policy Basics: The Child Tax Credit", Washington, DC. December 4. Downloaded from <http://www.cbpp.org/research/policy-basics-the-child-tax-credit> on June 29, 2015.

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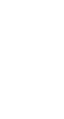
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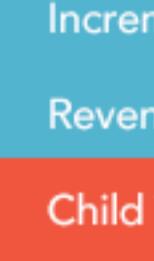
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Tax Credit

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Can poor families benefit from the child tax credit?

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Highlights

Families can receive a Child Tax Credit of up to \$1,000 per child. The credit is available to workers with at least \$3,000. It starts to phase out for single parents once adjusted gross income reaches \$75,000 (\$110,000 for married couples). After 2017, workers must have at least \$14,600 to receive the credit.

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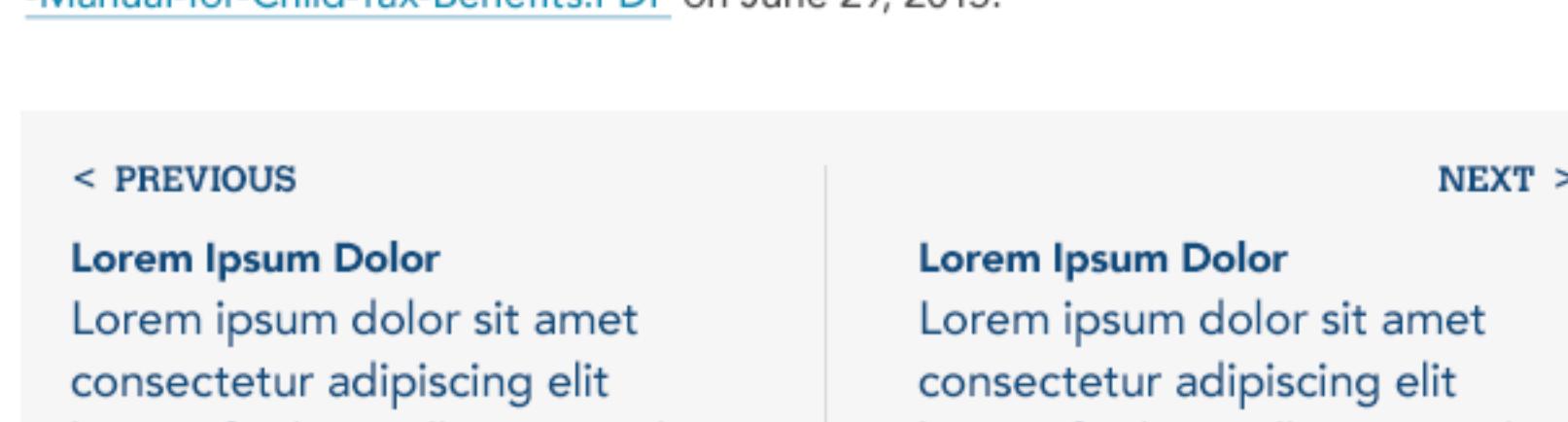
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Source: Urban-Brookings Tax Policy Center Microsimulation Model, (version 0515-1).

■ Average benefit, ARRA extended

■ Average benefit, current law

▲ Percent of tax units with benefit, ARRA extended

✖ Percent of tax units with benefit, current law

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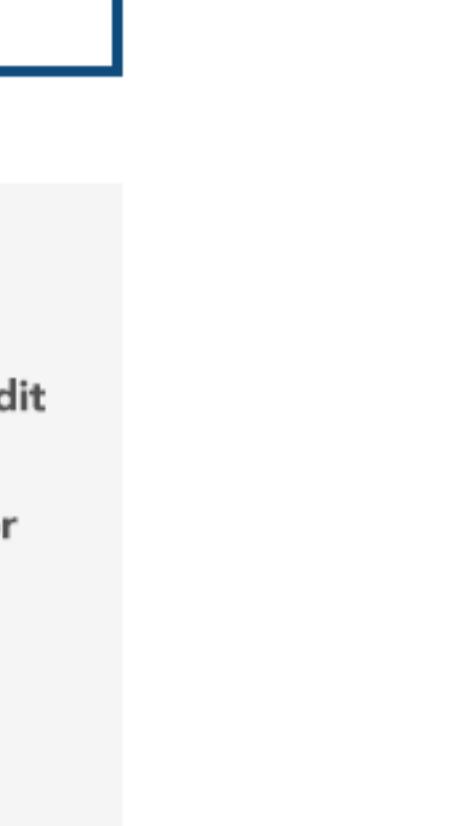
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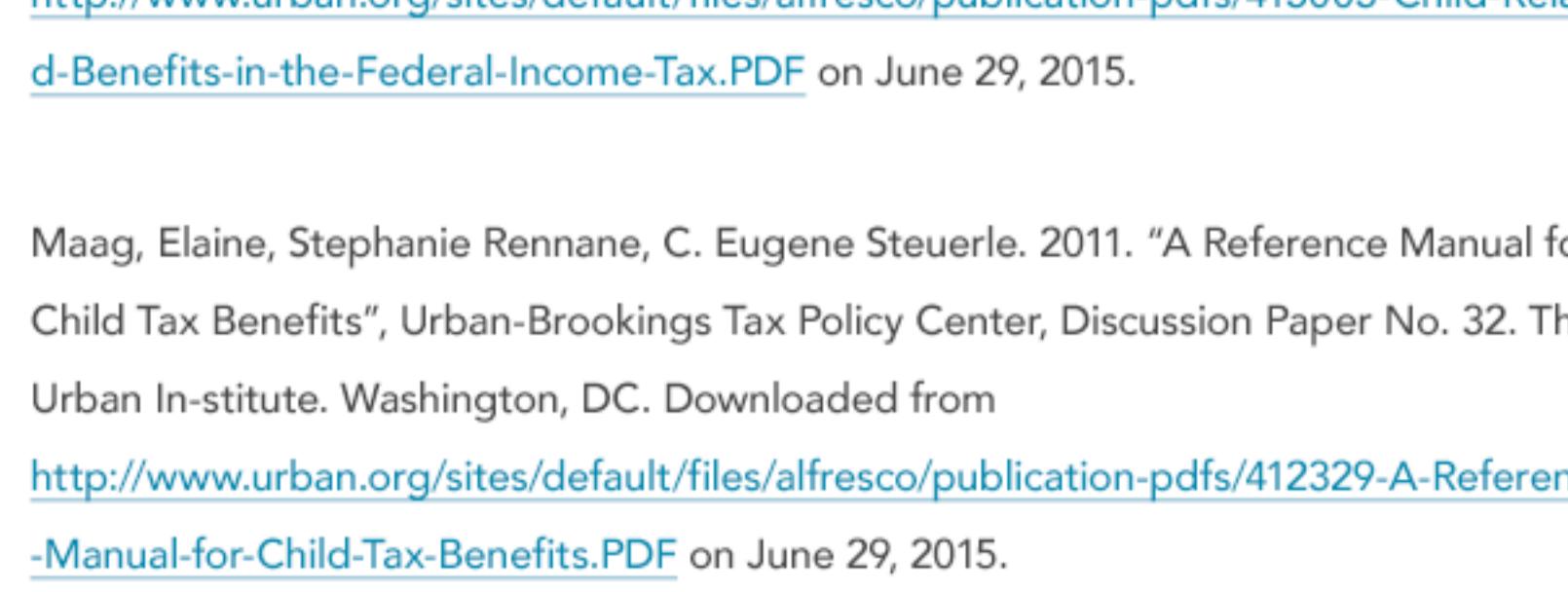
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