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Family-Friendly Tax Reform

By Paul Weinstein Jr.

Americans are increasingly frustrated with the complexity of the tax code and their belief that wealthy individuals and corporations are gaming the system.[1] Their frustrations are well founded, given that Congress and the president add scores of new tax loopholes for special interests each year. Last year alone, 10,000 pages of new tax breaks were inserted into the code.[2] But, while there are myriad tax loopholes available for those who can afford well-connected lobbyists, the broader fault with our system of taxation is that its complexity imposes enormous compliance costs on both individuals and businesses. In fact, the U.S. Department of the Treasury has estimated that the total cost of tax compliance in the United States is roughly $115 billion per year,[3] partly because more than one-half of all individual taxpayers now use paid preparers to help them with the arduous chore of filing.[4]

Meanwhile, the Bush administration has enacted a series of tax cuts that have not only riddled the code with new loopholes, but have also made the system less progressive. The middle-class share of the tax burden has risen, while the wealthiest Americans' share has dropped. Today, typical middle-class families can pay income tax rates of up to 25 percent, plus another 7.65 percent in payroll taxes.[5] Yet corporate executives can sell millions of dollars in stocks and pay a capital gains tax of just 15 percent.

This bias in favor of wealth and entrenched privilege, rather than work and the basic ethic of fairness, is wrong on both economic and moral grounds. But it gives progressives a political opening. They should champion a bold set of reforms that would tip the scales back in the other direction—harnessing the tax code as an instrument to expand middle-class opportunity. Specifically, they should propose eliminating special-interest loopholes, cutting corporate welfare, and expanding the tax incentives that encourage the most basic aspirations of families trying to live the American dream: The incentives that make it easier to pay for college, buy a first home, raise children, and save for retirement.

The case for that kind of reform is abundantly clear. The administration's tax policies are bankrupting future generations for the short-term benefit of those who need it the least today. Yet it shows no sign of letting up. In fact, after four years of sweet offerings for high earners, the administration is pushing for yet another round of cuts that would treat wealthy Americans to tax-free investment income and lower taxes on all other income—

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"One person with a belief is a social power equal to ninety-nine who have only interests."
—John Stuart Mill

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measures that would further exacerbate the government's ballooning budget deficits. A glaring case in point is the administration's plan to eliminate all existing IRAs and replace them with savings accounts that grow tax free, creating a significant tax shelter for wealthy Americans.[6] The plan is a classic bait-and-switch tactic that uses the idea of simplicity to accomplish a shift in the overall tax burden—in the wrong direction.

Congressional Republicans have been enthusiastic cheerleaders for the administration's tax policies. Indeed, they have joined in the misdirected enterprise by dusting off some of their own favorite tax proposals. Two schemes in particular that have recently risen from the grave are the ideas of a national sales tax and a "flat" income tax, respectively. Both proposals should have been discarded long ago, because they would leave most Americans worse off than the current system and each in its own way would abandon the principle of progressive taxation.

A national sales tax is a universal tax on the consumption of all goods and services, rather than a tax on a specific set of items that policymakers want to slow consumption of, such as tobacco or energy. Proponents of a national sales tax—including House Speaker Dennis Hastert (R-Ill.), who advanced a version of the proposal last year, and reportedly some White House economic advisers—argue that it would be a fair system because it would simply tax consumption. They argue that wealthy people consume more than lower-income people, so wealthy people would pay more taxes. But the

truth is that a national sales tax system would claim a far greater percentage of lower-income people's incomes than it would for higher-income people. Consider a family of four making $50,000 per year and a family of four making $500,000 per year. Both must buy essential items such as food and clothing, but the lower-income family—for whom every dollar counts—would see the sales taxes on those essential items add up to a significant slice of the family budget. The wealthy family, meanwhile, may not even notice the taxes. That is hardly fair. Some proponents have argued that the regressive nature of a national sales tax could be mitigated by taxing essential items such as food and clothing at lower rates—or exempting them altogether—and taxing luxury goods at higher rates. But such proposals would in many ways make the tax code more complicated than the current system.

Advocates for a so-called flat tax—including Rep. Sue Myrick (R-N.C.) in the last Congress—call for collapsing the existing five marginal income-tax rates into one. That idea sounds simple, but it would not be cheap. As former Undersecretary of Commerce Robert J. Shapiro has calculated, maintaining current federal revenues would require a 21 percent flat tax, with an initial exemption so as to not tax low-wage families into poverty.[7] That is cold comfort when you consider that less than one-quarter of all taxpayers are in the tax brackets above the 15 percent rate. And, if we were to keep the popular deductions such as the ones for mortgages and charitable contributions, the rate would likely have to rise to 29 percent.[8] A flat tax would thus become a substantial tax hike for a large majority of taxpayers.

The debate about tax reform could come to a head this July, when an advisory panel on federal tax reform created by the president is slated to provide recommendations on how to make the tax code fairer, simpler, and pro-growth. The commission is reportedly considering everything from modest changes to the existing mixed system of income and consumption taxes, to more radical reform ideas, such those that the administration and Republicans in Congress have been advocating.[9]

The plan outlined in this paper is radically different from the Republicans' regressive and counterproductive schemes—but it is no less ambitious. It is designed to shore up the very pillars of middle-class aspiration. It would make the tax code work for ordinary American families by helping them pay for college, buy a first home, raise their children, and save for retirement. Those incentives will help families get into the middle class and stay there. Just as importantly, this plan is fiscally responsible. Coupled with sensible spending cuts, it will help reduce, rather than fuel, our burgeoning federal debt.

"All told, the PPI plan will bring $436 billion in net new tax relief to American families."

All told, the PPI plan will bring $436 billion in net new tax relief to American families. The plan calls for ***eliminating 68 tax breaks*** that are either redundant, unnecessary, or primarily targeted to special interests, and replacing them with ***four new tax incentives*** that would be easily understandable, available to the vast majority of taxpayers, and consistent with the values of work and family. Because the four new incentives would replace existing tax breaks, this plan is budget neutral. It need not add a single dime to the federal deficit.[10]

An earlier paper by the Progressive Policy Institute, "A Return to Fiscal Responsibility," offered more than 50 specific recommendations to cut the federal deficit in half.[11] Those recommendations (none of which are used to pay for the tax reform advocated in this paper) included rolling back the Bush tax cuts for the very wealthiest Americans, cutting spending, and reforming the budget process. This paper focuses on simplifying the tax system, restoring fairness, and promoting broad upward mobility.

The four new tax incentives proposed here include:

- ❒ **A refundable College Tax Credit (CTC)** that would substitute for five different tax breaks and provide a credit of $3,000 per year to students for four years of college and two years of graduate school. That is enough to pay for almost all of the average annual tuition at public colleges and universities, and it is more than double the value of the current Hope Scholarship.

- ❒ **A Home Mortgage Deduction (HMD)** for all homeowners. Currently, the only taxpayers who can take the HMD are those who itemize. By allowing non-itemizers to claim the mortgage interest deduction, we can increase homeownership while reducing the number of Americans who must file the more complicated 1040 tax form.

- ❒ **A Family Tax Credit (FTC)** that would replace three existing tax incentives and provide greater benefits to more families than all of them combined.

- ❒ **A Universal Pension (UP)** that would replace all 16 existing accounts similar to Individual Retirement Accounts (IRAs) with one simple, portable retirement account for all workers. It would provide a $500 stake and tax-deferred savings to workers, who could roll their 401(k) plans into their UP when they change jobs. Funded by general revenues, UPs could also offer a progressive alternative to President Bush's plan to divert Social Security payroll taxes into private accounts.

All four of these tax incentives would be structured as so-called "above-the-line" income adjustments, making them available to taxpayers whether they itemize or not.

The advantages of this type of reform would be considerable. By removing the clutter of existing tax incentives, we can not only make the code easier to understand, but also make it fairer and more powerful. Specifically, this approach to reforming the tax code would achieve the following:

- ❒ **Make the system more generous:** It would provide more money for college, retirement, and to help raise children, while making the home mortgage deduction available to everyone.

- ❒ **Streamline the tax code and require taxpayers to do less paperwork:** By eliminating or consolidating 68 tax breaks into four new ones, this plan would cut the number of pages of code and regulations. (The Family Credit alone would eliminate 200 pages.) In addition, it would make those incentives "above the line" income adjustments (adjustments to income that are reported before the line on the 1040 tax form where you calculate your adjusted gross income), which would spare millions of taxpayers from having to use longer tax forms.

- ❒ **Reduce confusion:** There would be no need to hire an accountant or lawyer to figure out which IRA is right for you, or determine whether or not you qualify for tax breaks for college.

- ❒ **Treat everyone the same:** Presently, only one-third of Americans itemize their taxes—this means millions of middle-class and low-income families are not able to take advantage of the mortgage deduction. In addition, millions more do not contribute to an IRA or 401(k), because they cannot afford the match. By putting these four tax incentives above the line and making tax incentives for college

and retirement refundable, everyone will get a tax break.

- **Be deficit neutral:** Finally, unlike the Bush tax cuts, the new cost of each of these four tax incentives would be fully paid for by consolidating existing tax breaks for education, children, homeownership, and retirement, as well as by closing corporate tax loopholes and tax breaks for special interests.

Progressives can and should be the leaders in this effort. For too long, they have sat on the sidelines defending the status quo while allowing those on the right to propose reforms that sound great in theory, but in reality would hurt the middle class. The tax code was last overhauled in 1986, a time when Democrats like Sen. Bill Bradley (D-N.J.) and Rep. Dick Gephardt (D-Mo.) helped build the consensus for reform. It is time for a new generation of progressives to pick up the mantle of tax reform and make it a leading part of the progressive agenda. The plan presented here provides them with that opportunity.

A College Tax Credit

Recent government estimates say parents will spend $250,000 to raise a child to the age of 18—so a new baby may be the costliest investment they will ever make. And that figure does not include college. Today, a four-year college education—tuition, rent, food, books, and other expenses—can cost $16,000 to $150,000, depending on the school. Eighteen years from now, it is estimated that those costs will rise to $50,000 for a public university and more than $250,000 for a private school.[12]

To help students and families deal with the rising cost of college tuition, the federal government has increasingly turned to the tax code. As incomes rise with education, these incentives serve an important purpose. Yet, while tax incentives have expanded access to college, they have lagged behind skyrocketing college costs. For example, while tuitions and fees jumped 10 percent just in the last year, the maximum Hope Scholarship has not increased since it was created in 1997.[13] According to the congressional Joint Committee on Taxation (JCT), "the governmental funding of higher education has declined as a share of total funding."[14] And, as Washington has layered one new tax break upon another, the entire system of tax-based college subsidies has become confusing, and even contradictory. For example, under current law there is no uniform definition of qualifying education expenses, and there are different income limitations for the various incentives and provisions.[15]

The PPI proposes creating a single CTC to replace five existing tax breaks that currently help students pay for college: the Hope Scholarship, the Lifetime Learning Credit, the deduction for higher education expenses, the exclusion of employee-provided education benefits, and the exclusion for qualified tuition reductions. The CTC would be more generous than the existing system of college tax incentives in several ways: First, the CTC would cover just less than the average cost of annual tuition at most public colleges and universities and one-third of the average tuition at all institutions of higher education (private and public).[16] Second, because the credit would be refundable, it would be available to millions of low-income students who do not currently receive assistance because they have no tax liability. Third, since the CTC would be a credit (which reduces one's tax liability), rather than a deduction (which only reduces the amount of taxed income), everyone who qualifies would get the full value of the credit.

The CTC would be an improvement over the existing system in several other key respects as well. As a single credit with one set of rules, taxpayers would find it more accessible and easier to use. Moreover, the

streamlined rules would cut down on the red tape and confusion that can lead to tax penalties. Finally, since the same rules would apply to everyone, it would increase fairness.

With the CTC, any student attending college will receive a refundable credit up to $3,000 per year if the student is attending college more than one-half of the time and willing to do two summers of service (six months, total) while in enrolled in school. The credit would cover the first four years of college, for a total of up to $12,000 in incentives. In addition, individuals could also receive the CTC to attend graduate school, or to upgrade job skills at a degree-granting institution. A lifetime cap of $6,000 would be allocated on a per-student basis for those attending graduate school or enrolling in continuing education programs, with an annual limit of $3,000 per year.

Unlike current law, there would be no limit on the number of students per family who would be eligible for the credit. Furthermore, in contrast to the Hope Scholarship and the Lifetime Learning Credit, the CTC would be refundable, and would not be phased out for higher-income families. The combined effect would be to make the CTC available at the full $3,000 to any college student for all four years of college. This is a major upgrade over the Hope and Lifetime Learning credits, since not everyone is eligible for the maximum benefit of $1,500 in the first two years of college and $2,000 during the last two years that they provide.

"The College Tax Credit would provide any full-time college student a refundable credit up to $3,000 per year."

This proposal would also remove the requirement that Pell Grants and other need-based government aid be subtracted from a family's eligible college expenses, allowing those families to qualify for the total amount of the CTC. Under current law, the value of need-based aid, such as a Pell Grant, that is received by the child of a lower-income family may reduce or even eliminate the family's eligibility for a tax credit based on tuition expenses. However, a study by the Advisory Committee on Student Financial Assistance, a group created by Congress, found that even after receiving need-based aid, students from low-income families have as much as $3,800 per year in "unmet need"—college expenses that are not covered by assistance and that families may be unable to afford. Due to the financial barriers, even the most highly qualified students from low-income families attend college at a rate that is 20 percent lower than equally qualified students from wealthy families. If we make college aid benefit neutral, we can make student aid programs more effective by encouraging low- and moderate-income families to save for college.

The PPI estimates that the cost of such a credit would be approximately $175 billion over 10 years.[17] Consolidating the Hope Scholarship, the Lifetime Learning Credit, the deduction for higher education, the exclusion of employee-provided education benefits, and the exclusion for qualified tuition reductions could offset more than one-half of that cost (***$92 billion***).[18] An additional ***$55 billion*** could be raised by closing the loophole that allows companies to avoid U.S. taxes on foreign income that is derived from highly mobile income (foreign bonds, euros, etc.).[19] Another ***$20 billion*** could be raised by closing the so-called "Janitors Insurance" loophole, which would stop companies from accumulating tax gains from a kind of corporate-owned life insurance policy. These policies are sold to employees whose beneficiaries often do not realize the benefit. Instead, their employers become the beneficiaries—because they do not pay taxes on the policy's "inside buildup" that accrues as the value of the policy increases.[20] Additionally, approximately ***$1 billion*** could be raised by eliminating the tax breaks for vessel and aircraft leasing industries

that were included in the American Jobs Creation Act of 2004, signed into law by President Bush last year.[21] Repealing 18 business tax relief giveaways included in the same act would bring the final ***$7 billion*** needed to offset the CTC.[22]

A Home Mortgage Deduction for Everyone

Home purchases build savings and individual wealth, provide tax revenues for local governments, and stimulate growth in all housing-related industries. The primary public policy tool used to encourage people to buy homes is the HMD. Established in 1913, the mortgage deduction permits deductions of the interest paid on mortgages up to $1 million on a primary residence and one additional residence. In addition, the interest paid on home equity loans of up to $100,000 may be deducted.[23]

"The cost of an above-the-line HMD would be approximately $56 billion over 10 years, with the majority of the benefits going to those making $50,000 or less per year."

The national homeownership rate reached an all-time high of 68.6 percent of U.S. households in the fourth quarter of 2003.[24] Unfortunately, a significant number of Americans are unable to take advantage of the mortgage deduction because they do not itemize their taxes. Currently, only 28 percent of taxpayers and only one-half of the 72 million American homeowners itemize.[25] Furthermore, only one-fifth of the 28 million households with annual incomes below $50,000 received any homeowner subsidy.[26]

Moreover, while homeownership has increased among minorities, there is still a disparity between the homeownership rates for whites and the rates for African Americans, Hispanics, and other minority groups. For example, the home ownership rate for minority households has lagged behind that of the country as a whole by as much as 20 percent. This important disparity needs to be addressed.[27]

Clearly, the mortgage deduction is not helping those who need it the most—middle-income and working families. Fortunately, there is a simple way to fix this problem: make the deduction available to those who take the standard deduction by moving it above the line.

This would enable an additional 10 million Americans to take advantage of the primary incentive to help individuals purchase homes.[28] These filers could claim the deduction directly on the Internal Revenue Service (IRS) form 1040.[29] There would be no Schedule A forms to complete, with its percentage-of-income thresholds and deduction phase-outs. Furthermore, an above-the-line HMD would reduce taxpayers' adjusted gross incomes—the portion of one's income that is taxable—thus maximizing the effect of the credit.

The cost of an above-the-line HMD would be approximately $56 billion over 10 years, with the majority of the benefits going to those making $50,000 or less per year.[30] There are several logical options available to offset those costs, all of which would make the tax code more equitable. First, we could tax large credit unions (those with assets of more than $10 million, which act like for-profit banks and thrifts). That would raise ***$15.2 billion***.[31] Around ***$5 billion*** could be raised by preventing the timber industry from deducting production costs until goods or services are sold (as is the practice in other industries).[32] Another ***$3 billion*** could be saved by closing the "corporate jet" loophole, which currently allows businesses to take a deduction when executives make personal use of the company jet.[33] Approximately ***$8 billion*** could

be raised by clarifying standards and increasing the scrutiny of transactions that have characteristics of tax shelters.[34] Another ***$1.1 billion*** could be gained by giving equal tax treatment to sport utility vehicles and luxury cars used for business activity.[35] Almost ***$1 billion*** could be saved by effectively prohibiting the use of private activity bonds for the construction of sports facilities.[36] At least ***$19 billion*** could be raised by disallowing the "expensing" of exploration and development costs for extractive industries, and instead require companies to deduct those costs over time, as resulting income incurs (like most other businesses do).[37] Finally, ***$7.1 billion*** could be achieved by closing five loopholes relating to estate and trust tax law as recommended by the staff of the JTC.[38]

A Family Tax Credit

For personal income tax filers, perhaps no part of the code is more complicated than those provisions related to children and families. Leave it to Washington to saddle working parents with reams of paperwork in order to get the most basic tax relief. Although family-related tax credits have been expanded in recent years, they remain far too complicated and narrowly focused for many of their intended recipients to benefit. For example, hundreds of millions of dollars in refunds go unclaimed every year because of the difficulty of applying for the Earned Income Tax Credit (EITC).

The tax code currently contains several provisions intended to benefit taxpayers with children and families—the EITC, the Child Credit (CC), the Additional Child Credit (ACC), and the Child and Dependent Care Credit (DPCC). However, these provisions have different structures, rules for eligibility, and definitions. For example, there are currently 200 pages of instructions, worksheets, forms, and tables that taxpayers must navigate to determine if they qualify for those four tax breaks.[39]

The PPI believes it is vitally important to reform the portion of the tax code that provides support to families, in order to make it more accessible and more generous. To achieve real reform, a unified family credit should be established that promotes fairness, has one set of rules to ensure that it is easy to understand, is refundable so that it is available to all families, includes requirements that encourage work, and is more generous than existing credits.

Currently, there are three noteworthy proposals to create a unified family credit. For the most part, each would be a significant improvement over the existing system. The main issue for policymakers is to develop a way to pay for such a reform without adding to the budget deficit.

One of the first proposals to consolidate the various tax incentives for families was put forward by Robert Cherry and Max Sawicky of the Economic Policy Institute. The Cherry-Sawicky proposal would create a relatively simple, refundable tax credit with no phase outs—making it available to all working taxpayers with children. It would replace the EITC, CC, ACC, and DPCC.

Like the current EITC, Cherry and Sawicky's Single Family Credit (SFC) would rise for an initial range of earned incomes, flatten out over an additional range, and then phase down. The difference is that it would not phase out to zero. It would settle to a minimum benefit of $1,270 per child. According to Cherry and Sawicky, this is the value of the exemption and CC for taxpayers in the 28 percent bracket. Current eligibility restrictions based on interest and dividend income limits would remain in effect.[40]

Cherry and Sawicky argue their SFC would deliver 84 percent of its tax break to middle-class and low-income families—people earning

$65,000 per year or less. This would give millions of middle-class families, not just the poorest of the poor, a sizable tax break.

Unfortunately, the Cherry and Sawicky proposal is not cheap. It would cost approximately $32 billion per year.[41] A significantly less ambitious plan has been proposed by the staff of the JCT and the Congressional Budget Office (CBO). Both entities have suggested replacing the CC and DPCC with a consolidated credit. This consolidated credit would retain a refundable portion, which would be determined in the same way as the refundable part of the current child credit. However, unlike the current credit, there would be no phase out, and the amount of the credit would be indexed for inflation.[42]

The CBO-JTC proposal would cost less than the Cherry-Sawicky plan.[43] However, the lower price tag comes at a cost. For example, with this consolidation, some middle-income taxpayers with children would see their taxes rise because they would lose the DPCC. If the credit was increased, this problem could be alleviated (at greater cost, of course).[44]

A third proposal, offered by Rep. Rahm Emanuel (D-Ill.), would also significantly simplify the tax code, but would be less costly than the Cherry-Sawicky plan and more generous to families than the JCT-CBO proposal.[45] For those reasons, PPI believes it is the best of the proposals to create a single family credit.

Emanuel's proposal would create a unified Family Tax Credit that would cost approximately $250 billion over 10 years, on top of what is currently expended on the EITC ($390 billion), CC ($462 billion), and the DPCC ($21 billion). Under the proposal, families would receive $1 in a refundable credit for every $2 earned—with a maximum credit of $3,500 for a family with one child, $5,200 for two children, and $7,000 for three children.[46] By contrast, the EITC provides a maximum credit of $3,900 for a family with two children earning $15,000.

Not only would Emanuel's FTC be more generous than the EITC, it also would affect more families. The EITC evaporates entirely for two-child families that make more than $34,178. Under the FTC, families with two children and income between $35,000 and $120,000 would be eligible for a $3,500 credit.

The FTC would also greatly simplify the tax code. It would eliminate 200 pages of code with a 12-line form that would make it easier for families to determine whether they qualify for this important tax incentive.

> ***"The most simple and least costly family credit proposal is by Rep. Rahm Emanuel (D-Ill.), which would create a unified Family Tax Credit."***

The cost of this reform is significant. But reforming this section of the tax code is an important goal since it affects so many families. We can pay for this reform by adopting some of the recommendations of tax specialists Joseph Dodge and Jay Soled. According to a recent paper by Dodge and Soled, a large number of investors are overstating the price of stocks, businesses, and real estate. Capital gains and losses are currently reported on a honor system, unlike wages, which are directly reported to the IRS by employers. By instituting a true verification regime for capital gains, in which third party reporting requirements would include tax basis information, the federal government could collect an additional ***$250 billion*** over the next 10 years—enough to cover the cost of the Emanuel proposal.[47]

A Universal Pension

While Congress regularly adds new incentives to the growing array of U.S. tax

savings vehicles, the national personal savings rate continues to decline, and too few Americans are saving enough for retirement. Furthermore, only about one-half of all U.S. workers have a tax-deferred retirement account, such as an IRA or a 401(k), and only 16 percent of baby boomers have saved $100,000 or more for retirement.[48] Many low-income individuals do not have any savings, and pension coverage for those employed at small businesses is less than 20 percent, according to recent surveys. Moreover, a large number of people who do have savings plans such as 401(k)s deplete them by cashing out when they change jobs.[49]

The complexity of retirement savings incentives inhibits participation. One survey found that only 17 percent of employees knew of the variety of retirement programs geared specifically for workers.[50] What is more, the tax system perversely provides the biggest incentives to save to those who are already socking away the most, and it provides little incentive for those who lack retirement funds to start saving.

To really boost savings, we must overhaul the current system to let workers decide how much they can save (up to some uniform limit), give workers control of their investment choices, and fold all the existing tax-favored savings accounts into one UP that workers would take from job to job.

A UP would resemble today's traditional IRAs—with contributions up to $3,000 per year—but with a few key improvements. Unlike current law, workers' cash from 401(k) plans would be directly deposited into the new plans when they change jobs. That ensures portability and guarantees workers, not employers, will control the funds. In addition, each working American would receive $500 at age 25 to kick-start his or her personal retirement nest egg. Contributions by low-income individuals would be refundable, ensuring that more workers save for their retirement.

The key components of a universal pension should include:

- **Universal access.** To ensure universal access, the federal government will provide financial incentives to encourage Americans at all income levels to open a UP when they start working.

- **Greater choice.** Since they are under the control of the individual worker and not the employer, UPs will provide individuals with more investment choices.

- **Simplification.** By eliminating the complex system of IRA accounts and replacing it with a single account, all Americans—not just the financially sophisticated—will get a good deal. The UP would encompass all the benefits of existing IRAs while reducing the number of rules, the amount of paperwork, and the fees associated with the current system. Like most IRAs, the money contributed to UPs and the interest on those investments would grow tax-free until it is withdrawn.

- **Portability.** Universal pensions provide complete portability by going with every worker from job to job. Furthermore, an employee's 401(k) balance would automatically transfer to his or her UP whenever the worker changes jobs, eliminating paperwork and ensuring the money keeps earning interest seamlessly.

- **Protecting worker savings.** To encourage diversification and decrease the likelihood that investors lose their life savings if their portfolios are overly concentrated in their employers' stock, workers—after completing a three-year vesting period—could place a portion of their 401(k) into their UP. In addition,

unlike IRAs, UPs would be protected from bankruptcy proceedings.

While much of the cost of reforming our system of IRAs can be met by consolidating 16 of the existing retirement accounts into one UP, there are some additional costs. These include:

- ***$20 billion*** over 10 years to stake every employed American with $500 for their UP when they reach the age of 25;
- ***$20 billion*** over 10 years to make the UP refundable for low-income individuals; and
- ***$7 billion*** over 10 years to raise the income cap.

A number of reforms could be implemented to offset the $47 billion needed to finance these additional reforms:

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the dollar limit on IRA contributions was increased to $3,000 for 2004, $4,000 for 2005 through 2007, and $5,000 for 2008. After 2008, the limit is to be adjusted for inflation in $500 increments.[51] If Congress were to amend EGTRRA to limit contributions to $3,000 in 2007, with indexed inflation adjustments thereafter, we could save ***$24.2 billion*** over 10 years.[52]

Another ***$2 billion*** could be saved over 10 years by closing the CEO pay loophole that allows corporations to deduct performance-based executive pay over $1 million, and ***$5 billion*** could be saved by closing the Bermuda loophole that allows firms primarily owned by Americans to incorporate overseas and thus avoid U.S. taxes on income earned abroad. Most of the remaining ***$15.8 billion*** could be offset by closing eight loopholes identified by the staff of the JTC relating to pensions and employee benefits.[53]

Conclusion

Americans deserve a tax code that reflects their values and aspirations. Congress should enact tax reform that provides relief to all Americans; makes the code more rational; rewards work, family, and responsibility; and promotes upward mobility. The proposals described in this paper achieve those goals, and unlike the Bush administration's reckless tax agenda, they would be budget neutral.

Endnotes

[1] A 2003 Greenberg Quinlan Rosner poll found the factor bothering people the most about the tax system was not the amount they pay in taxes. (Fourteen percent of respondents listed that as their greatest concern.) Instead, it was the complexity of the tax system (cited by 31 percent of respondents as their greatest concern) and, especially, the feeling that the wealthy and corporations do not pay their fair share (cited by 46 percent of respondents). Other polling data has confirmed these findings.
[2] Testimony of Representative Rahm Emanuel before the House Subcommittee on Select Revenue Measures, Committee on Ways and Means, September 23, 2004.
3 Memorandum for Secretary O'Neill from Pamela Olson, Department of the Treasury, November 7, 2002.
4 *Ibid.*
[5] In 2005, single filers making between $29, 051 to $70, 350 and married filers making between $58,101 to 117,250 have a federal income tax rate of 25.
[6] "Over time, these proposals would allow an increasing share of the returns to wealth to be sheltered from taxation"; Gale, William; "Federal Revenue Options"; Testimony before the House Committee on the Budget, October 6, 2004.
7 Many low-income families do not currently pay taxes; we would need an initial exemption to avoid taxing them into poverty.
[8] *Ibid.*
[9] Crawford, Krysten; "Project Scrap-that-Tax Day 1; CNN/Money; February 16, 2005.
[10] All budget estimates in this paper are 10 year figures.
[11] Weinstein, Paul, "A Return to Fiscal Responsibility," Progressive Policy Institute, January 2004, *http://www.ppionine.org*.
12 "Trends in College Pricing, 2002," The College Board, *http://www.collegbaord.com/press/cost02/html/CBTrendsPricing02.pdf.*
[13] "2004-2005 College Costs," The College Board, *http://www.collegeboard.com/article/0,3868,6-29-0-4494,00.html*.
[14] "Present Law and Analysis Relating to Tax Benefits for Higher Education," Joint Committee on Taxation, July 22, 2004.
15 Joint Committee on Taxation, "Present Law and Analysis Relating to Tax Benefits for Higher Education,
" July 21, 2004.
[16] Based on data from the College Board, the average cost of public tuition at two and four year public institutions is $3,604 annually. The average cost of annual tuition at private and public institutions (two year and four year) is $9,096. *http://www.collegeboard.com/article/0,3868,6-29-0-4494,00.html.*
[17] This assumes a take-up rate of 65 percent among full time students. According to the National Center for Education Statistics, approximately 55 percent of enrolled students receive some form of financial aid (federal, state, private). There are roughly just over 9 million full-time students enrolled in accredited institutions of higher education in the United States. *http://nces.ed.gov/fastfacts/display.asp?id=98*.
[18] This figure assumes Congress will extend the deduction for higher education expenses. "Estimates of Federal Tax Expenditures for Fiscal Years 2005-2009," Joint Committee on Taxation, January 12, 2005.
[19] Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," January 27, 2005.
[20] Testimony of Representative Rahm Emanuel before the House Subcommittee on Select Revenue Measures, Committee on Ways and Means, September 23, 2004.
[21] Ashdown, Keith, "Taxpayers for Common Sense Statement on House Vote on Corporate Tax Bill," Taxpayers for Common Sense, October 7, 2004.
[22] Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 4520"; October 7, 2004. This includes sections A, B, D, and E of the Business Tax Incentives listed in the Joint Committee on Taxation report (but, does not include section C, "Community Revitalization," or Section F).
[23] "Tax Issues," Mortgage Bankers, Issue Paper, 2004.
[24] National Association of Realtors.
[25] Gale, William, (Senior Fellow, Economic Studies), "Easier, Fairer Taxes," *The New York Times*, April 12, 1997.
[26] Dreier, Peter, and John Atlas, "Give the Middle Class a Break," *Los Angeles Times*, January 20, 1995.
[27] *Ibid.*
[28] Currently, more than 25 million Americans own their home outright and thus would be unable to take advantage of an ALMD.
[29] The 1040 form can be found online at *http://www.irs.gov/pub/irs-pdf/f1040.pdf*.
[30] According to a study by the General Accounting Office from March 2002, "Tax Deductions: Further estimates of taxpayers who may have overpaid federal taxes by not itemizing," approximately 1 million Americans did not itemize their deductions, yet had mortgage interest that exceeded the standard deduction, costing these taxpayers some $473 million.

[31] "Budget Options," Congressional Budget Office, February 2005.
[32] "Budget Options," Congressional Budget Office, February 2001.
[33] Testimony of Representative Rahm Emanuel before the House Subcommittee on Select Revenue Measures, Committee on Ways and Means, September 23, 2004.
[34] Joint Committee on Taxation; "Options to Improve Tax Compliance and Reform Tax Expenditures," January 27, 2005.
[35] *Ibid.*
[36] *Ibid.*
[37] "Budget Options," Congressional Budget Office, February 2005.
[38] *Ibid.*
[39] *http://maxspeak.org/tax1.html.*
[40] Cherry, Robert, and Max Sawicky, "Giving Tax Credit Where Credit Is Due A 'Universal Unified Child Credit' that expands the EITC and cuts taxes for working families," Economic Policy Institute, April 2000.
[41] *Ibid.*
[42] "Budget Options," Congressional Budget Office, March 2003.
[43] *Ibid.*
[44] The CBO-JCT proposal also was proposed before the child credit was raised to $1,000, therefore some of the costs have changed, depending on how much of an additional increase is included.
[45] One of the ways to cut the cost of the Cherry-Sawicky proposal is to cap the number of children per family eligible for the credit at three. This is largely responsible for the difference in the estimated cost between the Cherry-Sawicky and the Emanuel proposal.
[46] Gross, Daniel, "The Tax Debate We Should Be Having," Blueprint Magazine, February 11, 2003, http://www.ndol.org.
[47] Dodge, Joseph, and Jay A. Soled, "Inflated Tax Basis and the Quarter-Trillion Revenue Question," Taxanalysts.com; January 25, 2005.
[48] Riddle, Jeremiah, *Viewpoint*, Fall 1998.
[49] "EBRI Research Highlight: Retirement and Health Data," Employee Benefit Research Institute, Special Report and Issues Brief, January 2001, *http://www.ebri.org*.
[50] "2000 Small Employer Retirement Survey," Employee Benefit Research Institute, American Savings Council and Matthew Greenwalk Associates, *http://www.ebri.org/rcs/.*
[51] "General Explanation of Tax Legislation Enacted in 107th Congress," Joint Committee on Taxation, January 24, 2003.
[52] EGTRRA's provisions are arranged to sunset after December 31, 2010. If they are allowed to expire, the dollar limit on annual IRA contributions would revert to its pre-2001 level of $2,000 in 2011. The savings proposed here assume Congress will not allow the provisions to expire.
[53] "Options to Improve Tax Compliance and Reform Tax Expenditures," Joint Committee on Taxation, January 27, 2005. This assumes the dividend tax cut is extended by Congress and the president.