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Tax Reform in the 114th Congress: An Overview of Proposals

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Summary

Many agree that the U.S. tax system is in need of reform. Congress continues to explore ways to make the U.S. tax system simpler, fairer, and more efficient. Identifying and enacting policies that will result in a simpler, fairer, and more efficient tax system remains a challenge.

On December 10, 2014, the Chairman of the House Committee on Ways and Means introduced a comprehensive tax reform proposal, the Tax Reform Act of 2014 (H.R. 1). The bill proposed substantial changes to both the individual and corporate income tax systems, reducing statutory tax rates for many taxpayers, while repealing dozens of credits, deductions, and other tax preferences. While no further action was taken on H.R. 1 in the 113th Congress, the proposal continues to inform the ongoing tax reform debate.

There are various policy options for achieving comprehensive tax reform. One option is a base-broadening, rate-reducing tax reform, in the spirit of the Tax Reform Act of 2014. An alternative approach would be to substantially revise or eliminate the current tax system, instead relying on an alternative tax base for revenues. Tax reform legislation introduced early in the 114th Congress has tended to take the latter approach, proposing a retail sales tax at the federal level or a flat tax. Similar proposals were introduced in the 112th and 113th Congresses, and did not advance.

Both Congress and the Administration have indicated interest in tax reform through their respective budget processes. The budget resolution for FY2016 (S.Con.Res. 11) communicates congressional support for action on tax reform. The President's FY2016 budget proposes a number of tax policy changes, including substantial changes in the international tax system.

The prevailing framework for evaluating tax policy considers equity (or fairness), efficiency, and simplicity. Equity examines the distribution of the tax burden across different groups. This information can then be used to assess the "fairness" of the tax system. A tax system that is economically efficient generally provides neutral treatment, minimizing economic distortions and maximizing output. A tax system that is simple reduces administrative and compliance costs while also promoting transparency.

Oftentimes, there are trade-offs to be considered when evaluating tax policy options. For example, shifting towards a consumption tax might enhance economic efficiency. However, taxing consumption rather than income tends to put an increased tax burden on lower-income taxpayers relative to higher-income taxpayers, reducing the progressivity of the tax system. Policymakers may want to consider the trade-off between equity and efficiency when evaluating tax policy options.

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Introduction

Late in the 113th Congress, former House Ways and Means Committee Chairman Dave Camp introduced a comprehensive tax reform bill, the Tax Reform Act of 2014 (H.R. 1). While no action was taken on H.R. 1 in the 113th Congress, tax reform remained a key issue of interest early in the 114th Congress. In January 2015, the Senate Finance Committee established five bipartisan working groups to evaluate tax reform options.[1]

There are various policy options for achieving comprehensive tax reform. One option is to enact a base-broadening reform, maintaining the current system with reduced tax rates, in the spirit of the Tax Reform Act of 2014. A second option is to substantially revise or eliminate the current tax system, instead relying on an alternative tax base for revenues (e.g., taxing consumption rather than income). Tax reform legislation introduced early in the 114th Congress has tended to take the latter approach, proposing a retail sales tax at the federal level or a flat tax. Either option can be designed to be revenue-neutral or change the revenue outlook, depending on the exact provisions of the reform.

As an alternative to comprehensive tax reform, Congress may choose to consider reforms to certain parts of the code. For example, Congress may choose to consider international tax reform options, or evaluate business-only options. Congress may also consider other non-reform but tax-related issues, such as the "tax extenders."[2]

Tax systems are often evaluated using the criteria of efficiency, equity, and simplicity. One goal of tax reform is to enhance economic efficiency, removing provisions in the code that adversely affect decisionmaking and economic output. Changes in tax policy also have equity implications, with respect to "fairness" of the tax code. The current tax code is widely seen as being overly complex. Thus, tax reform provides the opportunity to simplify the U.S. tax system. Balancing these three objectives often involves trade-offs. Balancing the trade-offs in these objectives is one of the challenges policymakers face in implementing tax reform.

Tax Reform Options

Fundamental or comprehensive tax reform may be achieved either by modifying the existing income tax system or by changing the source of tax revenue (e.g., replacing the current tax system). In modifying the existing tax system, base-broadening could raise additional tax revenues. The additional revenues could either be used to reduce tax rates or for deficit reduction. Similarly, revenues from a new tax (e.g., a consumption tax) could be used to offset reductions in current taxes, or to reduce the deficit. Much of the recent debate has centered around a revenue-neutral tax reform, with lower rates on individual and corporate income. Either base-broadening or an alternative revenue source could be used to pay for lower rates in a revenue-neutral tax reform.

[1] For details on the working groups, see The United States Senate Committee on Finance, "Hatch, Wyden Launch Bipartisan Finance Committee Tax Reform Working Groups," press release, January 15, 2015, http://www.finance.senate.gov/newsroom/chairman/release/?id=2ea8c8e5-c892-4230-9d1a-db7522a920be.

[2] CRS Report R43898, *Tax Provisions that Expired in 2014 ("Tax Extenders")*, by Molly F. Sherlock.

Income Tax Reform: Base-Broadening[3]

Some Members of Congress have expressed concern about the large number and high cost of tax expenditures.[4] Examples of tax expenditures include the deduction for mortgage interest on owner-occupied residences and the deduction for property taxes on owner-occupied residences. Many tax expenditures are seen as targets to be reduced or eliminated. In evaluating tax expenditures, one issue Congress may want to consider is whether the benefits of a particular tax expenditure exceed the costs of that tax expenditure.[5] Identifying and quantifying the costs and benefits associated with particular tax expenditure provisions, however, can be challenging.[6]

The current tax reform debate generally deals with the issue of broadening the individual and corporate income tax bases, often by scaling back or eliminating tax expenditures. The additional revenues could be used to lower marginal tax rates, reduce the deficit, or achieve some combination of these two options. Both the Tax Reform Act of 2014 and the Fiscal Commission's 2010 tax reform proposal pay for reduced tax rates at least in part by repealing or reforming many major tax expenditures.[7]

The tax expenditures associated with the individual and the corporate tax differ in their size and value, and thus in their scope for potential revenue generation. The potential revenue gain from individual tax expenditures is large as they currently result in roughly $1 trillion of lost revenue annually. While these large amounts suggest a significant scope for base-broadening, most of these tax expenditures arise from a limited number of provisions, many of which are popular and broadly used, are difficult to eliminate in a technical sense, and/or are considered desirable provisions.[8] In 2012, the Joint Committee on Taxation (JCT) found that a revenue-neutral reform that (1) repealed the AMT; (2) repealed all itemized deductions; (3) taxed capital gains and dividends at ordinary rates; and (4) retained the earned income tax credit (EITC), child tax credit, and tax benefits for retirement savings and healthcare could reduce rates by 4%. Thus, the top individual income tax bracket would be reduced from 39.6% to 38.02%.[9]

Corporate tax expenditures are relatively small in value, partially reflecting the smaller corporate tax base. Analysis suggests that eliminating all corporate tax expenditures would allow the

[3] Typically, a base-broadening tax reform is one that eliminates certain tax preferences, such as tax deductions, credits, or exclusions. This allows tax rates to be applied to a larger income base. Base-broadening can be used to pay for rate reductions in a revenue-neutral tax reform.

[4] For an analysis of tax expenditures, see CRS Report R44012, *Tax Expenditures: Overview and Analysis*, by Donald J. Marples.

[5] For background material on tax expenditures, see CRS Report CP10001, *Tax Expenditures: Compendium of Background Material on Individual Provisions—A Committee Print Prepared for the Senate Committee on the Budget*, by Jane G. Gravelle et al.

[6] For background on other considerations to be made when evaluating tax expenditures, see U.S. Government Accountability Office, *Tax Expenditures: Background and Evaluation Criteria and Questions*, GAO-13-167SP, November 29, 2012, http://www.gao.gov/assets/660/650371.pdf.

[7] The Fiscal Commission's illustrative tax reform proposal can be found in the Report of the National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010, available at https://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

[8] See CRS Report R42435, *The Challenge of Individual Income Tax Reform: An Economic Analysis of Tax Base Broadening*, by Jane G. Gravelle and Thomas L. Hungerford.

[9] See Letter from Joint Committee on Taxation to Honorable Max Baucus and Honorable Orrin G. Hatch, United States Senate, October 11, 2012, available at http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/112-1671.pdf.

statutory corporate tax rate to be reduced from 35% to roughly 28% to 29%.[10] These base-broadening provisions are also concentrated in a few provisions, which may be difficult to change, such as accelerated depreciation.[11] There are, however, some significant potential base-broadening provisions outside of tax expenditures. For example, additional revenues could result from taxing large pass-through entities that currently pay taxes at the individual level as corporations[12] or by restricting interest deductions.[13] Enacting additional base-broadening reforms could be used to reduce the corporate tax rate below what could be achieved through revenue-neutral policy that only eliminated tax expenditures.

There has been a particular focus, as well, on the tax treatment of foreign source income of multinationals. Under the current system, U.S.-based companies with foreign-source income may be subject to U.S. taxes on that income. However, deferral allows tax payments to be deferred until the income earned abroad is repatriated (returned) to the United States. Some proposals would eliminate the U.S. taxation of income earned abroad by U.S.-based multinationals, which could, depending on the details of the proposal, narrow the tax base. Another option is to increase the taxation of foreign-source income of U.S.-based multinationals, through limiting deferral, for example. Increasing the amount of foreign-source income subject to tax would broaden the tax base. International issues have also been an impetus for lowering the corporate tax rate.[14]

As an additional challenge, corporate tax reform, business tax reform, or individual tax reform in isolation would be difficult to achieve, as the corporate and individual tax systems are highly interconnected. Many of the corporate preferences also benefit unincorporated business, or "pass-throughs."[15] For pass-through entities, business income is subject to the individual income tax.

The Tax Reform Act of 2014 proposed reducing statutory tax rates in both the individual and corporate income tax systems. Under this proposal, there would have been two individual income tax brackets, set at 10% and 25%, with a 10% surtax for certain higher-income taxpayers, for a top individual rate of 35%. Corporate tax rates would have been reduced to 25%, with this reduction phased in over time. The cost of these rate reductions would have been partially offset through base-broadening, and partially through other revenue-raising policies, so as to be

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[10] CRS Report RL34229, *Corporate Tax Reform: Issues for Congress*, by Jane G. Gravelle and Memo from Thomas A. Barthold, Joint Committee on Taxation, October 27, 2011, available at http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/JCTRevenueestimatesFinal.pdf.

[11] See CRS Report R42726, *The Corporate Income Tax System: Overview and Options for Reform*, by Mark P. Keightley and Molly F. Sherlock and CRS Report RL34229, *Corporate Tax Reform: Issues for Congress*, by Jane G. Gravelle.

[12] See CRS Report R42451, *Taxing Large Pass-Throughs As Corporations: How Many Firms Would Be Affected?*, by Mark P. Keightley.

[13] According to one estimate, reducing the interest deduction to disallow the inflation premium would allow for a 2.5 percentage point reduction in the corporate tax rate. See CRS Report RL34229, *Corporate Tax Reform: Issues for Congress*, by Jane G. Gravelle.

[14] CRS Report RL34115, *Reform of U.S. International Taxation: Alternatives*, by Jane G. Gravelle, and CRS Report R42624, *Moving to a Territorial Income Tax: Options and Challenges*, by Jane G. Gravelle. For a discussion of the international effects of lowering the corporate tax rate, see CRS Report R41743, *International Corporate Tax Rate Comparisons and Policy Implications*, by Jane G. Gravelle. For a primer on international corporate taxation, see CRS Report R41852, *U.S. International Corporate Taxation: Basic Concepts and Policy Issues*, by Mark P. Keightley and Jeffrey M. Stupak.

[15] Non-corporate businesses, including S corporations and partnerships, pass their income through to owners who pay taxes. Collectively, these non-corporate business entities are referred to as pass-throughs. For these types of entities, business income is taxed only once, at individual income tax rates.

revenue-neutral over the 10-year budget window. Additional details on the Tax Reform Act of 2014 are provided in a section later in the report.

A New Tax or Revised Tax Base

Alternative revenue options may be sought for a number of reasons. If the revenues generated through base-broadening do not fully finance desired rate reductions, alternative revenue sources may be sought to fill the gap. Revenue from an add-on tax could allow for the retention of more tax expenditures and smaller reductions in other tax expenditures, or larger tax rate reductions. Further, Congress may choose to seek alternative revenue sources to reduce the budget deficit and national debt. An alternative revenue source or tax base (e.g., consumption) might also be supported as an option for improving economic efficiency.

There are several options for imposing a broad-based consumption tax. These include a value-added tax (VAT), a retail sales tax, and a flat tax. A value-added tax is a tax on the value that a firm adds to a product at each stage of production. The value the firm adds is the difference between a firm's sales and a firm's purchases of inputs from other firms. The VAT is collected by each firm at every stage of production. A retail sales tax is a consumption tax levied only at a single stage of production, the retail stage. The retailer collects a specific percentage markup in the retail price of a good or service, which is then remitted to the government. Both the VAT and the retail sales tax have the potential of a robust revenue yield.

Another option for implementing a broad-based consumption tax would be to levy a so-called "flat tax" (often referred to as a Hall-Rabushka flat tax after the two economists who popularized this proposal).[16] Flat tax proposals generally have two components: a wage tax and a cash-flow tax on businesses.[17] With this form, a flat tax is essentially a modified VAT, with wages and pensions subtracted from the VAT base and taxed at the individual level. Under a standard VAT, a firm would not subtract its wage and pension contributions when calculating its tax base. Under the flat tax, some wage income may not be included in the tax base because of personal exemptions.

Other potentially new revenue sources include environmental taxes or taxes on the financial sector. Environmental taxes have been proposed as an option to simultaneously reduce pollution and raise revenue. The most frequently discussed energy tax is a carbon tax that would be levied on the volume of carbon emitted.[18] Another alternative energy tax option would be higher gasoline taxes.[19] Options for imposing new taxes on the financial sector include a securities transaction tax[20] or taxes on certain types of financial institutions, such as systemically important

[16] For detailed information, see CRS Report 98-529, *Flat Tax: An Overview of the Hall-Rabushka Proposal*.

[17] A wage tax is a tax only on salaries and wages. A cash-flow tax is generally a tax on gross receipts minus all outlays.

[18] See CRS Report R42731, *Carbon Tax: Deficit Reduction and Other Considerations*, by Jonathan L. Ramseur, Jane A. Leggett, and Molly F. Sherlock.

[19] For an analysis of the gasoline tax, see CRS Report R40808, *The Role of Federal Gasoline Excise Taxes in Public Policy*, by Robert Pirog.

[20] For background, see CRS Report R41192, *A Securities Transaction Tax: Financial Markets and Revenue Effects*, by Mark P. Keightley.

financial institutions (SIFIs).[21] The Tax Reform Act of 2014 proposed an excise tax be imposed on the consolidated assets of SIFIs in excess of $500 billion.

Framework for Evaluation

In evaluating any change in tax policy, the prevailing economic framework is to analyze the tax policy for equity, efficiency, and simplicity. Tradeoffs may exist between these three objectives. For example, if greater income equality is desired, this may conflict with the goal of economic efficiency.

Equity

Economic theory maintains that it is not possible to make interpersonal comparisons of utility.[22] Hence, whether a change in the distribution of income, with gainers and losers, is an improvement in the national welfare is a value judgment. The effects on different groups, however, can be measured and debated. When considering the fairness of the distribution of tax burdens, the concepts of horizontal and vertical equity are often considered.

Horizontal equity holds that taxpayers with similar incomes should face similar tax burdens. Tax preferences that allow certain taxpayers to claim deductions, credits, or exemptions to reduce tax burdens often result in situations where taxpayers with similar incomes face different tax burdens. Evaluating horizontal equity involves exploring whether taxpayers in similar circumstances pay approximately the same amount of taxes. For example, will the tax burden on two cohabiting single taxpayers be the same as the burden on a similarly situated married couple?

Vertical equity examines the distribution of tax burdens across different income groups. Under an ability-to-pay standard, vertical equity would suggest that taxpayers in higher income groups pay more. How much more is a policy question. Should the after-tax distribution of income be the same as the pre-tax distribution (suggesting taxation should be proportional)? Or should taxpayers with a greater ability to pay have a proportionally higher tax burden (suggesting taxation should be progressive)? In looking at the income of taxpayers, is annual or lifetime income the appropriate ability-to-pay metric? There are also questions as to whether tax reform should seek to be "distributionally neutral," keeping the share of the tax burden borne by different income groups roughly the same.

Evaluating the fairness of tax policy, from an economic perspective, may also involve asking several other questions. For example, what will be the effect on taxpayers in different age groups? Will there be distributional effects by region of the country? Another consideration might be how minority groups could be affected.

[21] For background on these types of institutions, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

[22] In economics, utility is an abstract concept used to measure an individual's satisfaction or benefit from consumption of goods and services.

Efficiency

Tax policy should promote economic efficiency; that is, tax policy should be as neutral as possible by minimizing economic distortions.[23] Low marginal tax rates tend to lessen distortions. Taxes that are applied to a broad base, with few exclusions or exemptions, also tend to be more economically efficient.

Many efficiency questions concern household decisions, specifically those related to savings and labor choices. In the long run, savings used for investment promote economic growth. Increased labor supply can also positively contribute to GDP. Thus, in evaluating economic efficiency, the following types of questions might be asked. What will be the effect of a tax change on households' decisions to save versus consume? Will household decisions about the composition of goods and services consumed be affected? Will households' choices of leisure versus work be affected?

Other efficiency questions concern firms' decisions. What will be the effect on firms' decisions concerning the method of financing (debt or equity), choice among inputs, type of business organization (corporation, partnership, or sole proprietorship), and composition of output?

Simplicity

The greater the simplicity of the tax system, the lower will be the administrative and compliance costs. Tax compliance tends to increase with simplicity such that simplifying the tax system could help reduce the tax gap.[24] Thus, tax policy should eliminate any unnecessary complexity and promote transparency. Numerous questions concerning simplicity arise; among them are the following: How will a tax change affect federal administrative costs? Will the administrative costs of state and local governments change? How will compliance costs of households be affected? Will business compliance costs change?

Tax Reform in the 114th Congress

Tax reform options continue to be actively debated in the 114th Congress. While there has been sustained congressional interest in tax reform, it is not clear what form reform might take. Comprehensive tax reform, similar to what was proposed in the Tax Reform Act of 2014, remains an option. It is also possible that tax reform efforts proceed but target a specific sector of the economy, through a business-only tax reform or a reform of international tax law.

Committee on Finance

Early in the 114th Congress, Senate Finance Committee Chairman Orrin Hatch and Ranking Member Ron Wyden announced the creation of "tax reform working groups," with the goal of

[23] The loss in economic efficiency due to a tax is referred to by economists as the deadweight loss or excess burden of the tax.

[24] The tax gap is the difference between taxes that should have been paid if taxpayers were fully compliant with all tax laws and taxes that were actually collected.

providing tax reform recommendations.[25] The working groups were to provide recommendations for tax reform in five areas: (1) individual income tax; (2) business income tax; (3) savings and investment; (4) international tax; and (5) community development and infrastructure. In March 2015, the committee announced it would be seeking input from stakeholders on how to make the tax code "simpler, fairer, and more efficient."[26] Stakeholder submissions were posted on the Finance Committee's website in April 2015.[27] The committee has also held a number of hearings on tax reform in first session of the 114th Congress.

Legislative Proposals

Reform the Income Tax System

As of the date of this report, legislation that would provide a comprehensive reform of the income tax system has not been introduced. Comprehensive tax reform legislation was introduced in December 2014 as the Tax Reform Act of 2014 (H.R. 1), and is discussed below in the section "Tax Reform in the 113th Congress."

Reforming the Current Tax System Through Base-Broadening: Economic Analysis

Proposals that broaden the tax base and reduce statutory tax rates are widely believed to promote economic growth. The degree to which a specific set of policies is likely to affect growth, however, depends on changes in the effective marginal tax rates. It is possible for base-broadening to increase effective marginal tax rates, potentially offsetting any growth benefits that would be expected from statutory rate reductions.[28]

The Joint Committee on Taxation (JCT) prepared a macroeconomic analysis of the Tax Reform Act of 2014, which was released along with the discussion draft.[29] The JCT's analysis found that the Tax Reform Act of 2014 would have been expected to reduce effective marginal tax rates on labor, creating an incentive to work, and increased the after-tax income of individuals, increasing

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[25] Senate Committee on Finance, "Hatch, Wyden Launch Bipartisan Finance Committee Tax Reform Working Groups," press release, January 15, 2015, http://www.finance.senate.gov/newsroom/chairman/release/?id=2ea8c8e5-c892-4230-9d1a-db7522a920be. In a January 22, 2015, hearing on Jobs and the Economy Senate Finance Committee Chairman Hatch stated that he had "made tax reform my highest legislative priority for [the 114th] Congress." The Chairman's statement is available at http://www.finance.senate.gov/hearings/hearing/?id=626b3e14-5056-a032-52da-38f3dfeb77ba.

[26] Senate Committee on Finance, "Hatch, Wyden Launch New Effort to Seek Input on Bipartisan Tax Reform," press release, March 11, 2015, http://www.finance.senate.gov/newsroom/chairman/release/?id=3bcf1fcf-9dd8-47d4-9202-21a0870cd8d6.

[27] Stakeholder submissions to the tax reform working groups can be found at http://www.finance.senate.gov/legislation/.

[28] For a discussion of base-broadening and the effects on marginal tax rates in individual income tax system, see CRS Report R43079, *Restrictions on Itemized Tax Deductions: Policy Options and Analysis*, by Jane G. Gravelle and Sean Lowry. A discussion of base-broadening in the context of the corporate tax system can be found in CRS Report R42726, *The Corporate Income Tax System: Overview and Options for Reform*, by Mark P. Keightley and Molly F. Sherlock.

[29] U.S. Congress, Joint Committee on Taxation, *Macroeconomic Analysis of the "Tax Reform Act of 2014",* committee print, 113th Cong., February 26, 2014, JCX-22-14.

demand for goods and services. Both of these effects would be expected to stimulate the economy. On the corporate side, even though statutory tax rates would have been reduced, base-broadening provisions, including repeal of accelerated depreciation, would have led to higher effective tax rates on some capital investments. Overall, the JCT estimated that the increased cost of capital for domestic firms would lead to reduced investment in domestic capital stock. On net, the JCT estimates suggest that the provisions proposed in the Tax Reform Act of 2014 would increase economic output.

Replace the Income Tax System

Several proposals to replace the income tax system have been introduced in the 114th Congress. The Fair Tax Act of 2015 (H.R. 25/S. 155), the Flat Tax Act (H.R. 1040), and the Simplified, Manageable, and Responsible Tax (SMART) Act (H.R. 1824/S. 929) have all been introduced in previous Congresses. The Fair Tax Act of 2015 would replace the current income tax system with a national retail sales tax. Both the Flat Tax Act and the SMART Act would impose a flat tax system that is structurally similar to the Hall-Rabushka flat tax proposal, taxing wages and business taxable income.

Replacing the Income Tax System: Legislative Proposals in the 114th Congress

The Fair Tax Act of 2015 (H.R. 25/S. 155)[30]

This legislation proposes to repeal the individual income tax, the corporate income tax, all payroll taxes, the self-employment tax, and the estate and gift taxes. These taxes would be effectively replaced with a 23% (tax-inclusive, meaning that the rate is a proportion of the after-tax rather than the pre-tax value) national retail sales tax. The tax-inclusive retail sales tax would equal 23% of the sum of the sales price of an item and the amount of the retail sales tax. Every family would receive a rebate of the sales tax on spending amounts up to the federal poverty level (plus an extra amount to prevent any marriage penalty). The Social Security Administration would provide a monthly sales tax rebate to registered qualified families. The 23% national retail sales would not be levied on exports. The sales tax would be separately stated and charged. Social Security and Medicare benefits would remain the same with payroll tax revenue replaced by some of the revenue from the retail sales tax. States could elect to collect the national retail sales tax on behalf of the federal government in exchange for a fee. Taxpayer rights provisions are incorporated into the act. The sales tax would sunset at the end of a seven-year period beginning on the enactment of this act if the Sixteenth Amendment is not repealed. This amendment provided Congress with the "power to lay and collect taxes on incomes."

***The Flat Tax Act* (H.R. 1040)**[31]

This proposal would authorize an individual or a person engaged in business activity to make an irrevocable election to be subject to a flat tax (in lieu of the existing tax provisions). This act would also repeal estate and gift taxes.

For individuals not engaged in business activity who select the flat tax, their initial tax rate would be 19%, but after two years this rate would decline to 17%. The individual flat tax would be levied on all wages, retirement distributions, and unemployment compensation. An individual's taxable income would also include the taxable income of each dependent child who has not attained age 14 as of the close of such taxable year.

The flat tax would have "standard deductions" that would equal the sum of the "basic standard deduction" and the "additional standard deduction."

The "basic standard deduction" would depend on filing status:

- $32,496 for a married couple filing jointly or a surviving spouse

[30] The Fair Tax Act was introduced in the 113th Congress as (H.R. 25/S. 122) and the 112th Congress as (H.R. 25/S. 13).

[31] Similar legislation was introduced in the 113th Congress as the Flat Tax Act (H.R. 1040) and the 112th Congress as the Freedom Flat Tax Act (H.R. 1040).

- $20,739 for a single head of household
- $16,248 for a single person or a married person filing a separate return

The "additional standard deduction" would be an amount equal to $6,998 for each dependent of the taxpayer. All deductions would be indexed for inflation using the consumer price index (CPI).

For individuals engaged in business activity who select the flat tax, their initial tax rate would be 19% (declining to 17% when the tax was fully phased in two years after enactment) on the difference between the gross revenue of the business and the sum of its purchases from other firms, wage payments, and pension contributions.

For those employees electing the flat tax, government employers and employers of nonprofit organizations would pay a flat tax on their employees' fringe benefits, except retirement contributions, because activities of government entities and tax-exempt organizations would be exempt from the business tax.

Any congressional action that raises the flat tax rate or reduces the amount of the standard deduction would require a three-fifths (supermajority) vote in both the Senate and the House of Representatives.

The Simplified, Manageable, And Responsible Tax (SMART) Act (H.R. 1824/S. 929)[32]

This act would replace the current individual and corporate income taxes and estate and gift taxes with a flat tax. This flat tax proposal has two components: a wage tax and a cash-flow tax on businesses.

The individual wage tax would be levied at a 17% rate. The individual wage tax would be levied on all wages, salaries, pension distributions, and unemployment compensation. An individual's taxable income would include taxable income of each dependent child who has not attained age 14 as of the close of the taxable year. The individual wage tax would not be levied on Social Security income. Thus, the current partial taxation of Social Security payments to high-income households would be repealed. Social Security contributions would continue to be taxed; that is, they would not be deductible and would be made from after-tax income. Firms would pay the business tax on their Social Security contributions. Individuals would pay the wage tax on their Social Security contributions. The individual wage tax would have "standard deductions" that would equal the sum of the "basic standard deduction" and the "additional standard deduction."

The "basic standard deduction" would depend on filing status:

- $28,960 for a married couple filing jointly or a surviving spouse
- $18,490 for a single head of household
- $14,480 for a single person or a married person filing a separate return

The "additional standard deduction" would be an amount equal to $6,240 for each dependent of the taxpayer. All deductions would be indexed for inflation using the consumer price index (CPI).

Businesses would pay a tax of 17% on the difference (if positive) between gross revenue and the sum of purchases from other firms, wage payments, and pension contributions. This business tax would cover corporations, partnerships, and sole proprietorships. Pension contributions would be deductible but there would be no deductions for fringe benefits. State and local taxes (including income taxes) and payroll taxes (e.g., social security, Medicare, etc.) would not be deductible.

If the business's aggregate deductions exceed gross revenue, then the excess of aggregate deductions can be carried forward to the next year and increased by a percentage equal to the three-month Treasury rate for the last month of the taxable year.

Government employers and employers of nonprofit organizations would pay a 17% tax on their employees' fringe benefits, except retirement contributions, because activities of government entities and tax-exempt organizations would be exempt from the business tax.

A supermajority of three-fifths of the Members of the House or Senate would be required to (1) increase any federal income tax rate; (2) create any additional federal income tax rate; (3) reduce the standard deduction; or (4) provide any exclusion, deduction, credit, or other benefit which results in a reduction in federal revenues.

[32] The SMART Act was introduced in the 112th Congress as S. 820 and the 113th Congress as S. 173.

Replacing the Current Tax System with a Consumption Tax: Economic Considerations

Relative to the current system, it is often asserted that a flat tax (or consumption tax)[33] would increase economic efficiency.[34] This type of tax is imposed on a broad definition of wage income (or consumption), and there are limited deductions, exemptions, and credits to reduce tax liability.[35] Lower tax rates on a broader tax base tend to promote economic efficiency.[36] If the flat tax (consumption tax) is not applied to capital income or corporate income, the flat tax may contribute to additional capital accumulation and investment.[37] A flat tax (or consumption tax) system, however, is likely to be less progressive than the current tax system, particularly at the top of the income distribution. Thus, efficiency gains achieved by moving to a flat tax (or consumption tax) system would come at the cost of reduced equity, as higher-income groups would tend to see tax burdens decline while lower-income groups would tend to see increased tax burdens.

Another potential benefit of a flat tax system is simplicity. A flat tax system would impose one tax rate, and eliminate most of the tax deductions and tax credits currently in the tax code. However, much of the complexity in the current tax system is related to the definition of income, rather than the income tax rates. If the tax were applied only to wage income, this would create an incentive for non-wage compensation (e.g., benefits), as is the case in the current tax system with the exclusion for employer-provided healthcare. Further, if the flat tax system were to run parallel to the current income tax system, as proposed in H.R. 1040, the flat tax could create additional complexity for taxpayers trying to decide whether to elect flat tax treatment. There would also be horizontal inequities, as taxpayers with identical incomes and tax circumstances would have different tax liabilities under the flat tax and income tax systems.

Other Tax Reform Proposals

Legislation introduced in the 114th Congress would eliminate the current tax code, leaving it to Congress to design a new tax code. The Tax Code Termination Act (H.R. 27) would terminate the Internal Revenue Code, and declares that any new tax system should be a simple and fair system that (1) applies a low rate to all Americans; (2) provides tax relief for working Americans; (3) protects the rights of taxpayers and reduces tax collection abuses; (4) eliminates the bias against

[33] A flat tax is equivalent to a value-added tax (VAT) when there are no personal exemptions. Effectively, the wage portion of the flat tax is paid by households rather than businesses. Thus, a flat tax is effectively a consumption tax.

[34] A flat tax may yield efficiency gains by effectively taxing consumption rather than income, by broadening the tax base, by reducing tax rates, and by reducing compliance costs. For more, see William G. Gale, "Flat Tax," in *The Encyclopedia of Taxation & Tax Policy*, ed. Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, 2nd ed. (Washington, DC: Urban Institute Press, 2005), pp. 149-152.

[35] It is possible that deductions, exemptions, and credits could be used in a consumption tax system. As with an income tax system, deductions, exemptions, and credits that erode the consumption tax base may reduce the efficiency of the overall tax system.

[36] If tax deductions, credits, or exemptions address certain market failures, these provisions may enhance economic efficiency. Eliminating efficiency-enhancing provisions, even if the revenues are used to reduce tax rates, will not necessarily increase the efficiency of the entire tax system.

[37] The amount of additional capital accumulation and investment that occurs depends on the responsiveness of savings to changes in the tax rate. For background on this issue, see CRS Report R40411, *The Economic Effects of Capital Gains Taxation*.

savings and investment; (5) promotes economic growth and job creation; and (6) does not penalize marriage or families.[38]

Legislation has also been introduced in the 114th Congress to address equity concerns in the current tax system by implementing a so-called "Buffett Rule."[39] The Paying a Fair Share Act of 2015 (S. 161/H.R. 362) would impose a 30% minimum effective tax rate on taxpayers reporting at least $1 million in income.[40]

Fiscal Reform in Budget Proposals

Budget Resolution for FY2016[41]

After going to a conference in April 2015, the House and Senate agreed on a budget resolution (S.Con.Res. 11) for FY2016. As is required of a budget resolution, S.Con.Res. 11 includes enforceable aggregate levels of revenue for FY2016. Additionally, the budget resolution demonstrates some support for congressional action on tax reform.[42] Specifically, the resolution includes:

- A deficit-neutral reserve fund in the Senate for legislation related to tax reform.[43] Congress frequently includes "reserve funds" in the budget resolution. Such provisions provide the chairs of the House or Senate Budget Committees the authority to adjust the budgetary allocations, aggregates, and levels included in the budget resolution in the future if certain conditions are met. Typically these conditions consist of legislation dealing with a particular policy being reported by the appropriate committee or an amendment dealing with that policy being offered on the floor. Generally, the goal of such a reserve fund or adjustment is to allow certain policies to be considered on the floor without triggering a point of order for violating levels in the budget resolution.[44]
- Two policy statements expressing support in the House for tax reform.[45] The first policy statement communicates support for fundamental tax reform that will foster economic growth and job creation, and the second states that tax reform should be enacted that (1) simplifies the tax code; (2) substantially lowers tax rates for individuals and consolidates the current seven individual income tax

[38] The Tax Code Termination Act was introduced in the 112th Congress as H.R. 462 and the 113th Congress as H.R. 352.

[39] For additional background on the "Buffett Rule," see CRS Report R42043, *An Analysis of the "Buffett Rule"*.

[40] The Paying a Fair Share Act of 2013 (S. 321/H.R. 766) was introduced earlier in in the 113th Congress. The Paying a Fair Share Act of 2012 (S. 2230/H.R. 3903) was also introduced in the 112th Congress. On April 16, 2012, the Senate voted not to invoke cloture on S. 2230.

[41] This section was written by Megan S. Lynch, Analyst on Congress and the Legislative Process.

[42] While a budget resolution is not designed to create revenue policy, it often communicates congressional support for subsequent enactment of certain legislation.

[43] Sec. 4308.

[44] For a detailed description of reserve funds, see CRS Report R43535, *Provisions in the Bipartisan Budget Act of 2013 as an Alternative to a Traditional Budget Resolution*, by Megan S. Lynch.

[45] Sec. 6202 and Sec. 6204. Typically, such statements indicate that levels in the budget resolution assume such policies will be carried out.

> brackets into a fewer number; (3) repeals the Alternative Minimum Tax; (4) reduces the corporate tax rate; and (5) transitions the tax code to a more competitive system of international taxation.

The budget resolution also includes reconciliation instructions to several committees, including the committees with jurisdiction over tax reform, the Senate Finance Committee and the House Ways and Means Committee. These instructions trigger the reconciliation process by directing individual committees to develop and report legislation that would change laws within their jurisdiction to achieve a specified budgetary goal. During the final stages of the reconciliation process, the reported legislation is considered under expedited procedures in both the House and Senate. In responding to their reconciliation instructions, the Senate Finance Committee or the House Ways and Means Committee may choose to include in their reconciliation legislation changes to tax policy constituting tax reform.[46]

President's FY2016 Budget Proposal[47]

The President's FY2016 budget proposes a number of changes to current tax policy. Many of these changes were part of previous Obama Administration budget proposals. The President's budget uses an adjusted baseline, which assumes that the American Opportunity Tax Credit (AOTC), Earned Income Tax Credit (ETIC), and Child Tax Credit (CTC) expansions that were extended through 2017 as part of the American Taxpayer Relief Act (ATRA; P.L. 112-240) are made permanent.

The tax proposals in the President's FY2016 budget are divided into two groups. The first group of proposals is to be considered as part of a long-run revenue-neutral business tax reform. The revenue raised from the base-broadening proposals in this section would pay for a reduction in the corporate tax rate to 28%, with an effective rate of 25% for manufacturing. The President's FY2016 budget also provides a one-time $268 billion allowance for transportation infrastructure spending, which would be paid for using unspecified revenues generated through the transition to a reformed business tax system.

The business tax reform proposals in the President's FY2016 budget include incentives for research, manufacturing, clean energy, and small business. The proposed modification and extension of the research and experimentation tax credit would cost $127.7 billion between 2016 and 2026 according to the Administration's estimates. The President's FY2016 budget also proposes extending the increased expensing allowance for small businesses. Revenue-raising provisions in the President's business tax reform include changes in the tax treatment of derivatives and insurance products, repeal of certain tax incentives for fossil fuels, and repeal of last-in, first-out inventory accounting methods, among several other changes.

Also included as revenue-raising provisions are proposed changes to the U.S. international tax system. These changes include such things as a 19% minimum tax on foreign earnings; limitations on corporate inversions; interest deductions restrictions; Subpart F reforms; limits on

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[46] For more information on the reconciliation process, see CRS Report R41186, *Reconciliation Directives: Components and Enforcement*, by Megan S. Lynch.

[47] For details, see Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, Washington, DC, February 2015, http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

income shifting using intangible property transfers; and restrictions on hybrid arrangements to create stateless income. The Administration estimates the reforms to the U.S. international tax system would generate $238.3 billion between 2016 and 2025. Overall, the long-run revenue-neutral business tax reform section of the President's FY2016 budget would generate a reserve of $141.5 billion for revenue-neutral tax reform.

The second group of revenue proposals includes additional provisions related to manufacturing and clean energy, certain incentives for infrastructure, a proposal to expand the Earned Income Tax Credit (EITC), and other individual-level tax incentives. The most costly proposal in this section is a new second-earner tax credit for working couples, at $89.0 billion between 2016 and 2025, followed by proposed expansion of the EITC, at $59.9 billion between 2016 and 2025.

On net, the revenue proposals that are not related to baseline adjustments or reserved for revenue-neutral business tax reform would raise $1.5 trillion between 2016 and 2025. The provisions that would generate the most additional revenue between 2016 and 2025 include capping the value of certain tax expenditures at 28% ($603.2 billion); imposing a 14% one-time tax on untaxed overseas earnings ($268.1 billion); increasing the maximum capital gains rate to 24.2% ($207.9 billion); setting estate and gift tax parameters at 2009 levels ($189.3 billion); imposing a fee on certain financial institutions ($111.8 billion); increasing tobacco taxes ($95.1 billion); conforming Self Employment Contributions Act (SECA) taxes for professional services businesses ($74.6 billion); and imposing a "Buffett Rule" or "Fair Share Tax" ($35.2 billion).

Tax Reform in the 113th Congress

Several major tax reform proposals were put forward by Members in the 113th Congress. While comprehensive tax reform was not enacted, proposals introduced in the 113th Congress may continue to inform the debate.

Committee on Ways and Means and Committee on Finance

The House Committee on Ways and Means worked towards comprehensive tax reform in the 113th Congress. On February 26, 2014, Chairman Camp released the draft Tax Reform Act of 2014.[48] This proposal would have broadened the tax base and restructured statutory tax rates in both the individual and corporate income tax systems, changed the tax treatment of foreign-source income for U.S. multinational corporations, and made dozens of other changes to the federal tax system (additional details can be found in the shaded text box below). This reform built on earlier discussion drafts that had been released by Chairman Camp.

Chairman Camp's first tax reform discussion draft on international tax reform was released during the 112th Congress.[49] A number of the international tax reform proposals in the Tax Reform Act of 2014 appeared in this earlier discussion draft. Similar to the earlier draft, the Tax Reform Act of 2014 would have allowed a 95% dividends received deduction for foreign business income. As a transition rule, the earlier draft had proposed a 5.25% tax on undistributed foreign

[48] A full text of the draft and related materials can be found at http://tax.house.gov/.

[49] For the 2012 International Tax Reform discussion draft and related materials, see http://waysandmeans.house.gov/taxreform/.

earnings. The Tax Reform Act of 2014 also proposed taxing accumulated deferred foreign earnings, with a higher rate of 8.75% for cash, with other earnings held abroad taxed at 3.5%. In an effort to prevent tax base erosion, the Tax Reform Act of 2014 would have taxed foreign income generated by U.S. companies through the use of intangibles.[50]

Other proposals in the Tax Reform Act of 2014 were similar to proposals contained in Camp's previous discussion drafts. Similar to proposals made in Camp's January 24, 2013, financial products discussion draft,[51] the Tax Reform Act of 2014 would have required that derivatives be marked-to-market at year-end, such that taxpayers would recognize income or losses. With respect to small businesses, the Tax Reform Act of 2014 did not include the broader reform option that had appeared in the March 12, 2013, small business discussion draft.[52] Instead, the Tax Reform Act of 2014 proposed a number of changes to existing pass-through and partnership tax rules. Among the many proposals are provisions that would have taxed carried interest as ordinary income, changed rules related to partnership audits and adjustments, and restricted the use of publicly traded partnerships.

Former Committee on Finance Chairman Max Baucus also released several discussion drafts related to tax reform. The former chairman released discussion drafts related to international tax reform, tax administration, cost recovery and accounting, and energy tax policy. The discussion drafts were released in addition to a series of tax reform options papers put forward by the committee earlier in 2013.[53]

Under Senator Baucus's international tax reform proposal, passive and highly mobile forms of foreign-earned income would be taxed at the full U.S. rate, as would income earned from goods ultimately consumed in the United States. Two alternatives were put forth for taxing income earned from products and services sold abroad. "Option Y" would subject all foreign-earned income to a minimum tax, which the draft sets at 80% of the U.S. statutory rate. "Option Z" would tax 60% of foreign active business income at the U.S. rate. Similar to Chairman Camp's international tax proposals, undistributed foreign earnings would be subject to a one-time tax. The Baucus discussion draft sets this rate at 20%.

Reforms to cost recovery and accounting rules have also been put forward by former Chairman Baucus as a discussion draft. Proposed reforms would eliminate the modified accelerated cost recovery system (MACRS), enacting instead a system that uses asset pools and longer lives that more closely approximate economic depreciation. Certain intangibles, including research and experimentation as well as advertising expenditures, would be capitalized and amortized. Last-in, first-out (LIFO) inventory accounting rules would be repealed. Small-business expensing allowances would be increased such that more businesses would be allowed to use cash

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[50] Camp's earlier discussion draft had included two other options for addressing profit shifting concerns. These options included (1) current taxation of foreign profits when income is earned from intangibles, income exceeds the normal rate of return, and income is earned in a low-tax country (this is referred to as President Obama's "excess returns" proposal) or (2) tax income that is subject to an effective foreign tax rate below 10% unless it qualifies for a home country exception. For more on policy options for addressing corporate profit shifting, see CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle.

[51] For the Financial Productions discussion draft and related materials, see http://waysandmeans.house.gov/taxreform/.

[52] For the Small Business discussion draft and related materials, see http://waysandmeans.house.gov/taxreform/.

[53] The Senate Finance Committee's tax reform options papers are available online at http://www.finance.senate.gov/issue/?id=6c61b1e9-7203-4af0-b356-357388612063.

accounting. A number of similar proposals appear in the Tax Reform Act of 2014, discussed above.

Former Chairman Baucus has also released a discussion draft related to tax administration and energy tax reform. This tax administration draft contained several proposals designed to reduce the tax gap, enacting additional data reporting requirements and anti-fraud provisions. The energy tax reform discussion draft proposes clean energy production and investment tax credits designed to replace existing incentives for renewables and other clean electricity resources (e.g., nuclear, carbon capture, and sequestration). These credits would be available for the long term, but are designed to begin phasing out once the annual average greenhouse gas emissions rate falls below a specified threshold. The proposal also contains a new tax credit for clean transportation fuels.

Legislative Proposals

Reform the Income Tax System

The Tax Reform Act of 2014 (H.R. 1) was introduced late in the 113th Congress. This legislation was preceded by several tax reform discussion drafts, discussed above. Key provisions of this comprehensive legislation are provided in the text box below.

Reforming the Income Tax System: Legislative Proposals in the 113th Congress

The Tax Reform Act of 2014 (H.R. 1)[54]

This proposal would have made substantial changes to the current federal tax system, modifying individual, corporate, and business income taxes, while also changing the tax treatment of multinational corporations. The proposal would also have made a number of changes related to the treatment of tax-exempt entities, tax administration and compliance, and excise taxes.

Individual Income Tax

Under the proposal, there would have been two regular income tax brackets, with rates of 10% and 25%. A third bracket would have applied to an alternative definition of income, making for a top statutory rate of 35%. The 35% bracket results from a 10% tax on modified adjusted gross income (MAGI) above certain income thresholds ($400,000 for single filers; $450,000 for joint filers (adjusted for inflation)). The 10% bracket would have phased-out for certain higher-income taxpayers. Brackets would have been adjusted for inflation using chained-CPI. Dividends and capital gains would have been taxed as ordinary income, but 40% of net capital gains and qualified dividends would have been excluded from taxable income. The proposal would have also repealed the Alternative Minimum Tax (AMT).

Other substantial changes to the structure of the individual income tax system included an elimination of personal exemptions and an increase in the standard deduction. The standard deduction would have been set at $22,000 for joint filers, and $11,000 for other individual filers. An additional standard deduction of $5,500 would have been available for single filers with at least one child. The standard deduction would have been phased-out for certain higher-income taxpayers.

The proposal would have also modified or eliminated a number of individual income tax credits, deductions, and other provisions. Major changes included eliminating the deduction for state and local tax payments; scaling back the mortgage interest deduction and earned income tax credit (EITC); modification of the charitable deduction and education incentives; and changes in 401(k) and Roth IRA retirement savings vehicles.

[54] A full section-by-section summary of the Tax Reform Act of 2014, as prepared by the staff of the House Committee on Ways and Means, can be found at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf.

Corporate and Business Income Tax

All C corporations would have been taxed at a top statutory rate of 25% under the proposal, with the statutory rate reduction phased in through 2019. Other business income, including income earned by S corporations, partnerships, and sole proprietorships, would have been taxed through the individual income tax system. Similar to the individual system, the proposal would have modified or eliminated a number of corporate and business income tax credits, deductions, and other provisions. Among the proposed changes were the elimination of the modified accelerated cost recovery system (MACRS); requiring amortization of research and experimental expenditures and advertising expenses; a modification of the net operating loss (NOL) deduction; a phased-out repeal of the Section 199 domestic production activities deduction; and repeal of the last-in, first-out (LIFO) method of inventory accounting. The corporate AMT is also repealed.

Taxation of Multinationals

The proposal would have made significant changes to the tax treatment of foreign source income earned by U.S. multinational corporations. Specifically, it proposed adopting a 95% exemption for dividends received by U.S. corporations from foreign subsidiaries. Subpart F rules would have been modified, providing broad taxation of intangible income of foreign subsidiaries when earned, with foreign intangible income subject to a 15% rate (once fully phased in). The proposal also included "thin capitalization" rules that would have restricted domestic interest deductions. There would have also been a one-time tax on previously untaxed earnings and profits (E&P) of foreign subsidiaries of U.S. corporations. E&P retained as cash would have been taxed at 8.75% while any remaining E&P would have been taxed at 3.5%.

Other Changes

Numerous changes were also proposed with respect to tax-exempt entities, administration and compliance, and excise taxes. Among the proposed changes was an excise tax on systemically important financial institutions.

Additional legislative proposals in the 113th Congress would have reformed the current income tax system. Specifically, the Family Fairness and Opportunity Tax Reform Act (S. 1616) proposed substantive changes to the current income tax. Specifically, S. 1616 would have consolidated the tax brackets, repealed the alternative minimum tax (AMT), provided an additional child tax credit and personal credit, eliminated the standard deduction and most itemized deductions (retaining, with modifications, the deduction for mortgage interest and charitable contributions), in addition to making other changes to the tax code. Other legislation, such as the Flat Tax Rate Act (H.R. 5882), would have imposed a single income tax rate of 15%.

Replace the Income Tax System

Several proposals were introduced in the 113th Congress that would have replaced the income tax system with some alternative form of taxation at the federal level. The Fair Tax Act of 2013 (H.R. 25/S. 122) would have repealed the individual income tax, the corporate income tax, all payroll taxes, the self-employment tax, and the estate and gift taxes. These taxes would have effectively been replaced with a national retail sales tax. Thus, under H.R. 25/S. 122, the current federal tax system, based on taxing income, would have been replaced with a system that taxes consumption. The Fair Tax Act was reintroduced in the 114th Congress, and is discussed above.

The Flat Tax Act (H.R. 1040) proposed to allow taxpayers to elect to be subject to a flat tax, as an alternative to the current tax system. Individuals and businesses electing a flat tax would pay a flat rate of 19% for the first two years, and a rate of 17% thereafter. The Simplified, Manageable, And Responsible Tax (SMART) Act (S. 173) also proposed a flat tax of 17% on individuals' wages and business taxable income. The flat tax systems proposed in H.R. 1040 and S. 173 were structurally similar to the Hall-Rabushka flat tax proposal.[55] Both of these proposals were reintroduced in the 114th Congress, and are discussed above.

The American Growth & Tax Reform Act of 2013 (H.R. 2393) would have required the Secretary of the Treasury to submit to Congress a legislative proposal for a progressive consumption tax. H.R. 2393 would have been designed to eliminate the public debt outstanding. Specifically, the Treasury would have been directed to provide rates and details on a progressive consumption tax to eliminate the public debt under scenarios in which (1) the consumption tax in addition to other taxes; (2) the consumption tax would replace the individual income tax; and (3) the consumption tax would replace the corporate income tax.

The Progressive Consumption Tax Act of 2014 (S. 3005) proposed a 10% consumption tax on most goods and services (structured as a value-added tax (VAT)).[56] While the legislation would not fully replace the income tax system, it would have reduced individual and corporate income tax rates to a maximum rate of 28% and 17%, respectively. The legislation also would have broadened the income tax base, eliminating a number of individual tax expenditures. Further, the legislation would have provided an allowance of $50,000 for single filers ($100,000 for married filing jointly), that would have effectively exempted most taxpayers from the individual income tax. Refundable tax credits for families would effectively be replaced with rebates to offset consumption tax liability for lower-income families.

Other Tax Reform Proposals

Legislation introduced in the 113th Congress would have eliminated the existing tax code, leaving it to Congress to design a new tax code. The Tax Code Termination Act (H.R. 352) would have terminated the Internal Revenue Code, and declares that any new tax system should be a simple and fair system that met a set of criteria, as noted above.

The End Wasteful Tax Loopholes Act (S. 8) proposes to express the sense of the Senate that Congress should enact legislation to (1) eliminate wasteful tax loopholes; (2) eliminate corporate tax loopholes and wasteful tax breaks for special interests; (3) enhance tax fairness by reforming or eliminating tax breaks that provide excessive benefits to millionaires and billionaires; (4) crack down on tax cheaters and close the tax gap; (5) use the revenue saved by curtailing tax loopholes to reduce the deficit and reform the federal tax code; (6) address provisions in the tax code that make it more profitable for companies to create jobs overseas than in the United States; and (7) reform the tax code in a manner that promotes job creation, competitiveness, and economic growth.

The Paying a Fair Share Act of 2013 (H.R. 766/S. 321) would have imposed a 30% minimum effective tax rate on taxpayers reporting at least $1 million in income. This legislation was reintroduced in the 114th Congress, as noted above.

[55] For background information on the Hall-Rabushka flat tax proposal, see CRS Report 98-529, *Flat Tax: An Overview of the Hall-Rabushka Proposal*.

[56] Further discussion of S. 3005 can be found in William R. Davis, "Cardin's VAT Bill: Driving Debate Or Another Back-Seat Attempt," *Tax Notes*, January 19, 2015, pp. 329-334.

Fiscal Reform in Budget Proposals

General instructions for tax reform were not included in the Bipartisan Budget Act of 2013. Section 114 of the act, did, however, provide several deficit-neutral tax reform-related reserve funds for Senate budget enforcement.[57] The earlier Senate- and House-passed budget resolutions recommend substantial changes in current tax law. The House budget resolution (H.Con.Res. 25) called for revenue-neutral comprehensive tax reform, while the Senate budget resolution (S.Con.Res. 8) instructed the Senate Finance Committee to draft revenue legislation that would reduce the deficit by $975 billion over the 2013 to 2023 budget window.[58]

House and Senate Budget Resolutions

The House budget resolution (H.Con.Res. 25) was passed on March 21, 2013.[59] The accompanying H.Rept. 113-17 stated that H.Con.Res. 25 sought to grow the economy through tax reform.[60] Specifically, tax reform as outlined in H.Con.Res. 25, would have achieved the following objectives: (1) simplify the tax code to make it fairer to American families and businesses; (2) reduce the amount of time and resources necessary to comply with tax laws; (3) substantially lower tax rates for individuals, with a goal of achieving a top individual rate of 25%; (4) consolidate the current seven individual-income-tax brackets into two brackets with a first bracket of 10%; (5) repeal the Alternative Minimum Tax; (6) reduce the corporate tax rate to 25%; and (7) transition the tax code to a more competitive system of international taxation.[61]

H.Con.Res. 25 stated that revenue-neutral tax reform that meets the objectives listed above should have been reported by the Committee on Ways and Means to the House by December 31, 2013. This would have allowed Congress time to enact comprehensive tax reform during FY2014. The tax reform efforts that were being undertaken at the time by the Committee on Ways and Means are discussed in greater detail elsewhere in this report (see "Committee on Ways and Means" above).

The Senate budget resolution (S.Con.Res. 8) was passed on March 23, 2013. This budget resolution stated that by October 1, 2013, the Senate Committee on Finance was to report revenue legislation that would have raised $975 billion between fiscal years 2013 and 2023. The committee report accompanying S.Con.Res. 8 stated that these additional revenues would result

[57] For more information on reserve funds in budget resolutions, see CRS Report R40472, *The Budget Resolution and Spending Legislation*, by Megan S. Lynch.

[58] Additional legislative action is required to enact any policy proposals from a budget resolution.

[59] The Bipartisan Budget Act of 2013 (BBA; P.L. 113-67) included language stating that, in lieu of a budget resolution for FY2014 and FY2015, the Chairs of the House and Senate Budget Committees were permitted to each file a statement of budgetary levels in the Congressional Record, which would have effect in their respective chamber as if the levels had been included in a budget resolution. The Senate, therefore, did not consider a budget resolution for FY2015, and instead, on May 5, 2014, the Senate Budget Committee Chairwoman filed levels pursuant to the BBA, which had effect in the Senate. On April 29, the House Budget Committee Chairman filed such levels pursuant to the BBA, which had effect in the House. While the BBA permitted such levels to be filed, it did not preclude either House from otherwise considering a budget resolution. Subsequent to the Budget Committee Chairman filing such levels, the House, on March 10, 2014, the House passed a budget resolution for FY2015 (H.Con.Res. 96).

[60] U.S. Congress, House Committee on the Budget, *Concurrent Resolution on the Budget - Fiscal Year 2014*, Report to Accompany H.Con.Res. 25, 113th Cong., 1st sess., March 15, 2013, H.Rept. 113-17, p. 6.

[61] Ibid., p. 7.

from tax increases on "the wealthiest Americans and biggest corporations."[62] The committee report also noted that S.Con.Res. 8, as reported, supported the goal of comprehensive tax reform that "simplifies the tax code, increases fairness, generates economic growth, and improves the competitive position of U.S. businesses, if it is done in a way that is consistent with the revenue and progressivity goals" of the budget.[63]

President's FY2015 Budget Proposal[64]

The President's FY2015 budget proposed a number of changes to current tax policy. Many of these changes were part of previous Obama Administration budget proposals. The President's budget used an adjusted baseline, which assumed that the American Opportunity Tax Credit (AOTC), Earned Income Tax Credit (ETIC), and Child Tax Credit (CTC) expansions that were extended through 2017 as part of the American Taxpayer Relief Act (ATRA; P.L. 112-240) are made permanent.

The tax proposals in the President's FY2015 budget were divided into two groups. The first group of proposals was to be considered as part of a revenue-neutral business tax reform. The revenues raised from proposals in this section would have paid for a reduction in the corporate tax rate. The President's FY2015 budget also provided a one-time $150 billion allowance for transportation infrastructure spending, which would have been paid for using unspecified revenues generated through the transition to a reformed business tax system.

The business tax reform proposals in the President's FY2015 budget included incentives for research, manufacturing, clean energy, and small business. The proposed modification and extension of the research and experimentation tax credit would have cost $108.1 billion between 2015 and 2024. The President's FY2015 budget also proposed extending the increased expensing allowance for small businesses. Revenue-raising provisions in the President's business tax reform included proposed changes to the U.S. international tax system, changes in the tax treatment of derivatives and insurance products, repeal of certain tax incentives for fossil fuels, and repeal of last-in, first-out inventory accounting methods, among several other changes. Changes to the U.S. international tax system in this section would have generated $276.3 billion between 2015 and 2024. Overall, this section of the President's FY2015 budget would have generated $248.3 billion for revenue-neutral tax reform.

The second group of revenue proposals included additional provisions related to manufacturing and clean energy, certain incentives for infrastructure, a proposal to expand the EITC, and other individual-level tax incentives. The most costly proposal in this section was the proposed EITC expansion, at $59.7 billion between 2015 and 2024.

On net, the revenue proposals that were related to baseline adjustments or reserved for revenue-neutral business tax reform would have raised $1,048.1 billion between 2015 and 2024. The provisions that would have generated the most additional revenue between 2015 and 2024

[62] U.S. Congress, Senate Committee on the Budget, *Committee Print to Accompany S.Con.Res. 8 Together with Additional Views and Minority Views*, committee print, 113th Cong., 1st sess., March 2013, S.Rept. 113-12, p. 138.

[63] Ibid., p. 138.

[64] For details, see Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, Washtington, DC, March 2014, http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

included the 28% cap on the value of certain tax expenditures ($598.1 billion); setting estate and gift tax parameters at 2009 levels ($118.3 billion); increased tobacco taxes ($78.2 billion); expansion and indexing of the federal unemployment tax act (FUTA) wage base ($59.0 billion); a financial crisis responsibility fee ($56.0 billion); and imposing a "Buffett Rule" or "Fair Share Tax" ($53.0 billion). Similar revenue-raising proposals appeared in previous Obama Administration budgets. Notably excluded from the President's FY2015 Budget was a proposal which first appeared in the FY2014 Budget to re-index the tax code using chained-CPI.[65]

Concluding Remarks

Tax reform continues to be of interest in the 114th Congress. The Tax Reform Act of 2014, introduced late in the 113th Congress, continues to inform the debate. One open question is whether Congress will choose to pursue comprehensive tax reform that simultaneously addresses the individual and corporate income tax systems, including multinational corporations. An alternative may be to look at international or business-only reforms. The extent to which such reforms are feasible and would achieve the policy objectives of tax reform remains an open question.

Another open question is whether the federal tax system should continue to rely on taxing income as the primary source of revenue. Several tax reform proposals introduced in the 114th Congress would tend to shift the tax system away from taxing income, taxing consumption instead.

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[65] For background, see CRS Report R43347, *Budgetary and Distributional Effects of Adopting the Chained CPI*, by Donald J. Marples.