Fundamentals of Pro-Growth Tax Reform

By

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President Donald Trump, House Speaker Paul Ryan, Senate Finance Committee Chairman Orrin Hatch and House Ways and Means Committee Chairman Kevin Brady have proposed pro-growth federal tax reform, to restore booming economic growth, job creation, rising real wages and incomes, and prosperity for the middle class, working people and the poor. The basic tax reform components and policies to achieve these goals are straightforward, obvious, and generally agreed to among free market economists and citizen activists.

Fundamental Components of Pro-Growth Tax Reform

Lower Marginal Tax Rates. The greatest priority for pro-growth tax reform is to reduce marginal tax rates which is the rate that applies to the next dollar of income earned.

Lower marginal tax rates free producers to keep more of what they produce. That means greater incentives for people to engage in productive activities such as starting new businesses, expanding existing businesses, and creating new jobs which translates into higher economic growth.

This is the opposite of the "trickle-down economics" of the Keynesians who support increasing taxes to augment government spending. They believe that increased government spending trickles down, more than offsetting the loss of jobs, rising real wages and incomes, and general economic growth and prosperity arising from the tax increases. But these offsets and accompanying growth arise not from government spending more, but from private citizens and businesses producing more.

The proof is in President Reagan's tax and spending cuts which heralded booming economic growth and recovery, creating over 20 million new jobs in the 1980s, growing to 45 million jobs by the time the boom ended. Reagan's policies restored rising wages and incomes for the poor, working people, and the middle class. They reduced poverty every year after 1983 while he was President. The increased economic growth continued ultimately for 25 years, from late 1982 to late 2007, when accumulating departures from Reagan's pro-growth policies returned America to steep recession.

The same results were produced by President Kennedy's tax rate reductions in the early 1960s, which produced the economic boom of that decade.[1] Kennedy's and Reagan's tax cuts reduced America's top marginal income tax rate from 91% in 1963 to 28% in 1987. Economist Larry

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[1] The story of the Kennedy tax cuts is discussed in detail in Lawrence Kudlow, *President Kennedy and the Reagan Revolution: The Untold Story of American Prosperity* (

Kudlow explains that created the *untold* story of American prosperity because the ultra-left media won't tell the American people about it.[2]

In sharp contrast, President Obama's policies of higher marginal tax rates, explosive government spending, vastly increased regulation, and destabilizing monetary policies resulted in the worst economic recovery since the Great Depression[3], with falling real wages and incomes, stagnated economic growth, rising poverty and inequality. "By their fruits, you shall know them." Mathew 7:16

President Trump and Speaker Paul Ryan with House Ways and Means Committee Chairman Kevin Brady have called for three - instead of seven - personal income tax brackets with much lower rates: 12%, 25% and 33%. With phase-outs and supplemental tax triggers, the current top marginal tax rate is effectively 44.3%. So, such tax reform would produce a major cut of over 10 percentage points in the actual, effective top rate.

While actual bracket thresholds have not been finalized, our best estimates of tax savings at various income levels are as follows:

Married Filing Jointly		**Singles**	
Annual Income	**Annual Tax Reform Savings**	**Annual Income**	**Annual Tax Reform Savings**
$250,000	$7,161.00	$250,000	$5,369.25
$175,000	$4,326.50	$175,000	$3,739.75
$125,000	$4,017.50	$125,000	$2,551.75
$75,000	$2,197.50	$75,000	$2,008.75

Tax rates on capital gains, dividends and interest would be cut across the board by 50%, as a result of a new 50% exclusion of capital gains, dividends and interest income.

Progressivity would be retained by doubling the standard deduction - even more in Trump's proposal, where it is raised to $15,000 for singles and $30,000 for married couples.

Lower the Corporate Tax Rate. America today suffers from the highest corporate marginal tax rate in the developed world, if not the whole world, at nearly 40% (39.2%) counting state corporate rates on average. Corporate rates in Asia average half that at 20.1%, Europe less

[2] Id.
[3] Peter J. Ferrara, The Worst Economic Recovery Since the Great Depression, Heartland Institute

than half at 18.9%.[4] It doesn't take a degree in economics to see that leaves American businesses and their workers uncompetitive in the global marketplace.

The House GOP's Better Way proposal, supported by Speaker Ryan and Ways and Means Chairman Kevin Brady (R-TX), would cut the federal corporate rate to 20%, with a special rate of 25% for pass-through businesses, such as partnerships, S Corps, and sole proprietorships. The Tax Foundation estimates based on its Taxes and Growth model of the U.S. economy that this House GOP tax reform plan would increase real GDP by 9.1%, and real wages by nearly 8%, while creating nearly 2 million permanent full time jobs. The dynamic revenue loss, after counting the effects of increased economic growth, would be only $161 billion over the first 10 years.[5] The Computer simulations by an economics team led by Boston University Professor Laurence Kotlikoff estimate that this tax reform would increase US wages and GDP by up to 8%, and actually increase annual federal revenues on a dynamic basis by $38 billion.

President Trump's reform proposal would reduce both the corporate rate and a special pass-through rate to 15%, which would likely boost jobs, wages and the economy even more. These policies would liberate American business and its workers from the highest marginal tax rates in the world to among the lowest. That would benefit workers the most, because studies show that workers actually bear from 70% to 90% of corporate taxes in terms of lost jobs and lower wages. These provisions would restore booming, long overdue, economic recovery and growth.

Territoriality of the corporate tax must be adopted as well. Almost all countries today follow the principle of territoriality in taxation, which is the principle that income is taxed in the country where it is earned. If a business from any country earns income from operations or sales in Germany, it pays income taxes applicable in Germany, and not the taxes applicable to income in its home country.

But the United States does not follow this principle for American companies doing business abroad. If American companies earn income overseas through foreign operations, they pay applicable taxes on that income to the country where it is earned. When they bring that money back to America, they must pay taxes on the income again, up to the 39.2% top marginal rate.

This has led American companies to hold rapidly accumulating funds offshore, now totaling over $2 trillion. That $2 trillion plus could be invested in the US, creating jobs and supporting higher wages. But instead it is kept and invested in operations overseas because of this excessive, uncompetitive, outdated tax burden.

Indeed, American companies are increasingly fleeing the US, to avoid over-taxation, through a reorganization known as corporate "inversion". An American company merges with a foreign company from a lower tax, business friendly jurisdiction, such as Canada, or Ireland with its

[4] Arthur Brooks, "The Dignity Deficit: Restoring America's Sense of Purpose," *Foreign Affairs*, March/April 2017, p. 112.
[5] Kyle Pomerleau, Details and Analysis of the House Republican Tax Reform Plan, The Tax Foundation, July 5, 2016

12.5% corporate tax rate, or even the United Kingdom, which now has a 19% corporate rate, scheduled to decline soon to 17%. After the merger, the new company is no longer an American company, but Irish, or Canadian, or British. This tax flight is happening with even major, iconic American firms, especially pharmaceutical giants.

America needs to join the rest of the world, and modernize its tax system, by adopting the principle of territoriality. Both the House GOP Better Way tax reform plan, and the Trump reform plan, propose that US taxes would apply on a territorial basis to business income earned abroad.

Trump proposes, as well, a one-time corporate rate of 10% on foreign earnings now held overseas in the growing stockpile of over $2 trillion. If that money is brought home and invested in America it will create and finance new jobs here and could trigger substantial infrastructure improvements.

Expensing for Capital Investment. The general rule is business expenses, and all other expenses incurred for the production of income, are tax deductible in the year such expenses are incurred. That is because the income tax is a net income tax, not a gross income tax. This general rule, for example, applies to travel expenses, advertising expenses, wages and related expenses for employees, entertainment expenses for clients, etc.

But this general rule does not apply to capital expenses incurred to support the production of income. Such expenses are subject to depreciation rules, which means deductions for the cost must be spread over many years. The expenses may be incurred to increase worker productivity, as in the purchase of computers. The wages of workers are immediately deductible in the year they are paid, but deductions for the expenses of the computers must be arbitrarily spread out over many years.

This policy discriminates against **capital** investment, making it arbitrarily more expensive, resulting in the reduced investment in equipment that can increase the productivity of workers. That means lower wages and wage growth over time, because worker productivity determines the wages of workers and produces the funding available to pay those wages.

There is no good reason to arbitrarily penalize capital investment in this way. Capital investment should be treated equally with all other expenses for the production of income: deductible in full in the year incurred. That would maximize the incentive for capital investment to increase productivity and wages of workers.

Studies by The Tax Foundation, Inc. confirm that immediate expensing for capital investment, i.e. deduction of capital expenses in the year such expenses occur, provide the greatest impact on economic growth of any component of tax reform. Fortunately, both the tax reform proposals of President Trump, and those of the House GOP "Better Way" reform plan, include such immediate expensing of capital investment in the year incurred, and would abolish arbitrary depreciation.

These tax reforms would be very pro-growth, creating jobs and restoring rising real wages.

Relief from the Multiple Taxation of Capital. Another problem which can and should be addressed now through tax reform is the multiple taxation of capital income. Capital investment income is taxed not once, but several times. Often such taxation begins with the corporate income tax, a second time through the individual, personal income tax for any payment to shareholders such as dividends and a third time through the capital gains tax. Then there is a final layer of taxation through the death tax.

Kill the Death Tax. The death tax is unfair multiple taxation of the same, accumulated, capital investment income that has already been taxed several times. It often forces the sale of the family business, including family farms and ranches, to pay the tax, which can result in the loss of jobs. This excessive taxation discourages capital investment in the first place, which denies jobs and rising wages for working people.

Furthermore, those faced with the Death Tax spend heavily on life insurance to "insure around" the Death Tax. That is a "dead weight" loss to our economy which amounts to about $13 billion a year in premiums. That is why abolishing the death tax is included in pro-growth tax reform, as it is in the current proposals.

Capital investment is the foundation of job creation and rising wages, financing the startup of new businesses and the expansion of existing ones. Increased demand for labor from such investment is the central source of rising real wages, and capital investment often finances tools and equipment for workers that increase productivity, providing the funds to pay the increased wages. Overtaxing and consequently reducing such capital investment is anti-growth. Relief from multiple overtaxation is pro-growth, creating jobs and rising wages.

That is why abolishing the death tax should be included in pro-growth tax reform, as it is in current proposals.

Abolish the Alternative Minimum Tax (AMT) and Reduce the Tax Rate on Capital Through Exclusion. Abolishing the AMT is another pro-growth reduction in the excessive tax burden on capital. Reducing the taxation of capital through the 50% exclusion of income from capital gains, dividends and interest, as in the Ryan-Brady tax reform plans, supported by Trump, is a further very worthy component of pro-growth tax reform.

Other Issues (Including Some "Loophole" Closings):

- Charitable Deductions – Trump and Ryan/Brady propose no changes.
- Mortgage Interest Deduction - Trump and Ryan/Brady propose no changes.
- Increase in the Standard Deduction from $12,000 for family to $24,600 in Ryan / Brady – higher in Trump proposal. Home builders, realtors and others linked to the housing market fear that this will diminish the value of the mortgage interest deduction to lower income citizens, diminishing demand for home purchases.

- State Income and Property Tax Deductions – Both Trump and Ryan/Brady seek to eliminate these deductions. Blue state residents, including particularly California and New York, benefit the most from this off-set to federal personal income taxes, which penalizes – relatively – residents of states without a personal income tax. Congressional Republicans have little incentive to give relief to the constituents of Representative Nancy Pelosi (CA) and Senator Charlie Schumer (NV). Republicans may find it beneficial to their own housing interest constituents to continue the property tax deduction.
- "Pass Through" Rate Adjustment Issue – If the noncorporate business "pass through" rate is significantly lower than the top personal income tax rate bracket, some fear that wealthy business owners will "pack" their income into the "pass through." This has to be addressed in the final tax reform legislation.
- Business Interest Deductibility – Ryan / Brady proposes to eliminate tax deductibility of interest payments made by businesses or debt financing. The claim is that this "tilts the playing field" toward debt instead of equity financing. Its inclusion as a "loophole closer" may be motivated primarily by pursuit of "revenue neutrality." This issue remains unresolved, but if current year expensing of capital investments is growth enhancing, why not current year expensing of the cost of financing current year farm and other production?
- "Carried Interest" Tax Rate for Hedge Fund Managers – Both Trump and Ryan/Brady seek to change taxation for Hedge Fund Managers from the capital gains rate to the new personal income tax rates to end this special "carried interest" treatment for the Wall Street elite.

How Budget Reconciliation Rules, CBO Bean Counters and "Revenue Neutrality" Could Sink Tax Reform

The budget reconciliation process, requiring only 51 votes in the Senate, is generally accepted upon as the only way to finally achieve major tax reform of the Trump/Ryan-Brady type. But the arcane budget rules require that the tax cut not add to the deficit after a 10-year period. Since conservatives can't rely on the CBO bean counters to use proper dynamic revenue scoring to reach a balanced budget in 10 years, nor can they count on the Joint Committee on Tax Reform (JCT) to do much better, and since spending-cut offsets proposed by Trump may not be factored into the balance calculation, Ryan/Brady have proposed to seek "revenue neutrality" through a huge new tax increase: the "border adjustment tax." The only problem is this new tax is probably "dead on arrival" in the US Senate, threatening all aspects of tax reform (although a strong case has been made by wise conservative economists that such a tax would be a proper shift away from taxing income to taxing consumption).

Fortunately, Senator Orrin Hatch, Chairman of the Senate Finance Committee has suggested that tax reform not be held hostage to "revenue neutrality," commenting in a recent speech: "I don't see a problem with a tax reform proposal that loses revenue in the short term if we can

show that it will help put our economy on a better growth path."[6] This is wise given the record of President Reagan's tax cuts in the 1980s, President Kennedy's tax cuts in the 1960s, and the tax cuts of Treasury Secretary Andrew Mellon under Presidents Harding and Coolidge in the 1920s.

None of those tax cuts was designed to be revenue neutral when enacted. They were all adopted as big, pro-growth tax cuts as scored on a static basis at the time. But Reagan's 25% across the board tax rate cuts started a 25 year economic boom, from late 1982 to late 2007, which added trillions in increased GDP. That increased economic growth *increased* revenues from all federal taxes, which actually doubled while Reagan was President. Similarly, Kennedy's nearly 25% rate cuts caused an economic boom in the 1960s, with *increased* GDP and federal revenues. The Mellon/Harding/Coolidge tax rate cuts from the highs of World War I caused the economic boom known as the Roaring 20s, with sharply increased growth and federal revenues as well.

Senator Pat Toomey (R-PA), a member of the Senate Finance Committee has proposed a way around the reconciliation roadblock for tax reform today, based on this long history. Simply extend the 10 year "window" for revenue neutral balance to 20 years (or more) giving more time for growth inducing tax reform to play out and satisfy the reconciliation requirement. Other Senators are looking hard at this as are conservative economists and tax cut activists nationwide.

This year's tax reform, rate cut proposal can arguably have even bigger pro-growth effects than Reagan's historic tax cuts. While Reagan's personal, individual rate cuts were bigger than Trump/Ryan/Hatch/Brady, this year's business tax reform/rate cuts are much bigger than the business cuts under Reagan. Plus this year's reform has big cuts in the taxation of capital, with immediate expensing for capital investment (which the Tax Foundation scores as having even bigger pro-growth effects than rate cuts), territoriality for business tax income (equalizing U.S. business taxation with the rest of the world), a 50% exclusion for capital gains, dividends, and interest income (the equivalent of a 50% rate cut), and abolition of the death tax, the alternative minimum tax (AMT), and arbitrary depreciation, (which involve several layers more of the multiple taxation of capital). That should consequently produce even bigger increases in economic growth and revenues over the long run.

Conclusion: Tax Reform Will Lead to Major Economic Growth

The liberal Keynesian economists across the nation are standing in line to declare that the US is no longer capable of Kennedy / Reagan era rates of growth of 4 – 6% and that we are victims of a new era of 2% (or less) national annual growth. If that's the case you can kiss America – and western economies – goodbye and simply declare national bankruptcy because that would be the inevitable result.

[6] Blooomberg Global Transfer Pricing Conference – National Press Club – June 7, 2017

We must "grow" our way out of the Obama fiscal disaster or there will be no future for our nation, our children and grandchildren – or the industrialized, advanced nations of the world. Maybe we can learn best from the man himself – Ronald Reagan. In his autobiography, "Ronald Reagan – An American Life" (Simon Schuster, 1990), he reflected on the 1981 tax cuts in December 1982:

> *Maybe it's true, as some people say, that it's always darkest before dawn. Although I didn't realize it…the country had already begun the longest sustained economic expansion in peacetime history. Economic researchers say the turnaround began in November 1982, exactly one year after the first phase of the three-year, twenty-five percent tax cut went into effect.*
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> *It took another year for the expansion to gain full momentum, but we were on our way: We had started the process of getting government off the backs and out of the pockets of people and business, and they were responding with a burst of economic activity that would bring down unemployment, inflation and interest rates.*
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> *As the economy started to take off, I started joking around the Oval Office: "Do you notice they're not calling it 'Reaganomics' anymore?" Until the recovery began, "Reaganomics" had been a term of derision.*

What the Reagan three year, 25% tax cut for individuals and small businesses did was cause explosive 4% plus annual growth for years. Think what the key features of Trump – Ryan / Brady include: not only major personal income tax deductions by unprecedented corporate tax rate reductions, territoriality, bringing off-shore capital home, current year expensing of capital investments, killing the Death Tax, reduction of taxes on capital income growth, etc. The results for annual economic growth for our nation will be unprecedented – and we can finally balance the budget and systematically reduce our national debt held by the public to manageable levels. That will open an era for responsibly dealing with the unfunded liabilities of Social Security and Medicare as we return the "health net" programs, including Medicaid, to the states.

Contributors to Reform

The findings and conclusions in this paper are not those of the authors alone, but reflect the thinking and perceptions of a wide range of the most consistent, thoughtful and experienced conservative / free market tax specialists, economists, political advisors and experts in Washington and around the nation. All do not agree with each feature of the tax proposals but all support the principal thrust of tax reform to accelerate economic growth for America.

Meetings and "listening sessions" in Washington during April and May of 2017 (which have involved the following people / organizations) included:

- A Tax Cut Working Group Coalition meeting at the Heritage Foundation on April 26th hosted by David Burton and convened by the long-time coordinators of the Coalition Lew Uhler (National Tax Limitation Committee), Jim Martin (60+ Association) and Dan Mitchell (CATO).
- A White House meeting with Treasury Secretary Steven Mnuchin and NEC Director Gary Cohn hosted by Paul Teller, Legislative Liaison to the President on April 27th.
- A Tax Cut Working Group Coalition Meeting on May 17th at Americans for Tax Reform.
- A White House "Listening Session" on May 31st.

All of this has been preceded by the combined intellectual force of major thinkers who have come together to advise President Trump on major tax reform, pre- and post-election, including Steve Forbes, Art Laffer, Larry Kudlow, Steve Moore and others.

And, throughout 2016, Speaker Paul Ryan, one of the most creative and knowledgeable policy experts in the history of the US House of Representatives, was developing – with Ways and Means Chairman Kevin Brady – a comprehensive tax reform package as "The Better Way." And before and during his service as Chairman of the tax writing Ways and Means Committee, Paul Ryan had already thought through all of these issues and was prepared to lead.

Throughout this process we have worked in the Senate with Senator Orrin Hatch, Chairman of the Senate Finance Committee and his principal staff advisors on tax policy Bryan Hickman and tax counsel Mark Prater.

Those who have participated in the above-mentioned meetings include – but are not limited to:

Romina Boccia, Deputy Director, Thomas H. Roe Institute for Political Studies, Heritage Foundation;

David Burton, The Heritage Foundation's senior fellow in economic policy. Burton was general counsel at the National Small Business Association for two years before joining Heritage's Roe Institute for Economic Policy Studies in 2013;

Bob Carlestrom, former Senior Executive in the Reagan White House Office of Management and Budget, advisor to members of the House and Senate;

Veronique de Rugy, Senior Research Fellow at the Mercatus Center at George Mason University and a nationally syndicated columnist;

Chris Edwards, Director of Tax Policy Studies at the Cato Institute, formerly Senior Economist at the Joint Economic Committee;

Ryan Ellis, Tax Counsel, Akin, Gump, Strauss, Hauer and Feld, Washington DC, former General Counsel and Chief Economist, Americans for Tax Reform;

Steve Entin, former Deputy Assistant Secretary of the U.S. Treasury during the Reagan administration, and long-time collaborator with Norman Ture, a leading architect of the two great 20th century tax reforms and tax rate reductions under both President Kennedy and President Reagan, and now senior economist at the Tax Foundation, Inc.;

Owen Frisby, long time tax strategist, policy advisor and Washington coordinator for David Rockefeller;

Larry Hart, Strategist and Consultant for The American Conservative Union, President of Hartco Strategies; advisor to members of Congress;

Scott Hodge, President of the Tax Foundation, Inc., formerly of the Heritage Foundation and the Heartland Institute;

Phil Kerpen, President of American Commitment, an American free-market policy analyst and political organizer;

Jim Martin, Founder and President of 60Plus, a nationwide grassroots seniors' organization and key leader in ending the Death Tax;

Maurice McTigue, Vice-President for Outreach at the Mercatus Center at George Mason University, Director of the Mercatus Government Accountability Project, and member of the Mercatus Spending and Budget Initiative; formerly Secretary of Labor of New Zealand and advisor to the Prime Minister, one of the architects of the booming economic growth known as the New Zealand Miracle;

Dan Mitchell, Senior Fellow at the Cato Institute who specializes in fiscal policy, particularly tax reform, international tax competition, and the economic burden of government spending, former senior fellow with the Heritage Foundation, and an economist for Senator Bob Packwood and the Senate Finance Committee;

Max Pappas, Manager, External Outreach and Public Policy Partnerships with Google, formerly Director of Policy with FreedomWorks, and Chief Economist to Senator Ted Cruz;

Dick Patten, Founder of the American Family Business Foundation, advisor to the U.S. Senate, the U.S. House of Representatives and many state legislatures;

Tim Phillips, President of Americans for Prosperity with 36 state chapters and more than 3.2 million grassroots activists in 50 states fighting for free-market principles and policies;

Charlie Sauer, President with the Marketing Institute, former Washington Representative for NCPA;

Pete Sepp, President, National Taxpayers Union (NTU), who also supervises the research and educational operations of the National Taxpayers Union Foundation (NTUF);

William Shaker, President, Rule of Law Committee, CEO of the Washington Marketing Group, former Executive Vice President of the National Tax Limitation Committee;

Aaron Stover, Corporate Relations Officer at The Heartland Institute;

Richard Vedder, Distinguished Professor of Economics emeritus at Ohio University, Athens and Senior Fellow at The Independent Institute and advisor to the National Tax Limitation Foundation;

David Wallace, former Republican candidate for the U.S. Senate from Maryland, and longtime member of the Tax Cut Working Group Coalition.

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