No. 856 February 3, 2003

THREE WAYS TO MAKE PRESIDENT BUSH'S TAX PLAN EVEN BETTER

LAWRENCE H. WHITMAN

President Bush has advanced two sound tax principles: (1) Government should tax income only once; accordingly, policymakers should end double taxation of dividends. (2) Because future tax rate reductions will not help today's economy as much as tax cuts now, provisions of the 2001 tax cut scheduled for the future (particularly income-tax rate reductions) should occur immediately. These two commonsense principles and resulting policies would bolster the economy, lower unemployment, increase wages, and boost the stock market. To improve the President's proposal and unleash an even stronger economy, Congress should apply these principles to additional areas through the following policies.

End IRA income limits and age restrictions. The government prevents some people from investing in retirement accounts (deductible IRAs and Roth IRAs) on the basis of how much income they make. These limits are confusing, inconsistent, and economically damaging. For example, single people making more than $50,000 may not deduct traditional IRAs, and those making more than $110,000 may not use Roth IRAs. These restrictions discourage use of retirement accounts and, thus, depress investment, increase unemployment, and harm the economy. Policymakers should allow everyone, regardless of income, to use retirement accounts.

Current policy also forces people older than 70½ to withdraw money from (and pay taxes on) traditional retirement accounts such as non–Roth IRAs and 401(k)s. This policy is unfair and harmful: It punishes seniors who work and discourages others from doing so. Moreover, the government should not tell seniors when to withdraw their own retirement money. Ending this discriminatory age requirement would enhance freedom, help seniors, and remove one government barrier to working, thus triggering a stronger economy.

Some critics of the President's proposal to eliminate the double taxation of dividends mistakenly argue that it would not help individuals using only retirement accounts. In fact, the policy would increase general stock prices, benefiting all investors. Given their desire to help retirement account investors, these critics should support eliminating income limits and age restrictions for retirement accounts. The change would benefit retirement account investors and seniors and increase the use of retirement accounts, prompting more investment and thereby spurring the economy.

Produced by the
Thomas A. Roe Institute for
Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/research/taxes/em856.cfm*

Repeal President Clinton's 1993 tax increase on Social Security benefits. Before 1993, the government taxed only 50 percent of Social Security benefits. The rationale for this policy was that workers already paid income taxes on the 6.2 percent of their wages that went to Social Security through payroll taxes (employers pay the rest) and that the government should not tax this money again when people receive it as Social Security benefits. However, in 1993 President Clinton signed a law that abandoned this principle. The law stipulated that, while the government would still tax 50 percent of Social Security benefits of seniors earning between $25,000 and $34,000 ($32,000–$44,000 for married couples), it would tax 85 percent of benefits of seniors earning over $34,000 ($44,000 for married couples).

This policy double taxes Social Security benefits and punishes seniors who work, discouraging many from doing so. Policymakers should repeal this unfair double tax on Social Security benefits. This reform would remove a layer of taxation, help senior citizens, lower one more government obstacle to working, and improve the economy.

Make the *entire* 2001 tax cut effective immediately. Many of the tax reductions passed in 2001 will not take effect for years. This situation postpones the benefits of lower rates and causes economic inefficiency today. For example, under current law, the death tax will decline until eliminated in 2010. Until then, the government will impose high tax rates—over 40 percent—on the assets of the deceased. Moreover, unless policymakers act, in 2011 the death tax will return to higher rates. This situation demonstrates the need to make the entire 2001 tax cut permanent. (See Heritage Foundation *Backgrounder* No. 1614, "Make the Tax Cuts Permanent and Fully Effective Now.")

The delay in ending the death tax makes planning for it difficult and forces small-business owners, farmers, and others to divert money from constructive activities—expanding and hiring—into expensive planning to deal with onerous taxes. Ending the death tax immediately would liberate vast resources, helping workers, potential workers, and the economy. It is immoral to tax people when they die, and it is wrong to delay rectifying that injustice.

The 2001 tax legislation also increases the amount people may invest annually in retirement accounts. For IRAs, the limit will increase from $2,000 to $5,000. For 401(k)s and similar employer-sponsored accounts, the limit will rise from $10,000 to $15,000. However, these increases will not fully take effect until 2006 and 2008, respectively. The government should not punish investment, and it is wrong to delay correcting this problem. Immediately increasing the allowable limits in retirement accounts would spur investment, strengthen the stock market, help the economy, decrease unemployment, and increase wages.

The Federal Budget. Those who cite budget deficit concerns as a way to criticize the President's proposal and other pro-growth policies confuse cause and effect. The budget does not drive the economy; the economy drives the budget. The proper goal for policymakers should be a strong economy, not greater government tax revenue. Indeed, a robust economy is the best way to increase tax revenue. Moreover, policymakers should restrain runaway government spending, because sound budget policy entails controlling federal spending and enacting pro-growth tax rate reductions that unleash a vibrant economy.

Furthermore, despite claims made by opponents of tax cuts, no credible evidence supports the theory that government deficits noticeably increase interest rates. Japan has large budget deficits and interest rates near zero, and long-term interest rates in the United States have fallen while the federal budget has gone from surpluses to deficits. Allegations that deficits substantially increase interest rates are clearly wrong.

Conclusion. President Bush has advanced two sensible principles: End double taxation and accelerate future tax-rate reductions to go into effect today. Congress should further the President's plan by ending income limits and age restrictions on retirement accounts, repealing the tax increase on Social Security benefits, and making immediately effective the entire 2001 tax cut. The President has taken steps in the right direction. Now Congress can make a very good plan even better.

—Lawrence H. Whitman is Director of the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

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