

ISSUE BRIEF

No. 3599 | MAY 9, 2012

The 2012 Tax Policy Two-Step: Taxmageddon, Then Tax Reform

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The nation faces an unprecedented tidal wave of tax hikes on January 1, 2013. Aptly called “Taxmageddon,” at nearly \$500 billion the tax hike is so massive that it has accomplished what many regarded as impossible: consensus.¹ There is broad agreement that at least most of this tax hike must be prevented. The debate is really only about how much and when.

At the same time, there is a growing consensus in favor of tax reform. Both President Obama and the presumptive Republican presidential nominee Mitt Romney have called for reducing corporate income tax rates substantially.² With such an obvious need, many Members of Congress, echoing their constituents’ views, are frustrated with the lack of progress on tax reform. Many also express a reluctance to prevent

Taxmageddon without tax reform, suggesting that doing so smacks of once again “kicking the can down the road.” While these frustrations are understandable, nevertheless as matters stand, the correct two-step sequencing Members should embrace is to prevent all tax hikes now while working on and for tax reform in 2013.

Step One: Preventing Taxmageddon. On January 1, 2013, among other unfortunate tax consequences:

- Income tax rates shoot up,
- The child credit is cut in half,
- The marriage penalty roars back,
- The capital gains tax rate goes up,
- The dividend tax rate soars,
- The payroll tax rate jumps two percentage points,
- The death tax is restored to its punitive past,
- The Alternative Minimum Tax relief expires, and

- A uniquely pernicious additional payroll tax hike from Obamacare takes effect.

Collectively, this would by far be the largest tax hike in history. The effects on families and businesses would be devastating; the effects on the economy no less so.

Congress should make current tax policy permanent and eliminate, once and for all, this cavalcade of tax hikes. At the same time, Congress should repeal Obamacare and in the process eliminate its own panoply of harmful tax hikes. In the event it does neither, Congress should delay these tax hikes for as long as possible—whether one year, two years, or longer.

Nor should Congress wait until after the election to act. Taxpayers deserve more respect from their elected officials than being left in doubt about facing a massive tax hike. The economy also needs better tax certainty. And on this issue, voters in November should be able to cast their votes based not on what Members say they will do but on what they did before the election.

Also, without question Congress should not kick the Taxmageddon can down the road into early 2013,

This paper, in its entirety, can be found at <http://report.heritage.org/ib3599>

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much as it did with the payroll tax hike prevention enacted late last year. Just as taxpayers do not need a massive tax hike, they do not need the oppressive uncertainty of delaying Taxmageddon for a few months into 2013 only to face it again in the spring.

Step Two: Fundamental Tax Reform. Preventing Taxmageddon is not fundamental tax reform. Yet the consequences of not preventing Taxmageddon clearly move in the opposite direction of sensible reform. Consider the growing consensus to reduce the corporate income tax rate: A lower corporate tax rate is inconsistent with raising individual income tax rates—which will happen if Taxmageddon strikes.

True tax reform—involving the ideas contained in The Heritage Foundation’s New Flat Tax or even more traditional approaches like the flat tax or the national retail sales tax—generally involves reducing the tax bias against saving and investment.³ This is inconsistent with raising the tax rates on dividends and capital gains, which happens if Taxmageddon takes effect. While preventing Taxmageddon is

not tax reform, failing to prevent Taxmageddon runs directly and substantially counter to fundamental tax reform.

Even moving to a truly simplified, economically neutral tax system is an epic undertaking legislatively—and in terms of communicating what is happening and why to the American people. Thus, fundamental tax reform requires three essential elements to move forward.

1. It requires a consensus as to the goals. This consensus appears to be coalescing, at least with respect to corporate tax rates, which is a good start.
2. Fundamental tax reform will require many Members of Congress to become better informed about current tax law than they appear to be today. This is necessary both for understanding the reforms and for explaining them to their hopeful but anxious constituents.
3. Tax reform will require a clear vision and unwavering support from the President. Both

the vision and the support have been sorely lacking in this Administration. Hopefully, whoever is President in 2013 will give tax reform the attention and support it needs and deserves and will work with Congress to develop a federal tax system that would allow the economy to create jobs and raise wages in the face of stiffening global competition.

One at a Time. Congress should be aware that preventing the massive tax hikes of Taxmageddon and advancing tax reform are related but separate issues, and, by virtue of the calendar and electoral context, they should be addressed separately and in the proper order. First up should be preventing Taxmageddon. Then, Congress should use the ensuing window of time to advance tax reform.

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1. See Curtis S. Dubay, “Taxmageddon: Massive Tax Increase Coming in 2013,” Heritage Foundation *Issue Brief* No. 3558, April 4, 2012, <http://www.heritage.org/research/reports/2012/04/taxmageddon-massive-tax-increase-coming-in-2013>.

2. See the White House and the Treasury Department, “The President’s Framework for Business Tax Reform,” February 2012, <http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf> (accessed May 9, 2012); and Romney for President, “Tax: Fairer, Flatter, and Simpler,” <http://www.mittromney.com/issues/tax> (accessed May 9, 2012).

3. See J. D. Foster, “The New Flat Tax—Easy as One, Two, Three,” Heritage Foundation *Backgrounder* No. 2631, December 12, 2011, <http://www.heritage.org/research/reports/2011/12/the-new-flat-tax-easy-as-one-two-three>.