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Attacks on Tax Reform Miss the Mark

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Tax reform proposals like Heritage's New Flat Tax, Ways and Means Committee Chairman Dave Camp's plan, and Governor Mitt Romney's plan are susceptible to unfair attacks by the media, think tanks, and politicians. President Obama, for example, completely misstates the facts regarding Governor Mitt Romney's tax reform proposal by citing an unfair think tank analysis.[1]

The issue is a minor matter of $5 trillion. The continued obvious errors in the face of clear and unequivocal evidence to the contrary suggest that perhaps a remedial lesson on the facts is needed.

The Essentials of Tax Reform. The essentials of individual income tax reform are simple enough. Romney, for example, distills them down to three basic principles:

1. **Tax Rates.** Cut individual income tax rates by 20 percent.
2. **Revenue Neutral.** The Romney plan would neither raise nor lower overall tax receipts.
3. **Distributionally Neutral.** The Romney proposal would neither raise nor lower taxes for the middle class or higher earners.

President Obama's repeated references to the Romney plan producing a $5 trillion tax cut is obviously made in light of the proposed individual income tax rate cuts and other pro-growth policy improvements in the Romney plan, but they ignore the second principle of revenue neutrality.

Likewise, President Obama has often alleged that the Romney plan would produce a huge tax cut for the wealthy and a huge tax hike for the middle class even though that would violate the plan's third principle of distributional neutrality.

Connecting the Dots. The individual income tax reforms listed above follow the traditional and completely non-controversial formula for tax reform of lowering tax rates and expanding the tax base. This, for example, was the basis of the bipartisan, Reagan-era 1986 Tax Reform Act. It was also the basis for the tax reform structure outlined in President Obama's own Simpson–Bowles Commission report.[2]

It is also the basis for President Obama's own corporate tax reform proposed by his own Treasury Department.[3] As Obama himself adopts this formula for corporate tax reform, it is hard to understand how he fails to recognize the same formula in other individual income tax reform proposals.

The question remains: Can a tax reform proposal based on cutting income tax rates be revenue neutral? The question is, again, easily answered by the individual income tax reform contained in Simpson–Bowles. The Simpson–Bowles proposal not only reduced rates substantially, but ultimately produced a massive tax hike because it eliminated tax preferences more than it reduced tax rates. If broadening the base and lowering tax rates can produce a tax hike, it can certainly produce a revenue-neutral plan.

Question answered.

The True Meaning of Obama's Error. Despite the obvious allure of a pro-growth, revenue-neutral individual income tax reform based on the traditional formula of lowering

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tax rates and broadening the tax base, it is easy to see the difference between the Obama and leading tax reform proposals. The President argues for higher tax rates on small businesses, investors, and those who are most productive in our economy and otherwise offers nothing else of substance for individual income tax reform. This suggests he is content with the current tax system except that certain individuals should pay higher rates.

The contrast could not be more plain: Fundamental tax reform lowers rates, is revenue neutral, and promises fundamental reforms.

Tax Rates and Economic Growth. Are higher tax rates more conducive to economic growth or less? Fundamentally, that question lies at the heart of the difference between the Obama and reform approaches to tax policy. Obama presses for higher taxes on those in the higher tax rates but tax reform for those in the lower rates.

But it is not a tough question, and every person can answer it with ease by considering some related questions. For example, if the price of a ticket to a baseball game goes up, are you more or less likely to go to the game? Less, of course.

The same holds true for tax rates. Are you inclined to work more hours if you face a higher tax on your extra dollar of earnings, or are you inclined to work less? Most would work less, save less, invest less, risk less, and be less inclined to start up a new business or hire more workers for an existing business.

Analysts will argue well into the next century about the magnitudes of the effects, but the direction is plain enough. President Obama's higher tax rates will harm the economy; tax reform will help.

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1. Curtis S. Dubay, "Tax Policy Center's Skewed Analysis of Governor Romney's Tax Plan," Heritage Foundation *Backgrounder* No. 2735, http://www.heritage.org/research/reports/2012/09/tax-policy-centers-skewed-analysis-of-governor-romneys-tax-plan.
2. National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf (accessed October 11, 2012).
3. *The President's Framework for Business Tax Reform*, Joint Report by the White House and the Department of the Treasury, February 2012, http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf (accessed October 11, 2012).