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Tax To-Do List for 2012 for the President and Congress: Focus on Growth

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President Obama and Congress need to focus on policies in 2012 that will unleash the economic growth necessary to get the economy back on track, create jobs, and lower the unemployment rate.

As more government spending has failed to create that growth, the President and Congress should turn to removing the obstacles that Washington policies are placing in the way of economic expansion. They should start with taxes, since taxes are one of the foremost growth-inhibiting policies. The to-do list below will guide them on how to set the economy free.

Preventing Tax Hikes. If Congress and the President are to remove the tax obstacles impeding economic growth, they must not put any new hurdles in the economy's way. First and foremost, that means not raising taxes. To prevent tax hikes, the President and Congress must do more than avoiding actively raising taxes with new legislation. They must also undo tax hikes that have already occurred and prevent other tax increases scheduled to occur.

Take Care of Last Year's Business. At the end of 2011, a package of 51 tax-reducing provisions known as the "tax extenders" expired. At the same time, the patch that raises the income threshold over which taxpayers qualify for the alternative minimum tax (AMT) also expired. Unless Congress and the President act to extend these provisions retroactively, the tax hikes that occurred when they expired will remain in place. That will include a tax hike on millions of middle-income families who will pay the AMT that only "the rich" were supposed to pay.

- **To-Do #1:** Patch the AMT; let bad policies expire. Congress and President Obama should go through the individual provisions in the extenders and keep those that reflect sound policy and allow those that do not to permanently expire; chief among the latter are the ethanol credits. They should then lower other taxes by the amount these rejected provisions will raise.[1] They should also raise the AMT threshold permanently and index it for inflation so that middle-income families never face the threat of the AMT again.
- **To-Do #2:** Extend the payroll tax holiday or replace with a more pro-growth policy. President Obama and Congress also left undecided what they are going to do with the temporary payroll tax holiday. At the end of 2011, they

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extended it only through February 29. Obama and other supporters of the payroll tax holiday argue it encourages growth and should therefore be extended while the economy remains weak. However, the proof that it is not a pro-growth policy is the substandard growth the economy experienced in 2011. Even though the holiday will not inspire growth this year, either, Congress and the President should continue it for the remainder of 2012 to avoid a tax hike. A better option would be to replace it with tax relief that actually strengthens the economy as well as family budgets.

- **To-Do #3:** Make permanent the tax cuts that expire at the end of the year. The full array of the Bush tax cuts—everything from lower marginal tax rates for taxpayers at all income levels to the expanded child tax credit—expires at the end of the year. To avoid this major tax hike, which would sap the economy of the small amount of momentum it is building, Congress and President Obama need to extend all the Bush tax policies permanently. They should turn their attention toward doing so as soon as they take care of last year's overdue tax work, rather than waiting until the end of the year, as they have done in recent years with important expiring tax policies. Acting to avoid this enormous tax hike early in the year would increase certainty for businesses and reduce the chance that political tensions would derail an extension during what could be a contentious lame-duck session of Congress after the November election.
- **To-Do #4:** Avoid raising taxes after cutting taxes. There are sure to be calls for Congress to "pay for" extending the tax extenders, the AMT patch, and the Bush tax cuts by raising other taxes so as not to add to the deficit. But there is no need to pay for preventing tax hikes. None of these policies are new tax cuts. Most, with the exception of the 14-month-old payroll tax holiday, have been in law for many years. At the end of the year, the Bush tax cuts will have been in place for 12 years, while most of the policies that make up the tax extenders have been in place longer. Congress should extend all these tax-reducing policies without offsets.
- **To-Do #5:** Repeal Obamacare. While it may seem out of place to discuss the Patient Protection and Affordable Care Act (PPACA)—otherwise known as Obamacare—in a tax to-do list, it is important to remember it was as much of a tax hike law as it was a health care law. The biggest and most anti-growth tax in the PPACA goes into effect in 2013. The PPACA raises the Hospital Insurance (HI) portion of the payroll tax from 1.45 percent to 2.35 percent for families earning more than $250,000 a year and applies the HI tax to investment income for the first time. The investment portion of the tax is a 3.8 percent surtax (representing the 1.45 percent portion of employers' share of the tax plus the 2.35 percent portion of employees' share) applied to investment income of families making more than $250,000 a year. By lowering investment, this tax hike will stall the still-impending economic recovery and set the economy on a permanently lower growth track for the future. To prevent this, Congress and the President should repeal the PPACA and all the tax hikes it contains.

Take Care of This Year's Business. Once President Obama and Congress prevent tax hikes, they should turn their attention to actively improving the tax system so that it no longer inhibits growth. The best way to do that is through fundamental tax reform that lowers marginal tax rates and eliminates taxes on saving and investment.

Of course, 2012 is an election year, so major legislation like fundamental tax reform is unlikely to become law. Nevertheless, the tax code is an enormous burden on the economy and will remain so until it is overhauled. President Obama and Congress need to work toward reform in 2012 to lay the

1. Curtis S. Dubay, "The 2010 Tax Deal: A Chance for Congress to Lay the Groundwork for Tax Reform," Heritage Foundation *Backgrounder* No. 2569, June 13, 2011, at *http://www.heritage.org/research/reports/2011/06/the-2010-tax-deal-a-chance-for-congress-to-lay-the-groundwork-for-tax-reform*.

groundwork for legislation that will pass in the near future. They should look to The Heritage Foundation's New Flat Tax as their guide.[2]

- **To-Do #6:** Switch to the New Flat Tax. The New Flat Tax would tax individuals on what they spend each year rather than what they earn—by providing taxpayers a full deduction for their net savings (new savings minus what they spent from previous savings). It simplifies the system by removing all the deductions and credits currently in the code except those that are necessary to maintain neutrality, like the mortgage-interest deduction, the deduction for charitable contributions, and higher-education expenses. It levies one flat rate that would be considerably lower than today's top rate. For businesses, the New Flat Tax would lower their rate so that it would be on par with international standards, move to a territorial system away from the current worldwide system, and allow businesses to deduct all of their expenses, including immediately expensing the cost of new capital purchases. The New Flat tax is revenue-neutral and distributionally neutral, eliminating the biggest traditional political obstacles to tax reform.

Growth Is the Answer. In a contentious election year with a divided government, it will be difficult for Washington to be bold. But policies that are a drag on the economy—like today's convoluted tax code or new tax hikes—hurt American families and businesses. Stopping tax increases and improving the tax code are necessary steps to create the growth the economy so badly needs.

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2. J. D. Foster, "The New Flat Tax—Easy as One, Two, Three," Heritage Foundation *Backgrounder* No. 2631, December 13, 2011, at *http://www.heritage.org/research/reports/2011/12/the-new-flat-tax-easy-as-one-two-three*.