

INTRODUCTION

The Center for American Progress is pleased to host a full-day conference with academic and policy experts from around the country who will highlight options for reforming the tax code. Many experts agree that the tax code is in need of repair. Yet it has been 20 years since the landmark 1986 reform. Given the growing complexity of the tax code, increased revenue pressures, and a changing economy; tax reform will likely be a central issue for 2006 and beyond. This conference will provide a forum for sharing proposals—both quick fixes and broad overhaul—and for open and engaged discussion.

The papers included in this packet are the views of the authors and do not necessarily represent the position of the Center for American Progress.

Many of the papers included are preliminary and subject to revision - please contact the author before quoting or citing.

A NEW TAX FRAMEWORK

By Van Doorn Ooms

This brief paper summarizes the policy statement by the Research and Policy Committee of the Committee for Economic Development, *A New Tax Framework: A Blueprint for Averting a Fiscal Crisis*, September, 2005. The full statement is available at http://www.ced.org/docs/report/report_tax2005.pdf. The budget projections, revenue estimates, and corresponding figures in the original statement have been updated in this summary to reflect more recent information, in particular the Congressional Budget Office, *The Long-Term Budget Outlook*, December, 2005. Thanks go W. Bowman Cutter, who chaired the CED drafting committee, to the CED Trustees who participated in the project, and to William G. Gale and C. Eugene Steuerle, who advised on the original policy statement but bear no responsibility for the outcome. Thanks also to Carolyn Cadei for excellent research assistance.

BACKGROUND AND GENERAL DISCUSSION

The U.S. fiscal system faces two major problems. The first is an impending fiscal crisis; large and growing Federal budget deficits, by reducing national saving and investment, will soon threaten our economic growth and living standards. The structural fiscal gap for the Federal government through 2080, extending current tax and spending policies, is estimated at 7.3 percent of GDP.^a The second problem is that the income tax system has become unnecessarily complex and riddled with inequitable special preferences that distort our market economy. *These two problems are closely related:* An ineffective tax system cannot raise the revenues required to finance Federal expenditures and restrain budget deficits without placing heavy burdens on the economy and society. We need a simpler, more efficient, and fairer tax system as the foundation of a more productive economy and a sound long-term fiscal policy.

The fiscal crisis ahead will be driven principally by the impact of escalating health care costs on Medicare and Medicaid expenditures but also by the demographics of an aging society. *These cost pressures will be so intense that fundamental changes in our overall health care system, and correspondingly large reductions in the growth of Medicare and Medicaid spending, are unavoidable.* Medicare and Medicaid expenditures are projected by the Congressional Budget Office (CBO) to rise dramatically from four percent of GDP today to about nine to 12 percent in 2030, depending on the trajectory of health care costs. Similarly, CBO projections of current spending policies to mid-century show total expenditures of 38 to 56 percent of GDP.^b (See Figures 1 and 2 and the accompanying note describing projection assumptions.) Clearly, taxes cannot rise to cover federal expenditures that rise exponentially to 30, 40, and 50 percent of GDP. Tax increases of this magnitude are politically infeasible and would greatly impair economic efficiency and growth, so large reductions in expenditure growth are imperative.

However, expenditure reductions alone will not be enough. A critical implication of these CBO projections is that *even aggressive and painful changes to reduce expenditures in Medicare and Medicaid, with other spending restraints, are unlikely to restore fiscal balance if federal revenues remain at historical levels.* As two leading health economists have noted, the reductions in Medicare and Medicaid spending required to produce the “restrained spending” path in Figures 1 and 2 would be a “monumental achievement” requiring “aggressive action ... including some increase in the age of eligibility for Medicare, increased cost-sharing, selective purchasing, and the application of information technology.” Even with such measures, some rationing of care would likely prove necessary.^c

It therefore seems evident that the nation must undertake a budgetary “war on all fronts” by reforming entitlement programs, reducing discretionary (annually appropriated) spending, *and* by raising additional revenues. While recognizing, as noted above, that reductions in expenditure growth are imperative, this paper focuses on revenues and the tax system.

In theory, substantial additional revenues could be generated simply by raising income tax rates significantly. However, a proliferation of special tax preferences confronts taxpayers with bewildering complexity and makes the current income tax system complex, inefficient, and inequitable. Large increases in the marginal tax rates of this dysfunctional system would compound existing distortions and disincentives, further damaging the economy. Furthermore, raising income tax rates is likely to prove a counterproductive long-term strategy as globalization makes capital more mobile. Domestic production and jobs will become more likely to move offshore and foreign capital less likely to be invested here as income tax rates rise. Under these circumstances, the burden of capital income taxation will increasingly be shifted to workers. There is, therefore, a strong case for increasing income tax revenues by eliminating, reducing, and consolidating special tax preferences. Such “base broadening” and simplification would make the system simpler, fairer, and more efficient and would promote the growth of productivity and incomes. This strategy should be pursued to the extent feasible. Realistically, however, this approach is unlikely to meet our revenue needs, because there are major political and policy constraints on how far we can go in eliminating tax preferences and broadening the income tax base. It is striking that the 1986 Tax Reform Act (TRA), widely regarded as a dramatic achievement in base broadening, increased net income tax revenues by only about one-half percent of GDP by this means.^d Many major preferences in the tax code are today so embedded in our economic and social life and so deeply rooted politically that their elimination or great reduction is probably politically infeasible and in some cases unwise. Four sets of these preferences stand out:

- Tax privileged accounts for saving and retirement such as defined benefit pensions, 401(k) plans, and IRAs now form the foundation for private retirement saving.
- The exclusion from taxable income of employer contributions to employee health insurance similarly forms the basis of our private health insurance system.
- The Earned Income Tax Credit (EITC) has become the major pillar of low-income support.
- The mortgage interest deduction supports the value of homes that are the major asset of many families, who may have received little or no actual benefit from the tax preference.

The tax expenditures attributed to these four major sets of preferences now total approximately \$326 billion annually, about 36 percent of individual income tax revenues. This is not to argue that these preferences are sacrosanct and should be viewed as harmless in a tax reform effort. Indeed, some modifications, if appropriately phased in, would be desirable, as indicated in the recommendations below. It is to argue, however, that a program of base-broadening is unlikely to raise large amounts of additional revenue. Indeed, a simplification and base-broadening program that repeals the Alternative Minimum Tax (AMT) — the most complex and problematic feature of the current system — is likely to raise *less* revenue than the present system.

These considerations lead inexorably to the conclusion that we will need a new revenue source to supplement even a “reformed” income tax. The Committee for Economic Development (CED) has therefore proposed a national value-added tax (VAT), combined with modifications to the income tax (including a refundable low-income credit) that will shield the poor from the VAT and preserve overall tax progressivity. The United States needs *both* a VAT *and* an income tax — the former to raise revenues on a very broad base in an economically neutral manner, the latter to preserve the progressivity of the tax system. This new hybrid tax framework would greatly improve the U.S. fiscal outlook, as described below.

The CED framework summarized below also makes recommendations to reduce certain tax preferences and simplify the income tax system; to improve the taxation of capital income; to reform the legislative process to improve tax and budget policies; and to provide the resources and support to the Internal Revenue Service (IRS) required for an effective and fair tax system.

Taken together, these recommendations involve major changes in our tax system. However, unlike some “fundamental” tax reforms that involve scrapping the income tax entirely, this “hybrid” system would involve less severe transition problems and could be more easily implemented. The fundamental structure of the income tax would not change, and the journey to a VAT, which would admittedly require many difficult design choices, would take place on the well-prepared ground that dozens of other nations have covered in recent decades.

SUMMARY OF CED'S RECOMMENDATIONS

1. Eliminate and Reduce Tax Preferences, Simplify the Tax System, and Broaden the Tax Base.

We should remove unnecessary complexities and reduce or eliminate tax preferences that do not have a compelling rationale. Remaining preferences should be consolidated and simplified, and in some cases deductions should be converted into credits. While recognizing the political constraints on this approach, CED nevertheless makes the following recommendations in this area:

- Production tax subsidies that favor certain economic sectors or activities (such as energy, minerals extraction, timber, agriculture, housing, and “domestic production activities” should be eliminated or reduced. The home equity loan interest deduction should be repealed, the \$1 million limit on mortgages qualifying for mortgage interest deductibility should be gradually reduced, and the deductibility of interest on mortgages for second homes should be phased out.
- The current disarray of savings incentives should be replaced with one or two vehicles featuring simpler rules for eligibility, contributions, and withdrawals. To make saving incentives both more effective and more equitable, the exclusion of pension contributions from individual tax should be converted to a refundable fixed-rate credit.
- The bewildering and confusing tax benefits for low-income families and children should be simplified by standardizing definitions of income and eligibility and consolidating these benefits into a single refundable and indexed credit.
- An indexed cap should be placed on the open-ended exclusion of employer contributions to purchase health insurance.
- Tax subsidies for higher education should be substantially redirected into an expanded Pell Grant expenditure program that provides larger grants to more low-income students.

2. Phase in a Broad-Based 10 Percent Value-Added Tax (VAT) to Supplement the Income Tax.

A VAT would provide additional revenues to help meet the impending fiscal crisis and to allow lower income tax rates (and thus smaller economic distortions) than would otherwise be required. The VAT should have a single rate and its base should be as broad as possible to enhance both economic neutrality and revenues. The VAT's distributional effects should be addressed by modifications to the income tax, not by differential rates or exclusions of particular goods and services from the VAT.

The "deadweight" losses of economic efficiency from a broad-based VAT would be far lower than those of the current income tax, to say nothing of an income tax with substantially higher rates. A broad-based VAT would be largely neutral with respect to different economic activities and sectors and, by effectively expensing investment, avoid the large distortions in investment behavior produced by the current income tax. The shift of some taxes from income to consumption would increase saving and investment, in part by discouraging the export of capital that would result from higher income tax rates.

The design and implementation of a VAT would involve many difficult choices, as they have for the dozens of other countries that have adopted VATs in recent decades and additional administrative and compliance costs would be incurred. CED nevertheless believes that, relative to the alternatives, a combination of a VAT with an improved income tax is the best tax system we can realistically pursue. A VAT should be phased in as soon as possible to forestall rising deficits and debt burdens, increase the flexibility of our revenue system, and provide us with more options for a very difficult fiscal future.

3. Modify the Income Tax to Protect Low-Income Households and Support Progressivity.

A common objection to a VAT is that it is regressive. However, the income tax can be modified to address this problem by restructuring and expanding a refundable low-income tax credit, modifying income tax rates for those with tax liability, and increasing the standard deduction to raise the tax-entry threshold.

There have been recent proposals to consolidate some or all of the Earned Income Tax Credit (EITC), child credit, child and dependent care credit, dependent exemption, and head of household rate schedule into a single refundable credit.^e Such a unified credit could be expanded and structured

to redress the impact of a VAT on low-income households. Since there are approximately as many low-income childless households as those with children, the credit should provide relief to households both with and without children.

A critical but seldom discussed aspect of the impact of a VAT on low-income households is the importance of the revenue-raising capacity of the VAT for preserving low-income support programs, which will be under enormous political pressure as fiscal problems mount in coming years.

4. Repeal the Individual and Corporate Alternative Minimum Taxes.

We do not need two parallel tax systems to reduce tax preferences and promote equity. With AMT repeal, those targeted provisions of the AMT that discourage aggressive tax shelters should be incorporated into the regular income tax. *However, the introduction of a VAT and repeal of the AMT must be accompanied by changes in the income tax rate structure, standard deductions, and low-income credits to support the progressivity of the overall tax system.*

The AMT has become perhaps the most problematic feature of the income tax. It was originally intended to reduce tax avoidance by a small number of high-income individuals and corporations, but its complexity and inequity now threaten a creeping encroachment on millions of middle-class taxpayers. This has been deferred only by a series of one-year “fixes” in recent years. AMT projections have also led to the gross overstatement of official revenue estimates and contributed to unrealistic budget decisions. Its repeal has been recommended by the National Taxpayer Advocate and the IRS Oversight Board.^f The main barrier to its repeal is its extremely large impact on the budget deficit — over a trillion dollars over 2006-2015 if the 2001-2004 tax cuts are extended after 2010, and more than \$700 billion even if they sunset.^g This in itself provides a strong rationale for a VAT to raise revenues to finance AMT repeal.

5. Rationalize Capital Income Taxation by Integrating the Individual and Corporate Income Taxes, Narrowing the Differential Treatment of Ordinary Income and Capital Gains, and Modifying the Estate Tax.

We should tax capital income once, but only once, at rates that approximate those on other forms of income. Capital income is now taxed through the corporate income tax, but dividends distributed to shareholders are taxed again as personal income. Undistributed corporate income may also be double-taxed when it appears again as capital gains. The differential treatment of dividends and

interest income distorts choices regarding business organization and financing. Integrating the individual and corporate income taxes to address these problems could provide large gains in economic efficiency and horizontal equity.^h

The large differential between the top rate on ordinary income and that on capital gains, currently 20 or more percentage points, is an open invitation to tax arbitrage, tax shelters, and tax evasion. The currently complex treatment of capital gains should be simplified and this differential substantially reduced. One simple way to address both these problems would be to replace the multiple rates on different types of long-term gains with a deduction from taxable income of a fixed percentage of the gains. This would allow a simple computation similar to the percentage exclusion that was used during 1942-1985.

The estate tax should be retained. CED is strongly committed to the principle of equality of opportunity and does not believe that principle is compatible with the repeal of the tax on large estates that transfer major accumulations of wealth, especially in view of the increasing disparity in the distribution of wealth. One straightforward option would be to continue in 2010 and thereafter the scheduled 2009 exemption of \$3.5 million (\$7 million for couples) and top rate of 45 percent, with the exemption indexed for inflation.

6. Improve the Processes for Making Tax and Budget Policies.

Process changes are essential to help protect a new tax framework against renewed onslaughts of complexity and revenue erosion. In addition, rules for budget control should be restored and new requirements should be established for Congressional consideration of the long-term effects of fiscal policy. CED's recommendations in this area include the following:

- Congress should restore the pay-as-you-go (PAYGO) budget control rules that required that legislated tax cuts or increases in entitlement spending be financed by equivalent spending reductions or tax increases.
- Congress should change the rules for “budget reconciliation” to ensure that they are used for deficit reduction, not for increases in entitlement spending and tax cuts.
- Estimates of the budgetary cost of tax legislation should show the long-term impact on revenues when all provisions are fully phased in. This would discourage the use of misleading estimates that assume only “temporary” revenue effects.

- The Joint Committee on Taxation should also report the revenue-equivalent change in income tax rates that would be required to finance new tax expenditures.
- Congressional rules should preclude the consideration of tax legislation unless it is accompanied by a report by the Joint Committee on Taxation that estimates its impact on complexity and on reporting and compliance burdens.
- The Office of Management and Budget, the Treasury Department, and other federal agencies should conduct more rigorous evaluations of tax expenditures and their relationship to spending programs.

7. Provide the Internal Revenue Service (IRS) with Political Support and Resources

The IRS has for many years lacked the resources necessary to provide both high quality customer service and vigorous, effective enforcement of the tax laws. Audit rates on high-income taxpayers and corporations have declined dramatically, and the IRS has recently estimated the 2001 “tax gap” (between taxes collected and taxes owed) at \$345 billion.ⁱ The IRS Oversight Board has observed that “the stark budget reality [is that the] IRS does not have the resources to close the \$300 billion tax gap.” The Board also found in a recent survey that “one in five taxpayers now believes that it’s acceptable to cheat on their taxes,” and expresses concern that this trend will “place the entire tax administration system in peril.”^j There is a serious danger that taxpayers’ incentives to comply voluntarily with the tax laws will be compromised by weak enforcement and perceptions that the tax code is unfairly applied and enforced. It is also shortsighted, in an era of rising budget deficits, not to invest more resources in reducing a \$300 to \$400 billion tax gap. The administration and Congress should reaffirm their support for the IRS and its mission and restore IRS staff and funding to the levels required for effective administration and enforcement.

The Budget Impact of the New Framework

Table 1-A and Figures 1 and 2 show projected revenues, spending, and public debt assuming “current/historical” revenues and alternative spending assumptions related primarily to the trajectory of health care costs as incorporated in Medicare and Medicaid expenditures. (The assumptions for these projections are described in the note to Figure 1.) As noted above, even the “restrained spending” scenario, which implies a 60 percent reduction of “excess cost growth” in health care

below the historical trend, does not come close to restoring either fiscal balance or a sustainable fiscal policy that stabilizes the debt/GDP ratio. While deficits, of course, are smaller than under the “historical spending” scenario, they grow steadily to exceed six percent of GDP by 2025 and 11 percent of GDP by 2035. The debt/GDP ratio, reflecting the spiraling effects of higher interest costs, rises rapidly to 128 percent of GDP by 2035.

Table 1-B and Figure 3, in comparison, show the long-term budget effects of substituting the CED tax framework for “current/historical” tax policy, with the same “restrained spending” scenario. (The lower spending trajectory in Figure 3 results entirely from the lower interest costs associated with the higher revenues and lower deficits.) The simplified CED tax framework used for these projections assumes that tax policy is modified by the following changes, beginning in 2008:

- A phased-in VAT beginning at a five percent rate, rising to 10 percent in 2012;
- A refundable income tax credit providing VAT relief for low-income households;
- Unspecified reductions in tax preferences that raise 0.5 percent of GDP in revenues;
- Repeal of the AMT;
- Integration of the individual and corporate income taxes using an individual dividend exclusion;
- Retention of the estate tax with an indexed \$3.5 million exemption and 45 percent top rate, as provided in current law for 2009 (effective in 2010); and
- Long-term capital gains taxed by deducting 28.6 percent of the gains from taxable income (equivalent to a 25 percent top capital gains rate).

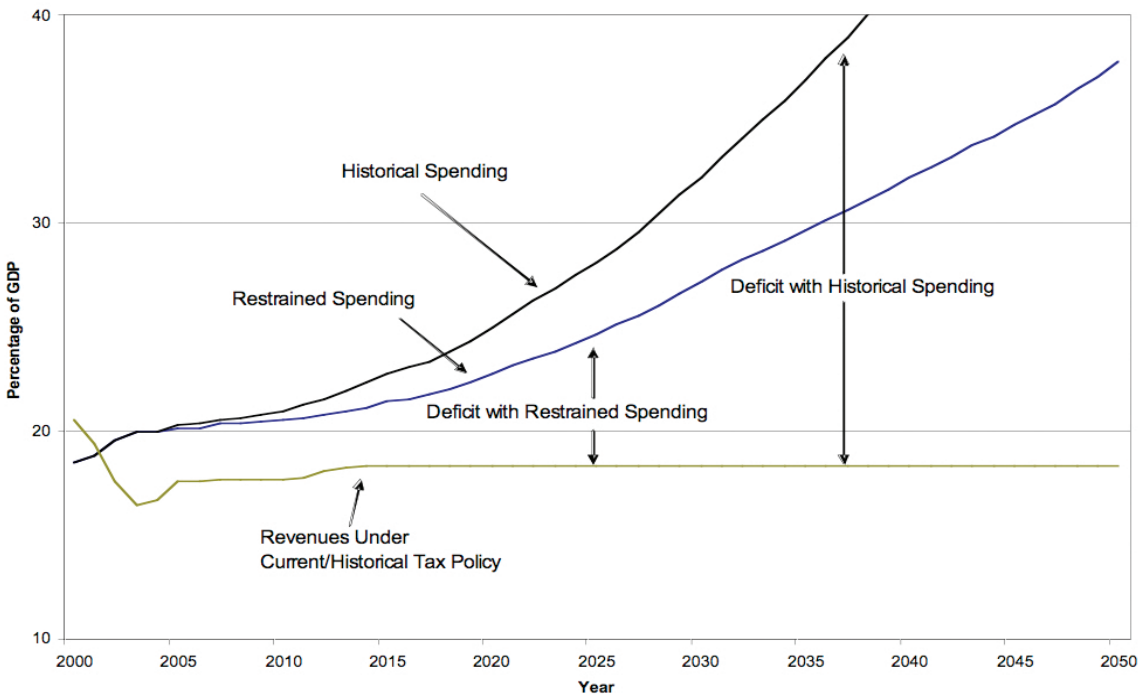
The improvement in the fiscal outlook from this program is striking. For several decades, the budget moves to balance or surplus, and the debt/GDP ratio falls dramatically. The proposed CED tax framework would raise net revenues by about 3.7 percent of GDP; an increase in income tax rates of 35 to 40 percent would be required to produce equivalent revenues. Eventually, of course, under these simplified and mechanistic assumptions, substantial deficits reappear and the debt/GDP ratio rises under the continuing pressures of rising health care costs.

Two caveats are important here. First, the assumed spending restraint is quite large, so that the projected budget surpluses during 2010-2033 may be optimistic. Whatever the degree of spending restraint, however, the budgetary impact of raising revenues in the near future would be dramatic. Second, higher revenues are no permanent budget panacea; as noted above, fundamental changes in

expenditure programs, and in particular the entitlement programs on “automatic pilot,” are not only necessary but inevitable in the long term. Nevertheless, the vital lesson to be drawn from Figure 3 and Table 1-B is that raising additional revenues early will not only reduce deficits and debt directly, but, by forestalling an explosion in interest costs, allow us to “buy time” to restructure health care and other expenditure programs. Table 1-B shows these remarkable fiscal benefits of compound interest; the larger revenues reduce interest costs in 2025 by 2.9 percent of GDP, three-quarters of the direct revenue impact of 3.7 percent, and by 2035 the interest effect is much larger.

There would thus be manifold benefits from CED’s new tax framework. A simpler and fairer income tax, maintaining relatively low marginal tax rates, would benefit taxpayers directly and improve economic efficiency and welfare. A supplementary VAT would raise efficiently the revenues needed to increase national saving and help forestall a fiscal crisis that would curtail growth of the economy and living standards.

Figure 1
Current Tax Policy With and Without Spending Restraint



Note to Figure 1: Sources and Assumptions for Figures 1-3 and Table 1

OPTIONS FOR TAX REFORM

Sources: Congressional Budget Office: The Long-Term Budget Outlook, December 2005; CED staff estimates of revenue effects of CED tax framework; CBO March, 2006 interest matrix for debt service effects of policy differences.

Both projections assume “current/historical” tax policy that is adjusted such that revenues increase gradually from their current low level of 17.5 percent of GDP (2005) to their 30-year historical average of 18.3 percent of GDP in 2014 and continue at that level until 2050. (This implies revenues by 2014 roughly halfway between CBO’s “current law” revenues of 19.6 percent of GDP that assume expiration of tax provisions as scheduled and continuation of an unmodified AMT and revenues of about 17.3 percent of GDP that assume extension of those provisions and an indexing of the AMT exemption from its 2005 level.)

The “historical spending” projection assumes that Medicare and Medicaid “excess cost growth” (the difference between the growth of costs per enrollee and that of per capita GDP) continues at the historical rate of 2.5 percent per year; that defense spending follows the Administration’s 2006 Future Years Defense Program through 2024 (when it is 2.9 percent of GDP) and then grows with inflation; that all currently scheduled Social Security benefits are paid; that other “mandatory” spending remains at its 2005 share of GDP; and that nondefense discretionary spending phases down to its historical 3.6 percent share of GDP in 2007 and remains there. The “restrained spending” projection differs primarily in assuming that Medicare and Medicaid “excess cost growth” is only 1.0 percent per year and that defense spending phases down to about 2.2 percent of GDP in 2024 before growing with inflation. Other categories of spending follow the same trends as those in the historical spending projection.

Figure 2
Federal Debt/GDP Under Two Long-Term Budget Scenarios

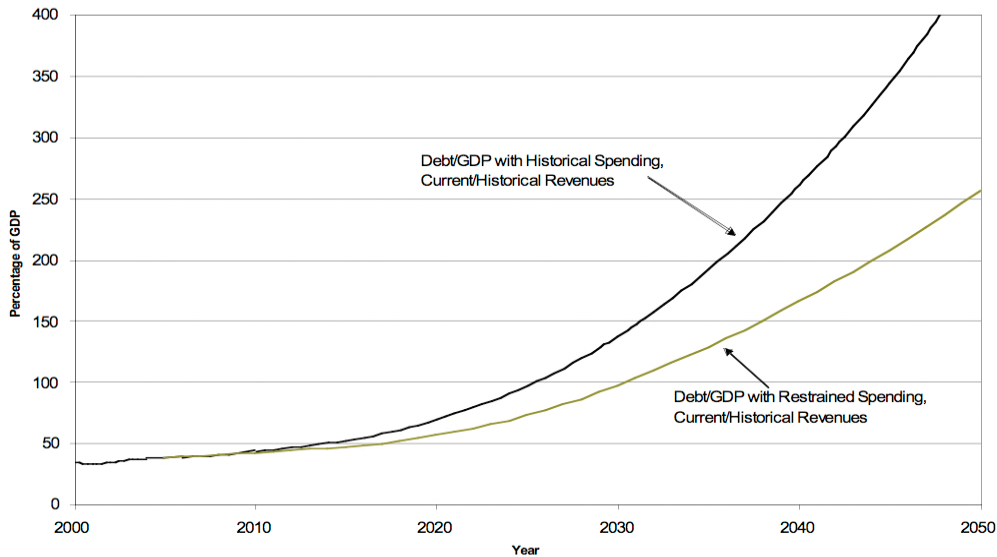
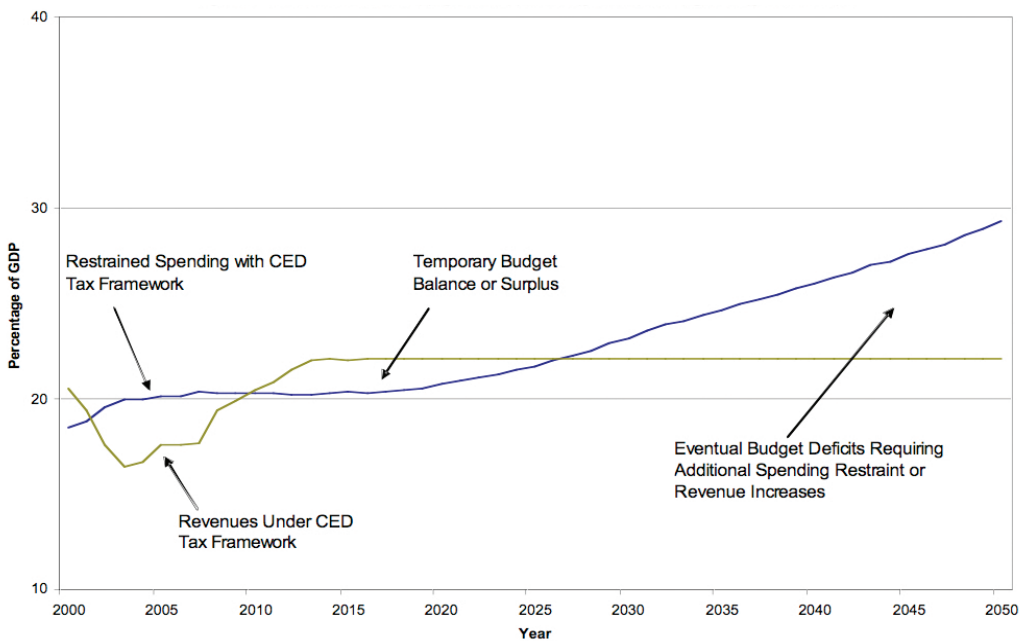


Figure 3
CED Tax Framework With Spending Restraint



**Table 1:
Budget Effects of Tax Policy Changes With Spending Restraint**

TABLE 1-A: EFFECTS OF CURRENT TAX POLICY AND SPENDING RESTRAINT					
	<u>2000</u>	<u>2005</u>	<u>2015</u>	<u>2025</u>	<u>2035</u>
<u>With Spending at Historical Trends</u> ¹					
Revenues (current/historical tax policy) ¹	20.5	17.5	18.3	18.3	18.3
Spending	18.4	20.2	22.7	28.0	36.8
Surplus/Deficit	2.1	-2.7	-4.4	-9.7	-18.5
Debt	34.5	37.8	52.7	97.2	192.4
<u>With Substantial Spending Restraint</u> ¹					
Revenues (current/historical tax policy) ¹	20.5	17.5	18.3	18.3	18.3
Spending	18.4	20.1	21.4	24.6	29.6
Surplus or Deficit (-)	2.1	-2.6	-3.1	-6.3	-11.3
Debt	34.5	37.8	47.0	72.3	128.2
 TABLE 1-B: EFFECTS OF CED TAX FRAMEWORK AND SPENDING RESTRAINT					
	<u>2000</u>	<u>2005</u>	<u>2015</u>	<u>2025</u>	<u>2035</u>
Revenues (current/historical tax policy, above)	20.9	17.5	18.3	18.3	18.3
Revenue Changes:					
VAT at 10 percent			4.0	4.0	4.0
Low-income VAT relief			-0.6	-0.6	-0.6
Reduce tax preferences			0.5	0.5	0.5
Repeal AMT ²			-0.3	-0.3	-0.3
Integrate individual and corporate taxes			-0.2	-0.2	-0.2
Maintain estate tax at 2009 exemption and rate			0.2	0.2	0.2
Reform capital gains taxation			0.2	0.2	0.2
Total Revenue Changes			3.7	3.7	3.7
Revenues, CED Tax Framework			22.0	22.0	22.0
Restrained Spending without CED Tax Framework (above)	18.4	20.1	21.4	24.6	29.6
Reduced Interest from Lower Deficits			-1.1	-2.9	-5.0
Restrained Spending with CED Tax Framework			20.3	21.7	24.6
Surplus or Deficit (-)	2.1	-2.6	1.7	0.3	-2.6
Debt	34.5	37.8	21.4	5.2	15.1

¹ For a description of the “current/historical” revenue projection and the two spending projections, see Note to Figure 1

² Difference between AMT repeal and the AMT modification assumed to be in the “current/historical” tax policy baseline, i.e. indexing of the AMT exemption from the 2005 level beginning in 2006

ENDNOTES

¹ Alan J. Auerbach, William G. Gale, and Peter R. Orszag, *New Estimates of the Budget Outlook: Plus Ça Change, Plus C'est la Meme Chose*, Brookings Institution, January 31, 2006. A 7.3 percent fiscal gap means that immediate and permanent reductions in spending or increases in revenues totaling 7.3 percent of GDP would be required to maintain the current ratio of federal debt to GDP through 2080, so that debt does not grow beyond the capacity of the economy to service it.

² Congressional Budget Office, *The Long-Term Budget Outlook*, December, 2005, Table 1-2, p. 12. A third projection would hold spending to 19 percent of GDP, but assumes zero “excess cost growth” in Medicare and Medicaid, which is implausible.

³ Henry J. Aaron and Jack Meyer, “Health,” in Alice M. Rivlin and Isabel Sawhill, eds, *Restoring Fiscal Sanity 2005* (Washington, D.C.: The Brookings Institution, 2005), pp. 88, 89.

⁴ See C. Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda*, (Washington, D.C.: The Urban Institute Press, 1992), Tables A-4, A-1. The net reduction in tax expenditures due to base broadening (excluding that which derived from rate reduction) was \$32.2 billion, or about 0.66 percent of GDP. These are measured on an “outlay equivalent” basis, however, so that the equivalent revenue gain would be significantly smaller. We take 0.5 percent of GDP as a very rough estimate of the gain. On a gross basis, before the “give-backs,” the base broadening was about 1.7 percent of GDP on an outlay equivalent basis, or perhaps 1.25 percent of GDP in increased revenues.

⁵ See Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, “A Unified Children’s Tax Credit” (paper presented at the National Tax Association’s 97th Annual Conference, Minneapolis, MN, November 11-13, 2004); also Robert Cherry and Max B. Sawicky, “Giving Tax Credit Where Credit Is Due A ‘Universal Unified Child Credit’ that Expands the EITC and Cuts Taxes for Working Families,” *Economic Policy Institute Briefing Paper*, no. 91 (April 2000).

⁶ Nina Olson, *National Taxpayer Advocate’s 2003 Annual Report to Congress* (Washington, D.C.: IRS, December 2003), p. 16; IRS Oversight Board, *FY2005 Budget/Special Report* (Washington, D.C.: IRS Oversight Board, March 2004), p. 22.

⁷ Tax Policy Center, T04-0127 - Summary of Effects of Various AMT Reform Proposals, 2005-2014, September 9, 2004 at <http://taxpolicycenter.org/TaxModel/TMDB/TMTemplate.cfm?Docid=697> The TPC estimates are \$1.1 trillion and \$710 billion (including interest) for 2005-2014.

⁸ Don Fullerton and Diane Lim Rogers, *Who Bears the Lifetime Tax Burden?* (Washington, D.C.: The Brookings Institution, 1993), pp. 223-228.

⁹ IRS Updates Tax Gap Estimates, February 14, 2006, at <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>

¹⁰ IRS Oversight Board, *Annual Report 2004*, pp. 1, 12.