

A Tax Plan for Progressives

A simpler and fairer tax code—one that rewards the hard work of the American middle class—can be good policy and smart politics.

BY JOHN S. IRONS AND JOHN PODESTA

FOR FOUR YEARS PRESIDENT BUSH HAS TOUTED his tax cuts as an economic cure-all, but middle-income workers have instead watched helplessly as the tiny tax cut they received has gone to pay for higher property taxes, tuition increases, and exploding medical costs. While the conservatives' tax initiatives have wreaked havoc on people barely living on their paychecks, wealthy taxpayers have enjoyed ever-higher incomes taxed at stunningly lower rates. Furthermore, Bush's tax cuts have wrecked public services and undermined prospects for long-term economic growth.

Progressives share a responsibility to not only oppose the conservative tax program but to offer a sensible alternative: reform to make our tax system fair, simple, and fiscally responsible. We need to see to it that middle-class Americans get the relief they need, and that our nation has the wherewithal to make the investments it must.

Since coming to Washington, President Bush has launched a series of initiatives to shift America's tax burden onto the shoulders of the middle class. The most notable were the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

The 2001 tax change phased in significant reductions in federal income-tax rates, phased out the estate tax, and provided modest tax breaks for families with children and for married couples. While most people remember a tax-refund check in the range of \$300 to \$600, the law also mandated a reduction in the tax rates in the top four brackets of at least 3 percentage points, and the creation of a new 10-percent bracket. In addition, there were other provisions that benefited upper-income taxpayers and those with significant annual retirement savings.

The president's 2003 tax change accelerated the phase-ins of the 2001 law while slashing the taxation of dividends and capital gains. Prior to the 2003 tax change, dividends were taxed according to the same rate schedule as ordinary income. The 2003 law taxed dividends at 5 percent and 15 percent to match the tax rates on capital gains, which were lowered from 10 percent and 20 percent. The oddly named Job Creation and Worker Assistance Act of 2002 reduced taxes for new business invest-

ments. And the American Jobs Creation Act of 2004 replaced export trade subsidies with myriad tax credits for businesses. Of the \$140 billion in corporate tax giveaways under that legislation, importers of Chinese ceiling fans received about \$44 million worth of lower import duties.

One result of these tax-code changes is that middle-income workers today can easily find themselves paying a tax rate on their wages *double* the 15-percent rate that millionaires pay on their investment income. The immense tax burden placed on wage earners mocks a core American value: our belief in fairness. Forcing middle-class workers to bear a greater share of the cost of government weakens their support for needed investments and stirs resentment toward those who depend on public services the most. In this respect, the tax policy enacted by the president and his supporters has less to do with conservative economics than conservative politics—promoting anti-government sentiment within the middle class and votes for politicians who echo it.

TRAGICALLY, THE ARGUMENT AGAINST THE BUSH TAX agenda was never heard. Instead of offering a progressive counter-narrative, Democrats too often allowed the right to set the terms of the debate. As a result, even those rare victories, such as the middle-class tax relief Democrats gained in the 2001 tax bill, were dwarfed by the system's growing regressivity.

While disappointing, the Democrats' dilemma is hardly surprising. Since the emergence of California anti-tax crusader Howard Jarvis and the state tax revolts of the mid-1970s, conservatives have transformed what should be a movement for tax fairness into a jihad against government spending. The right understands the language that taps into the public's anger and is not afraid to use it. Fearful of being branded "tax and spend liberals," many Democrats have too often chosen to run for cover, raising their heads only to plead for the status quo.

Is that the way it has to be? Hardly. Progressives can not only fight for fair taxes; we can even win. Opinion research tells us that most Americans regard President Bush's elbow-on-the-scale approach to tax rates as fundamentally unfair. What many are beginning to recognize is that it is also unsustainable. One



Democracy Corps poll in April of this year found respondents, by a margin of 74 percent to 17 percent, saying that the country is headed in the wrong direction on the federal budget deficit. Other polls have consistently found strong support for repealing some or all of Bush's tax changes if it means reducing the deficit or financing health care, education, and other priorities.

Last year, federal revenue, as a share of the economy, fell to its lowest level in nearly 50 years—just 16.3 percent of the gross domestic product. As a result of the right's efforts to “starve the beast” and lower taxes for America's wealthiest taxpayers, even a booming economy would leave the federal government trapped in a massive fiscal hole.

Yet what sticks in the craw of many Americans is not only that the conservative tax agenda favors the wealthy and fails to respond to budget deficits; it also is that, under President Bush, the tax code has become more complicated than ever. Since 2001, 10,000 pages have been added to the tax code and related regulations. One result of this tinkering and tweaking is that millions of American families will soon be ensnared in the additional complexity of the dreaded alternative minimum tax (AMT). Because the AMT is not indexed for inflation, and because the 2001–03 tax changes lowered tax shares of upper-income taxpayers without permanently adjusting it, the Urban-Brookings Tax Policy Center estimates that by 2010, as many as one-third of taxpayers will be affected by the AMT at a cost of more than \$100 billion.

Americans don't want to blow up our tax system and start over. Instead, we want to restore the values of progressive taxation that have historically guided U.S. tax policy. The federal income tax—the cornerstone of the tax code—needs to be restructured, simplified, and broadened. This means eliminating loopholes for corporations and wealthy individuals, simplifying the rate structure, and reversing the trend of unfairly lower tax rates on the capital income of the wealthiest Americans.

THE MODERN ECONOMY IS INCREASINGLY DRIVEN BY jobs in which advanced skills play an important role, and in which “human capital” is as important as physical capital, if not more so. A tax system that rewards wealth and accumulated capital at the expense of work and skill flies in the face of this fundamental economic change.

The Center for American Progress has put forward a new proposal to make the tax code fair, simple, and supportive of new economic opportunity. We would tax all forms of income according to the same rate schedule. This change would end preferential treatment for income from capital (wealth) over income from work by setting capital gains and dividend taxes equal to the tax rates on ordinary income.

We also would provide relief for the most regressive part of the system, the payroll tax. The Social Security payroll tax is currently 12.4 percent and split evenly between workers and their employers. The center's plan would reduce the tax rates on work by eliminating the employee side of the Social Security payroll tax. This would mean an immediate 6.2-percentage-point reduction in the tax rates on the first \$90,000 of income from salaries and wages. At the same time, we would make the employer side of the payroll tax less regressive by requiring employers to pay taxes on payroll incomes above \$90,000.

We would revamp the income-tax rate structure by reducing it to three tax brackets with tax rates set at 15 percent, 25 percent, and 39.6 percent—which we would also set as the tax rate on capital gains and dividends. The brackets would be set at taxable income levels of \$0, \$25,000, and \$120,000, with a \$10,000 standard deduction for married couples.

The net cost of the payroll-tax change would be about \$3 trillion over 10 years (the \$3.7 trillion in lost payroll-tax revenue would be partially offset by an additional \$700 billion raised by eliminating the cap). However, the reformed tax system would raise federal revenue overall by about \$500 billion

when compared with President Bush's policy. Because most taxpayers pay more in payroll taxes than in income taxes, the tax savings for middle-income households would be significant.

This simple restructuring of the tax code would also include an elimination of the AMT, rescuing 30 million taxpayers from the snare of complicated and expensive tax filings over the next several years. We would also reduce the income level needed to qualify for the full child tax credit, enabling more low-wage workers to receive it. By raising additional revenue, this simpler, fairer tax plan would also reduce the deficit and create a stronger foundation for economic growth.

Unlike the trifecta of right-wing tax-policy reforms—a flat tax, a value-added tax (VAT), or a national sales tax—our plan would maintain the current deductibility of charitable giving, home mortgage interest, state-tax deductibility, and other deductions in their current form. We believe that there is room enough to raise revenue without eliminating valuable deductions that serve important social interests.

Finally, the center's plan would replace the upside-down retirement savings deduction with a refundable credit. Currently, those in a higher tax bracket receive a greater tax benefit from retirement savings. For example, someone in the 15-percent bracket receives a 15-cent reduction in their tax share for each \$1 saved in a tax-preferred retirement account, while those with higher incomes in the 35-percent bracket receive a 35-cent reduction. Under our plan, everyone would receive a 25-percent refundable credit for retirement savings.

The center's plan would also retain current limits on contributions to these tax-preferred retirement accounts. For instance, a \$1,000 contribution to an IRA would give taxpayers a \$250 credit on their taxes—and the credit would be refundable to guarantee that low-income Americans would receive the same savings incentives as upper-income families. More than 60 million Americans would thus have a new or increased incentive to save.

Retirement savings would also be enhanced by exempting a portion of long-held assets from capital-gains taxes for those earning less than \$1 million a year. In addition, the plan would raise and dedicate enough money to the Social Security Trust Fund from general revenues to fill half of the gap between dedicated revenue and payments in the Social Security system.

A portion of the added revenue raised by our system could be used for further retirement savings incentives, which would offer additional matching funds for low-income savers while phasing out matching funds for those with annual incomes greater than \$100,000. We would also include a modest automatic contribution for low-income families, who are often unable to contribute due to a lack of disposable income. These accounts would be managed in a cost-effective manner limiting personal risk. This enhanced savings and retirement wealth would provide an important supplement to Social Security.

Simplifying the system by eliminating loopholes at the corporate and individual levels would save billions of dollars and offer an added degree of horizontal equity. In addition, the plan would retain a reformed estate tax, an important backstop to a fair and efficient tax code. Our proposed \$2.5 million exemption per individual (\$5 million per married couple) would ensure

that small family farms and businesses are not burdened by the tax, while preserving the estate tax on the very wealthy.

These changes are genuine reforms that would restore progressivity to the tax code, while at the same time raising additional revenue. With the center's plan, more than 70 percent of Americans earning less than \$200,000 a year would see an average tax cut of about \$600. Those making more than \$200,000 a year—the primary beneficiaries of the Bush tax changes—would see an increase in their tax share. Overall, the plan would raise nearly \$500 billion over 10 years when compared with Bush's tax proposals.

What's more, the center's tax plan would promote growth by reducing the deficit and boosting national savings, by rewarding work and promoting "human capital" formation through lower taxes on wages, and by expanding incentives to save for more than 60 million tax filers.

Under the center's plan, the CEOs of large corporations and other very wealthy Americans would have a tougher time dodging their tax responsibilities. And in a return to America's progressive values, this tax plan would make it clear that wealth and investment are no longer preferred to the hard work of the American middle class.

AS THE SOCIAL SECURITY DEBATE MOVES TO THE BACK burner, we will likely see a renewed drive by conservatives to replace the income tax with a flat tax, a VAT, a consumption tax, or even a national sales tax. While the details of each plan differ, their main thrust is clear: more of the same failed economic policy that rewards capital and the wealthy at the expense of work and the middle class.

Does the center's plan offer progressives the means to fight back and win? We think so, and we are not alone. Nobel laureate Robert Solow contrasted our proposal with other plans and endorsed it as not only fair but plausible. "When anybody tells you that they have a tax scheme which will allow you to file your income-tax return on a postcard, I often wonder where that postcard is going to be postmarked—someplace like Neverland," Solow said. "We're talking here about things that could, in fact, actually be done."

Ultimately, whether these things are done is less a question of economic science than political science. After all, it is of little consequence if progressives master the former but repeatedly fail in the latter. In 1995, Bryan Gould, a former Labour member of the British Parliament, recalled his own party's shortcomings in addressing tax policy, saying, "We found ourselves bogged down on an issue [taxation] which, notwithstanding Tory ineptitude, our opponents were bound to capitalize on in the end."

Today the stakes are far too high to allow our opponents to capitalize on tax policy any longer. For Democrats, the time to speak out for progressive tax reform is now. If they fail to, Americans will be paying the price for President Bush's ineptitude for generations to come. **TAP**

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