Economic Growth and Family Fairness Tax Reform Plan

A Pro-Growth, Pro-Family Tax Reform Plan

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Fixing Our Broken Tax Code

Why The Tax Code Needs To Be Fixed

Too many Americans believe the American dream is slipping out of reach for themselves and their children.[i] [ii] They see their cost of living rise while their paychecks remain stagnant. [iii] Too many Americans are out of work or underemployed. Increasingly the deck seems to be stacked against those who are working hard and playing by the rules, while the system seems rigged for insiders who don't.

This is largely the result of dramatic changes in our economy and in the failure of our government's outdated programs and policies to keep up. Perhaps no function of our government is more antiquated and dysfunctional than our federal tax system, which:

- Requires Americans to spend 6.1 billion hours per year preparing their tax returns[iv];
- Is so complex that only about 30% of individual filers itemize, meaning itemized deductions in their current form are useless to 70% of individual filers[v];
- Penalizes parents by requiring them to contribute twice to the old-age entitlement system[vi];
- Gives foreign companies an advantage over their American competitors in business done outside of our borders[vii];
- Encourages debt issuance and accumulation[viii], needlessly creating a riskier economy;
- Fails to sufficiently distinguish between businesses investing money into growth and new jobs and businesses accumulating cash and withdrawing profits;
- Taxes the same flow of money at several different points,[ix] hindering growth and hiding the true burden of the system;
- Creates an environment of confusion and uncertainty for individuals and firms – and unfair opportunity for the special interest lobbyists[x] - by designating a multitude of tax code provisions as temporary; and,
- Conspires with our outmoded welfare system to discourage work and investment in human capital by imposing very high effective marginal tax rates on families and individuals living near the poverty line[xi].

If these problems weren't bad enough, our complex, onerous tax code is enforced by an often unpredictable Internal Revenue Service. Simply put, our current system taxes too much, taxes unfairly, and stifles economic opportunity for American families, businesses, and individuals.

How We Can Fix The Tax Code

It does not have to be this way; we can do better. In this white paper, we outline a federal tax reform proposal that will resolve these major problems in the tax code. On the individual side, this proposal will eliminate the parent tax penalty, a crucial first step to restoring fairness to middle-income families. By simplifying the structure of the tax code, this proposal will also reduce the burden of confusing choices and excessive paperwork. Most itemized deductions will be removed, and those that remain will be accessible to all filers.

On the business side, this proposal will eliminate tax-induced bias in favor of debt, increase certainty, remove extraneous provisions and narrow exemptions, and streamline the taxation of businesses through a single-layer universal business tax rate. If adopted, these policies will significantly increase economic growth and prosperity, as businesses will be enabled to raise wages and create the jobs that Americans truly need. These changes will also bring parity of treatment to different types of business. This plan also modernizes our tax code to reflect the reality of our 21st century global economy. These reforms, if implemented into law, will make the United States a more attractive place for foreign investment and put American firms in a better position to compete abroad.

The changes outlined in this paper are not intended to be a cure-all and they do not represent the last word on tax reform. In fact, we acknowledge that several of these proposals should occur in conjunction with other policy improvements, such as reforms to our health care, education, retirement, entitlement, and welfare systems. Rather than putting forward a sweeping and overly prescriptive plan, this proposal outlines potential solutions that we would like to see proceed through Congress via regular order and be improved in the process. We invite constructive criticism and proposals to improve this plan. Those with suggestions are encouraged to send them to Tax_Reform@rubio.senate.gov or Tax_Reform@lee.senate.gov. We acknowledge and appreciate the input of our constituents, businesses, policy experts, colleagues serving with us in Congress, and all Americans. In summary, we believe a transparent and inclusive legislative process is essential to the tax reform process.

Everyone agrees that our tax system has been dysfunctional and unfair for far too long. It's time that Congress fixes it.

Statement of Principles

Any successful tax reform effort must define its principles. It is our opinion that tax reform must:

- Treat all families equitably and eliminate the tax code's biases against parents and married couples;
- Encourage economic growth that will yield more private sector jobs and higher wages;
- Remove crony biases in the code;
- Enhance the ability of firms located in the United States to compete in the global market; and
- Curtail the Internal Revenue Service's discretion and capacity for abuse.

Tax reform should seek to remedy all of the ills in the tax code. As such, this plan rejects the false choice that only one goal of reform can be pursued at a time and offers a package that is both pro-growth and pro-family. We believe that by cutting tax rates, eliminating double taxation, taxing saving and investment less punitively and lifting the burden placed on American families we can have both higher levels of growth, higher family incomes, and widely shared prosperity.

United States Senator
Mike Lee – UT

United States Senator
Marco Rubio – FL

Pro-Growth Business Tax Reform

Overview

Perhaps nowhere are the distortions of our broken tax code more obvious than in our system of business taxation. Simply put, the Internal Revenue Code limits economic growth, destroys jobs, and is fundamentally unfair. Americans will not experience the kind of widespread opportunity and shared prosperity they deserve unless we fix this destructive tax code.

Business taxation in the United States occurs across two separate and complex regimes – the corporate code and "pass-through" portions of the individual code.[xii] Our corporate tax rate is the highest in the developed world[xiii], which encourages businesses to incorporate abroad. The top tax rate on "pass through" businesses is even higher.[xiv] Moreover, our tax code is riddled with special-interest carve-outs that effectively function as subsidies for favored businesses and industries, yet companies that invest in growing the economy are unfairly penalized. There are provisions that encourage higher levels of debt[xv] and other provisions that tax the same flow of money multiple times[xvi].

This proposal aims to address each of these distortions. First, by effectively integrating the business tax system, our plan will eliminate double taxation, establish parity between pass-through entities and c-corporations, and remove the bias against capital investment.

We will also allow for full expensing of capital purchases. Under this structure, businesses will immediately be able to write off the costs of purchases, resulting in greater investment, higher employment, and more robust economic growth.[xvii] This provision will also mean eliminating the frequently outdated and sometimes-arbitrary depreciation schedules created by the IRS.

Finally, this proposal will restore fairness to the tax code, by leveling the playing field for all businesses, providing permanence in the code, and removing patchwork exemptions and special-interest carve-outs. We recognize that some incumbent corporations and others who rely on crony corporatist provisions will oppose our efforts to make the tax code simpler and fairer since tax simplification doesn't benefit them the way the current, broken system does. However, this is a necessary cost of creating a tax code that leads to greater opportunity for companies that are growing, which create jobs and new economic opportunities today and into the future. Our plan makes it easier for Americans to compete in the marketplace rather than in the backrooms on Capitol Hill.

Full Expensing for All Businesses

Current Law:

Under current law, when a business makes a capital investment, that business still must generally pay taxes on earnings without accounting for the full costs of these investments. Instead, firms can deduct the lost economic value of the purchase in a given year.[xviii] The loss of economic value is calculated using depreciation tables, which allow for part of the cost of the capital investment to be accounted for each year over several years.[xix]

The law includes certain provisions that attempt to address this bias, including "Bonus Depreciation" and Section 179 Expensing. There are also other provisions, such as the Research and Investment Tax Credit, which indirectly reduce the anti-investment bias of the code.

Our Changes:

This plan allows firms to deduct 100% of expenses, immediately accounting for the costs of capital investments in the year they are made and requiring businesses to pay taxes only on earnings after all expenses have been deducted from the business's taxable income. These new expensing rules will apply to all investment in equipment, structures, inventories and land. In years after the expenditure is made, there are no allowances for economic depreciation of the capital investment.

Why We Make These Changes:

The strength and health of an economy depends largely on the extent to which businesses choose to invest a portion of their earnings in their own growth and expansion – for example, by buying new equipment, upgrading their inventory, giving current employees raises or hiring new workers, or making infrastructure improvements. Business will make capital investments only when they can reasonably expect immediate costs to yield higher returns in the future. By taxing capital investments in the year they are made, and thereby raising the short-term costs of such investments, current law discourages businesses from investing in their own growth and creates a drag on the economy.

The changes under this plan flip this dysfunctional paradigm. As long as businesses are investing in capital, they will be able to deduct the full costs of these investments. In years where the firm is enjoying the return from the investment, there will be no tax deduction. This means that companies will – compared to the status quo - get better tax treatment when they are actively investing in capital and growing their businesses and less favorable tax treatment in years where they are not actively investing. This will encourage greater capital investment, higher employment, and better economic growth.

Creating Parity in the Taxation of Business Income

Current Law:

Under current law, corporate investments are taxed twice. First, these investments are taxed under the corporate income tax code when they produce returns. Then, when returns from the corporation investment are moved from the corporation to the investor, typically as capital gains or dividends, they are taxed again.[xx]

While corporations face double taxation, businesses organized as pass-through entities face higher top marginal tax rates than corporations, as they can be taxed at the new 39.6%[xxi] rate. These companies also pay an assortment of other taxes that are not applicable to corporations. Many small and medium sized businesses are taxed as pass-through entities rather than as c-corporations.[xxii]

2014 Taxation of Pass-Through Entities[xxiii]:

Rate	Single Filers	Married Joint Filers	Head of Household Filers
10%	$0 to $9,075	$0 to $18,150	$0 to $12,950
15%	$9,076 to $36,900	$18,151 to$73,800	$12,951 to $49,400
25%	$36,901 to $89,350	$73,801 to $148,850	$49,401 to $127,550
28%	$89,351 to $186,350	$148,851 to $226,850	$127,551 to $206,600
33%	$186,351 to $405,100	$226,851 to $405,100	$206,601 to $405,100
35%	$405,101 to 406,750	$405,101 to 457,600	$405,101 to $432,200
39.6%	$406,751+	$457,601+	$432,201+

2014 Taxation of C Corporations[xxiv]:

Taxable Income Over	Not Over	Tax Rate
$0	$50,000	15%
$50,000	$75,000	25%
$75,000	$100,000	34%
$100,000	$335,000	39%
$335,000	$10,000,000	34%
$10,000,000	$15,000,000	35%
$15,000,000	$18,333,333	38%
$18,333,333	…………………………..	35%

Our Changes:

This plan eliminates double taxation for all business income. C corporations would pay a 25 percent corporate tax. Since the businesses' income would be taxed at the entity level, dividends and capital gains on stock would not be subject to additional tax at the individual level. Shareholders would receive an annual informational statement indicating how much corporate tax had been paid on their behalf.

As under the current tax system, pass-through entities (partnerships, LLCs and S corporations) and sole proprietorships would not be subject to entity-level tax. Instead, this income would be reported as taxable income on the owners' tax return. The maximum tax rate applicable to pass-through entity income would be 25 percent. This maximum tax rate would be statutorily linked to the tax rate on C corporations, and would be referred to as the business tax rate.

In order to prevent abusive misallocation of labor income as business income, this plan also creates strong rules that preserve current tax arrangements for partnerships and independent contractors while discouraging abusive reclassifications. We also require that reasonable compensation be paid by pass-through entities to owners that work for the business.

Income Threshold	Pass-Through Rate Individual Filers	Pass-Through Rate Joint Filers	Corporate Rate
$0 to $75,000	15%	15%	25%
75,001 to $150,000	25%	15%	25%
$150,001 and higher	25%	25%	25%

Why We Make These Changes:

The high tax rates faced by many pass-through entities and the double taxation of business investments are both barriers to investment. This bias against investment hurts long-term economic growth and prevents job creation.

Double taxation also has other negative properties. Double taxation obscures the true burden of taxation, as rates reflect a lower tax burden than really exists. Double taxation is also inherently unfair, as individuals must pay taxes many times on the same income source. By eliminating double taxation and giving small firms access to the lower rate, we help balance the playing field between large and small firms.

It is important for the tax code to encourage investment in the United States. Our policy reforms will significantly reduce the tax incentives for businesses to participate in inversions, offshoring, profit shifting, and other activities that diminish economic activity within the borders of the United States.

By creating a single-layer of taxation while decreasing the business rate to 25%, and allowing for the full expensing of capital purchases, the United States will once again be a prime destination for business. Reforming the business tax code so that it is internationally competitive must be a top priority for policymakers.

Elimination of Extraneous Business Tax Provisions

Current Law:

The Internal Revenue Code includes an abundance of carve-out tax provisions that create advantages for special interests and distort the free market. Many of these tax provisions help certain industries to the disadvantage of others.

Some of these tax provisions are included in permanent law, and others are temporary tax provisions that are regularly renewed. Despite remaining in the code for long periods of time, the temporarily renewed provisions are known as "tax extenders," because Congress regularly reauthorizes these measures. Legislation maintaining "tax extenders" typically includes narrow, distortive tax provisions along with some tax provisions that are important to economic growth and do not create a market distortion.

Our Changes:

This proposal eliminates extraneous business tax provisions and does not renew any of the tax extenders that expired at the end of 2014. This plan's treatment of foreign sourced income, business expenses, interest expenses, and certain other issues render most tax extenders redundant.

Why We Make These Changes:

Congress has routinely renewed wasteful and complicated tax benefits in tax extenders packages alongside useful tax provisions. Carve-out provisions of the tax code are no longer necessary because this plan allows for 100% expensing, rendering special expensing provisions useless and extraneous. This plan also transforms the international system of taxation to conform to global norms, rendering extender provisions on foreign taxation redundant.

The tax code will no longer be a system with policies that are driven by any single member or effective lobbyist propping-up specific industries.

This plan will also do away with the ritual of extending temporary tax provisions. While it is true that some tax extenders provisions should be made permanent absent a comprehensive tax reform approach like the plan we are offering, the temporary nature of these provisions often blunts their economic impact. Further, the periodic renewal of these provisions makes achieving tax reform more difficult politically and creates a boon for lobbyists advocating specific provisions.

Other narrow, specific tax provisions are also eliminated to improve simplicity and move the government away from picking winners and losers.

Elimination of Interest From Tax Base

Current Law:

Generally speaking, under current law interest expenses are deductible and income from interest is taxable.[xxv] As such, equity financing leads to a less favorable tax environment, while borrowing leads to more favorable tax treatment.[xxvi]

Our Changes:

In general, this plan eliminates the deductibility of new debt. We also remove most income earned via interest from the tax base. Over time, this will help eliminate the pro-debt bias in the current code.

Why We Make These Changes:

The bias in the tax code favoring debt is economically inefficient and creates problems of corporate governance. By removing the tax incentive for debt, we encourage improvements in these areas. By making interest on debt non-taxable at the same time, we bring neutrality to the system while avoiding double-taxation of debt. Removal of taxation of interest will also lower borrowing costs, as is evidenced by the lower yields from bonds in the municipal bond market.

This plan does not treat debt less favorably than equity, but removes bias toward debt financing that currently exists in the code. Debt financing is also a riskier mechanism to start or grow a business.

Transition to an International Dividend Exemption System

Current Law:

The United States uses a worldwide system of taxation, where businesses first pay income tax in the foreign country where the income is earned, and then they pay additional taxes on that income when it is brought back to the United States.[xxvii] Taxes on eligible income are frequently deferred, meaning they are not paid until the income is returned to the United States.[xxviii] Currently, billions of dollars in productive capital is overseas where it can't be used in America to grow the economy, create jobs, or increase pay.

Our Changes:

Under this plan, the international system of taxation transitions to include a repatriation dividend exemption such that United States-domiciled businesses and their subsidiaries are taxed only in the country where their income is genuinely earned. During this transition, this plan creates a deemed repatriation at 6% for currently deferred taxes. This tax liability is booked immediately, but it is repayable over a 10-year time horizon.

This plan would also create strong rules regarding profit shifting and realization of intangible and financial income to decrease base erosion and disingenuous tax reduction maneuvers.

Why We Make These Changes:

We believe it is necessary to transition away from the current U.S. worldwide tax system because it creates a high barrier for businesses to expand abroad while remaining headquartered in the United States. The current system of taxation is not investment-neutral. American firms are taxed the same amount on income earned abroad as a business is taxed within the United States, yet they must compete with multinational corporations headquartered elsewhere that only pay the taxes within the countries they are operating within.

A territorial system, however, only taxes income earned within the United States and is therefore neutral to investment. Allowing U.S. firms the ability to invest by transitioning to a territorial system of taxation will lead to job creation and help reverse the recent trends of stagnant wage growth.

Changing to a territorial system of taxation would also keep the United States competitive in the global marketplace. Only six of 34 countries in the Organization for Economic Cooperation and Development (OECD) use a world-wide system of taxation, while everyone else operates under a territorial tax system. And, the six countries that currently operate under a world-wide tax system have a corporate tax rate much lower than the U.S.

Special Provisions Pertaining to Financial Institutions

Current Law:

Banks and other financial institutions present a special case for our tax reform proposal. Financial institutions are generally taxed like other businesses under current law, with the exception of certain special provisions that exist to deal with their distinct line of business.

Our Changes:

Financial institutions will have separate rules that provide for accurate taxation of their economic impact in the context of an interest-free tax base. In order to accomplish this, we recommend fully exempting financial institutions from our changes regarding the deductibility and taxability of interest. Instead, they will continue under current rules and the new business tax rate.

Why We Make These Changes:

As interest is fully removed from the tax base, it is difficult under our plan to properly tax financial institutions without special rules. As the core of financial service firms' business is the movement of cash, any tax exempting interest income and deductibility will fail to properly assess the economic value captured by firms, which is integral in assessing an appropriate tax burden.

As such, we must make special allocations for taxation within the financial system. One such option is full exemption, the option outlined above. However, we are open to other options for treating taxation of financial institutions under this proposed plan.

Carryover of Losses and Transitions

Current Law:

When a firm's total tax liability is lower than its total deductions in a certain tax year, it is defined as having a net operating loss (NOL). Under current law, NOLs can be carried forward to future tax years or used to recover prior tax payments, depending on circumstances.

Our Changes:

This plan allows for losses to be carried forward, but it does not provide interest on said carryovers. It also provides for a transition period where losses or exemptions recognized by the previous code can continue to be used. If, after 15 years, depreciation is still being realized on an investment made under the old code, the net present value of future depreciation will be recognized at that time.

Why We Make These Changes:

We believe carryover of losses is legitimate and needs to be respected to minimize disruption as we transition to our new system. After transition, carryover of losses will remain important economic policy, especially for growing firms. Investments made pre-transition should continue to receive the tax treatment firms anticipated when making the investment, as it would be excessively disruptive to remove such treatment.

Reforming the Treatment of Health Care in the Tax Code

Current Law:

Under current law, premium contributions from employers to sponsored health insurance plans are generally exempt from taxation. This exclusion is frequently mentioned as one of the largest tax expenditures.[xxix]

Our Changes:

We believe that there are possibilities for changing or reforming the exclusion for employer-sponsored health care, but any such reforms must be made in the context of reforming our health care system generally. This plan leaves the current system intact, but encourages broader reform of the health care system that could include modification of this exclusion.

Why We Make These Changes:

Although the employer exclusion creates a distortion by treating compensation in the form of health care premiums favorably relative to compensation in the form of cash, it would be imprudent and disruptive to eliminate this provision without creating alternative means to ensure sustained access to health care.

Creating Family Fairness in the Tax Code

Overview

The individual side of our tax code is a mess: individuals and small businesses face tax rates that are too high and a tax code that is too complex. The complexity of the tax code often benefits the wealthy and well connected who can afford accountants, lawyers, and lobbyists, yet leaves many people behind. Our system of funding old-age entitlement programs penalizes parents, and our bad habit of funding welfare through the tax code leaves us with a disorganized system that fails as a tax code and as a welfare program. We believe we can do better. This proposal would simplify the tax code, remove the marriage penalty, and lessen the parent tax penalty. It repeals all forms of double-taxation, including the estate tax. We also call for a retooling of the Earned Income Tax Credit in coordination with means-tested welfare programs to create a welfare system that works better and removes poverty traps.

Tax Bracket and Filing Status Consolidation

Current Law:

Under current law, there are seven separate tax brackets: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. There are also four basic filing statuses within the individual code: single, married filing jointly, married filing separately, and head of household.

2015 Individual Income Tax Rates, Standard Deductions Personal Exemptions, and Filing Thresholds[xxx]

If your filing status is Single		
Taxable Income		
Over	**But not over**	**Marginal Rate**
$0	$9,225	10%
$9,225	$37,450	15%
$37,450	$90,750	25%
$90,750	$189,300	28%
$189,300	$411,500	33%
$411,500	$413,200	35%
$413,200	and over	39.6%

If your filing status is Married filing jointly		
Taxable Income		
Over	**But not over**	**Marginal Rate**
$0	$18,450	10%
$18,450	$74,900	15%
$74,900	$151,200	25%
$151,200	$230,450	28%
$230,450	$411,500	33%
$411,500	$464,850	35%
$464,850	and over	39.6%

If your filing status is Head of Household		
Taxable Income		
Over	**But not over**	**Marginal Rate**
$0	$13,150	10%
$13,150	$50,200	15%
$50,200	$129,600	25%
$129,600	$209,850	28%
$209,850	$411,500	33%
$411,500	$439,000	35%
$439,000	and over	39.6%

If your filing status is Married filing separately		
Taxable Income		
Over	**But not over**	**Marginal Rate**
$0	$9,225	10%
$9,225	$37,450	15%
$37,450	$75,600	25%
$75,600	$115,225	28%
$115,225	$205,750	33%
$205,750	$232,425	35%
$232,425	and over	39.6%

Standard Deduction		
	Standard	**Blind/Elderly**
Single	$6,300	$1,550
Married filing jointly	$12,600	$1,250
Head of Household	$9,250	$1,550
Married filing separately	$6,300	$1,250

Standard Deduction for Dependents	
Greater of $1000 or sum of $350 and individual's earned income	
Personal Exemption	$4,000
Threshold for Refundable Child Tax Credit	$3,000

<u>Our Changes:</u>

This plan consolidates the existing brackets into two brackets, one taxed at 15% and the other taxed at 35%. We also eliminate the head of household filing status. All income earned up to $75,000 for singles and $150,000 for joint filers will be taxed at a 15% marginal rate. All income earned above this threshold will be taxed at a 35% rate.

Individual Filers:

Over	But not over	Marginal Rate
$0	$75,000	15%
$75,000	And over	35%

Joint Filers:

Over	But not over	Marginal Rate
$0	$150,000	15%
$150,000	And over	35%

<u>Why We Make These Changes:</u>

The tax code is in desperate need of simplification, and bracket consolidation is an important first step. With consolidated brackets and simplified filing, we create a more user-friendly tax system.

Child Tax Credit Consolidation and Enhancement

Current Law:

There are several credits that exist under current law that help mitigate the cost of raising children. These include the Child Tax Credit, the Dependent Care Credit, and the Adoption Tax Credit, among others. The current Child Tax Credit is defined by a formula, limited to $1,000 in value. [xxxi]

Our Changes:

This plan maintains current law for most child-related tax provisions while creating a new child tax credit. This tax credit is limited to a maximum of $2,500 per qualifying child. The new credit is partially refundable, limited to the sum of total income and payroll tax liabilities, including employer-side payroll tax liability. There is no phase-out as exists under the existing child tax credit. The new child tax credit will be charged after all other tax credits.

Why We Make These Changes:

Under current law, Social Security and Medicare, the old-age entitlement programs, are funded on a pay-as-you-go basis, not according to long-term payments into the system. As parents simultaneously pay payroll taxes while also paying to raise the next generation that will pay payroll taxes, parents pay more into the old-age entitlement systems. This creates a situation known as the "Parent Tax Penalty" where parents pay more, but are not compensated for these payments.

Our approach to refundability on the new Child Tax Credit is taken because payroll taxes fund the entitlement system, and this plan is specifically aimed at eliminating the inequity of tax treatment for those financing the entitlement system in the future via investment in children.

Consolidation of Filing System

Current Law:

Under current law, there is a bifurcated system of filing for taxes. Some individuals take a Standard Deduction, which allows for a set deduction of $6,200 ($12,400 for joint filers) from taxable liability in 2014. Other filers do not take the standard deduction, but instead use itemized deductions. Filers are able to claim personal exemptions as well, another means of reducing tax liability. Finally, there is also the Alternative Minimum Tax, which impacts income in excess of $117,300 ($156,500 for joint filers), adding further complexity to the individual tax code.

Our Changes:

This plan eliminates the standard deduction, thus ending the bifurcated system of tax filing. In place of the standard deduction and personal exemption, this plan creates a personal credit of $2,000 for individuals and $4,000 for joint filers. We also eliminate all itemized deductions except for a reformed home mortgage deduction and the deduction for charitable giving. Finally, we eliminate the Alternative Minimum Tax.

This plan would contain language harmonizing these changes with existing income definitions to prevent disruption to state tax codes.

Why We Make These Changes:

The bifurcated system means that most individuals do not have access to itemizing deductions, making these deductions useless to these filers. Beyond this, many itemized deductions are skewed toward decreasing the tax burden on upper-income individuals. This plan gives all tax filers useful access to the mortgage interest deduction and the deduction for charitable giving.

The personal credit offsets changes from the elimination of personal exemption, the loss of the 10% bracket, and the removal of the standard deduction.

Ending High Effective Marginal Tax Rates for the Poor

Current Law:

Under current law, low-income individuals receive benefits from a large assortment of means-tested programs and tax benefits. Principal among these benefits is the Earned Income Tax Credit (EITC). There is no overarching policy dictating eligibility standards that is uniform for the EITC and means tested programs. As such, loss of means-tested benefits and EITC can coincide with one another to create very high marginal rates, especially for moderate-to-low income individuals.

Our Changes:

We believe the EITC must be reformed in conjunction with means-tested welfare programs with the express goal of eliminating high marginal tax rates and related disincentives for work and human capital investment among low-to-low-mid income individuals. We mention these changes to illustrate the larger changes that will need to be made in conjunction with tax reform to resolve issues related to the EITC.

Why We Make These Changes:

Very high effective marginal tax rates mean that extra hours of work or raises do not necessarily translate into a higher standard of living. If the pay of a second parent working 15 hours a week is so heavily taxed that it barely raises take-home income, that parent may simply stay home. That parent is not staying home due to a personal choice, but due to a government policy that makes working those hours irrational. A young worker who might be able to get a raise if she gets an additional certification might avoid that raise if 90% of it is swallowed up by government and in addition to costs related to getting the certification in the first place. Keeping people from working and investing in human capital destroys the ladder of success.

By eliminating a complex and poorly coordinated means-tested welfare system and replacing it with a consolidated system of benefits, we eliminate a broken system of incentives. Reforming the EITC will help fix these problems, eliminating government interference that encourages the perpetuation of poverty.

Conclusion

America needs a new tax system that encourages economic investment and growth, drives up employment and wages, and also brings fairness to married couples, families, and smaller and emerging businesses. The plan we have outlined is our attempt to meet those challenges, and begin a long-overdue debate about the need for modernizing tax reform that is both pro-growth and pro-family.

Since the Great Recession, labor participation rates have plunged to historic lows, wages have remained stubbornly stagnant, and more old businesses are closing than new ones are opening. At the same time, while our nation remains the leader of the global economy, we have spent decades watching on the sidelines as other nations have reformed their tax laws to improve their competiveness. U.S. policymakers have instead spent their time creating distortions, loopholes, and hurdles that impede innovation, competition, and exceptionalism. Instead of meeting the challenges of the 21st century, America's tax writers are creating more of them all the time. It doesn't have to be this way.

Under our plan, every American will have the opportunity to succeed on a level playing field and in a free market. People will have the opportunity to go as far as their talents and work ethic will take them, because no longer will our tax system favor the corporate lobbyists and political insiders who thrive on in backroom deals that rig the economy for crony capitalist special interests. Ultimately, businesses reinvesting their profits and families with young children will benefit from fairer treatment when our tax code is ridded of special tax treatment and tax avoidance schemes. This will make it easier for Americans to find jobs and easier for businesses to create them. It will help restore upward mobility to the bottom of our economy, competitive vigor to the top, and greater access to opportunity within our middle class.

The policies contained within this plan are just a beginning of an important conversation about our country's future, but they are an important beginning. We must also reform government in the policy areas of welfare, health care, retirement security, education, regulation, and entitlements. We must tackle the true drivers of our debt if we want long-term success for a tax plan that reforms these distortions, leaving more money with the taxpayers and less with government.

The American Dream is in danger. However, we endeavor to empower individuals and society to create greater opportunities and lend each other a hand, allowing the American Dream to become stronger than it ever has been. Creating policies that reinforce the values of family, work, investment, and entrepreneurship is essential to empowering individuals, families, and communities to take care of themselves, and each other. We believe pro-growth, pro-family tax reform will empower the American people to succeed in a revived free market. We believe that doing so is a vital step toward restoring the American Dream and bringing it into reach of everyone.

Appendices

Illustrative Examples

Below is a series of examples of hypothetical taxpayers, and how we anticipate their annual tax burden would change under this plan. All changes in tax liability are approximated and rounded to the nearest $100.

Example One is a family of joint filers in Florida earning $50,000 per year, facing the parent tax penalty. Example Two is a single parent in Utah also earning $50,000 per year and also facing the parent tax penalty. Example Three is a joint filing couple in Utah facing both the parent tax penalty and the marriage penalty. Finally, Example Four is a childless single person in Florida earning $75,000 per year and facing no parent tax penalty or marriage penalty.

Example One - Joint Filer	
Income	$50,000
Children	2
Mortgage Interest	$0
Charitable Donations	$1,500
Applicable Student Loan Interest	$1,000
Retirement Savings	$2,500
Change in Tax Liability	**($4,500)**

Example Two - Single Filer	
Income	$50,000
Children	2
Mortgage Interest	$0
Charitable Donations	$1,500
Applicable Student Loan Interest	$1,000
Retirement Savings	$2,500
Change in Tax Liability	**($3,600)**

Example Three - Joint Filer	
Income	$200,000
Children	2
Mortgage Interest	$16,200
Charitable Donations	$10,000
Applicable Student Loan Interest	$0
Retirement Savings	$10,000
Change in Tax Liability	**($12,300)**

Example Four - Single Filer	
Income	$75,000
Children	0
Mortgage Interest	$10,800
Charitable Donations	$2,250
Applicable Student Loan Interest	$333
Retirement Savings	$3,750
Change in Tax Liability	**($1,500)**

Notes

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