Comments for the Record

House Ways and Means Committee

Hearing: How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs

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by Michael Bindner
The Center for Fiscal Equity

Chairman Camp and Ranking Member Levin,
Thank you for the opportunity to submit my comments on this topic.

I will leave it to others to describe how other companies compete and confine my remarks to how the United States should restructure its tax system with an eye to both competitiveness and how other countries should respond to what I propose.

There is more to tax reform than international competitiveness, as tax policy takes a back seat to factor prices in determining where retailers seek their suppliers, unless of course this committee is willing to enact a substantial value added tax to decrease imports and decrease exports. I do not believe that is the intention of the Committee, at least not at this time.

Tax reform, if undertaken at all, should have the goal of simplifying the collection of revenue while maintaining or improving its basic progressive structure (which in current law is more honored in its breach, given low taxes on capital gains and dividends). The use of the tax code to provide subsidies to working families must be maintained, but this should occur without requiring that every household file a tax return to receive them, often by paying others to do so and paying a premium for refund anticipation loans which are heavily marketed to those least able to afford the finance costs.

On the other hand, the number of people paying no tax as a result of these benefits has justly drawn criticism that a sense of shared sacrifice has been abandoned. This has led many to demand some form of consumption tax so that all are conscious of some sacrifice. Some form of visible consumption tax will also provide an incentive to save to those who otherwise would not because their incomes are too low to do so. The wealthy, however, need no such incentive – having the ability to satisfy all of their current economic needs with additional income to spare.

To satisfy both demands, the Center proposes a four part tax structure.

Part One is a Value Added Tax (VAT), which is suggested because of its difficulty to evade, because it can be as visible to the ultimate consumer as a retail sales tax and because it can be zero rated at the border for exports and collected fully for imports. As this feature has been well explained by others, I will not go into detail on this point. What is more important is to exercise care in delineating what is funded by such a tax.

We believe that VAT funding should be confined to funding domestic discretionary military and civilian spending. Zero rating a tax supporting such spending is totally appropriate, as foreign consumers gain no benefit from these expenditures. Likewise, making imports fully taxable for this spending correctly burdens the consumers who fully benefit from these services. As importantly, making such a tax visible provides an incentive to taxpayers to demand less of such spending.

An extreme example of such spending incentives would be the creation of a regional VAT funding regional appropriations, with varying rates depending upon spending levels. While creation of regional appropriations panels and government agencies can be accomplished under the *Constitution* as currently written, creation of any regional excise would require a constitutional amendment, as the *Constitution* requires all excises to be uniform.

In order to fully fund current domestic obligations, the Center calculates that the tax rate should be 13.3%. In order for this to be affordable, during the transition, income tax withholding tables should be adjusted to increase net income by the same percentage, with Social Security beneficiaries receiving a similar bump in payments. This is a "balanced budget" rate. It could be set lower if the spending categories funded receive a supplement from income taxes.

Part Two is a VAT-like Net Business Receipts Tax (NBRT). Its base is similar to a VAT, but not identical. Unlike a VAT, and NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

The key difference between the two taxes is that the NBRT should be the vehicle for distributing tax benefits for families, particularly the Child Tax Credit, the Dependent Care Credit and the Health Insurance Exclusion, as well as any recently enacted credits or subsidies under the *Patient Protection and Affordable Care Act (ACA)*. In the event the ACA is reformed, any additional subsidies or taxes should be taken against this tax (to pay for a public option or provide for catastrophic care and Health Savings Accounts and/or Flexible Spending Accounts).

The Child Tax Credit should be made fully refundable and should be expanded to include revenue now collected under the dependent exemption, the home mortgage interest deduction and the property tax deduction. Transitioning these deductions will allow a $500 per month per child distribution with payroll. It will likely increase incentives to expand affordable housing and may not decrease housing for the wealthy, who are less likely to forgo vacation housing or purchase of luxury housing for wont of a tax cut, as the richest families likely pay the alternative minimum tax anyway, so that they do not fully use this tax benefit now.

This tax should fund services to families, including education at all levels, mental health care, disability benefits, Temporary Aid to Needy Families, Supplemental Nutrition Assistance, Medicare and Medicaid. If society acts compassionately to prisoners and shifts from punishment to treatment for mentally ill and addicted offenders, funding for these services would be from the NBRT rather than the VAT.

An extreme example of this proposal is to have a differential regional rate and differential benefit levels for this tax, which may or may not require an amendment – as this tax may be far enough removed from the transaction level to be considered an income tax rather than an excise.

Again, in the extreme, this tax could also be used to shift governmental spending from public agencies to private providers without any involvement by the government – especially if the several states adopted an identical tax structure. Either employers as donors or workers as recipients could designate that revenues that would otherwise be collected for public schools would instead fund the public or private school of their choice. Private mental health providers could be preferred on the same basis over public mental health institutions.

Employers receive a tax credit if their retirees opt out of Medicare and Medicaid for seniors by fully employer funding of retiree health care, either by hiring doctors or purchasing comparable coverage, including catastrophic coverage in return for some kind of tax credit. ***This proposal is probably the most promising way to decrease health care costs from their current upward spiral – as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise.*** While not all employers would participate, those who do would dramatically alter the market. In addition, a kind of beneficiary exchange could be established so that participating employers might trade credits for the funding of former employees who retired elsewhere, so that no one must pay unduly for the medical costs of workers who spent the majority of their careers in the service of other employers.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

It is not appropriate for this tax to be zero rated, as doing so would decrease the incentive to pass these tax benefits to employees. As importantly, the tax benefits and government services provided under this tax go to workers and their families. As such, overseas purchasers accrue benefits from these services and should therefore participate in their funding.

If the NBRT is enacted in this way, the United States should seek modification to our trade agreements to require that similar expenditures not be funded with taxes that are zero rated at the border. As foreign consumers benefit from subsidies for American families, American consumers benefit from services provided to overseas workers and their families. This benefit should be recognized in international tax and trade policy and American workers should not be penalized when other nations refuse to distribute the cost of benefits to foreign workers to the American consumers who receive the benefit of these services. If our trading partners do not match this initiative, some items of spending could be shifted from NBRT funding to VAT funding, so that we are not making unilateral concessions in this area.

The VAT would replace income taxes collected at the lowest rate, while the NBRT would replace disability insurance, hospital insurance, the corporate income tax, business income taxation through the personal income tax and the mid range of personal income tax collection, effectively lowering personal income taxes by 25% in most brackets. Note that collection of this tax would lead to a reduction of gross wages, but not necessarily net wages – although larger families would receive a large wage bump, while wealthier families and childless families would likely receive a somewhat lower net wage due to loss of some tax subsidies and because reductions in income to make up for an increased tax benefit for families will likely be skewed to higher incomes. For this reason, a higher minimum wage is necessary so that lower wage workers are compensated with more than just their child tax benefits.

The NBRT rate is projected to be 27% before offsets for the Child Tax Credit and Health Insurance Exclusion, or 33% after the exclusions are included. This is a "balanced budget" rate. It could be set lower if the spending categories funded receive a supplement from income taxes.

Part Three is the continuation of a payroll tax for Old Age and Survivors Insurance (although insurance for survivors under age 60 may be shifted to the NBRT). Given the across the board decrease in gross income, the tax rate would have to be increased to 6.5% for employees and employers (provided younger survivors are excluded). To improve program progressivity, the employer contribution could be credited on an equal basis, moving redistributive effects from benefit distribution to revenue collection. Additionally, the amount subject to tax should be increased or the income cap eliminated, which would help both program income and support for lower income retirees.

Separation of this tax from the NBRT is necessary unless the employee contribution is to be totally eliminated with a uniform benefit or uniform. A separate payroll contribution is required as long as benefit levels are set according to income. If a uniform benefit is desired, then payroll taxes can be discontinued and the NBRT expanded. Employee contributions could not be zero rated at the border. If employer contributions are equalized and contributed to a public system, however, they could be incorporated into a VAT rather than an NBRT. This allows the Social Security system to benefit from foreign labor where outsourcing has occurred. Indeed, it would be an essential expansion of the tax base if globalization is to continue unabated.

The prospect of Personal Retirement Accounts can also be considered, although doing so is like holding a lightning rod in a thunderstorm. I do agree with President Obama that such accounts should not be used for speculative investments or even for unaccountable index fund investments where fund managers ignore the interests of workers. Investing such accounts in insured employee-ownership of the workplace would have an entirely different outcome, especially if voting shares occurred on an occupational basis with union representation. The impact at the international level of such employee-ownership if extended to subsidiaries and the supply chain is also potentially profound, especially in regard to transfer pricing and the international growth of the union movement. Those interested in my thoughts on this issue can contact me for more information.

Part Four is surtax on high income earners and heirs. It would replace the Inheritance or Death Tax by instead taxing only cash or in-kind distributions from inheritances but not asset transfers, with distributions remaining tax free they are the result of a sale to a qualified Employee Stock Ownership Plan.

In testimony before the Senate Budget Committee, Lawrence B. Lindsey explored the possibility of including high income taxation as a component of a Net Business Receipts Tax. The tax form could have a line on it to report income to highly paid employees and investors and pay a surtax on that income. We considered and rejected a similar option in a plan submitted to President Bush's Tax Reform Task Force, largely because you could not guarantee that the right people pay taxes. If only large dividend payments are reported, then diversified investment income might be under-taxed, as would employment income from individuals with high investment income. Under collection could, of course, be overcome by forcing high income individuals to disclose their income to their employers and investment sources – however this may make some inheritors unemployable if the employer is in charge of paying a higher tax rate. For the sake of privacy, it is preferable to leave filing responsibilities with high income individuals.

This surtax could have few rates or many rates, although I suspect as rates go up, taxpayers of more modest means would prefer a more graduated rate structure. The need for some form of surtax at all is necessary both to preserve the progressivity of the system overall, especially if permanent tax law enacted before 2001 is considered the baseline (which it should be) and to take into account the fact that at the higher levels, income is less likely to be spent so that higher tax rates are necessary to ensure progressivity.

This tax would fund net interest on the debt, repayment of the Social Security Trust fund, any other debt reduction and overseas civilian, military, naval and marine activities, most especially international conflicts, which would otherwise require borrowing to fund. It would also fund transfers to discretionary and entitlement spending funds when tax revenue loss is due to economic recession or depression, as is currently the case. Unlike the other parts of the system, this fund would allow the running of deficits.

Explicitly identifying this tax with net interest payments highlights the need to raise these taxes as a means of dealing with our long term indebtedness, especially in regard to debt held by other nations. While consumers have benefited from the outsourcing of American jobs, it is ultimately high income investors which have reaped the lion's share of rewards. The loss of American jobs has led to the need for foreign borrowing to offset our trade deficit. Without the tax cuts for the wealthiest Americans, such outsourcing would not have been possible. Indeed, there would have been any incentive to break unions and bargain down wages if income taxes were still at pre-1981 or pre-1961 levels. The middle class would have shared more fully in the gains from technical productivity and the artificial productivity of exploiting foreign labor would not have occurred at all. Increasing taxes will ultimately provide less of an incentive to outsource American jobs and will lead to lower interest costs overall. Additionally, as foreign labor markets mature, foreign workers will demand more of their own productive product as consumers, so depending on globalization for funding the deficit is not wise in the long term.

Identifying deficit reduction with this tax recognizes that attempting to reduce the debt through either higher taxes on or lower benefits to lower income individuals will have a contracting effect on consumer spending, but no such effect when progressive income taxes are used. Indeed, if progressive income taxes lead to debt reduction and lower interest costs, economic growth will occur as a consequence.

Using this tax to fund deficit reduction explicitly shows which economic strata owe the national debt. Only income taxes have the ability to back the national debt with any efficiency. Payroll taxes are designed to create obligation rather than being useful for discharging them. Other taxes are transaction based or obligations to fictitious individuals. Only the personal income tax burden is potentially allocable and only taxes on dividends, capital gains and inheritance are unavoidable in the long run because the income is unavoidable, unlike income from wages.

Even without progressive rate structures, using an income tax to pay the national debt firmly shows that attempts to cut income taxes on the wealthiest taxpayers do not burden the next generation at large. Instead, they burden only those children who will have the ability to pay high income taxes. In an increasingly stratified society, this means that those who demand tax cuts for the wealthy are burdening the children of the top 20% of earners, as well as their children, with the obligation to repay these cuts. That realization should have a healthy impact on the debate on raising income taxes.

Contact Sheet

Michael Bindner
Center for Fiscal Equity
4 Canterbury Square, Suite 302
Alexandria, Virginia 22304
571-334-6507
iowafiscalequity@verizon.net