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Not Too Shabby: Trump Tax Plan

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Donald Trump is nothing if not bold, and on tax reform that trait is laudable because the tax code is such a damaging mess. The administration has released proposals to guide the Republican tax reform push.

The proposals are mainly "supply side" in nature, meaning cuts designed to increase economic growth and raise family incomes. The plan, however, includes a few misguided parts.

The main thrust of Trump's plan is business tax reform. He would cut the corporate tax rate from 35 percent to 15 percent, which would have a huge and positive effect on the U.S. economy. It would encourage more capital investment and hiring, and it would reduce the incentive for corporations to avoid and evade taxes. As such, the rate cut would cause the income tax base to expand over time, thus offsetting revenue losses to the government.

Another key feature of the Trump plan is switching from a worldwide to a territorial system for corporations, meaning foreign subsidiaries would not be taxed on their business income earned abroad. That reform would encourage multinationals to move their headquarters to the United States. The administration has proposed substantial reforms to individual income taxes. The plan would reduce the number of tax brackets from the current seven to just three — rates of 10, 25 and 35 percent. That would simplify the tax code and reduce distortions. The plan would also repeal the special 3.8-percent investment tax that was imposed under Obamacare.

The Trump plan would eliminate some itemized deductions, such as the state-local tax deduction, which would simplify tax filing and create greater equity between taxpayers. It would also end the alternative minimum tax and the estate tax.

Trump's proposals lack detail so far, but people are concerned about the impact on deficits if revenues are cut too much. For the corporate portion of the Trump plan, policymakers should put their deficit concerns aside. As the corporate tax rate fell, the tax base would expand as investment increased and avoidance dropped.

We have real-world experience with recent corporate tax cuts in Canada and Britain. The former slashed its federal corporate rate from 29 percent to 15 percent, while the latter slashed it from 30 percent to 20 percent. In both countries, corporate tax revenues as a share of gross domestic product are roughly unchanged. The governments appear to have lost little if any revenue.

However, the dynamic effects of individual tax cuts are not as strong as with corporate cuts, so policymakers should be concerned about the deficit effects. Optimally, Trump and Congress should offset the estimated budget impact of reduced individual tax rates with both spending cuts and eliminations of tax deductions and credits.

All in all, the Trump proposals push tax reform in a good direction.

Republicans have an opportunity this year to pass reforms that would generate large gains in income and opportunity for every American family. They should seize it.

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