NATIONAL REVIEW

Tax Reform: Don’t Forget Personal Savings

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May 4, 2017

President Trump’s tax plan released last week reaffirmed his goal of slashing tax rates on businesses. The plan also proposed overhauling individual income taxes by simplifying the rate structure, increasing the standard deduction, and eliminating breaks such as the state and local tax deduction.

What was missing from the Trump plan were reforms to the tax treatment of personal savings. The plan would repeal the 3.8 percent investment tax imposed by Obamacare, but it was silent on the underlying dividend and capital-gains tax rates.

Meanwhile, the House Republican leadership plan would reform taxes on personal savings in two ways. First, it would drop the top dividend and capital-gains tax rates to 16.5 percent from the current 20 percent (23.8 percent when including the Obamacare investment tax). Second, it suggests adopting legislation by Senator Jeff Flake (R., Ariz.) and Representative Dave Brat (R., Va.) to create Universal Savings Accounts — USAs.

USAs would be like supercharged Roth Individual Retirement Accounts (IRAs). Individuals could contribute up to $5,500 a year in after-tax income into the accounts, and then the earnings would grow, free of any taxes on interest, dividends, or capital gains. At any time for any reason, people could withdraw money from the accounts without paying taxes or penalties, which would make the accounts simple, flexible, and liquid.

Such all-purpose savings accounts have been road-tested in Britain and Canada, as we discuss in a new Cato Institute study. British Individual Savings Accounts (ISAs) and Canadian Tax-Free Savings Accounts (TSFAs) are popular with people at all income levels and all age groups. The accounts encourage people to save as much as they can, knowing that they will have easy access to the funds if needed.

About 20 percent of Americans own Roth IRAs, but 43 percent of the British hold ISAs and 54 percent of Canadians own TFSAs. Also, while one-quarter of Roth IRA holders contribute to their accounts each year, more than half of the British and Canadian account holders do so.

Why the big difference? Roth IRAs and other U.S. savings vehicles — such as Education Savings Accounts (ESAs) — are for single purposes and have many rules on withdrawals. By contrast, USA-style accounts have no rules on withdrawals and can be used for all saving purposes. The high ownership and contribution rates of TFSAs and ISAs show that these factors make a difference.

Our tax code double-taxes saving in general but then gives targeted relief to certain types of saving. Universal savings accounts are the solution to these distortions.

The goal for U.S. tax reform should be to create equal treatment for different economic choices, including the choice between consumption and saving, and between different types of saving. Our tax code double-taxes saving in general but then gives targeted relief to certain types of saving. USAs are the solution to these distortions: They would end double-taxation for all types of saving.

People of all ages would use USAs. A Federal Reserve survey found that “retirement” is the primary reason people say they are saving only after the age of 40. Younger people have other savings needs that USAs would fulfill, such as saving to buy an automobile or start a business. The British and Canadian accounts enjoy high contribution rates by young people.

ISAs and TFSAs also have broad usage across income levels, including people with moderate incomes. Whereas just 7 percent of U.S. households with incomes of less than $50,000 have Roth IRAs, 55 percent of British ISA holders have incomes of less than $25,000, and 55 percent of Canadian TSFA holders have incomes of less than $37,500.

In fleshing out its tax plan, the Trump administration should start with the Flake-Brat legislation but go bigger by lifting the annual contribution cap to $10,000 or more. Such large accounts would cover all the non-retirement savings that most families need. The annual contribution cap on the successful British ISAs is 20,000 pounds, or about $25,000.

What about the politics of USAs? One thing we know is that the base of support would be very broad — a wide range of people would use USAs to meet a diversity of savings needs.

The tax, simplification, and liquidity benefits of ISAs and TFSAs have revolutionized personal savings in Britain and Canada. We think USAs would do the same in the USA.

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