

## Obama's Treasure Hunt

By Chris Edwards

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One news headline announcing the Obama administration's tax reform task force got it exactly right: "Obama Tax Panel on Treasure Hunt."<sup>1</sup> The task force, which is to report its findings by December, does not appear to be a serious effort at tax reform. Instead it seems to be another administration initiative to hold Americans upside down by the ankles and shake them.

A presidential "tax reform" effort reminds one of the bipartisan Tax Reform Act of 1986, which eliminated loopholes and dramatically cut tax rates. Could the Obama task force lead to similar major reforms? Very doubtful. While the task force has some talented members, the Democrats have moved so far to the left that there are few centrists around these days to broker a compromise deal with the Republicans, as occurred in 1986.

Consider that President Obama has been actively working against all four major themes of 1986: marginal rate cuts, tax base reform to increase neutrality and horizontal equity, distributional neutrality, and revenue neutrality.

Rather than cutting marginal tax rates, Obama plans to increase effective marginal rates at the top end in a variety of ways. Rather than reforming the tax base, Obama has proposed creating numerous special breaks, such as a new tax credit for college expenses.

Regarding the distribution of tax payments, Obama is raising taxes on households at the top while providing refundable giveaways to households at the bottom, such as the Making Work Pay tax credit and expansions in the child and earned

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<sup>1</sup>Jeanne Sahadi, "Obama Tax Panel on Treasure Hunt," CNNMoney.com, Mar. 27, 2009.

income tax credits. But the top fifth of households already pay an effective federal tax rate of 26 percent, while the bottom fifth pay just 4 percent, on average.<sup>2</sup> The tax code is already far too graduated, and Obama is exacerbating this inequity.

The fourth theme of 1986, revenue neutrality, is of no interest to the Obama administration. When announcing the new task force, the administration reiterated its promise not to raise taxes on families with incomes of less than \$250,000. But the president already broke that promise with a cigarette tax increase in February, and his cap-and-trade energy plan is effectively a large tax increase on all families. Healthcare reform might also include a significant tax increase on average families. Thus, it wouldn't be surprising if the Obama tax task force also morphed into a drive to raise taxes on the middle class.

Another issue is that the three stated goals of the task force — simplifying the tax code, closing loopholes, and reducing tax evasion — are in direct conflict with current Obama policies. Many of Obama's tax plans would further complicate the tax code, including his proposed tax credits and tax increases on multinational corporations. As for tax loopholes, Obama favors adding more special tax breaks in numerous areas such as alternative energy.

What about the task force's goal of reducing evasion? Obama's efforts to raise tax rates on individual income, dividends, and capital gains will increase incentives for evasion. And his plan to increase corporate taxes will likely erode the U.S. tax base as business activity moves offshore. Microsoft Corp., for example, has already said it will move jobs abroad if the Obama plan goes through.

All that said, the task force's goal of cutting "corporate welfare" is a good one.<sup>3</sup> It could, for example, propose eliminating the low-income housing tax credit (LIHTC), which is a

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<sup>2</sup>Congressional Budget Office, "Data on the Distribution of Federal Taxes and Household Income," Apr. 2009. These data include income taxes, payroll taxes, and excise taxes.

<sup>3</sup>Jeff Mason, "Volcker Panel to Study Tax Reform, Report to Obama," Reuters, Mar. 25, 2009.

\$5-billion-a-year giveaway to real estate developers.<sup>4</sup> Even better, it could propose cutting the \$90 billion of corporate welfare on the spending side of the federal budget.<sup>5</sup>

However, eliminating codified giveaways such as the LIHTC is a different matter than the general issue of growing business tax avoidance in the global economy. The Obama effort to impose even more tax rules and regulations on corporations is a dead end. We've been going down that road for more than two decades, and the only result is a highly complex and uncompetitive corporate tax code.

A much better way to deal with corporate tax avoidance and evasion is to cut statutory tax rates, as just about every other major nation has figured out.<sup>6</sup> Recent reforms in Canada's industrial heartland of Ontario, for example, cut the combined federal-provincial corporate tax rate to just 25 percent — 15 points lower than the average U.S. federal-state rate. Ontario's marginal effective tax rate on business investment is being cut in half.<sup>7</sup> Why did Ontario make those changes? To improve tax competitiveness, to generate economic growth, and to increase productivity, according to the government.<sup>8</sup>

While Canada is making fundamental reforms, Obama's task force is on a wild-goose chase to "aggressively" close the \$290 billion federal tax gap.<sup>9</sup> That won't do anything for American competitiveness, and it seems like a total waste of time given that U.S. tax compliance is already at a high level of about 86 percent.<sup>10</sup> That rate is higher than the U.S. compliance rate with seat belt laws, and it appears to be a higher tax compliance rate than in most other countries.<sup>11</sup>

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<sup>4</sup>Edward L. Glaeser and Joseph Gyourko, *Rethinking Federal Housing Policy* (Washington: American Enterprise Institute, 2008), pp. 112-114.

<sup>5</sup>See <http://www.downsizinggovernment.org/special-interest-spending>.

<sup>6</sup>For a discussion, see Chris Edwards and Daniel J. Mitchell, *Global Tax Revolution* (Washington: Cato Institute, 2008).

<sup>7</sup>See <http://www.rev.gov.on.ca/english/notices/str/01.html>.

<sup>8</sup>*Id.*

<sup>9</sup>Sahadi, *supra* note 1.

<sup>10</sup>Government Accountability Office, "Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap," GAO-07-391T, Jan. 23, 2007.

<sup>11</sup>The U.S. seat belt law compliance rate is 81 percent. See National Highway Traffic Safety Administration, "Seat Belt Use in 2006: Overall Results," Nov. 2006. For

The tax gap is not a primary problem — it is a side effect of our grossly complex tax law and high tax rates. The Government Accountability Office has noted that the proliferation of special tax breaks increases the tax gap by providing return filers more chances to claim unjustified benefits.<sup>12</sup> For example, about one-third of EITC payments are fraudulent or erroneous.<sup>13</sup> Politicians complain about the tax gap, but they are the ones responsible for more than doubling the number of federal tax expenditures since 1974.<sup>14</sup>

In sum, the Obama administration needs a more consistent and constructive tax policy approach. If it believes in a simplified tax code with fewer loopholes, then it should stop pushing to add new tax credits. If it favors reduced corporate tax avoidance, it should propose a reduction in the statutory tax rate.

Most importantly, the Obama administration should rethink its devotion to tax increases as the solution to seemingly every policy issue. Tax increases make no sense in the competitive global economy, and they imply that there are no savings left to be made on the spending side of the federal budget. But after years of studying federal spending programs, I am confident that that is not the case.<sup>15</sup> ■

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international comparisons of black markets, see Friedrich Schneider and Dominik Enste, "Shadow Economies Around the World: Size, Causes, and Consequences," IMF, Working Paper 00/26, Feb. 2000; and Friedrich Schneider, "Shadow Economies of 145 Countries All Over the World: What Do We Really Know?" Aug. 2006.

<sup>12</sup>GAO, *supra* note 10.

<sup>13</sup>GAO, "Federal Budget: Opportunities for Oversight and Improved Use of Taxpayer Funds," GAO-03-922T, June 18, 2003.

<sup>14</sup>GAO, *supra* note 10.

<sup>15</sup>I have begun to outline possible budget savings at <http://www.downsizinggovernment.org>.