

12:30 Fred Barbash-Moderator:

Leonard Burman is an Institute Fellow at the Urban Institute and director of the Tax Policy Center. He is an expert in public finance and modeling the effects of government policies on individuals' and firms' decisions. He has held high-level positions in both the executive and legislative branches, serving as Deputy Assistant Secretary for Tax Analysis at the Treasury from 1998 to 2000, and as Senior Analyst at the Congressional Budget Office. Dr. Burman is also a Visiting Professor at Georgetown University's Public Policy Institute, and had previously taught economics at George Washington University and Bates College.

Dr. Burman is the author of *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed*, and numerous articles, studies, and reports. Dr. Burman's current research is focused on the changing role of taxation in social policy, pension and retirement policy, estate taxation, the alternative minimum tax, and tax policy with respect to health insurance.

He's here to answer your questions about what's wrong with the tax system, and what we might do about it.

Welcome Len. And welcome to all of our participants. Thanks for being here today.

12:31 Len Burman:

Thanks Fred. As you know, Tax Day is our favorite holiday, although not quite as much fun as the day after tax day.

12:31 [Comment From Zachary]

I believe that increases in tax rates now or in the near future will undo much of what the president hopes to accomplish with the stimulus bill. Is there a way to increase long term tax revenue without raising individual or corporate tax rates?

12:32 Len Burman:

Zachary, that is a good point. Many skeptics of economic stimulus think that future tax increases or spending cuts will undo much of the effect of the stimulus. I think that's probably not true.

12:33 Len Burman:

However, it is true that our long-term fiscal situation is pretty dire and tax increases will definitely be in our future.

12:33 [Comment From Fred (Reston, VA)]

Opponents of any tax increases on the wealthiest Americans like to say that taxpayers in, say, the top 10% of the tax code pay something like 40 or 50% of all taxes. Is this true and if so why does it matter? Don't the wealthiest have a LOT MORE non-payroll income than regular working folk that they DON'T pay taxes on?

12:35 Len Burman:

High-income people do pay most of the income tax, although other taxes are more widely distributed. The top 20% pay 97% of income taxes and 80% of all federal taxes. However, they also earn 66% of income.

12:36 Len Burman:

I think that progressivity is a good thing. High income people obviously have much more ability to pay taxes than lower-income folks. Also, it should be noted that state and local taxes tend to be much more regressive (burdensome to low-income people).

12:36 [Comment From Susan]

Why is April 15 tax day? Why don't they stagger the deadlines, so that the work load evens out over the year?

12:37 Len Burman:

That is a great question. They considered March 15, but someone figured out that the Ides of March would be a bad idea.

12:38 Len Burman:

Seriously, I don't know. It would be very hard to administer a system with different filing dates.

12:38 [Comment From Guest]

I think 2 things need to happen to create a fair and equitable tax system: first, we need to simplify the tax system. Easier said than done. But secondly, we need to change the legislative process so that Congress won't insert things into the tax code, making it more complicated, to "reward" the lobbyists for special interests that keep them in office.

12:38 Len Burman:

Also, easier said than done. If you can figure out how to make lawmakers not muck up the tax code, you should receive a Nobel Prize.

12:38 [Comment From Cristina]

What are the ramifications of promising to not raise taxes on the lower 95% of Americans?

12:39 Len Burman:

Great question. This makes meaningful tax reform impossible, since you can't fix the tax system without raising taxes on some people. And it will make it virtually impossible to get the budget under control.

12:40 [Comment From Shawn]

Why do I have to pay the AMT when I'm a middle-class taxpayer? Why doesn't Congress just fix that once and for all?

12:41 Len Burman:

The AMT or alternative minimum tax is the poster child for dumb tax policy. Originally intended to hit millionaires, it now ensnares millions of upper-middle class people in a web of pointless complexity and extra taxes. Congress "patches" it every year to keep more people from being affected, but they don't enact a permanent fix because they are counting on the revenues the tax is supposed to bring in.

12:42 [Comment From George]

There's a perception that the gap between rich and poor widened substantially during the Bush Administration. Is that true? And if so, how did tax policies affect that gap?

12:43 Len Burman:

The gap did widen dramatically. By 2006, the share of income earned by the top 1% was the greatest since the eve of the great depression. The Bush tax cuts also widened the distribution of after-tax income because the tax cuts were largest (as a % of income) for the rich.

12:43 [Comment From Mary]

What do you think are the chances for tax reform in this Administration? The tax reform panel from the Bush administration made proposals, but this didn't go anywhere. Do you think the "right people" are now in place to actually make this happen?

12:45 Len Burman:

The president has asked former Fed Chairman Paul Volcker to head up a tax reform panel, but his promise to protect 95% of Americans from any tax increase almost guarantees that Volcker will fail. That is too bad because the tax system really is a mess. Also, we will need a fairer and more efficient tax code to pay the government's growing bills over time.

12:45 [Comment From Walter]

To raise additional revenue and garner support for the Administration's spending plans (particularly for education, health and energy); why not call for a VAT? The regressivity of a VAT could be offset by reducing or eliminating payroll taxes and increasing spending to benefit lower income families.

12:47 Len Burman:

A lot of people, including me, think that a VAT is in our future. The income tax simply won't be able to bring in enough to pay for government, especially if we offer health insurance to everyone and do other things Obama has promised. I like the idea of pairing a VAT with health insurance, which is what European countries do. Health insurance would more than offset the regressivity of a VAT.

12:47 [Comment From Laurie]

The debate over the estate tax is a political football. What are the facts, and what do you think good public policy should be?

12:49 Len Burman:

You're right that it's a very hot political issue. Right now the estate tax is scheduled to disappear for one year in 2010 and then return to pre-Bush levels in 2011. This has inspired many "throw momma from the train" jokes about how rich potential heirs might respond. The fact is that at current levels, very few estates (less than 0.2% of decedents) are affected.

12:50 Len Burman:

A lot of demagoguery has surrounded the issue of how it affects small businesses and family farms. The Tax Policy Center estimated that if current law is extended, as Obama proposes, 100 small businesses and farms would be affected in 2011. It is a nonexistent issue in the real world.

12:50 [Comment From Fred]

Thanks for answer to high-taxpayers question. Then, if that's true, why do conservatives wield that fact so effectively and liberals aren't very good at countering?

12:51 Len Burman:

In part, it is because Americans don't understand how the tax system works. A survey a few years ago found that most Americans thought that the rich weren't paying enough and also supported a flat tax, which would cut taxes dramatically on rich people.

12:51 [Comment From Carol]

Would a "flat tax" be fairer, subject to less cheating, and easier to file? Everyone would pay, say, 15% of their total income from all sources with no deductions.

12:55 Len Burman:

A flat tax would produce a big tax increase for middle income people. Most flat tax proposals would only tax wages at the individual level, which means that interest, dividends, and capital gains would be exempt – a huge windfall for the rich. Also, the very broad base envisioned by flat tax proponents is probably politically impossible. People like their mortgage interest, charity, and state tax deductions. That would require a higher rate.

12:55 [Comment From Eric in D.C.]

Why are tax forms so complicated, and is there any way to make them easier to use? Wouldn't easier forms make people more willing to pay their taxes and less resentful?

12:57 Len Burman:

The problem isn't so much the complicated tax forms, but the complicated tax law. The IRS could just say, report income on line 1, deductions on line 2, subtract the difference (line3), and report tax on line 4, but that would be way more complicated because you'd have to figure out what constituted legitimate income and deductions. The right answer would be to

trim many unwarranted deductions and tax credits, and make eligibility for those that remain simpler. For example, avoid phasing them out with income.

12:59 Len Burman:

And then there is the really stupid stuff like the alternate rates on capital gains and dividends (extremely complicated), the phase out of itemized deductions and personal exemptions, and the AMT. All of that stuff should be jettisoned. (Bush would have eliminated the phase outs but Obama proposes to reinstate them.)

12:59 [Comment From AMTbuff]

Did you see my proposal on TaxVoxBlog to replace the estate tax with cutting the current carry-over basis loophole in half? The basis of inherited property would be 50% of the value on the date of death unless the heir can prove a higher basis. There might be an exclusion, but far less than the estate tax's \$3.5M. What do you think of this approach?

1:01 Len Burman:

I saw the proposal. I think carry over basis is very hard to enforce. Also, it would raise much less revenue from people currently affected by the estate tax (the very rich and their heirs) and would be seen as a new burden on those with more modest means (family farms and businesses!!!). Bush proposed carryover basis, but with huge exemptions which would have made it virtually unenforceable and very complicated.

1:01 [Comment From Lawrence]

Is broadening the corporate tax a good idea? What about not taxing corporate income abroad until repatriation? Will companies leave the states?

1:02 Len Burman:

Yes. We have one of the highest corporate taxes in the developed world, but gain relatively little revenue. Broadening the base and lowering the corporate rate would be a good idea.

1:03 Len Burman:

Obama wants to limit corporations' ability to defer tax on foreign income. This is not a bad idea, but if you don't do it right, you can encourage American companies to move more of their operations overseas.

1:04 [Comment From Lawrence]

Is compliance really an issue? I read that Americans are among the most compliant in the OECD.

1:05 Len Burman:

I think it is. The IRS estimates that the "tax gap"--the difference between taxes due and what the IRS collects--is about 16% of revenues. We are more compliant than some other countries, but the government could do more to encourage voluntary compliance by making the tax system simpler and fairer (so people feel they are paying their fair share) and increasing enforcement.

1:05 [Comment From Mary]

Do you think the Earned Income Credit belongs in the tax code? Do you feel the IRS is able to effectively administer this credit? And what would happen in the event we replace the income tax with a VAT? Do you think this would be something that would be lost, or replaced with something else or perhaps administered by a different federal agency?

1:07 Len Burman:

I like the EITC. It encourages work and helps struggling families to live with some dignity. Participation is way higher than for other forms of assistance, such as Food Stamps. There is some noncompliance, in part because the rules are too complicated and in part for the same reasons people cheat on other parts of the income tax. For example, small businesses cheat a lot on the EITC.

1:09 [Comment From Bradley A. Blakeman]

Mr. Burman, in keeping with our Moderator's Arena Question of the Day, if you were God, what would you do with regard to tax reform? Income, estate, capital gains, etc. Thanks.

1:10 Len Burman:

I have proposed to enact a VAT to pay for health care for all Americans, so it would replace Medicare and Medicaid. Since the income tax would not pay for those programs, rates could be cut to 25% or less. I'd simplify the income tax enough so that most people would not have to file. I'd replace the estate tax with an inheritance tax. My paper is on our website, www.taxpolicycenter.org.

1:11 [Comment From Renee]

Many people receive income throughout the year that isn't documented with a 1099 or other type of "income tracking" mechanism. I would think this would be a motivating force for subject taxpayers to avoid reporting that income. What percentage of tax revenue do you think is forsaken each year because of this unreported income and what can be done to decrease underreporting of income?

1:12 Len Burman:

You are right that compliance is much higher when there is reporting. For example, Obama proposes that stock brokers report the purchase price of assets as well as sale price so the IRS could see what the taxable gain should be.

1:13 Len Burman:

There's a funny story about the power of reporting. In 1983, the IRS required that taxpayers report the Social Security Numbers of their children. Overnight, 6 million dependent exemptions disappeared. Some people apparently noticed for the first time that Fido was not actually human.

1:14 [Comment From Guest]

Why shouldn't all forms of income be taxed at the same progressive rates? In other words, tax income, dividends, capital gains, and others at same progressive rates?

1:16 Len Burman:

Capital gains and dividends are taxed lower rates for a couple of reasons. One it to offset the tax already collected from corporations, although I've argued that this is bad way to do that. Some think that taxing gains at lower rates encourages risk taking and entrepreneurship. These arguments are overstated (see my 1999 Brookings book, *Labyrinth of Capital Gains Tax Policy*). Also, there's probably too much, not too little risk taking as recent events show.

1:16 Len Burman:

(Which is to say I agree with you)

1:17 [Comment From Sarah]

Carol, no, it wouldn't be necessarily easier to file, it would kill those who can take deductions (families with kids and a house, for instance). Tax code isn't something you can just fix, and if we really want to talk about fixing government spending, give back the line-item budget veto Clinton had, and fix Social Security while you're at it.

1:17 [Comment From Jeffrey L Minch]

This is a wonderful mechanism for folks to have direct contact w/ experts in certain fields and I applaud Arena for making such an opportunity available. Having said that, your comment in regard to a proposed linkage between a VAT and health care funding exposes to me what is the greatest problem with our current tax system – it is a political tool to shape and, worse, to reward public policy initiatives without any regard to market influences and reality. A fair funding mechanism must be devoid of political influence.

1:17 [Comment From Frank]

Revenue aside, isn't their some way the tax forms could be easier? If smart people like potential cabinet secretaries are making mistakes, it seems impossible for people like me to figure it out.

1:18 Len Burman:

Yes. The forms could be simpler. However, there's no explanation for why Geithner couldn't figure out that he owed payroll tax.

1:18 [Comment From Dan]

Why couldn't we change from an income tax to a straight sales tax? Instead of having taxes come out of my pay couldn't we tax goods much the same way as cigarettes are taxed? Then everyone would be taxed for their consumption not their income. This would ensure that the "fair share" is paid by everyone correct?

1:21 Len Burman:

A lot of people favor a flat "national retail sales tax" or "FairTax." As my Brookings colleague Bill Gale has pointed out, it's not fair and the rates would have to be much higher than the advertised 23 percent advertised rate. It's not fair because low- and middle-income people spend all or most of their incomes while those with very high incomes spend only a fraction. Since the proposals would include a "rebate" for low-income people, that

means that middle-income people would end up paying much more. It would also produce a huge amount of noncompliance.

1:21 [Comment From Laurie]

In general, how is the financial crisis affecting tax policy? Is it tying the administration's hands? Opening new opportunities for reform? Both at the same time? How does the increasing national debt play in?

1:22 Fred Barbash-Moderator:

We've only got time for a few more questions.

1:23 Len Burman:

That is a great question. It creates both challenges and opportunities. In the short-term, obviously dealing with the crisis crowds out most other serious policy. However, when we get out of this, the president could use it as a rallying cry to motivate more serious long-term reform (because otherwise the next crisis will be much worse).

1:23 [Comment From AMTbuff]

Bradley, the God question is a great one, but you need to specify whether Len gets to be God forever or just enact a change one time. Because some changes are stable, but most are not. The political process undid half of the 1986 tax reform in fairly short order. Len, couldn't an income tax restricted to the top 5% but designed according to the wishes of 100% of voters end up harming the economy quite badly?

1:24 Len Burman:

For the record, I have no interest in being God. I've got my hands full trying to run the Tax Policy Center.

1:24 [Comment From Jane]

On another subject, would a VAT tax be practical for carbon emissions – tax the products manufactured based on the amount of carbon emitted to produce the product?

1:25 Len Burman:

Most economists think a carbon tax makes a lot of sense – taxing products based on their carbon content. It could also raise a huge amount of revenue – like \$100 billion per year – although a significant share would have to go to offsetting its effects on lower-income people.

1:25 [Comment From Sarah]

Tax forms are only truly complicated if you don't keep up with your financials. And with most people either getting programs like TurboTax or going to professionals (my family does both), the forms themselves don't really have any major problems.

1:26 [Comment From Adam in DC]

A large number of Americans use computing programs, online systems, or professional preparers for their tax forms. The producers of all of these products seem to benefit from the complication; will any of these groups pose a serious challenge to tax reform?

1:26 Fred Barbash-Moderator:

This is our final question today...

1:27 Len Burman:

Yes. They wanted my head when I was at Treasury and suggested that the government should provide software for free. But they are wrong. There should not be a lobby for tax complexity.

Thanks to everyone for the great questions.

1:28 Fred Barbash-Moderator:

Len: Thanks for answering all these questions today. I hope we'll be visiting with you before next April 15. And thanks to all of you for participating in this joint discussion here today. We'll be back again next week...and in Arena, we'll have some chat time before then.

Thanks to all.