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THE HAMILTON PROJECT RELEASES POLICY PAPERS ON REFORMS TO THE U.S. TAX SYSTEM IN TODAY'S GLOBAL ECONOMY

Former U.S. Treasury Secretaries Lawrence H. Summers and Robert E. Rubin Featured at Event

WASHINGTON, DC –The Hamilton Project, an initiative at the Brookings Institution, hosted a forum today entitled "Reforming Taxation in the Global Age," at the Georgetown Law Center in Washington, D.C. During the forum, the Hamilton Project released a new strategy paper and three new discussion papers examining the need to modernize and reform the U.S. tax code to reduce inequality, expand opportunity and respond to the realities of a global economy.

Government, business and policy leaders also convened a panel discussion on ways to improve the U.S. tax system, with participants including former U.S. Treasury Secretaries and Hamilton Project Advisory Council members Lawrence H. Summers and Robert E. Rubin; Brookings Vice President and Tax Policy Center Co-Director William G. Gale; Hamilton Project Director Jason Furman; Deputy Staff Director and Chief Tax Counsel for the Senate Committee on Finance (minority staff) Mark Prater; Harvard Business School Professor Mihir Desai; and former Assistant Treasury Secretaries for Tax Policy Pamela Olson and Jonathan Talisman.

Summers opened the forum by highlighting a new strategy paper he co-authored, along with Jason Furman and Hamilton Project Policy Director Jason Bordoff, on "Achieving Progressive Tax Reform in an Increasingly Global Economy." The paper highlights the enormity of the increase in inequality: in total \$664 billion has been shifted from the bottom 80 percent of households to the top one percent of households. At the same time, the tax system has become *less* progressive—since 1960 the average tax rate for the top 0.1 percent of households has been cut nearly in half while rising slightly for middle-income families

Summers noted that the erosion of progressivity in the tax code is the result of a combination of deliberate policy choices (like the 2001 and 2003 tax cuts) and the failure to reform the tax code to keep up with rapid changes associated with globalization and the increasingly sophisticated financial system. In particular, Summers highlighted the growing ease with which corporations have leveraged these factors to avoid paying taxes, thus contributing to the income gains for the wealthiest Americans.

"The increase in inequality has shifted \$664 billion from middle-class families to the most fortunate – the equivalent of taking away \$7,000 from each household in the bottom 80 percent. Rather than trying to offset part of this income shift, the tax code has become less progressive thus exacerbating these challenges," noted Summers. "This inequality, in turn, undermines political support for a competitive market economy, which contributes to economic growth. By making our tax system more progressive, we can help everyone share in the tremendous benefits generated by the economy while creating the political and economic conditions for sustained growth."

With recent tax cuts set to expire in 2010, policymakers are beginning to weigh various approaches to tax reform, which range from large scale reforms like the Tax Reform Act of 1986 to piecemeal changes to the tax code. In a new strategy paper that anticipates these reforms, the Hamilton Project outlines six broad principles that should guide progressive tax reform in today's global economy: 1) Fiscal responsibility requires addressing both taxes and spending; 2) rising inequality strengthens the case for progressivity; 3) the tax system should collect the taxes that are owed; 4) tax reform should strengthen taxation at the business level; 5) taxes for individuals should be simplified; and 6) social policy can and should often be done through the tax code – and it must be well-designed.

An important part of the progressive tax system is a robust tax on large bequests and gifts. The United States currently taxes large wealth transfers through the estate and gift tax, yet the estate tax was significantly reduced (and temporarily repealed) in the latest round of tax cuts. A Hamilton Project discussion paper by New York University Law School Professor Lily Batchelder argues that an inheritance tax offers a more streamlined and progressive approach. She proposes that heirs who receive more than $2.3 million should pay income taxes plus a 15 percent surcharge on any income they inherit above that amount. Batchelder argues that this new system would raise revenues equal to that of the current estate tax (which is set for temporary repeal in 2009) and offers a simplified approach that reduces the number of heirs burdened by the tax while better encouraging broad sharing of wealth and break up of dynastic fortunes.

Another area in need of broad reform is corporate taxation of multinational firms. As U.S. firms have become increasingly global, the treatment of foreign income has become a major source of tax avoidance. While the U.S. has the second highest statutory corporate tax rate among OECD countries, it has the fourth lowest corporate tax revenue as a share of GDP. Some suggest that increased sheltering activity and other disparities in income reporting are to blame. For example, the Netherlands, Ireland and Bermuda were the top three source countries of overseas profits reported by U.S. multinational corporations. Not coincidentally, these countries have effective corporate tax rates of 5.3 percent, 6.1 percent and 1.7 percent, respectively – compared to 26.3 percent in the United States.

A Hamilton Project discussion paper by Kimberly Clausing of Reed College and Reuven Avi-Yonah of the University of Michigan Law School argues that this allocation of profits reflects tax planning, not genuine economic activity, as evidenced by the fact that none of these three countries is among the top ten locations of U.S. multinational jobs. They propose that, instead of geographically sourcing corporate profits, the United States should tax the income of multinational corporations based on the share of total business activity in each country—the same "formulary apportionment" system currently used by states for corporate tax purposes. The authors argue that formulary apportionment is better suited to today's integrated global economy, simpler to administer, will reduce incentives for firms to make business decisions based on tax avoidance strategies, and will result in either lower corporate tax rates or increased tax revenues.

An alternative approach is comprehensive business tax reform, as developed in a Hamilton Project discussion paper by Edward Kleinbard, a leading tax expert at Cleary, Gottlieb, Steen and Hamilton LLP. His proposed Business Enterprise Income Tax (BEIT) attempts to tax all forms of capital income in a uniform manner by proposing a form of corporate integration that would allow businesses to deduct the cost of capital at the enterprise level and require individuals to pay taxes on the accrued normal returns of all their capital investments. The result, Kleinbard argues, would be to simplify the tax system, eliminate opportunities for tax shelters that exploit the various tax rules governing different assets, and perhaps most importantly harmonize the tax rates on different forms of business, sources of financing, and types of investment. In summary, the Kleinbard proposal would solve a major problem associated with our current tax system – which is the differential tax rates on different forms of capital income – without resorting to a consumption tax that sets all tax rates at zero.

Members of the expert panel summarized the discussion by noting that the goal of any tax reform measures should include progress toward reducing the nation's large fiscal gap, making the tax system more progressive, and helping to offset some of the increase in inequality in recent decades. A common thread throughout much of the discussion focused on finding tax reform measures that address inequality while also creating positive incentives for robust and socially responsible economic policies.

"Any attempt to restore fiscal balance will have to address both revenues and spending," noted former Treasury Secretary, Robert E. Rubin. "One challenge is to strike the right balance so that restoring fiscal balance is joined with public investment in areas critical to economic growth, broad participation in that growth and economic security for American workers and families."

"The tax code can be an effective tool in promoting social policy if applied wisely," noted Jason Furman, director of the Hamilton Project. "It can also have a negative impact if not used appropriately, such as in the case of taxes on health insurance which can raise health spending without providing help for many of the uninsured to get coverage. The bottom line: by making the tax system more progressive and making the tax code more fair and efficient, we can have a positive impact on a range of social priorities, from improving health insurance to expanding access to college."

About The Hamilton Project (www.hamiltonproject.org)
The Hamilton Project, named after the nation's first Treasury Secretary, Alexander Hamilton, seeks to advance America's promise of opportunity, prosperity, and growth. The project's economic strategy reflects a judgment that long-term prosperity is best achieved by making economic growth broad-based, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments. Our strategy —strikingly different from the theories driving economic policy in recent years— calls for fiscal discipline and for increased public investment in key growth-enhancing areas. The project will put forward innovative policy ideas from leading economic thinkers throughout the United States—ideas based on experience and evidence, not ideology and doctrine—to introduce new, sometimes controversial, policy options into the national debate with the goal of improving our country's economic policy.

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Media Notes: Any reporters wishing to interview representatives from The Hamilton Project, please contact Jennifer Devlin at 703-876-1714 or Jennifer.devlin@cox.net. Copies and/or summaries of the papers referenced here can be found on the web at www.hamiltonproject.org.