

July 31, 2006

**TO:** Interested Parties**FROM:** Anne Kim, Director of The Middle Class Project**SUBJECT:** Tax Reform and Economic Growth

Properly handled, we think that the tax issue can be a potent issue for progressive candidates. This memo includes messaging and policy ideas for progressives on taxes, including ways to talk about taxes if you believe that some ought to be increased.

Conservatives are certain to attack progressives as “tax and spenders.” Their main message for the past 30 years is that “fill-in-the-blank thinks the government does a better job of spending your money than you do.” You should expect your conservative opponent to brand you with this whether you support some kind of tax increase (including a repeal of the Bush tax cuts for the wealthy, for example) or not.

Because of this inevitability, we believe progressives should have a strategy for playing offense on issues of taxation and the economy as a whole. Your goal should be to frame the debate as one of competing tax plans, and this strategy should include the following elements:

- A **tax plan** that lays out your agenda to create a new era of middle-class opportunity and economic growth;
- A set of simple **contrasts** between whom your plan benefits and whom the conservative plan benefits; and
- A simple **critique** of the economic philosophy behind their plan and a compelling explanation of the economic philosophy behind your plan.

## I. The Plan

First, progressives should anchor their proposals on a solid set of foundational goals that should be made explicit. We propose the following four principles:

- To create middle-class opportunity
- To grow the economy
- To help small business
- To make the tax code simple and fair

Second, progressives should embrace a plan that substantially reduces taxes for the middle class. Following are some ideas (and please feel free to contact us for details on any of these):

## **Creating a new era of middle-class opportunity—tax cuts to help families meet their aspirations and overcome hurdles:**

- Paying for college
  - Create a broad-based college tuition tax break for all Americans by providing a deduction of up to \$10,000 for college tuition, or a credit of up to \$3,000.  
*Cost: Approximately \$3.3 billion per year<sup>1</sup> in incremental costs.*
- Balancing work and family:
  - Double the middle-class tax break for child care costs.  
*Cost: \$412 million a year to roughly double the Dependent Care Credit.*
  - Create a “new baby tax credit” to help young families with the costs of having a newborn at home.  
*Cost: \$6 billion a year for a \$1,000 credit for each of the first three years of a child’s life.*
- Buying a first home:
  - Create a \$1,500 first-time homebuyer credit.  
*Cost: Approximately \$3.6 billion.<sup>2</sup>*
- Caring for aging parents:
  - Expand the Dependent Care Credit to include caregiving expenses paid on behalf of an elderly parent.<sup>3</sup>  
*Cost: Approximately \$1.75 billion.<sup>4</sup>*

## **Growing the economy and helping small business:**

- Renew the R&D tax credit. [S. 41]  
*Cost: \$10 billion a year.*
- Appoint a commission on corporate tax reform to help modernize the corporate tax code and make America more attractive for global business investment and job growth.  
*Cost: Marginal.*

## **Promoting tax simplicity and fairness:**

- Eliminate rifle-shot tax breaks; make it a goal of Congress to shrink the size of the tax code by half in the next five years (60,000 pages to 30,000 pages).  
*Savings: This proposal could raise billions of dollars in revenue; for example, candidates can decide to choose a savings target—such as \$10 billion a year—for closing loopholes.*

There are differing views on whether tax cuts should be paid for. Conservatives don't consider tax expenditures to be "spending" (hence their opposition to applying PAYGO to tax cuts), and they haven't paid for tax cuts in six years. Moreover, their message on fiscal responsibility is wholly separate from their messaging on tax cuts.

The proposals above lay out approximately \$250 billion in tax cuts over 10 years, which are partially offset by the proposal to close loopholes for corporate rifle shots (\$100 billion). For candidates seeking additional sources of offsets, our appendix provides background information on Senator Kerry's proposal to repeal tax cuts for high-income households. This proposal would save \$611 billion over ten years, which provides ample room for the proposals above, plus AMT reform and other initiatives (see the Appendix for more details).

## II. The Contrast

Candidates should explicitly state the contrast between what their middle class tax cut plan does and what the conservative plan does.

- In the latest Republican tax bill, for every \$1 that went to the middle-class, \$111 went to the very wealthy. Every dollar of my \$250 billion tax cut goes to middle class families. [Brookings-Urban Tax Policy Center; Third Way]<sup>5</sup>
- Since taking control of Congress, Republicans have added 20,000 pages to the tax code. I want to cut the tax code in half by eliminating the pay-to-play special interest tax breaks that make the tax code unfair to anyone without a Washington lobbyist [Cato Institute]<sup>6</sup>

## III. The Critique

Progressive candidates must define conservatives by discrediting their economic worldview in a way that is both accurate and resonant to the middle-class. Moreover, progressive candidates must define their own economic worldview in a way that is both accurate and appealing to the middle class.

For example:

- 1. Conservatives believe the engine of the economy is the very wealthy; progressives believe the engine of the economy is the middle class.**

*Conservatives believe the wealthy are the engine of the economy. That's why they rewrote estate tax laws to help only those with millions of dollars. I believe the middle class is the engine of the economy and that is why my plan makes college tuition tax deductible for everyone.*

- 2. Conservatives believe deficits don't matter; progressives believe they hurt the economy and the middle class.**

*Conservatives believe that deficits don't matter and that is why America's national debt under George Bush grew by \$2.5 trillion. I believe deficits are*

*harmful to America, especially when we borrow from countries like China to finance our debt. That's why I believe new spending must be paid for and my opponent does not. [International Monetary Fund]<sup>7</sup>*

**3. Conservatives place absolute faith in corporations to do what is best for America; progressives believe that government and business must work together to meet America's interests.**

*Conservatives believe that we should trust corporations to look out for America's best interests. That is why instead of an energy policy, my opponent gave tax breaks to the oil industry. He thinks his plan is working and I think \$3 gasoline is harmful to our economy and the middle class.*

## **IV. Conclusion**

There is no doubt that your conservative opponent will seek to define you as a tax and spender. This has been in their playbook for 35 years. You must make this a debate about competing tax cut plans. Remember, if you only fight to a draw—you win. But to win, you must play offense.

*That's right, Buck Bickerson and Mitzi Chase each have tax cut plans.*

*The Bickerson plan will help wealthy families send their children to Europe in the summer. The Chase plan will help middle class families send their children to college in the fall.*

*It's your choice.*

*The Chase Plan—better for Colorado, better for America, better for you.*

## Endnotes

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<sup>1</sup> Existing tax breaks—the Hope Credit, the Lifetime Learning Credit, and the current \$4,000 tuition tax deduction—cost approximately \$7.1 billion a year. The cost estimate provided above is Third Way’s estimate of the incremental cost of consolidating and expanding these benefits. Therefore, the total cost of the proposed benefit would be \$10.4 billion a year.

<sup>2</sup> The National Association of Realtors estimates that about 40% of all homebuyers—or 3.2 million homebuyers annually—are buying their first home. This cost estimate assumes that all first-time homebuyers take full advantage of the credit. We also assume that the credit begins to phase out at \$75,000 in household income.

<sup>3</sup> Current law only allows the Dependent Care Credit to apply to qualified child care expenses incurred on behalf of a dependent under 13 years old.

<sup>4</sup> Third Way estimate.

<sup>5</sup> Based on estimates derived by the Tax Policy Center at the Brookings Institute combined with data from the IRS on the number of taxpayers within certain income brackets.

<sup>6</sup> *Ibid.*

<sup>7</sup> International Monetary Fund, World Economic Outlook Database, September 2005.

## Appendix

### Revenue Estimates/Costs of Miscellaneous Tax Proposals

#### Alternative Minimum Tax (AMT) reform

- By 2010, the AMT will affect about one-third of all taxpayers, and 52% of taxpayers liable under the AMT will be households making less than \$100,000 a year. [Urban Institute]<sup>1</sup>
- Cost of repeal:
  - Permanent repeal: Approximately \$1 trillion over ten years. [Urban Institute]<sup>2</sup>
  - One-year temporary fix (2005): Approximately \$34 billion. [Tax Policy Center]<sup>3</sup>
  - By 2008, it will cost more to repeal the AMT than to repeal the regular income tax and leave the AMT in place. [Urban Institute]<sup>4</sup>

#### Foreign Corporation/Expatriate Corporation Tax Proposals

- Corporate Patriot Enforcement Act. [HR 3959] [S.384 (108<sup>th</sup> Congress)] This proposal would prevent companies from reincorporating in foreign countries such as Bermuda to avoid U.S. income taxes on their profits.
  - Estimated savings: Sponsors of the bill say this proposal would save \$4 billion over 10 years.<sup>5</sup>
- Ending Abuses of the Foreign Tax Credit. In 2004, the Administration proposed changes to the Foreign Tax Credit to prevent taxpayers from improperly using the credit to avoid U.S. tax liability.<sup>6</sup>
  - Estimated savings: Treasury estimates that this measure would save \$1.1 billion per year.

#### Repeal of individual income tax cuts for households with over \$200,000 in annual income

- During the 2004 presidential campaign, Sen. Kerry proposed to repeal President Bush's tax cuts for taxpayers with household incomes over \$200,000. The information below comes from estimates prepared by the Urban-Brookings Tax Policy Center:
  - Estimated total savings, 2005-2014 (assuming the extension of the Bush tax cuts, as proposed by the Administration): \$611 billion<sup>7</sup>

- Specifics of Kerry proposal to repeal tax cuts for high-income households:
  - » Increase top two marginal tax rates to 36 and 39.6 percent (the current thresholds for the top brackets are \$336,550 and \$188,450 for married taxpayers filing jointly) [Internal Revenue Service].<sup>8</sup> This option alone would raise \$189 billion over ten years [Tax Policy Center]<sup>9</sup> ;
  - » Increase tax rate on capital gains to 20 percent for taxpayers in the top two tax brackets; increase tax rate on dividends to 36 percent and 39.6 percent for taxpayers in the top two tax brackets;
  - » Eliminate the repeal of the limitation on itemized deductions (Pease) and the personal exemption phaseout (PEP).
- Approximately 3.5% of U.S. households have incomes between \$200,000 and \$1 million.[Center on Budget and Policy Priorities]<sup>10</sup>

### Estate tax

- The Urban-Brookings Tax Policy Center also has available a variety of estimates on the revenue effects of different options relating to estate tax repeal and reform. The recent House-passed bill, HR 5638, is estimated to cost either \$229.4 billion or \$246.1 billion over ten years, depending on whether the capital gains rate returns to 20 percent after 2010 or the 15 percent capital gains rate is made permanent.<sup>11</sup> Under current law (i.e. without an extension), the estate tax is expected to raise \$354.7 billion from 2007-2016.

### Payroll tax relief

- General. The two largest components of the payroll tax are taxes for Social Security (OASDI) and for Medicare (HI).
  - Current tax rates (employer and employee share combined):<sup>12</sup>
    - » OASDI: 12.4%
    - » HI: 2.9%
  - Current maximum taxable earnings (2006):
    - » OASDI: \$94,200
    - » HI: No limit.
- Revenues. Revenues from the OASDI and HI taxes are estimated to total \$765 billion in 2006.<sup>13</sup>

- Distribution of burden. 62% of the payroll tax is paid by workers in households earning less than \$100,000 a year.<sup>14</sup> Payroll taxes also exceed individual income taxes for the majority of these workers.<sup>15</sup>

Income (AGI)	Percent of filers with payroll tax greater than income tax
Less than \$10,000	85.1%
\$10,000 to \$20,000	84.8%
\$20,000 to \$30,000	85.0%
\$30,000 to \$40,000	86.6%
\$40,000 to \$50,000	78.5%
\$50,000 to \$75,000	68.7%
\$75,000 to \$100,000	62.8%
All filers	73.9%

- Cost. There are approximately 134 million paid workers nationwide, which means that even a relatively small amount of relief can be costly.

Rebate per worker	Cost (2006)
\$500	\$68 billion
\$750	\$99 billion
\$1,000	\$126 billion

- Options for relief. There are three potential options for providing payroll tax relief: (1) a rebate on payroll taxes paid; (2) exempting some portion of wages from taxation (for OASDI) and (3) reducing the tax rate on taxable wages (for OASDI). The chart below shows the amount of exemption or payroll tax reduction necessary to deliver an average benefit of \$500, \$750 or \$1,000 per worker.

Average rebate per worker	Amount of exempt income	Payroll tax reduction
\$500	First \$8,064 earned	-1.4%
\$750	First \$12,070 earned	-2.0%
\$1,000	First \$16,129 earned	-2.6%

*Note that a rebate or an exemption would have the advantage of providing the same dollar amount of relief to all workers. As the following chart shows, a rate reduction, however, would skew the benefits to higher-income workers.*

Income	-1.4% rate reduction	-2.0% rate reduction	-2.6% rate reduction
\$10,000	\$140	\$200	\$260
\$20,000	\$280	\$400	\$520
\$30,000	\$420	\$600	\$780
\$40,000	\$560	\$800	\$1,040
\$50,000	\$700	\$1,000	\$1,300
\$60,000	\$840	\$1,200	\$1,560
\$70,000	\$980	\$1,400	\$1,820
\$80,000	\$1,120	\$1,600	\$2,080
\$90,000	\$1,260	\$1,800	\$2,340

- Offsets. The cost of payroll tax relief can be partially offset by the options laid out elsewhere in this Appendix. Nevertheless, the impact on the Social Security trust funds funded by OASDI revenues will be significant. Eliminating the cap on wages for the employer share of payroll taxes would raise \$64 billion in 2006. However, there are two disadvantages to this approach. First this proposal would be subject to the attack that it is raising taxes on business. Second and more significantly, many employers are likely to offset the additional amount paid in payroll taxes with reductions in wages or benefits.

## Endnotes

<sup>1</sup> Burman, L., Gale, W. and Rohaly, J., "The AMT: Projections and Problems," Urban Institute 2003, available at <http://www.taxpolicycenter.org/UploadedPDF/1000505.pdf>.

<sup>2</sup> *Ibid.*

<sup>3</sup> <http://www.taxpolicycenter.org/TaxFacts/TFDB/TFTemplate.cfm?Docid=198>. See also Andrews, E., "Cracking the Tax Code," *New York Times*, February 12, 2006, available at <http://www.nytimes.com/2006/02/12/business/yourtaxes/12wash.html?ei=5088&en=6f995f61782c2722&ex=1297400400&adxnnl=1&partner=rssnyt&emc=rss&pagewanted=print&adxnnlx=1151326396-YnzbigMGSA3jXobMd8taOw>.

<sup>4</sup> *Ibid.*

<sup>5</sup> Statement of Rep. Michael McNulty (D-NY), Hearing before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, June 25, 2002, available at <http://waysandmeans.house.gov/legacy/srm/107cong/6-25-02/107-75final.htm>. The hearing testimony also includes a list of recent corporate inversions.

<sup>6</sup> U.S. Treasury Department, "Treasury Announces New Budget Proposals: New Proposals Close Loopholes, Stop Abusive Tax Avoidance," January, 13, 2004, available at <http://www.ustreas.gov/press/releases/js1096.htm>.

<sup>7</sup> Urban-Brookings Tax Policy Center, "T04-0158 - Calendar-year revenue changes due to selected Kerry proposals, 2005-14," Oct. 13, 2004.

<sup>8</sup> Internal Revenue Service, 2006 Federal Tax Rate Schedules, available at <http://www.irs.gov/formspubs/article/0,,id=150856,00.html>

<sup>9</sup> Urban-Brookings Tax Policy Center, "T05-0264 - Rollback of Individual Income Tax Rates, Static Impact on Individual Income Tax Liability and Revenue, 2005-15," October 15, 2005, available at <http://www.taxpolicycenter.org/TaxModel/tmdb/TMTemplate.cfm?DocID=1011&topic2ID=40&topic3ID=58>

<sup>10</sup> Greenstein, B., Friedman, J. and Aron-Dine, A., "Two Tax Cuts Primarily Benefiting Millionaires Will Start Taking Effect January 1; Congress Declines to Rethink These Tax Cuts As It Proposes to Cut Aid to Low-Income Families," Center on Budget and Policy Priorities, December 28, 2005, available at <http://www.cbpp.org/12-28-05tax.htm>.

<sup>11</sup> Urban-Brookings Tax Policy Center, "T06-0186 - H.R. 5638 as Amended and Passed by The House, The Permanent Estate Tax Relief Act of 2006: Estate Tax Returns and Liability, 2007-16," June 20, 2006, available at <http://www.taxpolicycenter.org/TaxModel/tmdb/TMTemplate.cfm?Docid=1255&DocTypeID=5>

<sup>12</sup> Social Security Administration, Contribution and Benefit Base, available at <http://www.ssa.gov/OACT/COLA/cbb.html>

<sup>13</sup> Urban-Brookings Tax Policy Center, "Historical Payroll Tax Receipts," available at <http://taxpolicycenter.org/TaxFacts/TFDB/TFTemplate.cfm?Docid=46&Topic2id=50>.

<sup>14</sup> Urban-Brookings Tax Policy Center, "T05-0277 - Current-Law Distribution of Individual Income and Payroll Tax Burden, by Cash Income Class, 2005," available at <http://taxpolicycenter.org/TaxModel/tmdb/TMTemplate.cfm?Docid=1024&topic2ID=60&topic3ID=69&DocTypeID=1>

<sup>15</sup> Urban-Brookings Tax Policy Center, "Payroll and Individual Income Tax Burden, 2003," available at <http://taxpolicycenter.org/TaxFacts/TFDB/TFTemplate.cfm?Docid=279&Topic2id=50>