Murray Weighs In on Tax Debate in Response to Baucus and Hatch

By Niels Lesniewski Posted at 1:18 p.m. on July 30, 2013

Senate Majority Leader Harry Reid, D-Nev., may not have replied to the letter seeking input on a tax code overhaul from the Finance Committee leaders, but one of his most trusted lieutenants certainly did.

In a six-page letter dated July 26, Senate Budget Chairwoman Patty Murray outlined a vision for overhauling the tax code that's in line with the fiscal 2014 budget resolution she drafted that was adopted by the Democratic majority in the Senate.

In the letter, which was posted online on Tuesday afternoon, the Washington Democrat renewed her call to gain significant revenue through an overhaul of the tax code, in line with the $975 billion over 10 years specified by the budget. She cautioned against budgetary gimmickry and pushed against the use of "dynamic" scoring when measuring new revenue.

She also renewed her call to use new revenue to curtail or eliminate the effects of the sequester.

"Importantly, the additional revenue generated by any tax reform legislation should be measured by the Joint Committee on Taxation under its conventional scoring methodologies," Murray said.

Murray praised the efforts of Finance Chairman Max Baucus, D-Mont., and ranking member Orrin G. Hatch, R-Utah, on the underlying issue of overhauling the tax code. The two senators requested their colleagues provide suggestions for a "blank-slate approach."

Baucus and his House GOP counterpart, Ways and Means Chairman Dave Camp of Michigan, are on a road show to listen to perspectives on changing the tax code.

Interestingly, Murray referenced the need to invest in infrastructure projects, which is a point that President Barack Obama is highlighting Tuesday during a speech in Chattanooga, Tenn.

"[O]ur country's future competitiveness is threatened by inadequate investments in education, research, and infrastructure. The American Society of Civil Engineers gave our road, transit, and aviation systems grades of no better than 'D' in its latest report card. U.S. students lag behind their global competitors in the fields of the future — math and science," Murray said. "And sequestration is only adding insult to injury."

The full letter from Murray appears below:

Chairman Baucus and Ranking Member Hatch:

Thank you for this opportunity to provide feedback on the important topic of comprehensive tax reform. You are correct – our tax system is broken. It is inefficient, it is unfair to the middle class, it is far too complicated, and it will not generate sufficient revenue to tackle our long-term fiscal and economic challenges.

Simply put, our tax code was built for another era. It provides enormous back-door subsidies to certain individuals and companies who do not need them while offering little or poorly targeted support for many of the industries and activities that matter to regular Americans and hold the potential to create broad-based and sustainable growth. If we as a nation want to get our fiscal house in order while also keeping our promises to an aging population and making the critical investments that will ensure we can compete in the 21st century economy – then tax reform is one of the many areas we are going to have to get right.

For all of these reasons, the fiscal year 2014 Senate Budget that I worked with my Democratic colleagues to write explicitly recommends comprehensive tax reform. That budget, along with its accompanying policy document, lays out clear principles for tax reform – principles that our colleagues validated when the full Senate voted to approve it on March 23.

Tax Reform Must Raise Substantial Revenue for Deficit Reduction

There is general agreement that tax reform should bring in new revenue by broadening the tax base, but there is serious disagreement regarding what that new revenue should be used for. Some of our colleagues believe that every dollar of new revenue that comes in through closing loopholes and paring-back deductions, credits, and exemptions should go toward reducing tax rates, and none of it should be used to replace the damaging sequester and reduce budget deficits. I strongly disagree.

I support the approach taken in the Senate Budget, which calls for tax reform that raises $975 billion for deficit reduction over the next ten years. Critically, the budget calls for this new revenue to be raised through closing loopholes and reforming tax expenditures that primarily benefit the wealthiest Americans and biggest corporations – and not by tax increases of any kind on the middle class or most vulnerable families. Any additional revenue brought in through further base-broadening can and should be dedicated to targeted rate reductions that promote broad-based economic growth built from the middle out.

To me, the need for new revenue raised in a way that protects the middle class is clear. America faces very different challenges today than it did in 1986 when we last tackled this issue, and what led to successful tax reform then will not on its own produce bipartisan consensus now.

First of all, as a result of trillions of dollars in unfinanced tax cuts, two wars that were put on the national credit card, and the worst financial crisis and recession we have experienced in decades, the publicly held debt, as a share of the economy, is now twice its 1986 level and well above its historical average.

Looking ahead, ever-increasing ranks of retired Americans will place an added strain on the federal budget. In fact, by 2050, the ratio of those age 65 and over as a share of the working age, taxpaying population will almost double. Additionally, our country's future competitiveness is threatened by inadequate investments in education, research, and infrastructure. The American Society of Civil Engineers gave our road, transit, and aviation systems grades of no better than "D" in its latest report card. U.S. students lag behind their global competitors in the fields of the future – math and science. And sequestration is only adding insult to injury.

And finally, even if one assumes that every expiring tax incentive lapses as scheduled – a generous assumption – the projected average revenue level over the next ten years, 18.9 percent of gross domestic product (GDP), remains far below the levels experienced the last five times the budget was in surplus, when revenues ranged between 19.5 and 20.6 percent of GDP.

These are realities that Chairmen Packwood and Rostenkowski, along with President Reagan, did not have to consider in 1986. And they explain why every major bipartisan group that has examined our budget situation has concluded that it is folly to believe we can meaningfully and sustainably improve our long-term fiscal and economic outlook without additional revenue.

That is why under the Senate Budget, revenues would rise gradually, reaching 19.8 percent of GDP by 2023 – a wholly reasonable target considering that both the tax reform framework (i.e., the so-called "Zero Plan") contained in the original Simpson-Bowles report and the most recent plan of the Bipartisan Policy Center's Debt Reduction Task Force (i.e., "Domenici-Rivlin 2.0") would raise revenues to close to 21 percent of GDP by 2020 and 2022, respectively.

Importantly, the additional revenue generated by any tax reform legislation should be measured by the Joint Committee on Taxation under its conventional scoring methodologies. So-called "dynamic" revenue estimates – i.e., estimates which incorporate the feedback effects on revenue levels of anticipated changes in macroeconomic variables such as GDP and employment – would require our budget scorekeepers to make too many difficult judgment calls about the economic effects of tax reform for it to be a reliable and unbiased predictor of future revenue levels.

Growth-inducing tax policy should be pursued for its own sake – not as an end-run around the serious discussion we must have about our long-term budget challenges. Incorporating dynamic estimates into tax reform would be highly controversial, would impair the credibility of the budget process, and would not demonstrate that we are serious about addressing our deficits and debt.

Further to that point, tax-writers also should consider the budget impact of tax reform on the second decade in addition to its impact over the standard ten-year budget window. Reform must not be designed in a way that would cause it to raise revenue over the first ten years, but lose revenue later. Adjusting tax expenditures that represent mere shifts in the timing of deductions or income – such as accelerated depreciation or tax breaks that defer taxable income – could produce such a result. Tax reform is a once-in-a-generation enterprise – so we must not squander its potential to help put our budget on a track toward long-run sustainability.

Tax Reform Must Maintain or Increase Progressivity

The Senate Budget states that tax reform must maintain or increase progressivity levels relative to the tax code as it exists today. The wealthiest Americans have done spectacularly well, even in the wake of the Great Recession, while low-income and middle class families have experienced decades of stagnant wages. That is why it is critical that tax reform not shift tax burdens onto low-income and middle class Americans, who already are sacrificing greatly on account of unprecedented cuts to discretionary spending.

Importantly, by referencing the current tax code for its progressivity standard, the Senate Budget includes the effects on tax distribution of the 2009 enhancements to the Earned Income Tax Credit and Child Tax Credit – critical supports for low-income families that incentivize work and lift millions of Americans out of poverty each year – as well as the American Opportunity Tax Credit, all of which are scheduled to expire after 2017. By assuming a permanent extension of these credit enhancements in its baseline, the Senate Budget takes the position that any reformed tax code should maintain these, or comparable, tax incentives for our most vulnerable families.

Tax Reform Must Restore Fairness to the Tax Code

Today's tax system is deeply unfair. It is riddled with special provisions, or "tax expenditures," that are estimated to total a staggering $1.3 trillion this year alone. These provisions increase the deficit, add significant complexity to the tax filing process, and tilt the balance in favor of sophisticated taxpayers with the means to hire lawyers and accountants to find every available tax break.

On the individual side, roughly 70 percent of tax expenditures' cost is attributable to either deductions or exclusions which, by their very nature, deliver larger benefits to individuals in higher tax brackets. In fact, more than three-quarters of the total benefits of all itemized deductions flow to the top 20 percent of income earners, while the top 1 percent receives almost one-third of all benefits[1]. Meanwhile, the roughly two-thirds of all filers who do not itemize their deductions get no benefit from these provisions.

The skewed distribution of tax expenditure benefits helps explain why the effective tax rates of the wealthiest Americans have been driven to historically low levels. According to the Internal Revenue Service (IRS), the average effective federal income tax rate for the 400 wealthiest taxpayers has fallen from almost 30 percent in 1995 to only 19.9 percent in 2009, less than the rate paid by many middle class families. Such outcomes are inconsistent with our progressive tax rate structure and erode confidence in the tax system.

The Senate Budget offers various methods by which tax-writers could simultaneously improve the fairness of the individual tax system and reduce the deficit. One such method would be to convert certain itemized deductions into tax credits that could be enjoyed by all income taxpaying Americans, not just those who itemize. By limiting such credits to a certain amount – for example, 15 percent of the creditable expense – tax-writers could better target tax incentives to those individuals who actually need them while reducing the deficit in the process.

Another method would be to place a limit on the extent to which upper-income taxpayers can benefit from certain tax expenditures. In devising any such limit, however, tax-writers should consider the extent to which the tax code would retain a marginal incentive to engage in the affected activities and investments.

The tax code is also unfair to many business taxpayers. The particular industry in which a U.S. company operates, or whether it has subsidiaries abroad, now has an enormous influence on the extent to which it pays U.S. tax. In fact, some profitable companies have been able to avoid paying any income tax at all.

To address these problems, the Senate Budget calls for business tax reform that eliminates wasteful tax incentives for highly profitable companies, repeals unfair business tax breaks such as those for corporate jet owners and hedge fund managers, and addresses profit-shifting and other offshore tax avoidance schemes. To prevent against disadvantaging small businesses, which are often organized as so-called "pass-through" entities, the Senate Budget takes the position that the tax rules applicable to individuals and corporations should be reformed simultaneously.

The Senate Budget also calls on tax-writers to aggressively address the so-called "tax gap," or the difference between what taxpayers owe and what the IRS collects after enforcement efforts. The IRS estimated this gap was $385 billion, or 16 percent of total receipts, in 2006 alone. These revenue losses exacerbate budget deficits and shift an unfair burden onto taxpayers who pay what they owe.

Tax Reform Must Boost Economic Growth and Job Creation

Our current tax system also is highly inefficient and is a drag on economic growth. Much of this inefficiency is due to the myriad special tax breaks that encourage money to flow to activities and industries it would not otherwise be directed to absent a tax incentive. In some cases, the simple act of repealing a wasteful tax break may boost growth by increasing the efficiency with which capital is allocated.

In other cases, tax expenditures with legitimate policy rationales may be a drag on the economy because they are poorly targeted. In 2012, on average, the top 1 percent of income earners saw their after-tax income increase by nearly $250,000 as a result of tax expenditures while the middle quintile received an average benefit of only about $3,500[2] – making it clear that, in many cases, these tax breaks are targeted toward those individuals who need them the least and who are most likely to engage in tax-favored activities or investments even without a subsidy.

It is critical that any tax reform effort either restructure or repeal inefficient and poorly target tax breaks. At the same time, tax-writers should carefully consider maintaining or increasing support for those industries and sectors that are key to America's ability to create the jobs of the future and to remain a global leader in the 21st century economy.

Further, as you have noted, individuals and businesses incur more than $160 billion in costs each year just to comply with the tax rules. That is $160 billion that could be put to more efficient and productive use. For all of these reasons, the Senate Budget calls for tax reform that boosts economic growth and job creation by reforming inefficient tax breaks to better target their benefits, simplifying and increasing the certainty of our tax system, and ensuring U.S. businesses and individuals are well-positioned to compete in the global marketplace.

The Senate Budget also supports reductions in tax rates provided the budget's revenue and progressivity goals are also achieved. But again, it is imperative that any rate reductions be targeted in a way that promotes broad-based economic growth built from the middle out.

In closing, I share your belief that our tax system is deeply flawed and should be reformed. To that end, the fiscal year 2014 budget that I drafted lays out clear principles for tax reform that Democrats affirmed when they passed the budget through the Senate in March.

I also believe that tax reform and the larger debate over the federal budget are inextricably linked, and that making progress on one will bring us closer to tackling the other. For that reason, and because I know how important it is to the families, businesses, and communities I represent – I stand committed to working with you, and all senators, to find common ground so we can move tax reform forward.

Thank you for your strong leadership on this important matter.

Sincerely,

U.S. Senator Patty Murray