Tax Reform for Progressivity: A Pragmatic Approach

In a new book titled *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, The Hamilton Project offers a range of detailed proposals by leading economists and other experts for better tax policies that can raise revenue in a progressive and growth-friendly manner. In one chapter, Natasha Sarin of the University of Pennsylvania Carey Law School and Wharton School of Business, Lawrence Summers of Harvard University, and Joe Kupferberg of Harvard University and the University of Pennsylvania propose a suite of tax reforms to broaden the tax base and strengthen enforcement.

Sarin, Summers, and Kupferberg's proposal, if enacted, would raise an estimated $4 trillion in new revenue. The proposal calls for:

- Investing in tax enforcement and compliance.
- Closing individual tax shelters and loopholes.
- Reforming the corporate tax code.
- Overhauling capital gains taxation.

Issue Overview

- **Deterring illegal tax evasion can increase the efficiency and progressivity of the U.S. tax system.** This could be done by investing more in an underfunded Internal Revenue Service (IRS) and making better use of information reporting.
- **Broadening the tax base will remove opportunities for tax avoidance.** The tax code contains many carveouts, preferences, and shelters that tend to benefit high earners and render the tax system less efficient.
- **Reforming capital gains and corporate taxation are particularly important for raising tax revenue** and improving the equity and efficiency of the tax code.

The Challenge

In the coming decades, federal spending will need to grow just to enable the government to continue to provide the services it does today. There are many options for raising the necessary tax revenue. One important possibility—better enforcement—is motivated by the fact that in 2020 the IRS will fail to collect more than $630 billion, or nearly 15 percent of tax liabilities. Illegal tax evasion generates unfair differences in tax payments across otherwise similar individuals and firms.

The tax code also presents many legal opportunities for tax avoidance. Taxpayers differ in their ability to benefit from these opportunities, which generates further inequities. These avoidance opportunities can also lead taxpayers to engage in socially unproductive activities (e.g., avoiding realization of capital gains in order to benefit from stepped-up basis). Broadening the tax base can therefore enhance equity, efficiency, and revenue.

The Path Forward

Sarin, Summers, and Kupferberg propose several reforms to the tax system that both combat illegal evasion and decrease the opportunities for legal tax avoidance. There are numerous ways to alter the current tax system to raise substantial sums of revenue in highly progressive ways.

- **Invest in compliance ($1.2 trillion):**
  - Increase funding to the IRS to enhance and better target audit efforts.
  - Invest in information technology to update the 60-year-old IRS infrastructure.
  - Increase information reporting requirements.
- **Close individual tax shelters and loopholes ($1.3 trillion):**
  - Close the payroll tax loophole, which allows individuals to characterize their small business income as business profits rather than wage income to avoid the payroll tax.
  - Cap tax deductions, such as the mortgage interest, charitable giving, and medical expenses deductions at 28 percent.
  - End the 20 percent pass-through deduction, which enables certain types of businesses to deduct 20 percent of their business income from their taxable income.
  - Lower the estate tax threshold from $22.4 million to $7 million for couples.
- **Reform the corporate tax code ($770 billion):**
  - Increase the corporate tax rate from 21 to 25 percent.
  - Broaden the corporate tax base through per country accrual of global intangible low-taxed income credits.
  - Impose a minimum tax on book income, which would ensure that all profitable firms pay a minimum amount in taxes.
- **Overhaul capital gains taxation ($820 billion):**
  - Tax capital gains at ordinary levels rather than their preferential (and lower) rates.
  - Eliminate the stepped-up basis for capital gains that allow capital gains to be passed through generations without being taxed.
  - Close the carried interest loophole, which incentivizes private equity and hedge fund managers to receive their compensation in the form of carried interest instead of ordinary income.
  - Eliminate the tax preference for like-kind exchanges, which allows investors to avoid tax liability they would otherwise incur from sales of assets.
  - End tax advantages for charitable giving of long-term appreciated assets.

About the Authors

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