



A Fair and Simple Tax System for our Future: A Progressive Approach to Tax Reform

As a nation, we have established certain fundamental priorities: protecting the safety, security, and health of our citizens; ensuring the right to a world class education; providing vital public services; and preserving the dignity of our elderly and all those who take responsibility for their lives. The challenge of tax policy is to generate resources to support these priorities in a way that is consistent with three basic principles: fairness, simplicity, and opportunity.

Unfortunately, our tax code has diverged far from these principles in recent years. The tax share has shifted away from those who can best afford to pay and onto the middle class. Corporations have largely been able to avoid their obligation to pay taxes, in part by shifting operations overseas. The result is an increased reliance on a regressive payroll tax, which falls most heavily on lower- and middle-income taxpayers.

We propose a comprehensive tax reform plan to restore fairness, simplicity, and opportunity to our tax system while generating the resources necessary to meet our nation's commitments. Overall, the plan will reduce taxes for about 70 percent of tax filers earning under \$200,000 a year, providing an average tax cut of over \$600. Most of those making more than \$200,000 a year will likely see an increase relative to current tax policy. The plan is fiscally responsible, reducing the deficit by nearly \$500 billion over 10 years.

Restoring Fairness: After four years of policies that have shifted the tax share onto work and the middle class, hardworking families need real reform that increases after-tax incomes without bankrupting our economy. We propose fundamentally changing our tax structure in three ways:

- ***Tax Each Source of Income the Same.*** Each source of income – whether from dividends, capital gains, wages, or salaries – should be taxed according to the same progressive rate structure. This would reverse the radical direction of our current tax system, and it would ensure that a nurse or firefighter who receives his or her income through hourly work would not face a higher average tax rate than a wealthy investment banker who receives passive income from accumulated or inherited wealth.
- ***Reduce the Dependence on Regressive Payroll Taxes.*** The payroll tax has played an important role in our tax system by providing revenue to meet our nation's commitment to retirees. Yet the payroll tax is also among the most regressive in our overall tax system. We propose removing the employee component of the Social Security payroll tax, immediately reducing by 6.2 percent the tax rate all Americans pay on the first \$90,000 of earnings. At the same time, we propose removing the cap on the payroll taxes paid by employers, making income above the current cap subject to the employer-side tax, thus making the remaining payroll tax less regressive. To maintain our full commitment to financing Social Security, we would dedicate a portion of general revenues to the Social Security trust fund. By setting aside 2.25 percent of gross domestic product per year, we would solidify the financial status of the Social Security system – closing half of the current long-run shortfall – but in a fairer, more sustainable manner.
- ***Enhance the Take-Home Pay of Lower-Income Taxpayers.*** We also propose two specific reforms that are needed to raise the take-home pay of the lowest income earners in the country. First, to ensure that single working parents who currently receive the Earned Income Tax Credit (EITC) do not risk losing that benefit if they marry, we propose altering the tax code to eliminate this disincentive to marriage. Second, we would reduce the income threshold for the receipt of the Child Tax Credit to \$5,000 and eliminate inflation indexing. Over time this would increase the number of people who would receive the full benefit from the credit.

Simplifying the Tax Code: Recent tax policy changes have increased the complexity of our system while shifting the tax share to middle-class taxpayers. We would reverse this trend with three reforms:

- ***Reduce the Number of Income Tax Brackets.*** In addition to taxing each source of income equally, we would cut the number of income tax brackets in half, establishing a simpler, more progressive three-rate structure with rates at 15 percent, 25 percent, and 39.6 percent. The three tax rates would apply to brackets of taxable income of \$0 to \$25,000; \$25,001 to \$120,000; and \$120,001 and above. These brackets would be indexed for inflation. The standard deduction would be raised slightly to \$10,000 for a married couple and also indexed for inflation.
- ***Close Corporate and Individual Loopholes.*** The complexity of the corporate income tax is hurting our competitiveness and encouraging companies to shift production overseas. By broadening the base of the corporate tax structure we can enhance the overall efficiency of the system, keep rates at relatively low levels, and increase revenues. By closing some of the most egregious loopholes, we would also ensure that our tax code no longer offers affirmative incentives for wealthy individuals to shelter taxable income or for corporations to shift production outside the United States.
- ***Eliminate the Need for the Alternative Minimum Tax.*** If left in place under the current system, the Alternative Minimum Tax (AMT) will impact 36 million Americans by 2010. By overhauling the entire income tax code and eliminating personal income tax loopholes that are currently limited by the AMT, we would eliminate the need for an AMT, and thus address, in a fiscally responsible manner, an important tax challenge facing our country over the next decade.

Increasing Economic Opportunity: Unlike the old, failed right-wing supply-side policies, this plan embodies a new progressive growth strategy based on restoring fiscal discipline and expanding savings incentives to the middle class.

- ***Restore Fiscal Discipline.*** Restoring confidence and economic growth requires addressing the record deficits generated under the Bush administration, while keeping our country safe and meeting our commitments to our seniors. We would put our country back on a path toward closing our fiscal gap, thus increasing confidence in our economic future and allowing for productivity-enhancing investments in education and research that are keys to our nation's economic success.
- ***Offer Tens of Millions of Americans New Opportunities to Save and Create Wealth for Retirement.*** Today, our tax system is upside-down when it comes to offering incentives to save and create wealth for retirement. Because all retirement savings incentives are provided through up-front tax deductions, higher income individuals are given generous benefits to save while lower-income individuals are given little or no benefit. We propose leaving intact all aspects of our current retirement savings structure, including IRAs and 401(k) contribution limits and non-discrimination rules. However, we propose to do away with the upside-down deduction-based incentive and replace it with an across-the-board 25 percent refundable tax credit for retirement savings. For the 33 million Americans who currently have no income tax liability and hence receive no tax incentives to save, this reform would, for the first time, offer a generous incentive to build for retirement. In addition, in order to encourage long-term savings, we would allow those with incomes under \$1 million to exempt a portion of their long-held appreciated assets – up to 50 percent – from capital gains taxation.

Overall, our fiscally responsible proposal would make the tax system fairer and less complex, would efficiently raise additional revenue, and would provide higher after-tax incomes for millions of taxpayers. Our great nation deserves a sound tax system that enhances economic growth and allows everyone to benefit from the remarkable success of the American economy.