Gov. Perry’s tax plan, analyzed

By Editor Test *Wed, Nov 2, 2011*

The Tax Policy Center estimates that the Perry plan would lower federal tax liability by $995 billion in calendar year 2015 compared with current law, roughly a 27 percent cut in total projected revenue.

Governor Rick Perry has proposed major changes to the federal tax code as part of his recently released budget plan, “Cut, Balance, and Grow.” The Perry plan would retain the existing structure of the current individual income tax, but allow taxpayers the option of paying tax under an alternative system characterized by a single 20 percent tax rate.

A preliminary analysis of the Perry plan by the Tax Policy Center, based on information posted on the campaign website, public statements by Mr. Perry and his staff, and details contained in an analysis performed by John Dunham Associates (JDA) released by the campaign.

Description of Plan

Governor Perry’s individual “flat tax” proposal would create an optional alternative tax system with a single 20 percent tax rate, which effectively operates as an “alternative maximum tax.” The tax would apply to an income base similar to that in current law, with four major modifications:

1) Long-term capital gains, qualified dividends, and social security benefits would not be taxable

2) Taxpayers could claim a standard exemption of $12,500 for each individual and dependent

3) Taxpayers could continue to claim deductions for mortgage interest, charitable contributions, and state/local taxes paid but these deductions would phase out beginning at $500,000 of income

4) All other above-the-line deductions, itemized deductions, and credits would be eliminated

Taxpayers could choose either the current tax system or the alternative “flat tax” system, but once they opt into the new system, they could not switch back.

At the corporate level, the Perry plan would make four major changes:

1) Reduce the corporate income tax rate from 35 to 20 percent

2) Allow for immediate expensing of all investment purchases

3) Fully exempt foreign-source income of U.S. based corporations

4) Eliminate all other tax expenditures not related to depreciation, R&D, or foreign-source income

The Perry plan would also permanently repeal the federal estate tax and the surtaxes contained in the 2010

Patient Protection and Affordable Care Act (PPACA).

Because the Perry plan would retain the current system as an option, the details concerning that system matter a lot for estimating the plan's impact. Of particular importance is whether or not the Perry plan would extend the various individual income tax provisions that are scheduled to expire at the end of 2012. Based on material released by the campaign and statements by a spokesperson, we have concluded that the Perry plan would allow all of the provisions to expire as called for under current law.[2]

The Perry plan differs substantially from the standard flat tax as originally developed by Robert Hall and Alvin Rabushka and subsequently proposed by former House Majority Leader Dick Armey, former presidential candidate Steve Forbes, and others.

That plan would apply the same single tax rate to the entire cash flow of businesses. In other words, while firms could deduct cash wages, they could not deduct the cost of employee fringe benefits like health insurance and retirement contributions.

The Hall-Rabushka flat tax plan would also disallow deductions for employer-paid payroll taxes and interest payments. In contrast, according to a spokesperson for the Perry campaign, "[n]ormal businesses [sic] expenses that corporations recognize on their financial statements will continue to be deductible." That provision would shrink the tax base significantly, compared with the Hall-Rabushka Flat Tax plan.

Revenue Implications
The Perry plan would reduce federal tax revenues dramatically. TPC estimates that on a static basis, the Perry plan would lower federal tax liability by $995 billion in calendar year 2015 compared with current law, roughly a 27 percent cut in total projected revenue. Relative to a current policy baseline, the reduction in liability would be roughly $570 billion in calendar year 2015.

Appendix: Assumptions underlying Tax Policy Center analysis

- Based on the campaign's summary and the analysis from John Dunham Associates, TPC assumes that the existing tax law remains unchanged. In other words, all provisions currently scheduled to expire under current law will do so, including the annual patches to the AMT, the lower marginal rates and marriage penalty relief originally passed in 2001, the 15 percent rate on long-term capital gains and qualified dividends, and the higher amounts and increased refundability of the earned income tax credit and child tax credit. The expiration of provisions of existing law would affect those taxpayers who would otherwise see their tax liability higher under the optional flat tax system than under 2011 tax provisions.
- Income under the optional flat tax system equals current law total income less net long-term capital gains, qualified dividends, and taxable social security benefits received. Taxable income equals that income less a standard exemption of $12,500 for each individual and dependent and applicable deductions for mortgage interest, charitable contributions, and state and local taxes paid. These deductions are available to all taxpayers who opt into the alternative system. The new tax does not include any other above-the-line deductions, itemized deductions, and credits.
- Standard exemptions phase out for taxpayers at a rate of 2 percent for each $2,500 of income over

$500,000 (the current law rule for the personal exemption phaseout, or PEP). Deductions for mortgage interest, charitable contributions, and state/local taxes paid are reduced for high-income taxpayers by 3 percent of income over $500,000 (the reduction under current law—known as Pease—but without the provision limiting the reduction to 80 percent of total deductions).

- Businesses may fully expense all capital expenditures (equipment and structures) and research and development expenses. Businesses may continue to deduct normal business expenses, including interest paid and employee fringe benefits, as under current law. Foreign source income of U.S. corporations would not be subject to tax. All business-related tax expenditures, other than those that involve capital cost recovery and the deferral of foreign earned income, are repealed.
- The following transition rules would apply: 1) firms may deduct their existing basis in inventory, equipment, and structures at enactment over five years using the straight line method; 2) firms may claim existing net-operating losses (NOLs) and tax credits as under current law; 3) all undistributed foreign earnings at enactment are immediately subject to a one-time 5.25 percent tax, payable over five years.
- The estimates of the corporate tax provisions are based on the steady state tax system after the phase-in (with expensing replacing depreciation) and do not count the revenue losses in the transition from allowing deduction of existing asset basis over five years or the increased revenue from the tax on undistributed foreign earnings. We assume no net loss of revenue in the steady state from switching to a territorial system.