Lessons from Tax Reform School

By Eugene Steuerle *Thu, Nov 9, 2017*

Our guest columnist, a veteran of the 1986 federal tax overhaul, reveals the kind of chain reaction that can occur when you change the tax code.

Do you want to know why tax reform is so hard? Consider one seemingly simple idea that has been floated by President Trump and congressional Republicans in their Unified Framework: Roughly doubling the standard deduction.

The closer you look at this proposal, the more you see how complicated it is.

Is doubling the standard deduction a good idea? Well, maybe. By granting more taxpayers a larger reduction in taxable income without making them itemize a list of specific deductible expenses, boosting the standard deduction can substantially simplify the tax filing process. It would also reduce taxes for some middle-income households.

But… It costs money. The Framework would partially offset the expense by eliminating the personal exemption.

But… Exchanging a larger standard deduction for repeal of the personal exemption raises the relative burden of taxes on households with children.

But… The Framework attempts to offset the elimination of personal exemption with a bigger child credit. That might help reduce some of the higher taxes caused by repealing the personal exemption.

But… These adjustments cost revenue and so would reduce the amount of rate reduction that Congress can pay for.

And… The share of households (including non-filers) that itemize with the larger proposed standard deduction would be reduced, perhaps to as little as 5%, depending upon what happens to specific deductions.

But… If Congress reduces the number of itemizers, it would also reduce the number of people who'd take deductions for charitable giving, home mortgage interest and state and local taxes paid. That, in turn, has charities, homebuilders and state and local government officials worried.

And… Retaining tax incentives only for the highest income households makes zero sense for provisions meant to encourage families to own homes or give to charity.

But… Congress could create alternative subsidies for charitable donors, homebuilders and state and local governments.

But… That could cost more foregone revenue and reduce the size of any tax rate reduction that could be paid for.

And, whoops… So far, we've pretty much forgotten about the poor and moderate-income taxpayers who would benefit little or not at all by an increase in the standard deduction.

But… To help them requires yet more money and reduces the amount of rate reduction that can be financed in a tax reform package.

Thus, each decision on each individual change not only causes new interactions affecting the amount of revenue other provisions in a bill would gain or lose, but it alters the distribution of winners and losers among individuals and industries that also must be addressed.

And… These are some of the effects of only one simple reform. Now, think of what Congress and the President must tackle in a bill that revises the taxation of capital and labor, multinational corporations and partnerships, pensions and insurance.

And… You will get some inkling of why, as the president might say, "nobody knew" tax reform would be so hard.