NATIONAL CENTER FOR POLICY ANALYSIS

What Is in the Lee-Rubio Tax Plan?

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Senators Mike Lee (R-Utah) and Marco Rubio (R-Fla.) have released a blueprint for federal tax reform called the "Economic Growth and Family Fairness Tax Plan."

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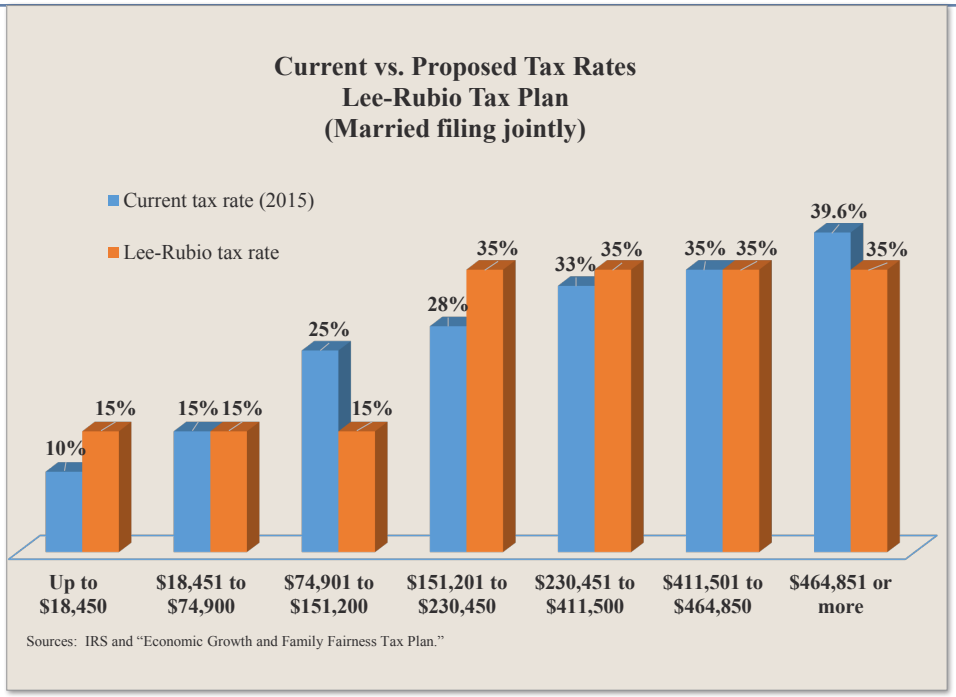
The plan's goal is to simplify the tax code and pave the way to a flatter income tax, reducing federal income taxes to just two tax brackets and eliminating capital gains taxes.

Income Tax Features of the Lee-Rubio Tax Plan. For the individual tax structure, the plan introduces a two-tier system to replace the current seven tax brackets. This plan moves America from a progressive tax structure to a bifurcated flat tax [see the figure]:

- All income earned up to $75,000 for singles and $150,000 for joint filers would be taxed at 15 percent.
- All income earned over those thresholds would be taxed at 35 percent.
- Thus, for a married couple filing jointly, the lowest income earners would pay more (rising from 10 percent to 15 percent), while the highest income earners would pay less (falling from 39.6 percent to 35 percent).
- However, there would be a large marginal tax hike for couples earning $150,000 to $200,000 a year, of 7 percentage points.

The Lee-Rubio plan also proposes to increase the child tax credit from $1,000 to $2,500. The higher credit is designed to eliminate the bias of the current tax code against parents, who not only pay payroll taxes, but also pay to raise children who will eventually pay for future retirees through their own payroll taxes. The Lee-Rubio plan keeps intact the personal exemption and two individual tax deductions: home mortgage interest and charitable contributions.

Corporate and Business Tax Features. For the corporate tax structure, the Lee-Rubio plan proposes to lower the rate from 35 percent, the highest rate globally, to 25 percent. But this rate could be much lower. In an NCPA study, "Simulating Elimination of the Corporate Income Tax," Laurence Kotlikoff of Boston University estimated the federal government could raise the same amount of money as the current corporate tax with a tax rate of only 9 percent, along with a transitional wage or consumption tax that would phase out over time.



Last year, the Obama Administration issued new rules designed to crack down on "tax inversions," where American firms incorporate in other countries in order to reduce their tax liability, even though they still have operations in the United States. But, as an alternative to the regulatory approach, the Lee-Rubio plan allows multinational firms to transition to a territorial tax system where income earned in a foreign country is subject to the income tax in that country.

Having tax policies and rates that are favorable to economic growth will encourage the return of capital to America, reducing corporate inversions. Lee-Rubio would also allow the nearly tax-free repatriation of the trillions of dollars of capital outside of the United States owned by American firms and individuals, in order to spur domestic economic growth.

Lee-Rubio also allows the deduction of 100 percent of capital investments in the same year they are made. Under current law, large capital expenditures must be deducted over several years, depending on the purchase. However, the present value of a dollar written off in the future is less than the value of a dollar write-off today.

The plan also proposes to tax business income only at the level of the business entity rather than as personal income, so that business owners and savers with a 401(k) or shares of stock are not taxed twice on the same income. This is a crucial step toward eliminating the double taxation of income and capital that is rampant in our tax code. The estate tax would be eliminated as well.

Steve Entin of the Tax Foundation found the reductions in the taxation of capital income in the Lee-Rubio tax plan would increase gross domestic product 15 percent over a decade, or about 1.45 percent annually above the baseline growth rate. Some economists worry the Lee-Rubio plan would increase the deficit. However, the Tax Foundation model shows federal revenues would be slightly higher after 10 years than under current tax law.

Conclusion: A Step in the Right Direction, with Some Improvements. The Lee-Rubio tax plan would reduce the complexity of the tax system and eliminate taxes on the productive activities of saving and investment. However, though a two-tiered system moves closer to a flat tax, the 35 percent bracket would raise the tax burden for households earning less than $200,000 a year, compared to the current system. A 22 percent to 25 percent top rate would be less burdensome.

Further, if the child tax credit is expanded, the NCPA recommends making it contingent on parents using it to provide health insurance for their children; or, if the children are otherwise covered, putting aside money in a Health Savings Account for the family's future medical needs.

Finally, continuing the home mortgage interest deduction contradicts a premise of the Lee-Rubio plan — that interest on savings and investment should not be taxed and interest on borrowing should not be deductible.

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