Insight

TAXES IN THE STIMULUS PACKAGE AND THE NEW CONGRESS

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Family Research Council believes that any changes in federal tax policy should serve three vital purposes at this time of uncertainty in the U.S. economy.

1. Proposals should favor permanent changes that foster long-term job creation by ensuring and increasing U.S. competitiveness in the world economy.

2. Gains in tax policy secured for the family from 1994-2004 and maintained for the past five years must not be reduced.

3. Tax changes are needed that promote personal savings, which will spur investment, and charitable giving to maintain thriving private and charitable sectors during this time of economic disruption.

Moreover, over the long run, tax simplification is needed so that families, businesses and investors can make wise long-term decisions and invest reliably rather than speculate for profit in a web of tax and investment schemes.

Throughout its history, FRC has focused on tax relief measures that proximately affect the family as our priority. We have endorsed and helped to secure:

1. The increase in the personal exemption from $1,080 to $2,000 in the Tax Reform Act of 1986 along with indexing of the exemption amount for inflation.

2. The enactment of the Child Tax Credit of $500 in 1996.

3. The doubling of the Child Tax Credit to $1,000 in President Bush's 2001 tax reform legislation (albeit this doubling of the credit expires after 2010).

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4. Elimination of the marriage penalty in the U.S. tax code in 2004 (albeit this correction of the marriage penalty also ends after 2010)

5. Other provisions that created incentives for Health Savings Accounts, Coverdell Savings Accounts for education, and death tax relief.

Moving forward, FRC believes that:

> As important as tax credits for children and marriage penalty relief are, they are irrelevant for bread-winners without jobs. In ordinary economic circumstances, especially given the erosion in the worth of child-based exemptions and credits, correcting these anomalies was not only FRC's top tax priority but the organization declined to take formal positions on other matters outside the scope of this relief. The following table, however, underscores the challenges that face the United States in restoring its economic health and creating more jobs.

Nation	Corporate Tax Rate (combined federal/state)
United States	39.3%[1]
Non-U.S. G-7 Countries	33.8%
Non-U.S. OECD Countries	31.9%
Germany	Under 30%[2]
United Kingdom	28%[3]
Ireland	12.5%

> Ireland's economic boom is directly attributable to corporate tax rates that are drawing companies out of Great Britain to the Emerald Isle. U.S. rates are higher than those of the rest of the developing world, a third higher than Germany and Britain's, and three times those of Ireland. As FedEx chairman and founder Fred Smith has argued, "[FedEx's] capital budget as we went into this year was about $3 billion. We went out to Boeing in July for our board meeting to see the new triple seven, [the Boeing 777] which we have bought. If we had a lower corporate tax rate with the ability to expense capital expenditures, guess what? We'd buy more triple sevens. We absolutely have to cut the corporate tax. Our current tax rate is about

[1] This and the following two data points are from the Tax Foundation at http://www.taxfoundation.org/research/show/23561.html
[2] Price Waterhouse Coopers web site at http://www.pwc.com/Extweb/pwcpublications.nsf/docid/45DD55FAD20224C7802571D8004EE546.
[3] Tax Foundation at http://www.taxfoundation.org/blog/show/23169.html

38%. Even Germany has a 25% rate." ("Washington is the Problem," *Wall Street Journal*, October 25, 2008.)

Recommendation 1: Reduce the U.S. corporate tax rate sharply.

> ***The United States should cut the corporate tax rate sharply to retain domestic businesses and attract overseas companies to relocate here and create new jobs. This policy is preferable to any plan to create new and temporary "hiring credits" as originally proposed by the incoming Obama administration, but now dropped from the new President's stimulus package. An alternative proposal released by the House Republican Study Committee on January 14 recommends reducing the U.S. corporate tax rate to 25%. Given additional state taxes faced by these companies, that national tax rate is the minimum cut necessary to put U.S. business taxes on par with the global competition.***

Second, in order to maintain predictability in the tax code and avoid a massive increase in 2011 just as the United States may be beginning a new era of economic growth, the tax cut measures adopted by Congress and signed by the President in 2001, 2003 and 2004 should be made permanent and even enhanced in modest ways. These tax changes include, most significantly (source: Andrew W. Grossman, "When Would the President's Tax Cuts Expire?" Heritage Foundation, November 2005):

1. **The Child Tax Credit**: This credit will shrink from $1,000 to $500 per child on January 1, 2011. The House Republican Study Committee proposal recommends increasing this credit to $5,000, a level that would better reflect the real cost to parents and the real value to society of investing in the next generation.

2. **The 10-Percent Bracket**: This bracket will be eliminated on January 1, 2011, raising the income tax burden of many workers by five percentage points.

3. **The 15-Percent Bracket for Joint Filers**: On January 1, 2011, the upper limit of this bracket will shrink from 200 to 167 percent of the upper limit for single filers, creating a marriage penalty.

4. **Standard Deduction for Joint Filers**: On January 1, 2011, this will shrink from 200 to 167 percent of the standard deduction for single filers, creating a marriage penalty.

5. **The Estate Tax**: The top rate for this tax will increase to 60 percent on January 1, 2011, and the value of an estate exempt from taxation will shrink to $1 million, which is less than it is today.

6. **The Income Tax**: Rates will increase between 3 and 4.5 percentage points in each bracket on January 1, 2011.

7. **Dividends:** Rates will rise to match standard income tax rates on January 1, 2011.

8. **Capital Gains**: Rates will rise to 10 or 20 percent, depending upon income, on January 1, 2011.

Recommendations 2 to 9: Congress should lift the expiration date on all eight of these pro-family changes in the tax code enacted during the past eight years. This will restore confidence, spur investment, and bolster marriage and the economy of the family household, the fundamental economy of the nation.
New tax breaks are being discussed for the Obama stimulus package that would not necessarily be inimical to families (e.g., the payroll tax credit and a business loss break). However these breaks are constructed, they represent short-term tax policy changes and do not permanently affect the tax code. The Bush stimulus package in early 2008 also returned a credit to most U.S. taxpayers but it is widely interpreted as having been put into savings by taxpayers or used to pay down household debt. While not an inherently unwise use of the funds, these were not uses that fueled short-term economic recovery.
FRC is not likely argue against payroll credit now because so many families will benefit, but we believe that the stimulus package offers a chance to enact some reforms that will stimulate two important goals: personal saving and charitable giving.

1. **Charitable Giving.** FRC has long favored some form of deductibility or credit for non-itemizers (who tend to be in the low income brackets) when they make gifts of cash or material to charity. As Arthur Brooks has demonstrated, the poor give much more, proportionately, to charity than middle- to upper-income individuals do, and conservatives donate more than liberals do. In one sense these facts argue that there is no problem to correct, but at another level it is clear that the tax code treats certain charitable givers inequitably. In fact, given the raft of refundable tax credits being discussed for low-income families, a deduction or credit that operates to reward those at lower income who are developing a habit of charitable giving could be a welcome step in the other direction. This

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Recommendation 10: FRC supports enactment of a federal income tax credit that would operate as a percentage of the cash or in-kind gifts made by non-itemizers in a tax year. The credit could be 50 percent of the first $200 of such giving in a tax year so that the total cost of the credit would be limited.

It is worth noting that there is little that a stimulus plan can do to assist charities, which are also being hard hit by the economy and a sharp decline in giving. The credit would of course be politically neutral and it should, unlike the emergency tax breaks for charitable giving after September 11, 2001, be available for both emergency social service organizations and public affairs groups.

Recommendation 11: Allow direct donations to charity without penalty from Individual Retirement Accounts, 401(k)'s, and similar retirement funds.

Under current law only individuals who have reached age 70-1/2 are permitted to make such penalty-free donations. This reform would help serve governmental as well as charitable interests, as there is evidence that contributions to charity produce an 8:1 benefit to the government, because the charity inevitably puts this money out into the economy -- which is much better in the short run for the government than letting the funds sit in a retirement account for decades.

Recommendation 12: Exempt interest on personal savings up to a fixed amount per person, say $200 for individuals and $400 for couples.

The tax code does very little to encourage habits of savings for small savers, and the low interest rates available on most conventional savings instruments do not help either. Various legislators are offering proposals that amount to redistributionism whereby government would create investment accounts for individuals at birth and deposit a fixed amount, say $500, into those accounts. Rather than use such means to promote personal investment/development, the federal tax code should exempt interest on personal savings up to a fixed amount per person, say $200 for individuals and $400 for couples. A proposal along these lines was advanced by Rep. Jim Saxton (R-N.J) (*see* http://www.house.gov/jec/fiscal/tx-grwth/exclude/exclude.htm) in 1998. Though modest, this idea could help shift family and individual habits and

[4] See Anne E. Kornblut, "In Obama Remarks, Theme of 'Responsibility' Emerges," *Washington Post* (January 19, 2009): A4.

rebalance our economy so that it is built on individual thrift and not merely on necessary and artificially stimulated consumption.

Recommendation 13: The Alternative Minimum Tax should be eliminated.

This tax hits families hard and eliminates gains from the child tax credit for many. It is doing the same damage that the federal tax code did during the 1950's, 60's, 70's and early 80's: through bracket creep increasing the taxes of married families with children. The AMT has the same adverse effect. Its original intent was to ensure that a handful of the highest-income Americans incur at least some tax liability and not avail themselves of tax shelters that would leave them with zero taxes. A "patch" of the AMT, as proposed by Congressional Democrats, does not redress the problem permanently. The need for constant patches and time-limited reforms and stimuli is a key indicator that our real tax problems – over-taxation and an incredibly complicated tax code – are not being solved.

Our nation's economy – and our families' livelihoods – deserve much better.