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BACKGROUNDER

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Tax Reform 2.0: Priorities After the Tax Cuts and Jobs Act of 2017

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Abstract

Following the most sweeping update to the U.S. tax code in more than 30 years, Americans are no longer suffering under its most burdensome features. The Tax Cuts and Jobs Act of 2017 (TCJA) simplified tax paying for many Americans, lowered taxes on individuals and businesses, and updated the business tax code so that American corporations and the people they employ can again be globally competitive. In 2025 most of the individual, and some of the business, tax cuts revert to pre-reform levels. The deadline gives Congress an opportunity to revisit the tax code, make much of it permanent, allow a few provisions to expire, and address many remaining issues not included in the 2017 tax law.

Americans are no longer suffering under the most burdensome features of the U.S. tax code. The Tax Cuts and Jobs Act of 2017 (TCJA) is the most sweeping update to the U.S. tax code in more than 30 years.[1] The new law simplified tax paying for many Americans, lowered taxes on individuals and businesses, and updated the business tax code so that American corporations and the people they employ can again be globally competitive.

Tax reform's initial economic success is apparent in the more than 350 businesses that announced raises, bonuses, and new investments directly benefiting millions of Americans—but the longer-run benefits are still on the horizon. Over the previous decade, business investment in the United States was unusually low, contributing to stagnant wage growth and a historically low number of new business start-ups.

The new permanent 21 percent federal corporate tax rate, down from 35 percent, is breaking the investment draught and turning

KEY POINTS

- Following the most sweeping update to the U.S. tax code in more than 30 years, Americans are no longer suffering under its most burdensome features.
- The new Tax Cuts and Jobs Act includes a series of tax cliffs, which provides an opportunity to improve and expand the many worthy parts of tax reform.
- Before 2025 when most taxes are slated to go back up, Congress should extend and expand full expensing, maintain lower individual tax rates, and permanently repeal the full SALT deduction.
- If Congress is unwilling to address unsustainable levels of federal spending, the American people will lose the opportunity for additional tax reform and will be forced to foot the coming bills through higher taxes.
- The ultimate goal of tax reform should always be to reduce the economic distortions caused by the current income tax system.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3296**

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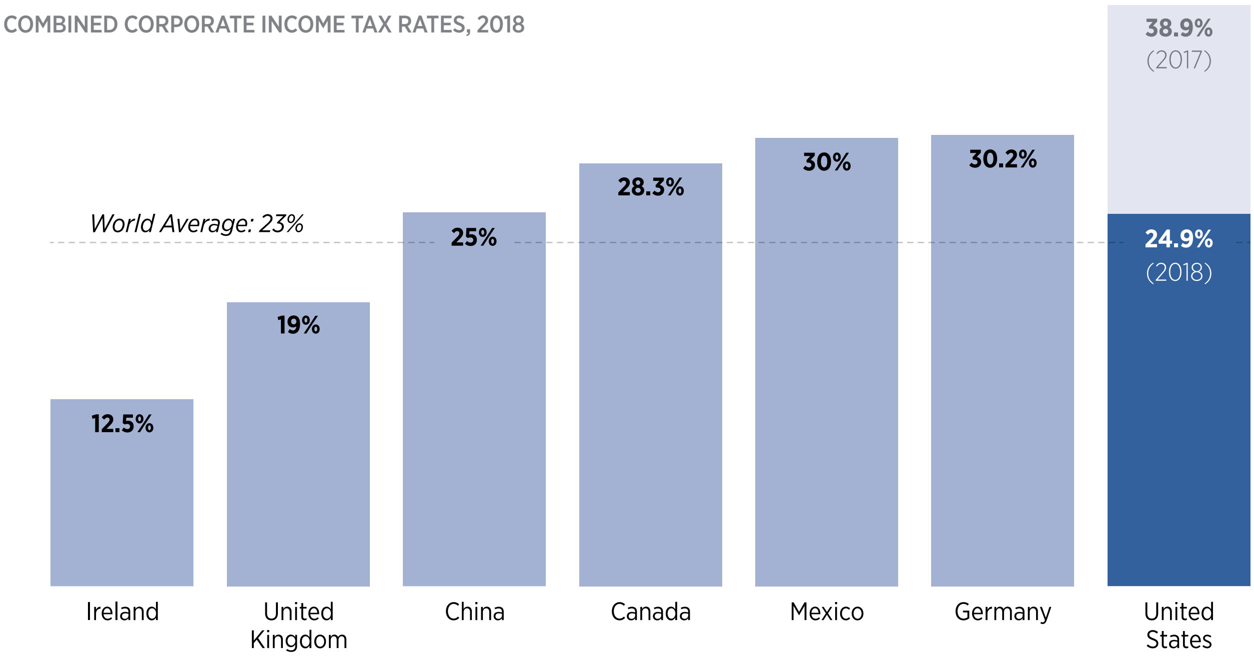
CHART 1

U.S. Lowers Corporate Tax Rate to Become More Competitive



SOURCES: OECD, "Table II.1. Statutory Corporate Income Tax Rate," http://stats.oecd.org/index.aspx?DataSetCode=TABLE_II1 (accessed March 7, 2018); KPMG, "Corporate Tax Rates: Federal and Provincial/Territorial Tax Rates for Income Earned by a General Corporation–2018," https://home.kpmg.com/content/dam/kpmg/ca/pdf/2018/01/federal-and-provincial-territorial-income-tax-rates-for-general-corporations-2018.pdf (accessed March 8, 2018); and Kari Jahnsen and Kyle Pomerleau, "Corporate Income Tax Rates around the World, 2017," Tax Foundation, September 7, 2017, https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/ (accessed March 8, 2018).

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around sluggish economic indicators. Lower business taxes attract investment in American manufacturing, research and development, and a larger, better-skilled workforce. Combined with average state tax rates, the U.S. now has a more globally competitive business-tax environment, with a combined average rate of 24.9 percent. A better business climate provides greater economic opportunities for Americans.

The fight for tax reform is, however, far from over. Advocates for pro-growth tax reform must work to defend and maintain the reforms included in the TCJA, while also recognizing the areas where the tax code can still be improved. Many of the individual and business tax cuts expire in 2025. Phase two of tax reform should build on the success of the TCJA by making much of it permanent, allowing a few provisions to expire, and addressing many remaining issues not included in the 2017 law. Prudent fiscal spending controls can further boost the successes of the TCJA in unleashing higher wages, more jobs, and continued expansion of opportunity through a larger and more dynamic economy.

Measures that Congress Should Extend or Expand

The new tax law includes a series of tax cliffs, which provide an opportunity to improve and expand the many worthy parts of the TCJA. On the flipside, the expirations also open the door to advocates for higher taxes and bigger government by which to hijack the success of tax reform. Congress should quickly return to the tax code and permanently cement the most important pieces of the 2017 reform.

1. The 2017 tax reform bill H.R. 1 is known as the Tax Cuts and Jobs Act. In a last minute procedural change, the act's name was stripped from the bill and remains officially nameless.

Allow Full Expensing. Full expensing allows businesses to deduct all investment expenses from taxable income, immediately. The expensing reforms included in the TCJA only allow businesses to deduct the full cost of a certain subset of investments. This artificially raises the cost of investment and slows job creation. Full expensing should be a primary component of any tax reform plan that emphasizes economic growth and the expansion of job opportunities.[2]

The TCJA expands the old-law 50 percent bonus depreciation for short-lived capital investments to 100 percent or "full expensing" for five years and then phases out over the subsequent five years. The TCJA also expands expensing for small businesses by raising the cap on eligible investment and increasing the phase-out amount.

A business owner who wants to expand by hiring 20 new employees knows he can pay the 20 additional salaries, but can he afford to expand his manufacturing space and buy the newest, most productive equipment? Without expensing, the tax code artificially makes the investment in new equipment and space more expensive by not letting the business owner deduct the full cost of the expansion in the year in which he makes the investment. Without the expansion, the business owner will not be able to add the new jobs, or increase productivity.

The TCJA limits expensing to equipment and ends the full benefit after just five years. Such temporary policy does little to lift long-run economic growth, and limiting the benefit to equipment exacerbates the relative tax disadvantage faced by longer-lived capital investments, creates new market distortions, and further undermines the economic growth promised by tax reform.

Making the temporary expensing included in the TCJA (restricted to equipment) permanent could double the economic boost projected from the 2017 reform.[3] Expanding the availability of expensing to all investments would further increase the level of domestic investment, permanently increasing the demand for labor, boosting job creation and wage growth to an even greater degree. Additional investments in longer-lived assets like new warehouses and factories are especially needed to create entry-level and middle-class jobs. The benefits of expensing would be shared by Americans at all income levels, especially those who need them the most.

Full expensing also greatly simplifies tax paying, as businesses would no longer have to track investments over many years for tax purposes, a requirement that costs businesses over $23 billion annually.[4] The benefits of expensing are not just for large corporations, but for all businesses, big and small. Small businesses and those who work in the emerging "gig economy" that cannot afford the complexity of the current system stand to gain the most.

Lower Rates Permanently. Tax rates for many families, individuals, businesses, and investors are still too high and threaten to increase after 2025. Permanently lower rates strengthen the economy by improving incentives to work, save, invest, and innovate—the building blocks of economic growth and prosperity.

For individuals and certain businesses, the top marginal federal tax rate is 40.8 percent, a combination of a top income tax rate of 37 percent and an additional 3.8 percent Obamacare tax on net investment. Americans in many states, such as California and Minnesota, still pay marginal income tax rates exceeding 50 percent, even after tax reform.

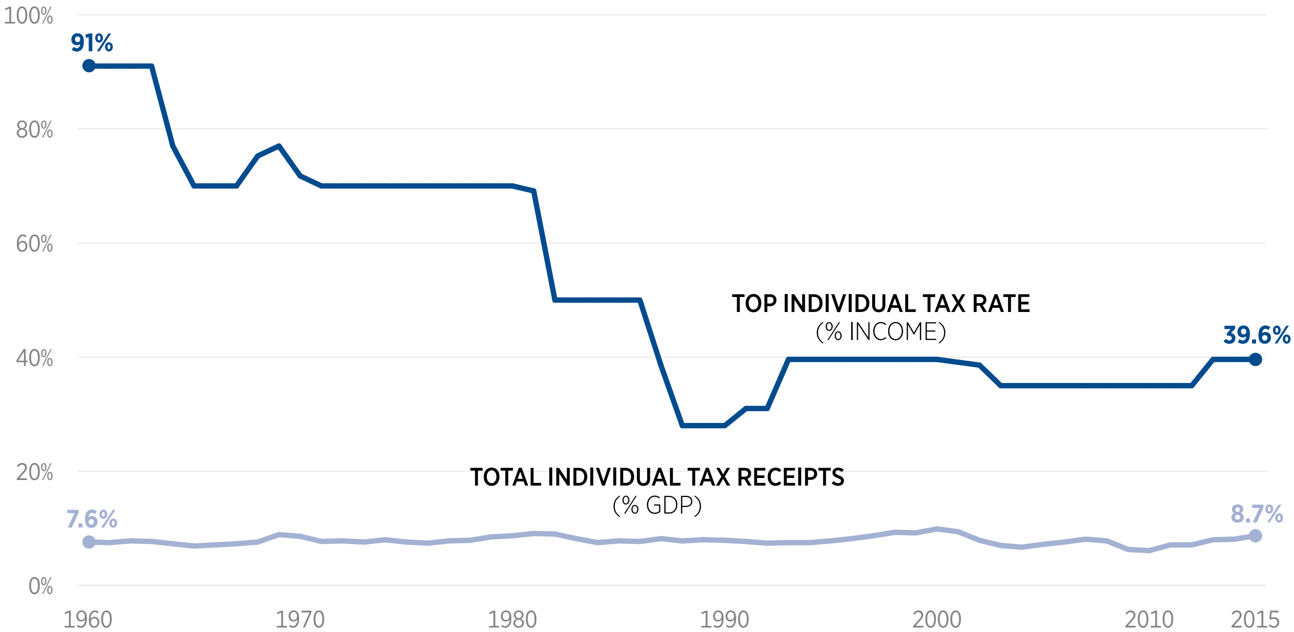
Despite the top federal individual tax rate fluctuating between 91 percent and 28 percent over the past 50 years, total individual tax receipts have remained fairly stable. High marginal rates reduce the strength of the economy and cut into tax revenue by discouraging additional work and productive entrepreneurship.

Fully Repeal the State and Local Tax (SALT) Deduction. The write-off for state and local taxes benefits only a minority of high-income taxpayers and provides a federal subsidy for the expansion of state-level bureaucracies and higher taxes. This forces people in low-tax states to subsidize big government in states like California, Illinois, and New

2. Adam N. Michel and Salim Furth, "For Pro-Growth Tax Reform, Expensing Should Be the Focus," Heritage Foundation *Issue Brief* No. 4747, August 2, 2017, http://www.heritage.org/taxes/report/pro-growth-tax-reform-expensing-should-be-the-focus.
3. "Preliminary Details and Analysis of the Tax Cuts and Jobs Act," Tax Foundation *Special Report* No. 241, December 2017, https://taxfoundation.org/final-tax-cuts-and-jobs-act-details-analysis/ (accessed February 3, 2018).
4. Scott A. Hodge, "The Compliance Costs of IRS Regulations," Tax Foundation *Fiscal Fact* No. 512, June 15, 2016, https://taxfoundation.org/compliance-costs-irs-regulations/ (accessed July 31, 2017).

CHART 2

High-Income Tax Rates Don't Raise Receipts



SOURCES: Office of Management and Budget, *Historical Tables*, "Table 2.3—Receipts by Source as Percentages of GDP: 1934–2023," https://www.whitehouse.gov/omb/historical-tables/ (accessed March 7, 2018), and Internal Revenue Service, "SOI Tax Stats Historical Table 23," https://www.irs.gov/statistics/soi-tax-stats-historical-table-23 (accessed March 7, 2018).

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York.[5] Simply limiting the deduction has already forced state governments to recognize their onerous tax burdens. New Jersey reportedly shelved an income tax increase, and other states are working to circumvent the cap—implicitly admitting that their fiscal policies are unsustainable absent the support of out-of-state taxpayers.

Under the TCJA, taxpayers who itemize their taxes will be able to deduct up to $10,000 of state and local property taxes and income taxes (or sales taxes) paid. The new deduction limit expires after 2025, reinstating the previously unlimited subsidy. In tax reform 2.0, Congress should eliminate all state and local tax deductions, for individuals and corporations. The full and permanent elimination of these deductions could allow federal tax rates to decline further—creating a more even playing field and allowing for more robust economic expansion.

Maintain Simplification. The TCJA simplifies individual taxpaying by consolidating and repealing unnecessarily complex provisions in the tax code and cutting the percentage of tax filers who need to itemize their deductions in half. These reforms should be extended permanently, before they expire in 2025.

The standard deduction is almost doubled, consolidating the additional standard deduction and personal exemptions into one larger write-off. For married joint filers, the deduction is $24,000; for single filers, it is $12,000. The child tax credit is also doubled under the TCJA, from $1,000 to $2,000 per child. The new larger credit offsets the repeal of the personal exemption for dependents and in many cases expands the federal tax subsidy for parents with children.

The repeal of the various exemptions eliminates the need for the complicated and obscure personal

5. Rachel Greszler, Kevin D. Dayaratna, and Michael Sargent, "Why Tax Reform Should Eliminate State and Local Tax Deductions," Heritage Foundation *Backgrounder* No. 3256, October 17, 2017, http://www.heritage.org/taxes/report/why-tax-reform-should-eliminate-state-and-local-tax-deductions.

exemption phase-out (PEP), which adds more than one percentage point per person to affected taxpayers' marginal tax rates. Also temporarily repealed is the phase-out of itemized deductions (Pease), which adds an additional percentage point to affected taxpayers' marginal tax rates. Congress must permanently repeal these provisions to enshrine a simplified tax code.

This simplification, however, comes at a cost. The consolidation and expansion of the standard deduction and child credit will exempt 5 million more people from paying any income tax at all in 2018.[6] When fewer people pay income taxes, fewer people care about the cost of government. Decreasing the number of households that pay any federal income tax lowers the personal cost of future government expansions, which could lead to higher overall tax rates in the future.

Repeal the Estate and Gift Tax. The federal estate tax (the "death tax") and gift taxes should be fully repealed, as they are an additional layer of tax on saving and investment. Every dollar of an estate has either been previously taxed or will be taxed under some other provision of the tax code. The death tax always adds an extra layer of tax to a family's savings. The tax often falls most heavily on inherited family businesses, which can have large valuations, but little available cash to pay the tax, requiring the business to be sold or loans to be taken out.

When fewer people pay income taxes, fewer people care about the cost of government.

The basic exclusion from the estate tax is temporarily doubled under the TCJA from $5.6 million per person to about $12 million. The 40 percent asset tax remains in the tax code and the exclusion reverts to pre-TCJA law after 2025.

Not permanently repealing the death tax is economic malpractice. In addition to confiscating generational bequests, the death tax likely does not raise any net revenue since it slows growth, diminishing potential revenue collection, and encourages tax avoidance by giving assets to relatives in lower income tax brackets, costing more in lost income tax revenue.[7]

Measures that Congress Should Allow to Expire

The new tax law includes some temporary provisions that should be allowed to expire. The pass-through deduction and the new family-leave credit create artificial economic distortions by picking winners and losers through the tax code and increasing complexity.

Pass-Through Deduction. Pass-through businesses that pay their taxes as individuals and face the new lower individual tax rates have access to a newly created business deduction. Pass-throughs are able to deduct 20 percent of certain types of non-salary business income, bringing the top marginal tax rate on certain pass-through income down to 29.6 percent. The deduction includes complicated restrictions and phase-outs for service providers in the fields of health, law, consulting, athletics, financial, or brokerage services if their married joint income is over $315,000.

Low marginal tax rates for small and pass-through businesses are a crucial component of a pro-growth tax code, as they account for 90 percent of businesses and employ over half the private-sector workforce.[8] However, the newly created rate differential between individual wage income and pass-through business income will increase the incentives to artificially treat income from wages as business income. The deduction has introduced a litany of new problems. For example, it has created artificial tax advantages for certain types of grain cooperatives and real estate investment trusts over their differently orga-

6. Tax Policy Center, "T17-0335–Tax Units With Zero or Negative Federal Individual Income Tax Under Current Law and the Tax Cuts and Jobs Act, 2018-2027," http://www.taxpolicycenter.org/model-estimates/conference-agreement-tax-cuts-and-jobs-act-dec-2017/t17-0335-tax-units-zero-or (accessed February 3, 2018).
7. John L. Ligon, Rachel Greszler, and Patrick Tyrrell, "The Economic and Fiscal Effects of Eliminating the Federal Death Tax," Heritage Foundation *Backgrounder* No. 2956, September 23, 2014, http://www.heritage.org/taxes/report/the-economic-and-fiscal-effects-eliminating-the-federal-death-tax.
8. Scott Greenberg, "Pass-Through Businesses: Data and Policy," Tax Foundation, January 17, 2017, https://taxfoundation.org/pass-through-businesses-data-and-policy/ (accessed February 14, 2018).

nized competitors. This new, and narrowly tailored, tax privilege has no consistent policy rational, arbitrarily favors certain types of businesses over others, introduces new complexity, and will provide new opportunities for unproductive tax planning.

The new deduction stems from an inherent inconsistency in the income tax system that taxes different business income differently. The current tax system taxes corporate income twice. For an investor in a traditional C corporation, the return on investment is not just taxed as corporate income—it is taxed a second time at 20 percent when the gain is realized as a dividend payment or capital gain. The total comparable effective rate on C corporations is 36.8 percent—which is higher than the 29.6 percent paid by pass-throughs qualifying for the deduction and about the same as those high-income service industries denied the deduction.[9]

Within the context of the current income tax, the corporate tax should ultimately be eliminated, or at least integrated into the individual income tax by allowing a credit for taxes paid.[10] As part of a holistic reform of business taxation, the 20 percent deduction should be replaced with a system that equalizes business taxation and further lowers tax rates on investments.

Paid Family-Leave Credit. The TCJA created a new tax credit program for paid leave, which should be allowed to expire, if not repealed before the date.

The new employer credit for paid family and medical leave allows a tax credit of up to 25 percent of wages paid to employees on qualifying leave. The new TCJA credit is only available for employees making under $72,000, and expires after 2019.

The temporary credit should be allowed to expire, as it is unlikely to induce new employers to offer qualifying paid-leave programs. Instead, the benefit will accrue to business owners who already offer such programs as a federally subsidized windfall profit. The credit should also not be made permanent. The narrowly tailored rules to access the credit are likely to derail the impressive expansions of privately provided leave programs, which have emerged as a margin of competition for employers to attract talent. Following in the footsteps of other new federal entitlements, the narrowly circumscribed credit is likely to grow over time. In contrast to the seemingly small $2 billion a year cost of the current credit, a credit to fully subsidize 16 weeks of paid leave (the goal of many advocates) would cost well upwards of $300 billion per year—more than the cost of the entire Medicaid program.[11]

New Considerations for Tax Reform 2.0

Remove Tax Favoritism. The tax code is still glutted with set-asides for the politically connected. These credits, deductions, and exemptions inhibit economic growth by subsidizing activities supported by special interests with higher tax payments by everyone else. This cronyism slows economic growth as people's time and investments are wasted on politically favored projects over those valued by consumers. The economy suffers because of the distortion.

Lawmakers should not use the tax code to pick winners and losers. That means that future tax reforms should eliminate, or at least substantially reduce, individual and corporate deductions, credits, exclusions, and exemptions that are not economically justified. Tax reform should eliminate unjustified tax subsidies that benefit particular industries, such as the myriad tax breaks for the production and consumption of politically favored types of energy and energy-efficient products.

In their quest for social and economic engineering, tax software has permitted the creativity of policymakers in Washington to run amok, creating tax complexities far beyond what even tax profes-

9. The new pass-through tax advantage is only strictly true for qualified dividends. The capital gains tax rate may be lower or higher in real terms depending on how long the stock is held, the interest rate, the inflation rate, and other variables. See Jared Walczak, "Are Pass-Through Businesses Treated Fairly Under the Senate Version of the Tax Cuts and Jobs Act?" Tax Foundation, November 17, 2017, https://taxfoundation.org/pass-businesses-treated-fairly-senate-version-tax-cuts-jobs-act/ (accessed December 6, 2017).

10. David R. Burton, "Tax Reform: Eliminating the Double Taxation of Corporate Income," Heritage Foundation *Issue Brief*, May 18, 2017, https://www.heritage.org/taxes/report/tax-reform-eliminating-the-double-taxation-corporate-income.

11. Rachel Greszler, "Paid Family Leave: Avoiding a New National Entitlement," Heritage Foundation *Backgrounder* No. 3231, July 20, 2017, https://www.heritage.org/jobs-and-labor/report/paid-family-leave-avoiding-new-national-entitlement, and Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, the 'Tax Cuts and Jobs Act,'" JCT-67-17, December 18, 2017, https://www.jct.gov/publications.html?func=startdown&id=5053 (accessed February 3, 2018).

sionals could manage, unaided by electronics. The multitude of credits, exemptions, exclusions, and deductions are each subject to special rules, interact with one another, and often phase out over different levels of income. The complexity of the tax code is made increasingly worse through hundreds of special preferences for state and local taxes, research and development, higher education, private housing, and investment in new markets, just to name a few.

Tax reform should eliminate unjustified tax subsidies that benefit particular industries, such as the myriad tax breaks for politically favored types of energy and energy-efficient products.

Get Interest Right. How the tax code handles interest is a frequent topic of misunderstanding. If interest income is taxable to lenders, it should be deductible to borrowers so that it is only taxed once. If interest is not taxable, it should not be deductible. Either treatment keeps taxes from influencing decisions to issue and take on debt.

The current treatment of interest in the tax code is neither uniform nor ideal. The TCJA limited the corporate deduction for net interest expense by capping it at 30 percent of earnings before interest and taxes.[12] Many forms of interest expenses are not deductible for the individual and can often escape taxation when distributed to international or other tax-preferred entities. Short of moving to a fully consistent treatment of interest, a partial limit on the net interest deduction is an acceptable short-term compromise to bring greater partial parity between debt and equity financing.[13]

In any future tax reform, Congress should choose one fully consistent treatment of interest and apply it uniformly. Getting this issue right is important because, if done incorrectly, it could have serious negative ramifications for the economy, resulting in new or increased forms of double taxation.

Tax Each Dollar Only Once, Through Universal Savings Accounts. The current tax code double-taxes many forms of savings and investment. Defining the right tax base (that is, what the tax code taxes) can remedy the bias against saving and investment, which is as important as lowering the tax rate.

Income that is saved or invested is taxed, and the return on that savings or investment is then taxed again. Moreover, income from investments in corporations is taxed yet again—first at the corporate level and then when individuals receive dividends or pay capital gains on corporate stock. By double- or triple-taxing saving and investment at high rates, the tax code deters families from saving for retirement, education, a rainy day, or for any other purpose they desire. This bias against savings and investment results in less capital formation, a less productive economy, and lower real wages.

One small step toward protecting all income from double taxation is through a universal savings account. Like the current tax treatment of personal retirement savings through employer sponsored 401(k) plans or individual retirement accounts (IRAs), income deposited into universal savings accounts would only be taxed once—allowing any investment growth to be withdrawn without a tax penalty. Different from retirement savings, these accounts would contain no restrictions on disbursements, allowing families to spend their money when it suits them best.

Repeal the Alternative Minimum Tax (AMT). The tax code remains absurdly complex. As if one tax code was not bad enough, there is a parallel tax called the AMT, which was repealed for corporations, but remains on the books with a higher exemption for individuals.

The individual AMT applies a two-rate alternative tax schedule to a more broadly defined measure of income and allows a narrower set of deductions. The tax increases the tax liability of those who can uniquely lower their effective tax rate through the normal tax system. The AMT does its intended job poorly and inefficiently by burdening taxpayers with additional paperwork and by not addressing the underlying problem—the tax code has too many credits and deductions that are easily gamed. The AMT should be fully repealed for all taxpayers.

12. For the first four years, the cap applies to a slightly different definition of earnings before interest, taxes, depreciation, and amortization.
13. Alan Cole, "Interest Deductibility–Issues and Reforms," Tax Foundation *Fiscal Fact* No. 548, May 4, 2017, https://taxfoundation.org/interest-deductibility/ (accessed September 29, 2017).

Repeal the Foreign Account Tax Compliance Act (FATCA). Signed into law in 2010, FATCA is intended to make it harder for Americans to keep money overseas and out of the reach of the IRS. The law requires foreign financial institutions, such as banks, to identify and report to the United States most types of transactions for all American clients. These new regulations are enforced by the threat of applying a 30 percent withholding tax on revenues generated in the United States by the noncompliant foreign financial institution.

The reporting burden and withholding penalty faced by foreign banks trying to comply with FATCA regulations has made it easier for many Americans to renounce their citizenship than to find a bank that is willing to bear the bureaucratic costs of complying with the law. In 2016, 5,411 people renounced their U.S. citizenship, the largest number of published expatriates in one year, continuing a four-year streak of record-breaking numbers. The compliance costs of these burdensome new rules—to both the U.S. government and American taxpayers—are far greater than the additional revenue the law brings in.[14]

Cut Spending and Reject All Forms of Tax Increases. Systemic deficits and growing debt constrain tax reform efforts and unnecessarily turn any conversation on tax reform into a debate about how to raise additional revenue. The ever-present constraint of the deficit imperils the successes of the TCJA tax cuts. Mounting debt and widening deficits will force Congress to make a false choice between letting the temporary tax cuts expire and extending them at the cost of further increases to the debt.

Often forgotten in Washington is the third option: Cut spending. The problems of deficit and debt are driven by too much spending, not too little tax collection. Without spending-based reforms, deficits will continue to grow, requiring still higher taxes in the future. Even under the TCJA revenue reductions, the size of the tax cuts are miniscule compared to the coming spending increases. Outlays will continue to far exceed revenues until Congress places meaningful constraints on federal spending.

In the face of rising deficits and unwillingness to address increasing spending, legislators have historically sought new sources of revenue or allowed tax cuts to expire. Portions of both the Reagan tax cuts in 1981 and the Bush tax cuts in the early 2000s were ultimately reversed. Spending reforms are a critical component of sustainable tax reform in light of high government deficits and debt.

In the face of rising deficits and unwillingness to address increasing spending, legislators have historically sought new sources of revenue or allowed tax cuts to expire.

Rather than reign in federal spending, there are proposals to levy additional new forms of taxes. These proposals often include a value-added tax (VAT), a carbon tax, a border-adjustment tax (BAT), or new excise taxes on sugar or financial transactions. In addition to not addressing the drivers of ballooning spending, new tax systems would increase complexity and likely allow the federal government to extract higher taxes from American taxpayers.

Prohibit Interstate Taxation. States have long yearned to collect sales taxes on purchases their citizens make from out-of-state businesses. Twenty-five years ago, in *Quill v. North Dakota,* the Supreme Court ruled that a state cannot require businesses to collect sales taxes for it unless those businesses have a physical nexus—such as a building, warehouse, or employees—in that state. The prohibition on interstate taxation is being challenged at the nation's highest court.

If the Supreme Court upends a quarter-century of precedent on sales taxes it will put consumers—especially customers of small, Internet-based retailers—at risk of new and higher taxes and more burdensome regulatory compliance costs. There is still no good reason to expand the reach of state tax collectors. While seeming to level the retail-tax playing field, an expansion of interstate taxation would instead create new burdens, while bulldozing fundamental principles of federalism.[15] Congress should

14. Adam N. Michel, "Why Record Numbers of Americans Are Renouncing Their Citizenship," The Daily Signal, April 24, 2017, http://dailysignal.com/2017/04/24/why-record-numbers-of-americans-are-renouncing-their-citizenship/ (accessed February 16, 2018).

15. James L. Gattuso and Adam N. Michel, "Taxing Out-of-State Sales: Still a Bad Idea," Heritage Foundation *Issue Brief* No. 4798, December 18, 2017, https://www.heritage.org/taxes/report/taxing-out-state-sales-still-bad-idea.

step forward to protect and codify the pro-federalism protections set out in *Quill*.

Reject a Gas-Tax Hike. Since the effective completion of the Interstate Highway System in the early 1990s, Congress has expanded use of gas-tax revenues far beyond maintaining a limited federal system of Interstate highways, instead electing to dole them out to politically favored projects.[16] Nearly 30 percent of gas-tax dollars are diverted to projects wholly unrelated to the National Highway System, while Members of Congress have continually expanded gas-tax funding to roads far outside the scope of the federal government.[17]

Instead of increasing this regressive tax, which clearly no longer serves its stated purpose, it should be gradually eliminated, allowing states to adopt their own means of raising infrastructure revenues.

Resist a Value-Added Tax (VAT). The VAT is a major source of tax revenue for every industrialized country in the world except the United States. In addition to calls for additional revenue, proponents often cite the economic virtues of the VAT as an additional reason for the United States to adopt it. While the VAT may have some economic advantages compared to other tax systems, these theoretical advantages would apply only if it replaces all other federal taxes. If Congress simply added a VAT on top of the current tax system, its comparative advantages would disappear.[18] It would raise taxes by hundreds of billions, or even trillions, of dollars each year, enabling an expansion in the federal government's size and scope while reducing the share of income that Americans get to keep and spend on what they see fit.

Veto a Carbon Tax. Interested in raising revenue and combatting global warming, some policymakers in Washington have floated the idea of a carbon tax. Like all new sources of revenue, a carbon tax would not address the long-run fiscal deficits driven by spending. A carbon tax would instead drive up energy costs, reduce employment, and shrink incomes—harming the most vulnerable low-income Americans the most. The costs would come with no tangible environmental benefits. Unilaterally reducing greenhouse gases would leave global emissions largely unchanged. Future carbon emissions will come overwhelmingly from developing countries (China and India, for example), which show little appetite for squeezing economic growth for the sake of the environment. The economic, environmental, and political realities surrounding a carbon tax clearly indicate that this is bad policy.[19]

Conclusion

The ultimate goal of tax reform should always be to reduce the economic distortions caused by the current income tax system. Most economists agree that a flat consumption tax is the most efficient way for government to raise the limited revenue it needs to carry out constitutionally proscribed duties. A flat tax applies a single tax rate to all of an individual's earnings and related benefits after subtracting the net amount contributed to savings. This eliminates the current income tax system's bias against saving by taxing each dollar only once, and ensures that tax is paid only on what individuals consume—not on the savings they make available for investment by others.

Each of the changes listed above will move the tax code closer to a system that protects savings and investment from additional layers of tax and ultimately in the direction of a consumption tax. In 2025, most of the individual and some of the business tax cuts in the TCJA revert to pre-reform levels. The deadline means that in the coming years Congress will need to revisit the tax code to keep taxes from going back up. If Congress is unwilling to address the entire federal fiscal picture, the American people will be forced, one way or another, to foot the coming bills from ongoing spending profligacy.

What the future of reform looks like is uncertain, but there exists an opportunity for Congress

16. "Gas tax" is shorthand for the federal per gallon tax levied on gasoline and diesel fuels under 26 U.S. Code § 4081.
17. Michael Sargent and Nicolas D. Loris, "Driving Investment, Fueling Growth: How Strategic Reforms Can Generate $1.1 Trillion in Infrastructure Investment," Heritage Foundation *Backgrounder* No. 3209, May 8, 2017, http://www.heritage.org/transportation/report/driving-investment-fueling-growth-how-strategic-reforms-can-generate-11.
18. Curtis Dubay, "The Value-Added Tax Is Wrong for the United States," Heritage Foundation *Backgrounder* No. 2503, December 21, 2010, https://www.heritage.org/taxes/report/the-value-added-tax-wrong-the-united-states.
19. David W. Kreutzer and Nicolas D. Loris, "Carbon Tax Would Raise Unemployment, Not Swap Revenue," Heritage Foundation *Issue Brief* No. 3819, January 14, 2013, https://www.heritage.org/environment/report/carbon-tax-would-raise-unemployment-not-swap-revenue.

to provide even more far-reaching and permanent reforms and solidify America as a global destination for business investment, benefiting American workers through untold economic opportunity.

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