



## Stealth Approach to Tax Reform

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Unbeknownst to many of the loudest advocates for radical change in our archaic tax code, fundamental tax reform is already under way. Mercifully, this lack of awareness extends to the opponents of reform -- of whom there are surprisingly many.

Aided by veterans of the last tax-reform wars, the Bush administration seems to be quietly and efficiently putting in place the real substance of tax reform. It is taking form through a series of familiar and eminently sensible changes to the tax code, identified in the 1990s, that eliminate the principal tax impediments to economic growth.

This politically adept and economically wise approach is in great contrast to the "radical" origins of tax reform only a few years ago. A near rebellion against the current income tax code arose during the first half of the 1990s. The code's huge size and mind-boggling complexity were held up to ridicule. Examples of frightening invasions of privacy and taxpayer abuse abounded. The tax code was a true villain. Calls went up to "tear it out by the roots" and to replace it with something better. It was all great fun and it was all part of a conservative-led, anti-big-government uprising that produced the Republican takeover of the House of Representatives in 1994. Even Bill Clinton was moved to declare that the "era of big government" was over.

To have listened to much of the bombast in the 1990s was to have concluded that most tax reformers wanted to abolish the tax code, not replace it with something better. Nevertheless, the upheaval and debate did produce two valuable alternatives to the current tax code: the "Flat Tax" and the "USA Tax" (also known as "Nunn-Domenici" after its two senatorial sponsors). While both were much simpler (the Flat Tax even promised to reduce tax returns to a postcard), their main focus was on curing the very bad economics of the current tax code. The USA Tax, in particular, illustrated to many people, especially members of Congress, one very crucial point. That is, it is easy to stay within the American tradition of taxing income while at the same time (a) lowering the exorbitantly high marginal tax rates that discourage work and (b) eliminating the existing tax penalty on personal saving and the penalty on business capital investment, both of which under present law substantially depress productivity and wage gains. The USA Tax and the Flat Tax also illustrated how to reform the corporate tax, and, most significantly, the USA Tax showed how to stimulate exports and good manufacturing jobs in the United States instead of driving U.S. companies offshore as does the current tax code. The USA Tax went even farther and brought foreign companies within the ambit of the U.S. tax system when they compete in our economy.

While both the Flat Tax and the USA Tax were good replacements for the current code, they were destined never to be enacted into law. Rhetorical excesses made them seem too radical and experimental. Many thought the mental gymnastics required to understand how these new tax structures actually worked (really, very simply) too hard. In short, the good tax-reform proposals of the mid-1990s were a symphony with too many notes for Congress to play.

By 1998, however, the economic substance of tax reform had been translated into five fairly easy and familiar amendments to the current code - nothing frightening or radical at all. The "Five Easy Pieces," as they came to be called by many tax-reform cognoscenti, are: (a) lowering marginal rates; (b) eliminating the double tax on corporate earnings; (c) accelerating depreciation, ultimately to the point of 100 percent first-year expensing for business capital investment; (d) expanding the Roth IRA to all personal saving; and (e) excluding export and other foreign trade income of American companies from tax in much the same way that other countries do in the world marketplace.

"Stealth" tax reform is already under way. As the accompanying graphic shows, all of the "Five Easy Pieces" have either been enacted in some form, are in the process of being enacted, or are about to begin that process. Each has its own merits and a powerful political constituency. Altogether, they add up to fundamental tax reform.

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