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Details and Analysis of Senator Rick Santorum's Tax Plan

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Key Findings

- Senator Santorum's tax plan would enact a 20 percent flat tax on individual and corporate income, and repeal a number of complex features in the current tax code.
- Senator Santorum's plan would cut taxes by $3.2 trillion over the next decade on a static basis. However, the plan would end up reducing tax revenues by $1.1 trillion over the next decade when accounting for economic growth from increases in the supply of labor and capital.
- According to the Tax Foundation's Taxes and Growth Model, the plan would significantly reduce marginal tax rates and the cost of capital, which would lead to a 10.2 percent higher GDP over the long term, provided that the tax cut could be appropriately financed.
- The plan would also lead to a 29 percent larger capital stock, 7.3 percent higher wages, and 3.1 million more full-time equivalent jobs.
- On a static basis, the plan would cut taxes by 3 percent on average for all taxpayers. The top one percent of taxpayers by income would have the highest increases in after-tax income, along with the lowest ten percent. However, some upper-middle-income deciles would have decreases in after-tax income.
- Accounting for economic growth, all taxpayers would see an increase in after-tax income of at least 7.5 percent at the end of the decade

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This week, former Senator Rick Santorum released details of a tax reform plan.[1] This plan would institute a flat 20 percent tax rate on all varieties of individual income. It would also consolidate all deductions into a single $2,750 per person credit, which would be refundable up to the amount of an individual's earned income. The plan would also reduce the corporate income tax to that same 20 percent rate. In addition, the plan would eliminate the estate tax and the Alternative Minimum Tax.

Our analysis finds that the plan would reduce federal revenues by $3.2 trillion over the next decade. However, it also would improve incentives to work and invest, which would increase gross domestic product (GDP) by 10.2 percent over the long term. This increase in GDP would translate into 7.3 percent higher wages and 3.1 million new full-time equivalent jobs. After accounting for increased incomes due to these factors, the plan would reduce tax revenues by $1.1 trillion.[2]

Details of the Plan

Individual Income Tax Changes

- Consolidates the current seven tax brackets into one bracket at 20 percent on all personal income.
- Eliminates the personal exemption and standard deduction.
- Taxes long-term capital gains and qualified dividends at ordinary income tax rates.
- Eliminates all itemized deductions except for the home mortgage interest deduction and the charitable deduction. Places a tighter cap on the home mortgage interest deduction.
- Eliminates the Alternative Minimum Tax.
- Eliminates the Net Investment Income Tax of 3.8 percent and the Medicare surtax of 0.9 percent, which were passed as part of the Affordable Care Act.
- Creates a refundable tax credit, replacing the current earned income tax credit, of $2,750 per person, not to exceed the filer's earned income.
- Preserves the exclusions from income of pension contributions, employer-provided health premiums, and imputed rent, similar to current law.

1 Rick Santorum, *A Flat Tax Is the Best Path to Prosperity*, The Wall Street Journal, Oct. 11, 2015, http://www.wsj.com/articles/a-flat-tax-is-the-best-path-to-prosperity-1444600639.

2 For a reduction in revenues of this size, it is also likely appropriate to consider the macroeconomic effects that the Taxes and Growth Model does not predict. Among these are the fiscal costs of higher interest payments, as well as the macroeconomic effects of the spending reductions needed to bring the budget into balance.

Business Tax Changes

- Reduces the top corporate income tax rate from 35 percent to 20 percent.
- Allows all capital investments to be fully deductible in the year they are purchased.
- Eliminates the deductibility of interest paid for businesses.
- Most small corporate tax expenditures (those not pertaining to deferral or to asset lives) are eliminated.
- Manufacturing corporations will have a 0 percent rate in the first year, which would phase up to the 20 percent rate over two years.
- Enacts a one-time deemed repatriation tax of 10 percent on all foreign profits currently deferred.

Other Changes

- Eliminates the estate tax.

Economic Impact

According to our Taxes and Growth Model, the increased incentives to work and invest from this tax plan would increase the size of the economy by 10.2 percent over the long run. The plan would lead to 7.3 percent higher wages and a 29 percent larger capital stock. The larger economy would mainly result from a significant reduction in the service price of capital, due to the rate reductions for business and the immediate cost recovery. In addition, the reduction of marginal tax rates on individual income would increase incentives to work and result in 3.1 million full-time equivalent jobs.

Table 1.
Economic Impact of Senator Santorum's Tax Reform Plan

GDP	10.2%
Capital Investment	29%
Wage Rate	7.3%
Full-time Equivalent Jobs (in thousands)	3,135

Source: Tax Foundation Taxes and Growth Model, Oct. 2015.

Revenue Impact

Overall, the plan would reduce federal revenue on a static basis by $3.2 trillion over the next ten years. Most of the revenue loss is due to the reduction in individual and corporate income taxes, which we project to reduce revenues by approximately $1.7 trillion and $1.3 trillion, respectively, over the next decade. The remaining static cost ($238 billion) comes from the elimination of the estate tax.

If we account for the economic growth that the plan would produce, the plan would end up lowering revenue by $1.1 trillion over the next decade. The larger economy would increase wages, which would narrow the revenue lost through the individual income tax by about $1.1 trillion and increase payroll tax revenues by $743 billion, with the remainder of the recouped revenue coming from other taxes.

Table 2.
Ten-Year Revenue Impact of Senator Santorum's Tax Reform Plan (Billions of Dollars)

Tax	Static Revenue Impact (2015-2024)	Dynamic Revenue Impact (2015-2024)
Individual Income Taxes	-$1,724	-$645
Payroll Taxes	$0	$743
Corporate Income Taxes	-$1,260	-$1,105
Excise Taxes	$0	$61
Estate and Gift Taxes	-$238	-$238
Other Revenue Sources	$0	$90
Total	-$3,223	-$1,093

Source: Tax Foundation Taxes and Growth Model, Oct. 2015.
Note: Individual items may not sum to the total due to rounding.

Distributional Impact

On a static basis, Senator Santorum's tax plan would increase after-tax incomes by 3 percent, on average. Taxpayers in most income groups would see higher after-tax incomes, while taxpayers in the upper-middle income bracket would see lower after-tax incomes.

Taxpayers in the bottom decile would see a 13.9 percent increase in after-tax income due to the refundable per person credit. The next five deciles (the 10^{th} through 60th percentiles) would see increases in after-tax adjusted gross income (AGI) of between 0.4 and 2.1 percent. Upper-middle-income taxpayers with incomes that fall within the 60th to 90th percentiles would see decreases in their after-tax AGI of between 0.3 and 1.3 percent. Finally, taxpayers with incomes that fall in the highest income class (the 90-100 percent decile) would see an increase in after-tax income of 6.7 percent. The top 1 percent of all taxpayers would see a 15.4 percent increase in after-tax income.

On a dynamic basis, the plan would increase after-tax incomes by 11.2 percent on average. All deciles would see an increase in after-tax AGI of at least 7.5 percent over the long term. Taxpayers that fall in the bottom decile would see their after-tax AGIs increase by 22.5 percent. The middle eight deciles would see increases in their after-tax AGI between 7.5 and 11.5 percent. The top decile would see an increase in after-tax AGI of 14.3 percent, and the top 1 percent of all taxpayers would see an increase in after-tax AGI of 21.0 percent.

Table 3.

Distributional Analysis for Senator Santorum's Tax Reform Plan

Effect of Tax Reform on After-Tax Income Compared to Current Law

All Returns by Decile	Static Distributional Analysis	Dynamic Distributional Analysis
0% to 10%	13.9%	22.5%
10% to 20%	0.4%	7.5%
20% to 30%	1.2%	8.7%
30% to 40%	1.8%	10.2%
40% to 50%	2.1%	11.5%
50% to 60%	1.1%	10.3%
60% to 70%	-0.3%	8.7%
70% to 80%	-1.2%	7.7%
80% to 90%	-1.3%	7.6%
90% to 100%	6.7%	14.3%
99% to 100%	15.4%	21.0%
TOTAL FOR ALL	3.0%	11.2%

Source: Tax Foundation Taxes and Growth Model, Oct. 2015.

Conclusion

Senator Santorum's tax plan would enact a number of tax reforms that would lower marginal tax rates on labor. In addition, the reduced corporate income tax with immediate cost recovery would significantly reduce the cost of capital. These changes in the incentives to work and invest would greatly increase the U.S. economy's size in the long run, leading to higher incomes for taxpayers at all income levels. The plan would also be a large tax cut, which would increase the federal government's deficit by over $3.2 trillion on a static basis and $1.1 trillion on a dynamic basis.

Modeling Notes

The Taxes and Growth Model does not take into account the fiscal or economic effects of interest on debt. It also does not require budgets to balance over the long term, nor does it account for the potential macroeconomic effects of any spending cuts that may be required to finance the plan.

Senator Santorum has proposed a repeal of the Patient Protection and Affordable Care Act, colloquially known as Obamacare. Included in these modeling provisions are the 3.8 percent surtax on investment income, and the 0.9 percent Medicare surtax. However, not included are the provisions more specifically applicable to the health care law, such as its excise taxes, its mandate penalties, and its premium tax credits for plans purchased over the exchanges.