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Details and Analysis of Senator Ted Cruz's Tax Plan

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Key Findings

- Senator Cruz's (R-TX) tax plan would enact a 10 percent flat tax on individual income and replace the corporate income tax and all payroll taxes with a 16 percent "Business Transfer Tax," or subtraction method value-added tax. In addition, his plan would repeal a number of complex features of the current tax code.
- Senator Cruz's plan would cut taxes by $3.6 trillion over the next decade on a static basis. However, the plan would end up reducing tax revenues by $768 billion over the next decade when accounting for economic growth from increases in the supply of labor and capital and the much broader tax base due to the new value-added tax.
- 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 13.9 percent higher GDP over the long term, provided that the tax cut could be appropriately financed.
- The plan would also lead to a 43.9 percent larger capital stock, 12.2 percent higher wages, and 4.8 million more full-time equivalent jobs.
- On a static basis, the plan would cut taxes by 9.2 percent, on average, for all taxpayers.
- Accounting for economic growth, all taxpayers would see an increase in after-tax income of at least 14 percent at the end of the decade.

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This week, Senator Ted Cruz (R-TX) released details of a tax reform plan.[1] This plan would institute a flat 10 percent tax rate on all varieties of individual income, with a large standard deduction and personal exemption. It would also repeal all itemized deductions except for the charitable deduction and the home mortgage interest deduction. The plan would replace the corporate income tax and all payroll taxes with a broad-based "Business Transfer Tax," or value-added tax (VAT), with few exemptions. The plan would maintain the Child Tax Credit and expand the Earned Income Tax Credit by 20 percent. In addition, the plan would eliminate the Estate Tax, the Alternative Minimum Tax, the Net Investment Income Tax, and miscellaneous credits.

Our analysis finds that the plan would reduce federal revenues by $3.6 trillion over the next decade. However, the plan would improve incentives to work and invest, which would increase gross domestic product (GDP) by 13.9 percent over the long term. This increase in GDP would translate into 12.2 percent higher wages and 4.8 million new full-time equivalent jobs. After accounting for increased incomes due to these factors, the plan would reduce tax revenues by $768 billion.

Details of the Plan

Individual Income Tax Changes

- Consolidates the current seven tax brackets into one bracket at 10 percent on all personal income (wages, salaries, interest, capital gains, dividends, and business income).

- Increases the Standard Deduction from $6,300 ($12,600 married filing jointly) to $10,000 ($20,000 married filing jointly).

- 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.

- Eliminates all individual tax credits except for the Child Tax Credit and the Earned Income Tax Credit. Expands the Earned Income Tax Credit by 20 percent.

1 *The Simple Flat Tax Plan*, Oct. 28, 2015, https://www.tedcruz.org/tax_plan/.

- Preserves the exclusions from income of pension contributions, employer-provided health premiums, and imputed rent, similar to current law.

- Creates a new "universal savings account" that allows up to $25,000 of tax-deductible saving.

- Eliminates the payroll tax.

Business Tax Changes

- Eliminates the corporate income tax.

- Provides a temporary tax holiday at a 10 percent rate (instead of a full 35 percent rate) on any deferred foreign profits that are repatriated.

Other Changes

- Enacts a broad-based, 16 percent "Business Transfer Tax" or value-added tax. This tax is levied on all business profits, less capital investment. This would include the payroll of business, government, and non-profit institutions, as well as net imports. The tax would exempt from taxation the purchase of health insurance. A business transfer tax is also often known as a subtraction-method value-added tax. While its base is identical in economic terms to that of the credit-invoice VAT seen in many OECD countries, it is calculated from corporate accounts, not on individual transactions. [2]
- Eliminates the estate tax.

Economic Impact

Senator Cruz's tax reform would be a significant shift from the current tax code. Under this plan, the income tax would be greatly diminished in its importance compared to current law. Instead, the U.S. federal government would raise 71 percent of all revenue from the new broad-based value-added tax. The tax is a broad consumption tax that would include most of U.S. GDP, including both wages and profits.[3] Due to these changes, the taxation of investment would significantly decline, which would greatly increase incentives to save and invest.

2 This rate is in tax-inclusive terms. This is equivalent to a credit-invoice value-added tax or sales tax of approximately 19 percent on goods and services.

3 This makes it similar to the combination of a payroll tax and a corporate income tax with immediate cost recovery. Both the payroll tax and the corporate income tax under current law would be eliminated under the proposal.

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 13.9 percent over the long run. The plan would lead to 12.2 percent higher wages and a 43.9 percent larger capital stock. The larger economy would mainly result from a significant reduction in the service price of capital, due to the elimination of the corporate income tax and the significant reduction in the individual income tax. In addition, the reduction of marginal tax rates on individual income would increase incentives to work and result in 4.8 million full-time equivalent jobs.

Table 1.

Economic Impact of Senator Cruz's Tax Reform Plan

GDP	13.9%
Capital Investment	43.9%
Wage Rate[4]	12.2%
Full-time Equivalent Jobs (in thousands)	4,861

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

Revenue Impact

The Senator's plan would eliminate the corporate income tax, the payroll tax, and the estate tax, which combined would reduce federal revenue by $17.3 trillion over the next decade. The reduction in individual income tax rates would lower revenue by an additional $11.8 trillion. Most of this revenue would be made up for with revenue from the new 16 percent value-added tax. This tax would raise $25.4 trillion over the next decade. On net, the plan would reduce federal revenue on a static basis by $3.6 trillion over the next ten years.

If we account for the economic growth that the plan would produce, the plan would end up lowering revenue by $768 billion over the next decade. The larger economy would increase wages, which would narrow the revenue lost through the individual income tax by about $700 billion. In addition, the new value-added tax would end up raising $2.2 trillion more over the next decade, due to growth of the economy.

Table 2.

Ten-Year Revenue Impact of Senator Cruz's Tax Reform Plan (Billions of Dollars)

Tax	Static Revenue Impact (2015-2024)	Dynamic Revenue Impact (2015-2024)
Individual Income Taxes	-$11,802	-$11,135
Payroll Taxes	-$12,658	-$12,658
Corporate Income Taxes	-$4,413	-$4,413
Excise Taxes	$0	$83
Estate and Gift Taxes	-$238	-$238
Other Revenue Sources	$0	$122
Business Transfer Tax (VAT)	$25,444	$27,471
Total	**-$3,666**	**-$768**

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

4 The wage rate change here includes both growth in labor productivity and changes to the tax burden on labor through payroll and business transfer taxes.

Distributional Impact

On a static basis, Senator Cruz's tax plan would increase after-tax incomes by 9.2 percent, on average. Taxpayers in all income groups would see higher after-tax incomes.

Taxpayers in the bottom decile would see a 4.3 percent increase in after-tax income due to the expansion of the Earned Income Tax Credit, which more than offsets the impact of the new value-added tax. The next six deciles (the 10^{th} through 70^{th} percentiles) would see increases in after-tax adjusted gross income (AGI) of between 1.2 and 2.4 percent. High income taxpayers that fall in the highest income class (the 90-100 percent decile) would see an increase in after-tax income of 17.4 percent. The top 1 percent of all taxpayers would see a 29.6 percent increase in after-tax income.

On a dynamic basis, the plan would increase after-tax incomes by 21.3 percent on average. All deciles would see an increase in after-tax AGI of at least 14.2 percent over the long term. Taxpayers that fall in the bottom decile would see their after-tax AGIs increase by 15.3 percent. The middle eight deciles would see increases in their after-tax AGI between 14.2 and 18.4 percent. The top decile would see an increase in after-tax AGI of 27.1 percent, and the top 1 percent of all taxpayers would see an increase in after-tax AGI of 34.2 percent.

Table 3.

Distributional Analysis for Senator Cruz'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%	4.3%	15.3%
10% to 20%	2.4%	14.8%
20% to 30%	1.5%	14.2%
30% to 40%	1.3%	14.5%
40% to 50%	1.2%	15.5%
50% to 60%	1.5%	16.0%
60% to 70%	2.0%	16.4%
70% to 80%	2.8%	16.8%
80% to 90%	4.5%	18.4%
90% to 100%	17.4%	27.1%
99% to 100%	29.6%	34.2%
TOTAL FOR ALL	9.2%	21.3%

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

Conclusion

Senator Cruz's tax plan would significantly alter the federal tax code. It would completely repeal the corporate income tax and all payroll taxes and enact a 10 percent income tax and a 16 percent "business transfer tax" or value-added tax. These changes to the tax code would increase the incentives to work and invest and 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 $3.6 trillion on a static basis. Accounting for the growth caused by the plan, federal revenues would decline by $768 billion over the next decade.

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.

We modeled most of the major provisions outlined above, except for a few that are beyond the scope of the model, or require data that is not available. We did not model the economic impacts nor the costs of the proposed universal saving accounts. We did not model the repatriation tax holiday. We assumed that the EITC expansion was applicable to all currently eligible taxpayers. As such, their EITC payments increased by 20 percent. In modeling the value-added tax, we held prices constant and passed the tax back to the factors of production.

Under current law, some taxes on labor are explicitly levied on nominal wages, reducing take-home pay, while others are implicitly passed on to workers through lower nominal wages. The business transfer tax would also fall substantially on payrolls, but it would do so entirely through implicit reductions in nominal wages rather than explicit reductions in take-home pay. The change in wage rate reported here is the net of growth in labor productivity as well as the explicit and implicit changes in worker take-home pay due to taxes.