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Details and Analysis of Dr. Ben Carson's Tax Plan

By Kyle Pomerleau
Director of
Federal Projects

Key Findings

- Dr. Ben Carson's tax plan would replace the federal income tax code with a modified Hall-Rabushka-style flat tax of 14.9 percent.
- Dr. Carson's plan would cut taxes by $5.6 trillion over the next decade on a static basis. However, the plan would end up reducing revenues by $2.5 trillion over the next decade when accounting for economic growth, due to increases in the supply of labor and capital.
- The plan would also result in increased outlays, due to higher interest on the debt, creating a 10-year deficit somewhat larger than the estimates above.
- The plan would move to a consumption base, which would significantly reduce the cost of capital. According to the Tax Foundation's Taxes and Growth Model, the plan would lead to a 16 percent higher GDP over the long term, provided that the tax cut could be appropriately financed.
- The plan would also lead to a 46.6 percent larger capital stock, 10.9 percent higher wages, and 5.2 million more full-time equivalent jobs.
- On a static basis, the plan would increase taxes on all income groups except the top 10 percent of taxpayers. The plan reduces the after-tax income of the bottom three income deciles by as much as 14.8 percent. The top decile would see an increase in after-tax income of 16 percent and the top 1 percent would see an increase of 33 percent.
- Accounting for economic growth, all taxpayers would see an increase in after-tax income of at least 0.5 percent in the long term.

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Editor, Melodie Bowler
Designer, Dan Carvajal

Tax Foundation
1325 G Street, NW, Suite 950
Washington, DC 20005

202.464.6200

taxfoundation.org

This week, Dr. Ben Carson released details of a tax reform plan.[1] This plan would replace the current federal income tax (both individual and corporate) with a 14.9 percent Hall-Rabushka-style flat tax. The plan would tax all wage income and business income at 14.9 percent. Capital gains, dividends, and interest income would be tax-exempt at the individual level. Businesses would be allowed to fully expense capital investment, but would no longer be able to deduct interest expenses. The plan would also eliminate all itemized deductions and all tax credits except for the foreign tax credit. The plan would further expand the tax base by including fringe benefits, such as employer-provided health insurance, in the tax base.

Our analysis finds that the plan would reduce federal revenues by $5.6 trillion over the next decade. However, it also would improve incentives to work and invest, which would increase gross domestic product (GDP) by 16 percent over the long term if the tax cuts were appropriately financed. This increase in GDP would translate into 10.9 percent higher wages and 5.2 million new full-time equivalent jobs. After accounting for increased incomes due to these factors, the plan would reduce tax revenues by $2.5 trillion.[2]

Details of the Plan

The Hall-Rabushka Flat Tax was introduced in 1981 by economists Robert E. Hall and Alvin Rabushka. Their plan was put forth as a complete replacement for the federal income tax. Although the Flat Tax looks like the current U.S. income tax with a few modifications, it is structured to be economically equivalent to a consumption tax or value-added tax (VAT), with a flat, low rate. It does this chiefly by 1) allowing the full expensing of capital investment, 2) eliminating the taxation of interest, dividends, and capital gains at the individual level, and 3) eliminating several exemptions and deductions that are inconsistent with a consumption tax base, such as the exemption for employer-provided health insurance.[3]

The Flat Tax has a much broader base than current law and can raise substantially more revenue for any given tax rate. The Hall-Rabushka Flat Tax also maintains a slight amount of progressivity by exempting some portion of wage income from taxation through a large standard deduction and personal exemption.

The Carson plan deviates slightly from the Hall-Rabushka Flat Tax by also including a $100 per person minimum tax.

1 "Prescription for Growth." Carson for President 2016. https://www.bencarson.com/hubfs/issues/20160103_Prescription_for_Growth.pdf?t=1451944573348. Additional details have been provided by the campaign and are listed in the Appendix.

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.

3 Hall, Robert E. and Alvin Rabushka, "The Flat Tax Second Edition," Stanford, California: Hoover Institution Press, 1995.

Individual Income Tax Changes

- Eliminates the current progressive income tax brackets and replaces them with a 14.9 percent flat tax rate.
- Alters the standard deduction and personal exemption to exempt wage income of a filer under 150% of the federal poverty level.
- Eliminates the taxation of dividends, capital gains, and interest income.
- Eliminates all itemized deductions.
- Eliminates the income exclusion for employer-provided health insurance and other fringe benefits.[4]
- Eliminates all tax credits, such as the Child Tax Credit and the Earned Income Tax Credit. The foreign tax credit would remain.
- Eliminates the Alternative Minimum Tax.
- Eliminates the Net Investment Income Tax of 3.8 percent and the 0.9 percent Medicare surtax, which were both passed as part of the Affordable Care Act.
- Eliminates the taxation of Social Security benefits.
- Enacts a $100 per citizen minimum tax.

Business Tax Changes

- Replaces the current graduated corporate income tax with a flat 14.9 percent tax on corporate income.
- Enacts a territorial tax system that exempts 100 percent of foreign earnings of U.S. corporations from domestic taxation.
- Allows full expensing for all capital investment.
- Eliminates all other credits and deductions not pertaining to cost recovery. The foreign tax credit would remain.
- Eliminates the deductibility of interest expenses, but exempts interest income from taxation for non-financial institutions.
- Eliminates the deduction for the employer-side payroll tax.
- Eliminates the corporate Alternative Minimum Tax.

Other Changes

- Does not alter payroll taxes.
- Eliminates the estate and gift taxes.

4 Under the Hall-Rabushka Flat Tax, these fringe benefits would no longer be deductible by businesses. Economically, this is nearly identical to requiring individuals to pay tax on the value of these benefits.

Economic Impact

Overall, Dr. Carson's plan would nearly eliminate the taxation of investment, which would greatly increase incentives to save and invest. In addition, the much lower marginal rates on wage income would greatly increase the incentive to work, leading to higher workforce participation and more hours worked.

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 16 percent over the long run. The plan would lead to 10.9 percent higher wages and a 46.6 percent larger capital stock. The larger economy would mainly result from a significant reduction in the service price of capital, due to the full expensing of capital equipment and the reduction in tax rates for corporate and pass-through businesses. In addition, the reduction of marginal tax rates on individual income would increase incentives to work and result in 5.2 million full-time equivalent jobs.

Table 1.
Economic Impact of Dr. Ben Carson's Tax Reform Plan

GDP	16%
Capital Investment	46.6%
Wage Rate	10.9%
Full-time Equivalent Jobs (in Thousands)	5,213

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

Revenue Impact

Overall, the plan would reduce federal revenue on a static basis by $5.4 trillion over the next 10 years. Most of the revenue loss is due to the reduction in the individual income tax, which we project to reduce revenues by $3.2 trillion over the next decade. The reduction in the corporate income tax would reduce revenues by approximately $2.2 trillion over the next decade. The elimination of the estate and gift taxes would reduce revenue by another $229 billion.

If we account for the economic growth that the plan would produce, the plan would end up reducing federal revenue by $2.5 trillion over the next decade. The larger economy would increase wages, which would decrease the amount of revenue lost through the individual income tax to $1.3 trillion. Payroll tax revenue would increase by about $1.2 trillion. The corporate income tax would lose slightly more on a dynamic basis ($2.4 trillion) than on a static basis, as businesses invest more and take more deductions for capital investments.

Table 2.

Ten-Year Revenue Impact of Dr. Ben Carson's Tax Reform Plan (Billions of Dollars)

Tax	Static Revenue Impact (2015–2024)	Dynamic Revenue Impact (2015–2024)
Individual Income Taxes	-$3,205	-$1,251
Payroll Taxes	$0	$1,157
Corporate Income Taxes	-$2,183	-$2,368
Excise Taxes	$0	$101
Estate and Gift Taxes	-$229	-$229
Other Revenue Sources	$0	$118
Total	-$5,617	-$2,472

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

Distributional Impact

On a static basis, Dr. Carson's tax plan would increase after-tax incomes by 4.5 percent, on average. Due to the elimination of nearly all credits, all itemized deductions, and the exclusion of employer-provided health insurance, taxpayers in the bottom nine deciles would see a decrease in after-tax adjusted gross income (AGI) of between 1 and 14.8 percent. Taxpayers in the top decile would see much lower marginal tax rates, which would offset the much broader tax base. Their after-tax incomes would increase by 16.2 percent. Taxpayers in the top 1 percent would see their after-tax AGI increase by 33.4 percent.

On a dynamic basis, the plan would increase after-tax incomes by 19.8 percent, on average. All deciles would see an increase in after-tax AGI. However, taxpayers in the bottom deciles would see a much smaller increase in after-tax income than those at the top. The after-tax incomes of taxpayers in the bottom three deciles would increase by between 0.5 percent and 6.3 percent. Taxpayers in the middle deciles would see a 10.1 to 15.6 percent increase in after-tax AGI. The top ten percent of taxpayers would see after-tax incomes rise by 30.3 percent, and the top 1 percent's incomes would rise by 44.5 percent, on a dynamic basis.

Table 3.
Distributional Analysis for Dr. Ben Carson'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%	-13.10%	2.46%
10% to 20%	-14.83%	0.51%
20% to 30%	-9.67%	6.30%
30% to 40%	-5.11%	10.09%
40% to 50%	-3.17%	12.61%
50% to 60%	-2.90%	13.24%
60% to 70%	-2.97%	13.40%
70% to 80%	-2.60%	13.91%
80% to 90%	-0.95%	15.61%
90% to 100%	16.21%	30.30%
99% to 100%	33.44%	44.58%
TOTAL FOR ALL	4.50%	19.86%

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

Conclusion

Dr. Ben Carson's tax plan would replace our current income tax system with a modified Hall-Rabushka Flat Tax, a type of consumption tax. Moving to a pure consumption tax 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. On a static basis, the plan would raise taxes on a number of taxpayers, compared to current law, due to the elimination of most credits and deductions. On a dynamic basis, taxpayers in all income groups would see at least a small increase in after-tax incomes. The plan would also be a large tax cut, which would increase the federal government's deficit by over $5.6 trillion on a static basis and over $2.5 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.

We modeled the provisions outlined above, except for the switch to a territorial tax system. We did not account for profit shifting from abroad due to a lower U.S. corporate income tax rate, nor did we model any possible transitional costs associated with the plan. Our distributional analysis does not account for citizens of the U.S. that do not currently file but would be subject to a minimum tax. We modeled the minimum tax as a per filer tax of $100.

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Appendix

Details of Carson Plan, According to the Campaign

1. The plan enacts a Robert Hall-Alvin Rabushka flat tax on wage and corporate income of 14.9 percent.
2. The plan enacts a territorial tax system that exempts 100 percent of foreign earnings from U.S. taxation. As such, any dividends that are remitted to domestic corporations from foreign subsidiaries would not be subject to any additional tax in the U.S.
3. All personal dividends, capital gains and interest income would be excluded from taxation. Interest expenses would no longer be deductible by businesses or individuals.
4. The plan would allow all capital expenditures to be fully expensed.
5. The 14.9 percent tax rate would begin at the first dollar of earned income above 150 percent of the official "poverty defined household income" for the given number of individuals in that household. One hundred fifty percent of the federal poverty line (FPL) for 2015 was $17,655 for a single individual and an additional $6,240 for each additional member of the family. This is roughly equivalent to a standard deduction of $11,415 (for all filers) and a personal exemption of $6,240.
6. The "de minimus" tax of $100 would apply to all U.S. citizens. As such, all citizens would pay tax equal to the greater of 14.9 percent of wage income or $100.
7. All itemized deductions would be eliminated, such as the deduction for state and local income taxes, home mortgage interest, and charitable contributions. All credits except for the foreign tax credit would be eliminated, such as the Child Tax Credit and the Earned Income Tax Credit.
8. Consistent with the Hall-Rabushka Flat Tax, the plan would eliminate the employer-provided health insurance exclusion for the income tax.
9. Consistent with the Hall-Rabushka Flat Tax, the plan would eliminate the taxation of Social Security benefits, but disallow the business deduction for employer-side payroll tax paid.
10. The Alternative Minimum Tax for individuals and corporations would be eliminated.
11. The plan would eliminate the Net Investment Income Tax and the Medicare surtax.
12. The estate tax and gift taxes would be eliminated.
13. No changes would be made to payroll taxes.
14. No changes would be made to tariffs and other excise taxes.