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Details and Analysis of Rep. Jim Renacci's Tax Reform Proposal

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Key Findings:

- Rep. Jim Renacci's (R-OH) tax plan would reform the individual income tax code and replace the corporate income tax with a 7 percent value-added tax.
- The congressman's plan would reduce federal revenues by $845 billion over the next decade. However, the plan will end up raising revenue when accounting for the increased economic output in the long run.
- 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 5.6 percent higher GDP over the long term and 1.9 million additional jobs.
- On a static basis, the plan would lead to 2.1 percent higher after-tax income for all taxpayers and 6.6 percent higher after-tax income for the top 1 percent. When accounting for the increased GDP, after-tax incomes of all taxpayers would increase by an average of 4.4 percent.

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Rep. Jim Renacci's tax plan would reform the individual income tax by reducing marginal tax rates on individuals, simplify the tax code by eliminating most itemized deductions, and significantly expand the Earned Income Tax Credit (EITC). The plan would repeal the corporate income tax and replace the lost revenue with a 7 percent credit-invoice value-added tax (VAT). This VAT would apply to all private businesses and the federal government, but exempt nonprofit organizations and state and local governments. The plan would also eliminate the alternative minimum tax and enact a one-time tax on all deferred foreign earnings of multinational corporations.

Our analysis finds that the plan would reduce federal revenues by $600 billion over the next decade. The plan would also decrease marginal tax rates on both labor and capital. As a result, the plan would increase the size of gross domestic product (GDP) by 5.6 percent over the long term. This increase in GDP would translate into an 18 percent larger capital stock and 1.9 million more full-time equivalent jobs. After accounting for the economic effects of the tax changes, the plan would end up raising revenue.

Details of the Plan

Individual Income Tax Changes

- Consolidates the current seven tax brackets into three, with a top marginal tax rate of 35 percent (Table 1)
- Taxes capital gains and dividends as ordinary income
- Increases the standard deduction from $6,300 to $15,000 for single filers and from $12,600 to $30,000 for married couples filing jointly.
- Increases the personal exemption from $4,050 to $5,000

Table 1.

Individual Income Tax Brackets under Rep. Renacci's Tax Plan

Tax Rates		Taxable Income Brackets	
Ordinary Income	Capital Gains and Dividends	Single Filers	Married Filing Jointly
10.00%	10.00%	$0-$50,000	$0-$100,000
25.00%	25.00%	$50,000-$750,000	$100,000-$1,500,000
35.00%	35.00%	$750,000 and above	$1,500,000 and above

- Expands the Earned Income Tax Credit by increasing phase-in rates by 40 percent for taxpayers with children and by 100 percent for taxpayers without children. All other parameters would remain the same (details in the appendix)
- Eliminates the Alternative Minimum Tax
- Eliminates all itemized deductions except for the mortgage interest deduction and the charitable deduction. Caps the mortgage interest deduction at $500,000 of acquisition debt

Business Income Tax Changes

- Eliminates the corporate income tax
- Enacts a deemed repatriation of currently deferred foreign profits, at a tax rate of 8.75 percent for cash and cash-equivalent profits and 3.5 percent on other profits

Other Changes

- Creates a 7 percent credit-invoice method value added tax. Applies to all private business and the federal government. Exempts nonprofit organizations and state and local governments

Economic Impact

According to the Tax Foundation's Taxes and Growth Model, Rep. Renacci's tax plan would increase the economy's size by 5.6 percent in the long run. The plan would lead to 4.7 percent higher wages, an 18 percent larger capital stock, and 1.9 million more full-time equivalent jobs. The larger economy results from significantly lower marginal tax rates on capital and labor income.

Table 2.

Economic Impact of Rep. Renacci's Tax Reform Plan

GDP	5.6%
Capital Investment	17.8%
Wage Rate	4.7%
Full-time Equivalent Jobs (in thousands)	1,877

Source: Tax Foundation Taxes and Growth Model, March 2016.

Revenue Impact

Overall, the plan would reduce federal revenue on a static basis by $845 billion over the next 10 years. Most of the revenue loss is due to much lower individual income tax collections, which we project to reduce revenues by approximately $5.9 trillion over the next decade. In addition, the elimination of the corporate tax would reduce revenues by approximately $3.6 trillion (net of the one-time tax on deferred foreign earnings). However, most of the revenue is replaced by the 7 percent VAT, which we project would raise $9.4 trillion over the next decade. The new VAT would result in a slightly smaller wage tax base and thus reduce payroll tax revenue by $733 billion.

If we account for the economic impact of the plan, it would end up raising $695 billion over the next decade. The larger economy would result in higher labor force participation and higher wages. This would broaden the income, payroll, and VAT bases and lessen the revenue loss of the plan.

Table 3.

Ten-Year Revenue Impact of Rep. Renacci's Tax Reform Proposals (Billions of Dollars)

Tax	Static Revenue Impact (2016-2025)	Dynamic Revenue Impact (2016-2025)
Individual Income Taxes	-$5,917	-$5,081
Payroll Taxes	-$733	-$361
Corporate Income Taxes	-$3,613	-$3,613
Excise Taxes	$0	$40
Estate and Gift Taxes	$0	$17
Other Revenue (VAT)	$9,418	$9,692
Total	**-$845**	**$695**

Note: Individual items may not sum to the total due to rounding.
Source: Tax Foundation Taxes and Growth Model, March 2016.

The largest source of revenue loss in the plan is the consolidation of the tax brackets, which would reduce revenue by approximately $4.8 trillion over the next decade. The elimination of the corporate tax would also significantly reduce revenue: $3.7 trillion over the next decade (Table 4).

Enacting the VAT would raise $7.4 trillion on net. As stated above, the VAT itself would raise $9.4 trillion over the next decade. However, the VAT would reduce pretax wages paid by businesses, shrinking the individual income tax and payroll tax base, which would reduce revenue raised by those taxes.

Table 4.

Ten-Year Revenue and Economic Impact of the Renacci Plan by Provision (Billions of Dollars, 2016-2025)

Provision	Change in Static Revenue from Provision	Change in GDP from Provision	Change in Dynamic Revenue from Provision
Eliminates the Alternative Minimum Tax	-$354	-0.3%	-$428
Eliminates all itemized deductions except for the mortgage interest and charitable contributions deductions	$2,331	-0.4%	$2,218
Caps the mortgage interest deduction at $500,000 of debt	$334	0.0%	$321
Eliminates most non-business personal credits	$27	0.0%	$26
Taxes capital gains and dividends as ordinary income	$1,691	-3.8%	$512
Increases the standard deduction to $15,000/$30,000 and the personal exemption to $5,000	-$3,401	1.2%	-$2,955
Consolidates individual income tax brackets into three of 10 percent, 25 percent, and 35 percent	-$4,833	4.0%	-$3,642
Expands the Earned Income Tax Credit	-$449	-0.2%	-$502
Eliminates the corporate income tax	-$3,798	7.5%	-$1,984
Creates a 7 percent value added tax	$7,422	-2.5%	$6,944
Enacts a deemed repatriation of deferred foreign-source income	$185	0.0%	$185
Total	**-$845**	**5.6%**	**$695**

Source: Tax Foundation Taxes and Growth Model, March 2016.

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Components of the Dynamic Revenue Estimate

The Renacci tax plan's dynamic revenue impact of $695 billion over the next decade can be broken down into four pieces: the marginal tax cuts, economic growth, base broadeners, and the value-added tax.

The plan would cut individual income tax rates, expand the standard deduction and personal exemption, and eliminate the corporate income tax. Combined, these cuts would reduce federal revenue by $12.8 trillion if enacted alone.

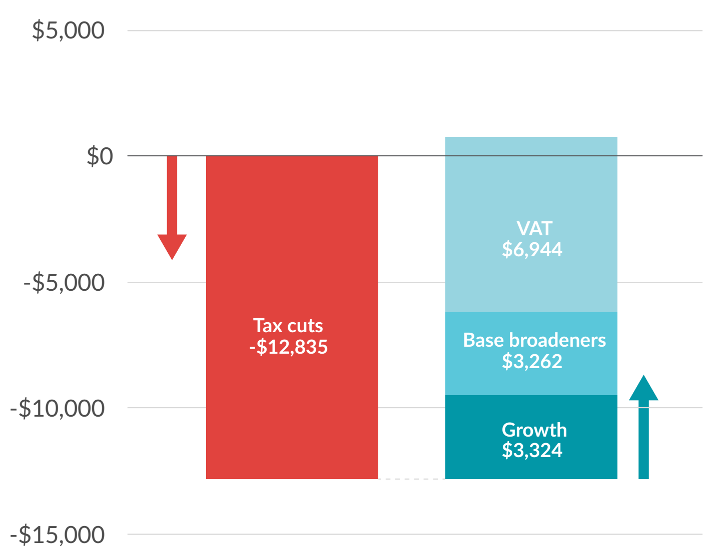
However, these cuts would reduce marginal tax rates on work, saving, and investment. As a result, the size of the economy would increase, boosting incomes, and growing the payroll and income tax bases. Overall, growth from the marginal rate cuts would reduce the 10-year cost of the plan by $3.3 trillion.

Then, the plan would make up even more revenue through broadening the individual income tax base. For example, it would eliminate most itemized deductions and personal credits, tax capital gains and dividends as ordinary income, and cap the mortgage interest deduction. Together, these base broadeners would reduce the cost of the plan by $3.3 trillion.

Finally, the plan would end up raising revenue on a dynamic basis, due to the new 7 percent value-added tax, which would raise $6.9 trillion.

Most of the Dynamic Revenue Comes from the new Value-Added Tax

Dynamic Revenue by Component (Billions of Dollars)



Source: Tax Foundation Taxes and Growth Model, March 2016.

Distributional Impact

On a static basis, the Renacci plan would end up increasing after-tax income of all taxpayers by at least 0.6 percent. Taxpayers in the bottom four quintiles would see modest increases in their after-tax income, with those in the bottom quintile seeing an increase of 1.7 percent. In contrast, taxpayers in the top quintile would see an increase in after-tax income of 3.1 percent. The top 1 percent of all taxpayers would experience a 6.6 percent increase in their after-tax income.

After accounting for economic effects, taxpayers would see their after-tax incomes increase by an average of 4.4 percent. The larger economy in the long run would mean higher wages and capital income.

Table 5.

Distributional Analysis for Rep. Renacci's Tax Plan

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

Returns with positive AGI by Quintile	Static	Dynamic
0% to 20%	1.7%	5.3%
20% to 40%	1.2%	5.3%
40% to 60%	1.1%	5.4%
60% to 80%	0.6%	4.7%
80% to 100%	3.1%	4.0%
90% to 100%	3.6%	3.3%
99% to 100%	6.6%	2.2%
TOTAL	**2.1%**	**4.4%**

Conclusion

Rep. Jim Renacci's tax plan would reform the individual income tax and replace the corporate income tax with a credit-invoice value-added tax. If enacted, his plan would reduce federal revenues by $845 billion over the next decade. The Renacci plan would significantly reduce marginal tax rates on capital and labor income, which would result in a substantial increase of the size of the U.S. economy in the long run. This would increase the revenue that the tax plan would ultimately collect, making the plan slightly revenue positive. Rep. Renacci's plan would increase after-tax incomes for taxpayers at all income levels.

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 or distributional effects of any changes to government spending that may accompany the tax plan.

In modeling the value-added tax, we assumed 5 percent noncompliance and no small business exemption. Higher levels of noncompliance and the introduction of an exemption would reduce the amount of revenue the value-added tax would ultimately collect. We also assumed that businesses would be allowed to deduct unused depreciation against the new value-added tax.

We did not model how the plan would affect the frequency of capital gains realizations. To the extent that the plan causes households to realize capital gains less frequently, it will raise less revenue than estimated above. Additionally, our model results do not account for the possibility that pass-through businesses may reorganize as C corporations as a result of the plan.

The Expanded Earned Income Tax Credit

Under current law, the Earned Income Tax Credit (EITC) provides a refundable credit to low-income taxpayers with earned income. The credit phases in as taxpayers earn more income until the credit hits a maximum. Once a taxpayer hits a certain income limit, the credit begins phasing out. The phase-in rate and credit sizes vary by the number of children in a household, with the largest credit available to taxpayers with three or more children.

The Renacci tax plan would increase the current law phase-in rates for taxpayers with children by 40 percent and by 100 percent for taxpayers without children. For example, the phase-in rate for a taxpayer with no children is 7.65 percent under current law. Under this proposal, the phase-in rate would be 15.3 percent. Since the credit phases in faster, the ultimate credit size is larger. These taxpayers would receive a maximum credit of $1,012. In addition, the income level at which the credit ultimately phases out to zero will be higher. Taxpayers with no children could receive some amount of EITC up to $21,481, while under current law, the max income would be $14,880.

2016 Earned Income Tax Credit Parameters and Parameters under Proposal

Current Law

Filing Status		No Children	One Child	Two Children	Three or More Children
Single or Head of Household	Income at Max Credit	$6,610	$9,920	$13,930	$13,930
	Maximum Credit	$506	$3,373	$5,572	$6,268
	Phaseout Begins	$8,270	$18,190	$18,190	$18,190
	Phaseout Ends (Credit Equals Zero)	$14,880	$39,296	$44,648	$47,955
Married Filing Jointly	Income at Max Credit	$6,610	$9,920	$13,930	$13,930
	Maximum Credit	$506	$3,373	$5,572	$6,268
	Phaseout Begins	$13,810	$23,730	$23,730	$23,730
	Phaseout Ends (Credit Equals Zero)	$20,420	$44,836	$50,188	$53,495

Proposal Parameters

Filing Status		No Children	One Child	Two Children	Three or More Children
Single or Head of Household	Income at Max Credit	$6,610	$9,920	$13,930	$13,930
	Maximum Credit	$1,012	$4,722	$7,801	$8,777
	Phaseout Begins	$8,270	$18,190	$18,190	$18,190
	Phaseout Ends (Credit Equals Zero)	$21,481	$47,738	$55,231	$59,861
Married Filing Jointly	Income at Max Credit	$6,610	$9,920	$13,930	$13,930
	Maximum Credit	$1,012	$4,722	$7,801	$8,777
	Phaseout Begins	$13,810	$23,730	$23,730	$23,730
	Phaseout Ends (Credit Equals Zero)	$27,040	$53,288	$60,781	$65,411