

Tax Mavens

Major Tax Reform – Are we reaching the tipping-point?

Q & A with Scott Hodge, President of the Tax Foundation

“I think the Cubs will win the World Series before California overcomes its fiscal challenges.” - Scott Hodge

By: Tim Kelly, *MST Student*

Scott Hodge is the president of the Tax Foundation, a nonpartisan tax research group based in Washington, D.C. and one of the nation’s leading visionaries on tax policy, the federal budget and government spending. He has authored several books on the federal budget and government spending. His editorial and opinion pieces have appeared in many leading publications such as *The Wall Street Journal*, *The Washington Post*, *USA Today* and *The Washington Times*. In addition, he is regularly interviewed on major radio and television network news shows broadcasted through CBS, NBC, ABC, CNN and Fox.



The mission of the Tax Foundation is to educate taxpayers about sound tax policy and the size of the tax burden borne by Americans at all levels of government. One of the Tax Foundation’s most popular tools for educating the public is Tax Freedom Day® which is a date when Americans will work to have earned enough money to pay the year’s tax obligations at the federal, state and local levels. This year, the date arrived on April 12, the 102nd day of 2011. Detailed facts and figures from hundreds of studies on tax policy and government spending at the federal level and all fifty states can be found at the Tax Foundation’s website, www.taxfoundation.org.

Fun Fact 1:

Scott Hodge’s uncle Max Hodge created the Mr. Freeze character for Batman!

Given the turmoil surrounding government deficits and tax reform, we thought it would be good to get an update from Mr. Hodge on the prospect for major tax reform at both the federal and California levels.

SJSU CTJ: We haven't had major tax reform in this country since President Reagan and Representative Rostenkowski worked together in 1986. The frequency of Congressional hearings on the topic has increased relative to previous years. Two recent presidential commissions, the Economic Recovery Board, chaired by Paul Volker, and the National Commission on Fiscal Responsibility and Reform, co-chaired by Erskine Bowles and Alan Simpson, call for comprehensive tax reform. With all this activity, one might think we are getting closer to major tax reform for both businesses and individuals.

Fun Fact 2:

Scott enjoys collecting antique and contemporary art glass. He has taken glass blowing lessons.

HODGE: I think momentum is building for fundamental tax reform, but we are in what could be called the "build up" stages that could culminate in action sometime in 2013. Typically, Washington needs to chew on big issues for a while until there is critical mass for actual legislation. The prelude to Reagan's 1981 tax plan was Jack Kemp's tax cut proposals during the late 1970s. The 1986 reform was preceded by the so-called Treasury 1 and Treasury 2 reports. We are in a similar phase of trial balloons and public debates that will be absorbed into next year's presidential campaigns. I do believe tax issues will be top tier issues in the 2012 election debate. This will be a very welcome debate.

SJSU CTJ: On the corporate side, the Tax Foundation supports lowering the corporate tax rate and moving to a territorial system to level the playing field and make U.S. businesses more competitive in the global market. Realizing that it takes leadership from the President and legislature to pass major tax reform legislation, what do you think will get us to the tipping point and when will it happen?

HODGE: I thought the tipping point in the U.S. debate would be Japan's announcement that it would cut its corporate rate in 2011. The earthquake and tsunami obviously derailed Japan's legislative agenda and the indignity of the U.S. assuming the place of top tax rate in the industrialized world. That threat will remain out there into next year. Don't forget, however, that Canada and the U.K. both cut their corporate tax rates this year and will make further cuts next year. So when we think of low tax competitors to the U.S., we're no longer talking about the Irelands and Singapores of the world -- the Big Boys of the G7 are now getting into the game and we are falling further and further behind.

SJSU CTJ: What reforms are needed for individual taxpayers in order to sell corporate tax reform to the voters?

HODGE: We think about this question a lot because there is a lot of anti-corporate sentiment in America right now. We must find ways to convince people that the lion's share of the economic burden of corporate taxes falls on workers through lower wages and productivity, while the remaining share hits them directly in their 401k. We have to personalize the issue or the debate will be swamped by stories about General Electric's tax bill.

Don't forget that corporate and individual reforms are inexorably linked. First, the top rates for individuals and corporations are at the same level for the first time in the history of the code. Second, there is now more business income taxed under the individual code than under the corporate code so we have to think in broader terms of "business tax" reform, not just "corporate" reform. The bottom line challenge, however, is overcoming public opinion. That will be a tough hill to climb.

SJSU CTJ: Here in California, we are facing a never-ending budget crisis. What are the prospects for California in overcoming its fiscal challenges, reducing its high tax burden and improving its business climate?

HODGE: If I were you, I would start looking for jobs in any other state -- except Illinois. Run now and don't look back. LOL

I think the Cubs will win the World Series before California overcomes its fiscal challenges. Greece may overcome its fiscal challenges before California. In many respects, California is a microcosm for the U.S. Politicians have made promises they can't keep (and taxpayers can't afford) and the tax system is broken beyond repair -- besides being too progressive. The only question is, which will default first, California or the U.S. government.

SJSU CTJ: Are there lessons to be learned from current and proposed tax reforms underway in other states such as Rhode Island, Vermont, Georgia, Michigan, Ohio and Wisconsin?

HODGE: The lesson is that tax competition is alive and well in the states. We have fifty laboratories of democracy and it is fun to have a national perch to watch it unfold. Not long after Illinois fell on its sword with a massive tax rate hike on individuals and businesses, Indiana cut its corporate tax rate and Michigan replaced its old

Fun Fact 3:

Scott is a Milton Friedman fan. He says Friedman was the greatest economic communicator the world has ever known. Per Scott: "My goal is to always communicate tax issues in a way real people -- like my Mom - can understand. Uncle Milty was the greatest."

system with a conventional corporate tax. We'll be watching closely to see if (and how many) people and firms move out of Illinois to their Midwest neighbors with friendlier tax systems. I know the Wisconsin governor is anxious to get in the game and overhaul their tax system because Wisconsin has had one of the highest tax burdens in the nation for more than four decades. New Jersey Governor Christie is trying to reverse that state's image as one of the worst business climates in the nation. My only wish is that Washington would catch the tax competition fever.

SJSU CTJ: 'Fail often and fail early' is a saying we often hear in Silicon Valley. In your efforts to educate taxpayers on tax reform, what works best to effect change?

HODGE: Well, overcoming misperceptions may be the hardest task of all. Despite the fact that roughly half of all American households pay no income taxes, people still believe that the Bush tax cuts benefited only the 'rich' and that the 'rich' don't pay their fair share. What does seem to work is the assurance that tax reform will level the playing field. People are inherently insecure that the guy next door has found a loophole that allows him to save more on his taxes than they can. I think most people would support tax reform if they were assured that Donald Trump paid the same rate of tax they do and couldn't avoid paying his "fair share" by hiring clever tax advisors. I think we can move the reform ball over the goal line if we can convince people that tax reform will bring simplicity and the certainty that everyone will pay equally.

Fun Fact 5:

If he could have dinner with anyone next week, Scott would dine with Governor Chris Christie of New Jersey.

SJSU CTJ: As we look ahead to the coming tax reform showdown, are there any new studies coming out of your research department that you would like to tell us about?

HODGE: At the federal level, we are heavily focused on building the economic and intellectual case for corporate tax reform. Look for studies on effective tax rates, territorial versus worldwide systems, "good" versus "bad" base broadening, and "who really pays the corporate income tax."

At the state level we are in the final stages of a major study comparing the actual business tax burdens of the states. Our model compares how much various proto-typical firms would pay in each state if they are a new firm or a mature firm. I believe this will be the first study of its kind anywhere. Stay tuned.