Op-Ed Contributors

Closing Loopholes Isn't Enough

By LEONARD E. BURMAN and JOEL B. SLEMROD

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REPUBLICANS in Congress say they will do anything rather than raise tax rates. Apparently, that includes rushing headlong over the fiscal cliff and throwing the economy into a possible recession.

When, in an effort to avert the now infamous tax increases and spending cuts to take effect on Tuesday, House Speaker John A. Boehner proposed his so-called Plan B — which would have nudged up tax rates only for those earning over $1 million a year — rank-and-file Republicans promptly rebelled, storming their party caucus with the rhetorical equivalents of pitchforks.

One can't argue with religion — and for some, the unwillingness to bend on marginal rates is just that. But for many politicians, the refusal to raise tax rates rests on a faulty premise.

The Congressional Budget Office projects that if the United States follows a likely scenario in terms of demographic changes, spending and economic growth through 2035, America's coffers may fall short by as much as $2 trillion a year in current dollars. With a predicted gap so large, any deal to restore the country's fiscal balance must include at least some new revenue.

But even those Republicans who acknowledge that additional tax dollars will be necessary say we can get what we need without increasing a single tax rate. All we have to do is close up some "loopholes" and "broaden the base"! We can keep in place the Bush-era tax cuts, they say, and make up any lost revenue simply by eliminating various deductions, exclusions and credits.

At first glance, the idea seems great. Who wouldn't want to root out the tax evaders and finaglers who are shirking the shared burden? And the idea of a broader base of taxpayers paying lower rates across the board sounds so much simpler and fairer for every citizen.

But closing loopholes is neither sufficient to do the job nor as "fair" to everyone as it might seem.

There is no painless way to raise revenue, as past attempts have shown. Increased levies on corporations are ultimately passed along to shareholders, workers or customers. Raising taxes on foreign companies increases the cost of capital as businesses keep their cash overseas. Even a fix as "obvious" as doubling down on audits to catch tax cheaters ends up creating a burden for honest citizens caught in the snare.

Closing loopholes and purging deductions are no more exempt from the laws of tax physics than any of the above.

Both Democrats and Republicans have considered phasing out the mortgage interest deduction, and there are good economic arguments for doing that. But it might depress an already weak housing

market and hit some middle-class homeowners hard.

Eliminating the charitable deduction could devastate many philanthropic organizations and the people they serve. You can go down the line with many exemptions, deductions and credits and find an unintended, and unfortunate, consequence.

Likewise, more sweeping attempts to broaden the base can end up doing more harm than good.

Most states tax only retail sales to consumers — but some, for example, also tax sales to other businesses. This tax, called a gross receipts tax, certainly has a larger base than a retail sales tax since businesses at each stage of manufacturing, distribution and marketing end up being taxed.

Supporters of the idea say this cascading tax can be assessed at a much lower rate and still collect the same revenue over all, spreading out the pain. But it is a poorly designed tax, because it taxes products that involve many stages of production more than those produced in only one or two steps. That, in turn, encourages companies to merge to avoid paying multiple layers of tax — whether or not that makes any business sense.

To be sure, there are constructive ways to broaden the base. There are few compelling reasons, for example, that employer-provided health insurance, which is part of compensation, should be exempt from income tax. This tax break costs around $250 billion a year and makes gold-plated health insurance more attractive to workers, which drives up health costs. Eliminating it would be a good first step in shoring up the federal budget.

We could also turn the mortgage interest deduction into a flat 15 percent tax credit and cut the maximum deductible mortgage to $500,000, which would help many homeowners who do not itemize deductions, while curtailing subsidies for high-income people who don’t need help. This would raise about $40 billion in 2014, according to the nonpartisan Tax Policy Center. And we could allow a deduction for charitable contributions over 2 percent of adjusted gross income, which would save $20 billion in 2014 without discouraging most donations.

But in the end, none of these fixes will be enough to raise the revenue we need to balance the budget, begin to pay off America’s debt and avoid the fiscal cliff. Nor can we cut spending enough to achieve those goals. An aging population expects the government to make good on promises for retirement support and increasingly expensive health care — so cuts in popular programs big enough to avoid higher taxes are simply not in the cards.

That leaves us with one choice: do all of the above. Let’s trim spending where we can, broaden the base where it makes the most sense and, yes, raise marginal tax rates as well. Returning tax rates to Clinton-era levels for married filers making over $250,000 a year and singles making $200,000 or more, as President Obama has proposed, would be a good start, and might provide the impetus for more serious discussions of tax and entitlement reform.

The only thing we shouldn’t do is pretend any of these fixes will be painless or easy for everyone.

They won’t. Even in a happy, thriving democracy, someone ends up holding the bag.

Leonard E. Burman, a professor of public administration at Syracuse University, and Joel B. Slemrod, a professor of economics at the University of Michigan, are the authors of “Taxes in America: What Everyone Needs to Know.”

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