Paving the Way for Economic Growth: Reforming the Notorious U.S. Tax System

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The debate surrounding tax reforms has always been in a constant state of flux. The U.S. tax system stands in urgent need of reform, as we are facing numerous challenges when it comes to determining the needs of our society.

High taxation can lead to poor living standards among low- and middle-income citizens. High taxes can also push away foreign investors looking to set up companies within the U.S. market. It is, therefore, important to have reforms that will provide equitable taxation to individuals within the society while simultaneously promoting business growth.

The U.S. federal tax system is renowned for its complexity and contains over 2,600 pages of Code, making it convoluted for people to pay their taxes. In such a context, reforms of the U.S. tax system are considered to be a central issue of the current administration.

While tax reforms can help prevent tax avoidance and evasion owing to the complexity of the tax framework, the importance in reforming the tax system also lies in the fact that it helps taxpayers understand the benefits of their tax payment.

It is under such context that House Republicans released a tax reform “Blueprint” on June 24, 2016, which essentially seeks to reduce the tax rates for individuals and businesses alike and seeks to make U.S. businesses more competitive.

The Blueprint was carefully crafted by House Ways and Means Committee Chairman Kevin Brady. Given the extent to which this tax reform seeks to modify the existing tax framework, it is therefore essential to understand how this tax reform might benefit the U.S. economy and promote economic growth and sustainability.

Benefits for Individuals

The most important aspect of the Blueprint is its powerfully simple vision of reform. The proposed reform seeks to make taxes very fair and simple for all parties. It envisages that the average American citizen ought to be able to pay their taxes by simply filling in a postcard. This ensures that the tax code is considerably flatter and simpler.

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By creating this simple framework, not only is tax filing made easier, it also makes it possible for the American people to do so while preserving their peace of mind. As the Blueprint notes, this is particularly important during critical moments such as getting a job, raising a family or planning for retirement.

One key benefit from this is that Americans can save substantial amounts of time which is otherwise wasted in completing tax forms and filing tax returns. Therefore, the simplicity achieved through the tax reform can help make individuals more time-efficient, allowing them to focus this resource on other profitable avenues.

Similarly, the proposed tax reform seeks to achieve fairness by implementing a flatter tax system. This is considered to be necessary because the current framework is beset with too many brackets, very high rates and the existence of special interest breaks throughout. The proposed framework seeks to completely abolish such multiplicity and replace it with just three tax brackets. At the same time, it seeks to lower the top individual income tax rate to just 33 percent with the other brackets being placed at the 12 percent and 25 percent margins.

This makes the entire tax framework flatter and thereby fairer. When a tax system is underpinned with notions of fairness, whereby if each taxpayer feels that the system is fair, it strongly enhances the legitimacy of the tax-paying exercise.

Benefits for Corporations

The new tax framework is also very conducive to job creation and wage increases for Americans across the board. This is achieved because the tax framework will lower taxes imposed on small businesses to 25 percent through a separate low tax rate category. Similarly, the framework would provide “full and immediate write-offs” on any new asset investments.

The combination of these elements will have the effect of allowing U.S. businesses to regain their economic competitiveness and compete with foreign businesses.

The U.S. corporate tax of 39 percent stands at the highest rate among its peers in the world. As a consequence, this high corporate tax severely affects businesses within the United States. At the moment, other developed countries such as Switzerland enjoy a low corporate tax rate of around 21 percent, while the global average stands at 25 percent.

By reducing corporate taxes through this Blueprint, the U.S. would slip from its position as having the highest corporate tax rate amongst the Organization for Economic Co-operation and Development countries to a mere 20 percent corporate tax rate.

High corporate taxes in the U.S. send companies investing abroad to earn their revenues in other countries with more favorable conditions. According to Bloomberg, U.S. companies

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were holding about $2.6 trillion in foreign countries as of 2016. This means that more jobs are created in foreign countries, and that those tax revenues are given to foreign countries.

For example, if a company chooses to set its factories in China and manufacture all its products there, then China will benefit from high employment rates and also increased tax revenues. Apple has a larger number of employees in its Chinese factories as compared to its headquarters in the United States. U.S. companies are thus providing higher revenues to other developing countries with lower corporate taxes.

In the long run, the economies of these developed countries grow faster than the U.S. economy, thus presenting a threat to be the next world economic powerhouse.

Corporate tax reforms will help reduce the number of local companies taking their business to other countries with a better taxation system. Additionally, the reforms will also attract foreign companies to expand into the U.S., which will boost the economy significantly.

Finally, the proposed framework also seeks to introduce a territorial system of taxation in the U.S. with more competitive rates. Instead of taxing at the source of production of goods and services, the new framework seeks to impose the tax in the jurisdiction where the goods are being consumed or purchased. Such a change is considered to be very beneficial because it solves one of the most vexing issues of the international taxation of corporate income.

By imposing taxes in this manner, it is irrelevant as to where the company is headquartered, thereby eliminating the need for corporate inversions, where U.S. companies transfer ownership to a foreign parent companies.

Finally, a Way Forward

The U.S. federal tax system faces a great number of challenges in proving its efficiency. The country requires a complete tax system overhaul to ensure that enough taxes are generated to cover federal government expenditures while at the same time improving economic growth and sustainability.

Chairman Brady's new proposed tax reform has the potential to fundamentally change the U.S. federal tax system for the betterment of economic growth. Not only does this protect U.S. businesses, it is directly beneficial to the average American citizen as well. It remains to be seen whether these benefits will be realized if the tax reforms are executed in the near future.

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