

April 15, 2015

The Honorable Mike Crapo
Co-Chair
Savings and Investment Working Group
United States Senate
Washington, D.C. 20515

The Honorable Sherrod Brown
Co-Chair
Savings and Investment Working Group
United States Senate
Washington, D.C. 20515

Dear Senators Crapo and Brown:

As co-chairs and staff of the *Tax Alliance for Economic Mobility*, we are pleased to submit our comments in support of inclusive, progressive, equitable and impactful tax reform. The Tax Alliance for Economic Mobility is a national coalition of asset-building advocates, tax reform experts, researchers, representatives of organizations of color and grassroots constituents working together to advance federal policies that expand savings and investment opportunities for lower-income households through reform of the U.S. tax code. (Note that the recommendations included in this letter are reflective of the Tax Alliance for Economic Mobility as a whole and not necessarily the position of each individual member.)

Context for remarks:

As you know, the U.S. tax code plays a major role in encouraging American households to save and invest. These tax subsidies – in the form of deductions, credits, deferrals, exclusions and preferential rates – encourage households to buy homes, start businesses, or save for higher education or retirement. In fact, of the more than \$1 trillion in tax subsidies delivered through the individual tax code in 2013, over half (\$540 billion) subsidized household savings and investment.ⁱ

The Tax Alliance for Economic Mobility is focused on household savings and investment because America’s families need both an adequate income and savings opportunities to build their financial security, contribute to the economy and move up the economic ladder. They also need savings to provide a cushion in times of temporary financial hardship and resources to invest in their future. The Great Recession resulted in an enormous loss of household wealth, and lower-income households and households of color in particular are struggling to get back on their feet. Today, four out of ten households – and two out of three households of color – have so little savings that they couldn’t cover three months of living expenses if their income was disrupted.ⁱⁱ

While encouraging households to save and invest is a socially beneficial goal, research shows the benefits of current tax expenditures to encourage savings and investment primarily accrue to wealthier households, those least in need of the mobility boost. For example, using available data on distributional

benefits covering \$340 billion of these wealth-building tax expenditures, the Corporation for Enterprise Development found that the bottom 60 percent of households received only 12 percent of the benefits, and the top 1 percent of households received *more benefits than the bottom 80 percent combined*.ⁱⁱⁱ In similar reports, the Tax Policy Center found that 70 percent of tax savings from mortgage interest, property tax deductions and employer-based retirement savings goes to the top 20 percent of households;^{iv} and a 2013 CBO report found that the top 20 percent of households receive 93 percent of the benefits from preferential tax rates for capital gains and dividend income.^v In short, this is an inefficient and inequitable approach to helping Americans build savings and wealth.

Key tax policy flaws producing an “upside down” tax code:

Currently, tax expenditures are “upside down”—the more an individual or family needs support, the less support they get. As a result, the majority of Americans receive relatively little benefit. Several key flaws drive inefficient outcomes:^{vi}

- First, three out of four taxpayers don’t itemize on their taxes (including 87% of households making less than \$50,000), so they cannot benefit from itemized deductions.
- Second, for most tax expenditures the level of benefit is a function of the filer’s tax rate, so higher-income/higher-rate filers receive the greatest benefit.
- Third, in most cases, the larger the asset, the greater the level of public subsidy. For example, the larger the home and greater the mortgage, the higher the public subsidy provided through the mortgage interest deduction.
- Finally, the structure of tax-code based support prevents many families from benefiting. For example, in order for a worker to benefit from retirement tax programs, she must have access to a retirement savings account; but roughly half of workers do not have access.

Tax reform goals and principles:

The overarching goal of the Tax Alliance for Economic Mobility is to change the structure of existing tax-based savings and investment subsidies in a way that is *inclusive, progressive, equitable and impactful*—we support policies that significantly increase benefits for those who are the least economically mobile: lower-income households and households of color. Furthermore, where relevant and feasible, Alliance members support policies that are *automatic*—they include automatic enrollment features and low costs to maximize access by low-income households; *simple*—they’re easy for everyone to understand; and *transparent*—they include provisions that enable Americans to measure and track outcomes over time.

Policy priorities:

The following section highlights policy areas, and specific policy proposals, that are in alignment with the principles of the Tax Alliance for Economic Mobility:

➤ Support Economic Mobility and Financial Security

Despite recent economic growth, millions of American households are living in a state of financial insecurity. Today, more than 50 million households do not have enough savings to sustain themselves for just three months if faced with a job loss, medical emergency or other major unforeseen expense.^{vii} Economic mobility – the ability of families to move up the economic ladder from one generation to the

next – has long been a central tenet of the American Dream, yet research shows that children raised at the bottom of the economic ladder are likely to stay there as adults.^{viii}

The Tax Alliance for Economic Mobility supports the following policies to increase the economic mobility and financial security of working families:

- *Make critical provisions of the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) permanent* – The EITC and CTC are tax credits that build the financial security of working families; and recent research shows they lead to improved school performance, higher education enrollment and increased earnings.^{ix} Research also shows that these tax credits do more than just boost income—they are crucial policies for helping low-income working Americans save and plan for the future.^x Unless Congress acts, critical provisions of the EITC and CTC will expire in 2017, meaning that some 50 million Americans, including 25 million children, would lose part or all of their EITC or CTC. The Tax Alliance supports the permanent extension of those key provisions.
- *Expand access to the EITC for childless workers* – Low-income workers who are not raising children, including full-time workers earning the minimum wage, receive little or nothing from the EITC. We support an expansion of the EITC so that childless workers and non-custodial parents have a pathway to move out of poverty and build their financial security.
- *Financial Security Credit* –The idea behind the Financial Security Credit is to use the federal tax system to provide lower-income families with the same kind of saving incentives that upper-income families enjoy. It would incentivize tax-time saving by allowing them to contribute a portion of their tax refund to an eligible savings account with federal matching funds deposited directly into the designated account.^{xi} A proposal to create such a credit was introduced in the 113th Congress as the Financial Security Credit Act of 2013.
- *Universal Savings Credit* – The notion of a Universal Savings Credit is to simplify the many existing savings incentives in the individual tax code by turning deductions into one credit. Taxpayers would receive the credit as a percentage of their contribution into an eligible savings account, regardless of income or tax liability, with federal matching funds offered for lower-income households.^{xii}

➤ Encourage Child Savings

Over 1.3 million American children – and more than half of minority children – are born each year into families with negligible savings to invest in their futures. Yet research indicates that lower-income children with even moderate savings are more likely to be invested in their future and succeed in life. For example, research shows that low- and moderate-income children with college savings of just \$500 or less are three times more likely to enroll in college and four times more likely to graduate.^{xiii}

The Tax Alliance for Economic Mobility supports the following policies to support lifelong savings, starting at birth:

- *Establish universal savings accounts at birth* – Children’s Savings Accounts (CSAs) are based on the simple idea that all families, given the right support, will save and invest in the talents and

aspirations of their children. The ideal federal CSA policy would create progressive, life-long, asset-building savings accounts at birth for every child in the country. These accounts would support savings for higher education, homeownership, retirement and other mobility-enhancing purposes. This basic structure has been proposed for over a decade—the ASPIRE Act has been repeatedly introduced with bipartisan support since 2005. The Act would create an account for all children at birth, seeded with \$500 and an additional deposit for children of low-income parents.

- *Reform federal 529 account structure to facilitate more inclusive plans* – 529s are tax-benefitted college savings accounts, created through federal policy and offered by the states. They offer a universal savings platform and all states have at least one plan. However, lower-income households receive few benefits: households in the bottom half of the income distribution own less than 2% of all savings in these accounts.^{xiv} Federal legislation could facilitate, encourage and subsidize more inclusive 529 plans in the states. Already, many states are reaching out to lower-income populations to increase their participation through lower fees, matched savings and other strategies. State advances that are increasing college savings among lower-income residents could inform federal 529 policy reform to include more children.^{xv}
- *Establish Kid’s Roth* – Smaller scale reforms could move our retirement tax policy modestly in the right direction. The "Roth at Birth" idea is to create a life-long, scalable, low-cost national children savings account product through simple modification of the "earned income requirement" applicable to existing Roth IRAs and to use a child's parents' earned income to determine allowable contribution levels. Bipartisan Kid’s Roth legislation was introduced in 2014, including the Roth Accounts for Youths Savings Act (RAYS Act), which would allow parents to contribute to Roth IRAs on behalf of their children without increasing the cost of federal Roth IRA policy.

➤ Maximize Access to Retirement Savings

The federal government spent \$146 billion on retirement tax incentives in 2014. These incentives for savings into 401(k)s, IRAs, and other qualified accounts are upside down – those Americans who are most likely to face financial insecurity in retirement receive the least support. In 2013, the top 1% of households received more from these programs than the entire bottom 60% combined. Retirement tax programs allow high-income workers to shelter vast sums of income from taxes while doing little to help many workers build adequate retirement savings. This is an inefficient and ineffective way to expand retirement security.

The Tax Alliance for Economic Mobility supports the following policies to support lower-income households to save for retirement:

- *Expand the Saver’s Credit* – Uniquely, the Saver’s Credit focuses support on low- and moderate-income workers. But it accounted for less than 1% of total spending on retirement tax programs last year because it suffers from several design flaws that limit its effectiveness and reach. For example, because the credit is non-refundable, workers who pay payroll taxes but owe little or no income tax receive little or no benefit. Reforms to the Saver’s Credit should expand this program so that more low- and moderate-income workers receive assistance to save for

retirement. Such reforms could be paid for by addressing some of the inequitable features of existing retirement tax programs.

- *Support federal Auto IRA policy* – With Auto IRA, employers who do not offer a retirement plan to their employees must set up an IRA savings plan, then deduct and transfer a percentage of workers' paychecks into the retirement account. Although workers can opt out, examples from the private sector indicate that few workers choose to do so. Research shows that moving to automatic enrollment could boost participation rates above 90%. Auto IRAs were included in President Obama's FY 2016 budget, and state-level auto-IRA programs have been advanced in Illinois, California, and other states.
- *Expand myRA* – In the absence of Auto IRA or an employer-sponsored retirement savings account, workers could simply open their own IRA, but the complexity of available options drives down take-up rates. The President's myRA program addresses this issue by creating a safe, affordable, and simple retirement savings alternative. Currently in the pilot stage, employers participating in myRA allow employees to contribute via payroll deduction to a myRA account, which is structured like a Roth IRA. Initial investments can be as low as \$25 with contributions as low as \$5 via payroll deduction. Any reform of retirement tax programs should expand myRA or a similar simple retirement savings account option in order to increase access to tax-preferred retirement savings accounts

➤ Expand Access to Higher Education

Federal tax expenditures that help families cover the costs of higher education are the largest form of federal student aid, yet most of the benefits accrue to higher-income students. Tax alliance members support the expansion of higher education tax expenditures that are accessible to lower-income households, paid for by eliminating or limiting regressive benefits such as deductions for tuition, student loan interest, and fees, that are mostly benefitting higher-income tax payers.

- *Reform the American Opportunity Tax Credit by making it permanent and fully refundable* – The American Opportunity Tax Credit (AOTC) is accessible to more low- and moderate-income households than other higher education tax subsidies because it is a credit that is partially refundable. Expanding the refundable portion of the AOTC and making it permanent would help to expand access to lower-income households. Other reforms could increase access to the AOTC by allowing low- and moderate-income families to access the credit before they are required to pay for higher education expenses.

➤ Support Homeownership

Tax benefits to support homeownership – including deductions for mortgage interest and property taxes – are the largest individual tax expenditures; but they primarily subsidize wealthier households. Only one out of four taxpayers claim the home mortgage interest deduction. Of households that claim it, the greatest subsidy goes to the wealthiest households because the higher the filer's tax bracket the greater the value of their deduction; and the larger their home – and loan – the greater the size of the mortgage interest that is eligible for deduction.

The Tax Alliance supports policies that allow lower-income households and households of color to purchase their first home and build home equity through the following approaches:

- *Cap the mortgage interest deduction (MID) or turn it into a credit* – Several proposals would scale back or reform the mortgage interest deduction, including three major bipartisan panels that have proposed converting the home mortgage interest deduction to a credit and lowering the maximum amount of interest it covers.^{xvi} The Tax Alliance supports these and other efforts to reform the MID so that lower-income households who don't itemize will benefit.
- *Support asset-building alternatives to deductions for mortgage debt* – Unlike other reform proposals focused on subsidizing debt, economists with the Tax Policy Center have proposed three reforms that would help lower-income households to access and build assets through homeownership. The proposals include a first-time homebuyer's credit, a refundable tax credit for property taxes paid, and an annual flat-amount tax credit for homeowners. Each would cap the home mortgage deduction at 15 percent, repeal the property tax deduction, and retain the existing tax treatment of capital gains on owner-occupied housing.^{xvii}

➤ Support New Entrepreneurs

Creating and owning a business has long been a path to financial success and economic mobility. In fact, business equity represents nearly one fifth of total household wealth nationwide. 13 million American microbusiness owners – those with five or fewer employees – earn less than \$50,000 per year. But these entrepreneurs and those aspiring to join their ranks face unique hurdles that can prevent them from successfully growing wealth through their businesses. Federal tax reforms should address these issues in order to boost entrepreneurship and financial security together.

- *Make EITC/CTC reforms, cited above, to support new entrepreneurs* - No existing tax credits explicitly target lower-income entrepreneurs, but the EITC and CTC are important resources for them. Self-employment income counts as income for the EITC so self-employed micro-entrepreneurs are eligible.^{xviii} All of the recommended improvements to the EITC and CTC described above will benefit lower-income entrepreneurs.
- *Establish a New Entrepreneurs Tax Credit* – One way to give tax relief to newly self-employed individuals and microbusiness owners is a New Entrepreneur's Tax Credit that would offset start-up costs and liabilities entrepreneurs face in their first year of business. The credit would be most impactful if refundable.^{xix}
- *Create Retirement Bonds for Entrepreneurs* – Retirement Bonds (or "R-Bonds") would create a new type of savings bond, issued by the U.S. Treasury, paying a small amount of interest and having the same tax preferences as IRAs. R-Bonds would allow self-employed individuals and microbusiness to save for retirement through their tax form.^{xx}

The current tax code includes billions of dollars of incentives to increase families' economic mobility by encouraging them to save and invest. Unfortunately, because of the way most of the policies have been designed, families who are most in need of the mobility boost are the least likely to receive it. Not only is this inefficient, it's counter to American ideals of equity and fairness.

Thank you for your consideration of our proposals. Please let us know if we can provide any additional information.

Sincerely,

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Tax Alliance for Economic Mobility members represent the following organizations: AARP; Aspen Institute/Initiative on Financial Security; Asset Funders Network; Center for American Progress; Center for Community Change; Center for Social Development at Washington University in St. Louis; Center on Budget and Policy Priorities; CFED; Color of Change; Emory Law School; Center for Global Policy Solutions; Greenlining Institute; Insight Center for Community Economic Development; Institute for Women’s Policy Research; Institute on Assets and Social Policy; Leadership Conference on Civil and Human Rights; Massachusetts Budget and Policy Center; NAACP; National Association of Latino Community Asset Builders; National Coalition for Asian Pacific American Community Development; National Council of La Raza; National Urban League; New America Foundation; Office of the Treasurer/City and County of San Francisco; Oklahoma Native Assets Coalition; PICO National Network; Pew Charitable Trusts; PolicyLink; Skadden, Arps, Slate, Meagher & Flom LLP; UCLA Asian American Studies Center; Urban Institute; and United Way Worldwide.

ⁱ Ezra Levin et al., “Upside Down to Right Side Up: Redeploying \$540 Billion in Federal Spending to Help All Families

ⁱⁱ CFED Assets and Opportunity Scorecard, 2015.

http://assetsandopportunity.org/assets/pdf/2015_Scorecard_Report.pdf

ⁱⁱⁱ Levin et al.

^{iv} Benjamin H. Harris, C. Eugene Steuerle, Signe-Mary McKernan, Caleb Quackenbush and Caroline Ratcliffe, “Tax Subsidies for Asset Development: An Overview and Distributional Analysis,” The Urban Institute and Urban-Brookings Tax Policy Center, August 2014.

^v Congressional Budget Office, “The Distribution of Major Tax Expenditures in the Individual Income Tax System,” May 2013.

^{vi} Levin et al.

^{vii} CFED Assets and Opportunity Scorecard.

^{viii} Pew Charitable Trust/Economic Mobility Project, <http://www.pewtrusts.org/en/archived-projects/economic-mobility-project>.

^{ix} Chuck Marr, Chye-Ching Huang, and Arloc Sherman, “Earned Income Tax Credit Promotes Work, Encourages Children’s Success at School, Research Finds,” Center on Budget and Policy Priorities, revised April 15, 2014.

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- ^x Sarah Halpern-Meekin et al. *It's Not Like I'm Poor: How Working Families Make Ends Meet in a Post-Welfare World*, January 2015.
- ^{xi} New America Foundation, "A Citizen's Guide to the Financial Security Credit." October 2013.
- ^{xii} Center for American Progress, "The Universal Savings Credit," July 19, 2013.
- ^{xiii} For more information, see CFED, Children Savings Accounts, <http://cfed.org/programs/csa/>
- ^{xiv} Levin et al.
- ^{xv} Clancy, M. M., Sherraden, M., & Beverly, S. G. (2015). *College savings plans: A platform for inclusive and progressive Child Development Accounts* (CSD Policy Brief 15-07).
- ^{xvi} Will Fischer and Chye Ching Huang, "Mortgage Interest Deduction is Ripe for Reform: Conversion to Tax Credit Could Raise Revenue and Make Subsidy More Effective and Fairer." Center on Budget and Policy Priorities. Revised June 2013.
- ^{xvii} Benjamin H. Harris, C. Eugene Steuerle and Amanda Eng, "New Perspectives on Homeownership Tax Incentives," Tax Notes/Special Report, December 23, 2013.
- ^{xviii} Katherine Lucas McKay, Lauren Williams, Alicia Atkinson and Ezra Levin, "Enhancing Support for Lower Income Entrepreneurs," CFED, January 2014.
http://cfed.org/knowledge_center/resource_directory/search/enhancing_support_for_lower_income_entrepreneurs_through_major_public_systems
- ^{xix} McKay et al.
- ^{xx} McKay et al.