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Slashing Tax Rates and Cutting Loopholes

Options for Tax Reform in the 119th Congress

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EXECUTIVE SUMMARY

The 2017 Tax Cuts and Jobs Act (TCJA) marked a significant overhaul of the US tax system. It reduced taxes for individuals and businesses through the end of 2025 and boosted economic growth. However, beginning in 2026, Americans face an automatic tax increase of about 8 percent (more than $400 billion a year).

In the context of the debate over the expiration of the TCJA, the next Congress has an unprecedented opportunity to cut tax rates to their lowest level in almost a century. The Cato Institute is putting forth this tax plan that pairs massively pro-growth tax cuts with the elimination of $1.4 trillion worth of annual tax loopholes, corporate welfare, and other special-interest tax subsidies. The plan would reduce the top income tax rate to 25 percent, the capital gains rate to 15 percent, and the corporate rate to 12 percent; enact full expensing for all investments; and repeal the estate tax, alternative minimum tax, and net investment income tax.

The more aggressively Congress eliminates loopholes in the tax code and cuts spending, the deeper it can slash tax rates, eliminate the costliest taxes, and boost the economy.

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INTRODUCTION

In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA), which cut taxes for individuals and businesses. Most of the changes for individuals expire at the end of 2025; beginning in 2026, taxes will increase by more than $400 billion a year.[1] The 2025 "fiscal cliff" is an opportunity to cut tax rates, eliminate tax loopholes, reduce spending, and boost economic growth.

Presidential candidates and policymakers aspiring to be part of the 119th Congress, which will be constituted in January 2025, will need to address the pending tax increases while facing unprecedented levels of spending and structural budget deficits. However, deficits need not constrain pro-growth tax reform. Policymakers could continue improving the tax system's economic efficiency by pairing lower tax rates with spending cuts and additional limits on tax loopholes.

> "Congress has an unprecedented opportunity to cut tax rates to their lowest level in almost a century."

The 119th Congress should build on the successes of the TCJA by prioritizing economic growth, simplification, and fiscal responsibility. True tax reform, compared to simple tax cuts, is a trade-off between the tax base (the things subject to tax) and tax rates. Tax reform should increase economic efficiency and the equal application of the tax code. The core challenge in any reform is the political interests invested in keeping the existing system. If Congress is not willing to cut spending or eliminate politically popular tax loopholes, the trade-off is higher tax rates and slower economic growth. Slower growth will make it harder to tackle the long-run fiscal imbalance of more than 10 percent of all future GDP ($245 trillion in present value).[2] Deficit-neutral, pro-growth tax reform is not constrained by fiscal space; tax reform that does not exacerbate the deficit is constrained only by a political preference for the current level of spending and hundreds of billions of dollars in tax preferences.

This policy analysis proposes slashing individual and business tax rates to their lowest levels in almost a century in a deficit-neutral framework.[3] Congress could do this by cutting tax loopholes and reducing the top income tax rate to 25 percent, the capital gains rate to 15 percent, and the corporate rate to 12 percent. It could also consolidate individual tax brackets to approximate a flat tax system, institute full expensing for all investments, and repeal the estate tax, alternative minimum tax, and net investment income tax. To offset these tax cuts, Congress should eliminate more than $1.4 trillion in annual tax loopholes and other subsidies. Ideally, Congress would also cut spending by reforming mandatory spending programs, such as Social Security, Medicare, and other automatic health spending. Significant spending cuts could allow even more aggressive reforms that eliminate many of the costliest taxes on business income and investment returns. More moderate reforms, with less aggressive and less pro-growth rate reductions, could leave the most politically popular tax subsidies.

PRINCIPLES FOR REFORM

The US tax code has increasingly extracted more resources from the private economy in ever more complicated ways. Tax reform to support a limited government should strive to reverse both trends by lowering tax rates, simplifying tax rules, reforming the tax base, and ensuring that these changes are permanent.

Before the TCJA, congressional Republicans built consensus around the reform's main parameters. In 2014 and again in 2016, Dave Camp and Paul Ryan, the chairmen of the Ways and Means Committee, each released comprehensive tax reform discussion drafts.[4] Presidential campaigns, including Donald Trump's 2016 campaign, also released proposals.[5] These proposals were primarily motivated by a consensus that the US business tax system was globally uncompetitive. America's high corporate tax rate and outdated international tax rules resulted in significant losses of domestic investment, business headquarters, and jobs.[6]

The TCJA cut the corporate tax rate, cut personal tax rates (lowering the tax bill for the average family of four by about $3,000), simplified taxpaying, and overhauled the international tax system, among many other reforms.[7] Table 1 summarizes the major reforms in the TCJA along with scheduled changes in 2026. The law met its primary goal of increasing economic growth, investment, and wages, which was driven by a permanent reduction of the corporate income tax and other temporary business tax cuts, such as expensing.[8] The individual changes were mildly pro-growth

Table 1

Major recent tax changes and future expirations

Provision	Current status in 2024 (current policy)	Policy in 2026 after TCJA expiration (current law)	IRC section
Individual marginal tax rates Rates apply to taxable income within designated tax brackets.	Seven brackets: 10%, 12%, 22%, 24%, 32%, 35%, 37%	Seven brackets: 10%, 15%, 25%, 28%, 33%, 35%, 39.6% Above 15%, taxable income ranges generally capture more income in higher tax brackets.	Sec. 1
Standard deduction Standard deduction reduces taxable income to create a zero-rate tax bracket; not available for taxpayers who itemize.	Single: $14,600; married: $29,200	Single: $8,300 Married: $16,600	Sec. 63
Personal exemptions Exemptions reduce taxable income for self, spouse, and child.	None; exemption set at $0	Exemption: $5,300	Sec. 151
Child tax credit Tax credit reduces taxes owed. Some low-income taxpayers with little or no tax liability can receive a direct payment in the form of a refundable credit.	$2,000 tax credit per child under 17 years old; phaseout for higher-income taxpayers begins at $400,000 for married filers.	$1,000 tax credit per child under 17 years old; phaseout for higher-income taxpayers begins at $110,000 for married filers.	Sec. 24
Credit for other dependents Tax credit for dependents not eligible for the child credit	$500 credit per dependent	No credit available	Sec. 24(h)(4)
State and local tax (SALT) deduction Itemized deduction for income or sales and property SALT payments	Deduction capped at $10,000	Unlimited deduction	Sec. 164
Mortgage interest deduction (MID) Itemized deduction for interest paid on first and second homes	Interest paid on up to $750,000 of mortgage debt is deductible.	Limit increases from $750,000 to $1 million of mortgage debt.	Sec. 163(h)
Limits on certain other individual itemized deductions	Limits on deduction for personal casualty and theft loss and wagering losses; no deduction for miscellaneous expenses, such as employee expenses and tax preparation fees	Fewer limits on deductions for losses and miscellaneous expenses	Sec. 62, 67, 165, 212
Overall limitation on itemized deductions Known as Pease limitation	No overall limit	For higher-income taxpayers, some itemized deductions reduced by 3% of income above certain thresholds	Sec. 68
Fringe benefits exclusions Exclusion of employer-provided bicycle commuter and moving expense reimbursements from taxable income	Bicycle and moving expense reimbursement included in taxable income; does not apply to moving expenses for military members	Up to $20 per month of bicycle expenses and all qualified moving expenses not subject to income or payroll taxes	Sec. 132
Moving expense deduction Above-the-line (not itemized) deduction for qualifying moving expenses	Available for military members only	Available to all qualifying individuals	Sec. 217
ABLE accounts Tax-favored savings accounts for qualifying disabled individuals	Higher ABLE account contribution limits for employed individuals, availability of saver's credit, and tax-free rollovers from 529 education savings accounts	Contribution limits return to annual gift tax exemption for all individuals; saver's credit not eligible, and 529 rollovers are taxable.	Sec. 25B, 529
Health insurance premium tax credit Refundable tax credit to cover cost of insurance premiums purchased on ACA marketplace based on income, family size	Full premium coverage up to 150% of poverty line for Medicaid-ineligible; no income limit on credit to offset premiums above required contribution percentages	Higher premium contribution percentages at all income levels; credit not available above 400% of poverty line	Sec. 36B

Table 1 (continued)

Major recent tax changes and future expirations

Provision	Current status in 2024 (current policy)	Policy in 2026 after TCJA expiration (current law)	IRC section
Alternative minimum tax (AMT) Parallel income tax system with different definition of taxable income; tax rates of 26% and 28% after an AMT exemption	AMT exemption of $133,300 (married), phased down for high-income taxpayers; 2017 AMT applies to about 200,000 taxpayers.	Lower exemptions and phaseout income levels so that the AMT will likely apply to more than 5 million taxpayers.	Sec. 55
Expensing Businesses generally must deduct the cost of new investments over time (from 3 years to 39 years), depending on the asset.	Through 2022, 100% first-year bonus deduction (full expensing), phasing down 20% each year for 5 years; bonus deduction of 60% allowed in 2024	20% bonus deduction in 2026; beginning in 2027, normal depreciation rules apply.	Sec. 168
Pass-through deduction for business income Personal business income is generally taxable at individual income tax rates.	Deduction equal to 20% of qualifying business income; above certain income limits, deduction subject to restrictions based on industry and business wages paid	No deduction	Sec. 199A
Employer credit for paid leave Business tax credit for wages paid to employees on family and medical leave	Credit is up to 25% of wages paid for up to 12 weeks; does not apply to leave pay required by law.	No credit available	Sec. 45S
Limitation on losses for noncorporate taxpayers Business losses can generally be deducted from taxable income.	Non–C corporation losses in excess of income or gain from such activities, subject to annual limit of $610,000 (married); disallowed losses can be carried forward.	Losses can generally offset more income, subject to fewer limits; takes effect January 1, 2029.	Sec. 461(l)
International taxes TCJA included three new international taxes on certain foreign income (GILTI, FDII) and cross-border transactions (BEAT).	Effective tax rates: GILTI: 10.5%–13.125% FDII: 13.125% BEAT: 10%	Effective tax rates increase to: GILTI: 13.125%–16.406% FDII: 16.406% BEAT: 12.5%	Sec. 59A, 250, 951A
Opportunity Zones (OZs) Capital gains from qualified OZs deferred and excluded from income	No election for deferral of gain after December 31, 2026	After 2026 election date and staggered holding periods, no tax benefits for OZ investments	Sec. 1400Z
Estate and gift tax Inheritances and gifts are taxed at 40% after excluding a fixed amount from taxation.	Exclusion of $13.61 million per person	Exclusion of $7.15 million per person	Sec. 2001, 2010
Corporate tax rate	21% tax rate	No change, permanent reform	Sec. 11(b)

Sources: "Reference Table: Expiring Provisions in the 'Tax Cuts and Jobs Act' (TCJA, P.L. 115-97)," Congressional Research Service, November 21, 2023; Internal Revenue Code; and author's calculations.

Notes: Many details for taxpayers in specific circumstances are excluded for simplicity. Expirations happen on December 31, 2025, unless otherwise noted. The values for 2026 are adjusted for inflation assuming September 2024 through August 2025 Chained Consumer Price Index for All Urban Consumers is 177. Excluded items include rule changes to charitable contributions deduction, combat-zone tax benefits for military members in the Sinai Peninsula, and capitalization rules for citrus plants lost by casualty. ABLE = Achieving a Better Life Experience; ACA = Affordable Care Act; BEAT = Base Erosion Anti-Abuse Tax; FDII = Foreign-Derived Intangible Income; GILTI = Global Intangible Low-Taxed Income; HSA = health savings account; IRC = Internal Revenue Code; TCJA = Tax Cuts and Jobs Act; and (married) = married filing jointly.

and included significant simplifications to taxpaying for those who itemize.[9]

While the 2017 reform benefited taxpayers and the economy, it did not make most of the changes permanent. In the years since, Congress has increased the tax code's complexity, added new taxes on corporate income and stock buybacks, and created new tax subsidies. Thus, simply removing the expiration dates from the current law to make the TCJA permanent wastes an opportunity to address the unfinished business of much-needed tax reform.

Unlike in the years before 2017, no coalition of policymakers has been doing the hard work of building public consensus around the next tax reform.[10] The most ambitious tax legislation passed out of the Ways and Means

Committee in the 118th Congress primarily addresses already-expired business tax cuts, extending them through 2025.[11] A bipartisan tax bill pairs the temporary extension of the business tax cuts with an expansion and modification of the child tax credit.[12]

A more comprehensive tax package in the 119th Congress should build on the successes of the TCJA by prioritizing economic growth, simplification, and fairness without adding to the deficit.

Choosing a Pro-Growth Tax Base

The history of American tax changes has been one of incremental reforms. This approach requires policymakers to ensure that proposals move toward a simple, pro-growth tax base.

Determining the tax base—what is subject to tax—is the most economically consequential decision in designing a tax system.[13] A low tax rate on the wrong tax base can have outsized adverse economic effects. For example, a 5 percent annual tax on wealth can be equivalent to a 100 percent income tax rate.[14] A 100 percent tax on income eliminates all financial incentives to work or invest.

Traditional income tax systems encourage consumption over saving by assessing multiple layers of tax on interest and investment returns. Wages are taxed by income and payroll taxes. If income is saved for future consumption, the increase in value is taxed again as interest, capital gains, dividends, and transfers at death. The corporate tax adds yet another layer of tax on income earned from corporate equity investments. Proposals to tax unrealized capital gains through mark-to-market taxes and wealth taxes could further increase effective tax rates on saving.[15] Many of the reforms in President Biden's Fiscal Year 2025 budget proposal aim to increase taxes on investment income.[16]

When the tax system lowers the after-tax return to savings (by increasing taxes on savings and investment), investors and entrepreneurs have fewer resources to invest in future technologies, expand their businesses, and raise wages. The US system mitigates the worst of these effects by taxing capital gains and corporate income at rates below top wage tax rates, and through tax-advantaged savings accounts, but additional reforms are needed.

A tax base that taxes income from labor and capital equally creates the smallest economic distortions. Such a tax is commonly referred to as a consumption tax, and there are many ways to design a consumption tax base.[17] Sales taxes, value-added taxes, and consumed-income taxes (income taxes with a deduction for savings) all reach theoretically similar economic results.[18] The TCJA moved the tax code a step closer to a consumed-income tax.

Ideally, the federal government should shrink so much that the Sixteenth Amendment—which authorized the modern income tax—could be repealed outright. Short of repealing the Sixteenth Amendment, policymakers should continue pursuing reforms to the income tax system that alleviate double taxation and lower taxes on saving, investment, and work.

Eliminating double taxation would lead to a substantially larger economy with more opportunities and better pay for American workers. According to an analysis by the Tax Foundation, simplifying the tax code and eliminating the double taxation of business income would increase long-run GDP by 2.5 percent, grow after-tax income by 3.5 percent, and add 1.3 million full-time-equivalent jobs.[19] Eliminating the double taxation of personal savings would result in even larger economic gains.

> "Simply making the TCJA permanent wastes an opportunity to address the unfinished business of much-needed tax reform."

Improving the tax base—that is, reforming the base by removing loopholes that benefit various special interests—can also be a more economically powerful reform than cutting tax rates, although policymakers should pursue both rate reductions and base reforms. For example, allowing an immediate deduction for new business investments, a practice called full expensing, could result in almost six times more GDP growth per dollar of lower revenue compared to personal income tax cuts.[20] Many improvements to the tax base also increase revenue, which could help offset tax cuts such as full expensing, lower capital gains taxes, and lower corporate income tax rates.

Pro-growth tax changes must also be permanent. Individuals and businesses are always planning for the

future, and they often factor taxes into those decisions. Thus, temporary tax changes have little effect on long-term planning and economic growth. Congress often pursues short-term tax changes—as it did for TCJA—to obscure the true budgetary effects of permanent policy and to accommodate arcane procedural rules. In 2025, there will be strong political pressure to extend the tax cuts for just one or two years. Temporary extensions followed the tax cuts signed into law by President George W. Bush in the early 2000s.[21] Congress extended the tax cuts temporarily once, before the middle-class tax cuts were made permanent in 2013 in the fiscal cliff deal under President Barack Obama. The deal with Republicans allowed top income and capital gains tax rates to return to pre-2000 policy.[22]

The most pro-growth tax reforms focus on permanent changes to the tax base that support long-term investment, productivity growth, and economic expansion.

Cutting Tax Loopholes: Reforms for Simplification, Transparency, and Fairness

Since the early 20th century, the federal tax code has grown exponentially longer, more complex, and more unequal. Congress has added hundreds of credits, deductions, preferences, and other loopholes that provide trillions of dollars in subsidies to politically favored industries and move millions of Americans entirely off the tax rolls. Between 1970 and 2023, the number of these tax expenditures—so-called because they can function in ways economically similar to direct spending programs—increased from 53 to 205.[23] From 1980 to 2020, the percentage of tax filers who paid nothing in income taxes rose from 19 percent to 37 percent.[24]

Not every officially tallied tax expenditure should be repealed. Many such deductions, exemptions, and rate reductions help move the tax code toward a more neutral consumption-based tax.[25] Genuine tax loopholes (as measured from a consumption tax base and listed in Tables A1 and A2 in the Appendix) should be repealed. These credits and deductions often function less like tax cuts and more like unlimited, unappropriated spending.[26] They create cottage industries for lobbyists, lawyers, and accountants who profit from the complexity and opacity of the 75,000 pages of tax laws and IRS regulations.[27] A variety of studies indicate that income tax compliance costs are at least 10 percent of the associated tax revenues, or about $260 billion in 2024, and likely much higher.[28]

Congress has also consistently reduced the number of individual taxpayers through policies such as the child tax credit, the earned income tax credit, the standard deduction, and personal exemptions. By pushing millions of lower-income Americans off the income tax rolls, the tax code has become less equally distributed and more dependent on a narrower segment of upper-income taxpayers for a growing share of the federal tax burden. Between 1980 and 2021, the share of income taxes paid by the top 1 percent of income earners increased from 19 percent to 46 percent.[29] Including payroll taxes and other sources of federal revenue, the lowest-income 20 percent of Americans are projected by the Treasury Department to be net beneficiaries of the tax system in 2024. On average, 59 million people receive more payments through the federal income tax than they pay in taxes through other sources.[30]

Policymakers cannot continue to exempt ever larger shares of American families and politically favored industries from the federal tax system. If Congress must have goals other than raising revenue to supply public goods—goals such as poverty alleviation, labor force incentives, family subsidies, or industrial policies—they should be pursued as part of a unified budget and through purpose-built programs funded by the annual appropriations process. This would increase transparency, allow more regular congressional review, and clarify trade-offs between competing priorities.

Deficits Constrain Tax Reform

The Congressional Budget Office (CBO) projects that in 2026 the federal deficit will be $1.7 trillion (5.5 percent of GDP), rising to $2.6 trillion in 2034 (6.2 percent of GDP).[31] These figures assume three things: that tax revenue increases by about $450 billion a year following the expiration of a majority of the TCJA after 2025; that interest rates remain low; and that discretionary spending grows slower than the economy. Without spending cuts, lowering federal revenue is fiscally irresponsible, as current deficits are already economically unsustainable.

Historically, congressional tax changes—Ronald Reagan in the 1980s, Bill Clinton and the congressional Republicans

in the 1990s, Bush and Obama in the 2000s, and Trump in 2017—have kept taxes as a share of the economy around its half-century average of about 17 percent. Figure 1 shows that Congress has kept tax revenue relatively constant but, since the early 2000s, has failed to keep spending from growing faster than the economy. The CBO projects this trend to continue over the next three decades, even as revenues rise above the historical average. Figure 1 also shows that making the TCJA permanent without any additional reforms would reduce revenue below the historical average until 2054 on a static basis. Accounting for projected economic growth from keeping taxes low, revenue could remain below 17.3 percent of GDP through 2047.[32] Spending is projected to keep climbing, growing faster than the economy year after year.

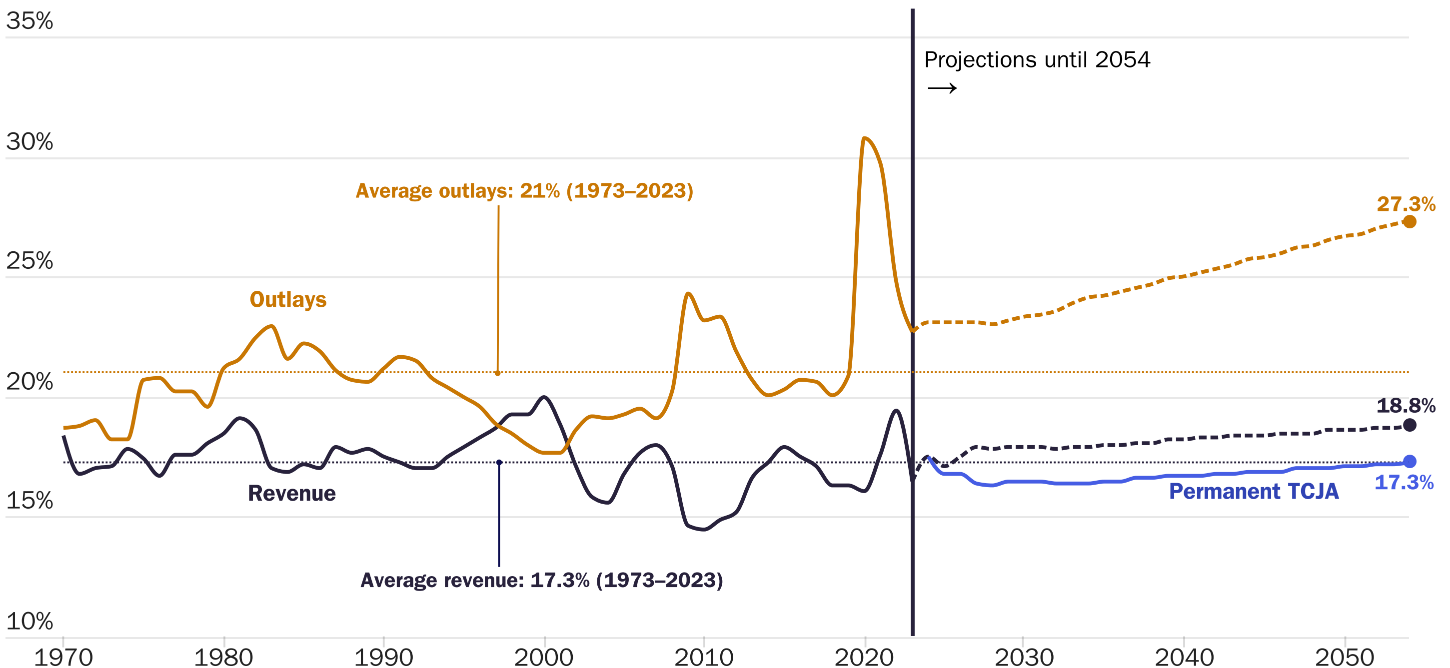
Policymakers must begin by deciding what portion of the economy the federal government should control. If long-term federal spending rises to 28 percent of GDP, then federal revenues must also rise. Collecting 28 percent of GDP in revenues today would require a 60 percent increase in federal taxes or a $3 trillion tax increase in 2024. The revenue increases called for in President Biden's FY 2025 budget proposal would cover only about 17 percent of that tax increase.

If, instead, Congress cuts spending to match historical average tax collections (17.3 percent of GDP), it could cut taxes by about $200 billion a year after 2026. Neither of these options is immediately politically feasible, but over the medium term, lower spending is eminently achievable.[33] Eventually, Congress will need to bring the government spending it authorizes closer into line with the taxes the federal government collects. The current path is unsustainable.[34]

Tax increases alone cannot address unsustainable deficit growth, nor should they. The erosion of fiscal space is driven almost exclusively by net interest costs and federal health spending.[35] Long-term fiscal sustainability will require reforms to programs such as Social Security, Medicare, Medicaid, and federal insurance subsidies.[36] Tax increases fail to balance budgets because they depress GDP growth (shrinking the available tax base) and do nothing to reform the spending programs that fuel fiscal crises. This is demonstrated across a wide range of countries' historical experiences with fiscal adjustments. Tax-increase-based reforms fail to stabilize budgets, while spending-based policy changes are more likely to reduce debt-to-GDP ratios successfully.[37] Tax increases

Figure 1

Federal outlays and revenue with 2017 Tax Cuts and Jobs Act (TCJA) extension, share of gross domestic product



Sources: Author's calculations; "The Budget and Economic Outlook: 2024 to 2034, Historical Budget Data," Congressional Budget Office, February 2024; "The Long-Term Budget Outlook: 2024 to 2054," Congressional Budget Office, March 20, 2024; and "Budgetary Outcomes under Alternative Assumptions about Spending and Revenues," Congressional Budget Office, May 2024.

cannot fix unsustainable growth in spending programs.

The level of spending determines the long-run tax rate. Tax cuts alone do not change the size of government without a balanced budget constraint. Tax cuts without offsetting spending cuts shift the cost of the unfunded spending onto future taxpayers and disguise the actual cost of current government services through so-called fiscal illusion.[38] Future generations will pay the costs of current government spending through some combination of higher taxes, higher inflation, and slower economic growth.

> "Tax increases alone cannot address unsustainable deficit growth, nor should they."

Without spending cuts, tax cuts are less effective because taxpayers know that taxes will have to rise in the future if spending reforms are not implemented. Historically, tax cuts have been partly reversed within five years of passage because they were not paired with spending cuts.[39] Portions of both the Reagan tax cuts in 1981 and the George W. Bush tax cuts in the early 2000s were reversed over deficit concerns. Making matters worse, the 2017 tax cuts were followed by spending increases rather than spending cuts. In the years following 2017, outlays increased by 8 percent, and Congress increased discretionary spending limits by $617 billion.[40]

Without spending changes, the necessity of future tax increases dampens the projected pro-growth effects of fiscally unsustainable tax cuts. In 2020, John Cogan, Daniel Heil, and John Taylor estimated that holding federal expenditures at the pre-pandemic level of about 20 percent of GDP—thereby preventing sizable future tax increases—would boost the real annual GDP growth rate by as much as 10 percent in the short run and 7 percent in the long run.[41] Because most tax cuts reduce revenue, spending reforms have long been a critical missing component of sustainable, pro-growth tax reform.

Debating the Baseline

The debate over the deficit effects of any future tax legislation will turn on differences between *current policy* and *current law* baselines. The CBO estimates future revenue based on what is written in law. For example, it assumes that on January 1, 2026, most of the tax code will revert to the 2017 law (increasing taxes). However, the current policy baseline, sometimes called the alternative fiscal scenario by the CBO, assumes that Congress will not allow current law to take effect by extending popular temporary policy. In this case, current policy assumes that Congress will extend the 2017 tax cuts. Scored from a current law baseline, the extension of the TCJA is a tax cut and adds to the deficit. Scored from a current policy baseline, the extension of the TCJA prevents a tax increase and does not add to the deficit.

Policymakers should expect public discourse on the deficit effect or "cost" of any future tax legislation to be measured from a current law baseline. This is standard convention. It is also unlikely that congressional scorekeepers will accurately and quickly include economic effects to allow revenue estimates to incorporate positive—or negative—macroeconomic feedback. Future tax changes should be revenue-neutral (pairing tax cuts with tax base reforms) or deficit-neutral (pairing tax cuts with spending cuts) to pursue fiscal sustainability. Pursuing all three at once—reforming the tax base, reducing spending, and cutting tax rates—is preferable.

OPTIONS FOR REFORM IN 2025

Policymakers should view pro-growth tax reform in 2025 as a continuum, ranging from removing the upcoming TCJA expiration dates to throwing out the entire Internal Revenue Code (IRC) and starting from scratch (with something like a national flat consumption tax as proposed by Robert Hall and Alvin Rabushka, aka the Hall–Rabushka flat tax, or a flat tax system like the one used in Estonia, as modeled by the Tax Foundation).[42] While starting from scratch is most desirable, the historical model of successful reform is one of incremental changes.

Tax reform that successfully boosts economic growth, simplifies taxpaying, and maintains sufficient revenue levels will need to address many economically complex and politically challenging issues. Pro-growth tax reform that improves the tax base and cuts tax rates is constrained only by lawmakers' unwillingness to confront entrenched special interests and limit long-standing tax loopholes.

The 2025 tax expirations present an opportunity to expand on the TCJA's most successful features, further

cutting tax rates and simplifying taxpaying. Table 2 summarizes an aggressive Cato plan to slash tax rates and eliminate tax loopholes. This sample plan is designed to be close to revenue-neutral before accounting for the resulting economic growth, which would boost revenue in the long run and allow for additional future tax cuts.

The Cato plan cuts the top individual tax rate to 25 percent, the capital gains rate to 15 percent, and the corporate rate to 12 percent. It consolidates individual tax brackets to approximate a flat-rate tax system, allows full expensing for all investments, and repeals the estate tax, among many other reforms (see Table 3 and Table A1, which summarize the changes described in the following text). The Cato plan offsets rate reductions by eliminating more than $1 trillion in annual tax loopholes and other subsidies. The revenue estimates are rough approximations but illustrate the dramatic opportunity for fiscally sustainable, pro-growth tax cuts that Congress could enact without spending cuts. With spending cuts, tax rates could be lowered even further.

The following subsections detail more than a dozen pro-growth tax cuts and more than 60 tax loopholes for Congress to repeal or scale back. All revenue figures are annual post-2026 averages measured from a current law baseline after the TCJA expires. Estimates are derived independently from a variety of sources and may be different when multiple policies are pursued simultaneously and taxpayers change behavior.[43] For example, the value of a deduction declines when tax rates are lower. Transition rules are also important and can affect revenue estimates, especially for provisions tied to existing investments. The estimates in Table 2 attempt to roughly account for some interactions and are thus not a straight summation of the individual proposals in the remaining tables. Any final plan should adjust the tax changes or spending levels to ensure that the plan is close to deficit-neutral. All other totals are simple sums.

Raising revenue on its own is not a desirable policy goal, but the $1.4 trillion in annual tax loopholes described below illustrates the magnitude of available fiscal space if Congress wants to pursue tax cuts beyond those included in the TCJA. Congress could cut taxes even further if it cut direct spending, as it should. Cutting spending could allow some of the most politically popular tax subsidies to remain or, ideally, for rates to be cut further. Congress could start by scaling back the more than $1 trillion a year in federal government grants to state and local governments for education, housing, welfare, transit, and other activities.[44] Reforms to health and retirement programs like Social Security and Medicare are also necessary, and to keep taxes low for the long term, spending cuts will need to exceed revenue reductions.

Reforms That Cut Tax Rates and Reduce Revenue

Tax reform should improve the economic and administrative functioning of the tax system. When improvements to the tax code increase revenue, they should be used to offset other structural reforms and reduce tax rates. The more aggressive Congress is at eliminating

Table 2
A Cato tax plan to slash tax rates and cut loopholes

Proposal	Billions, annual
Individual tax cuts, 25% top rate	–$779
12% corporate tax rate	–$192
Other business tax cuts, expensing, territorial	–$145
15% tax rate on all capital gains and dividends	–$84
Repeal individual loopholes	$963
Repeal business loopholes	$227
Total	**–$9**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates roughly capture interaction effects between some changes and thus do not sum from figures in Table 2 and Table A2. Estimates are not the product of a formal tax model and should be interpreted as rough approximations.

preferences in the tax code and cutting spending, the deeper it can slash tax rates and boost the economy.

The most important tax cuts described in this section and summarized in Table 3 include:

- permanent full expensing;
- an internationally competitive corporate income tax system;
- low top marginal income tax rates for workers and small businesses;
- low capital gains and dividends tax rates;
- universal savings accounts; and
- no alternative minimum taxes or estate tax.

Full expensing. The normal income tax rules require businesses to deduct the cost of new investments over their asset life (between three and 39 years). These rules increase the after-tax cost of new investments because the real value of the associated tax deduction declines with inflation and time.

The TCJA temporarily fixed this problem by allowing businesses to fully deduct the cost of many new investments in the year they are made; this is called full expensing or 100 percent bonus depreciation. Beginning in 2023, equipment and other short-lived investments lose 20 percentage points of the 100 percent bonus deduction each year through 2026. In 2022, companies were also required to start amortizing research expenses over five years instead of the previous policy of immediate deduction.[45] Each of these changes increases the effective tax rate on business investments.

Congress should permanently restore full expensing as it was for tax years 2018–2021, lowering revenue by about $60 billion a year ($43 billion for equipment and $17 billion for research and development). Congress should also expand expensing to longer-lived structures by allowing the

Table 3
Tax reforms that reduce revenue

Proposal	Description	Billions, annual
Expensing	100% first-year investment deduction for all short-lived assets	$43
Research and development expensing	100% first-year deduction for research and experimentation expenditures	$17
Neutral cost recovery	Adjust long-lived structures deduction for inflation and real rate of return	$1
Corporate income tax	Cut corporate income tax rate to 12 percent	$192
Territorial corporate tax	Full territorial corporate income tax; full participation exemption; repeal GILTI, FDII, and BEAT	$45
Corporate alternative minimum tax	Repeal corporate alternative minimum tax	$22
Lower individual rates	Two tax brackets: 12% rate for most taxpayers; 25% rate on income above $168,600	$779
Capital gains and dividends	Cut capital gains and dividends tax rate to 15%	$16
Net investment income tax	Repeal net investment income tax	$31
Stock buyback excise tax	Repeal buyback excise tax	$9
Universal savings accounts	Create Roth-style universal savings accounts with $10,000 annual limit	$4
Individual alternative minimum tax	Repeal alternative minimum tax	$70
Estate tax	Repeal estate, gift, and generation-skipping tax; carryover basis at death	$17
Total		**$1,246**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes. BEAT = Base Erosion Anti-Abuse Tax; FDII = Foreign-Derived Intangible Income; and GILTI = Global Intangible Low-Taxed Income.

same immediate deduction or implementing a "neutral cost-recovery system," which provides a similar economic benefit as expensing at a lower fiscal cost by allowing businesses to index their write-offs for inflation and time.[46] Neutral cost recovery reduces revenue by $1 billion a year.

Because expensing is just a change in the timing of deductions, the long-run revenue effect is likely positive after accounting for the larger economy.[47] In the 10-year budget window, expensing's static revenue loss is overstated by almost 50 percent because of the policy's strong pro-growth effects.[48]

Corporate income tax. The federal corporate income tax rate is 21 percent. Unlike most other provisions in the TCJA, the corporate tax rate is permanent and not scheduled to increase in 2026. When accounting for average state taxes (6 percent), American corporations face a combined average statutory tax rate of 25.8 percent. This is higher than the non-US Organisation for Economic Co-operation and Development's average rate of 23.6 percent and well above Ireland, which has Europe's lowest rate of 12.5 percent.[49]

> "To keep taxes low for the long term, spending cuts will need to exceed revenue reductions."

Congress should cut the federal corporate rate to 12 percent or lower. A 12 percent federal corporate tax rate would lower revenue by $192 billion a year on a static basis. After accounting for substantial inbound profit shifting and additional economic growth, the rate reduction would lower revenue by about $86 billion a year.[50]

Despite significant reforms in 2017, the United States still applies an overly complex system of taxing foreign profits. The three-part TCJA international tax system also includes automatic tax increases on foreign income in 2026.[51] Under a low-enough corporate tax rate and 100 percent expensing, Congress could repeal most cross-border tax rules or dramatically scale them back. International tax reforms should include a full participation exemption for dividends and capital gains and repeal the tax on Global Intangible Low-Taxed Income (GILTI), the Base Erosion and Anti-Abuse Tax (BEAT), the deduction for Foreign-Derived Intangible Income (FDII), and the Corporate Alternative Minimum Tax (CAMT). Repealing GILTI, BEAT, FDII, and an expanded participation exemption would lower revenue by $45 billion a year. Repealing CAMT would lower revenue by $22 billion.

A lower corporate tax rate that applies only to domestic income, paired with permanent full expensing, would make the United States the world's most attractive international destination for multinational investment.

Individual income tax rates and pass-through businesses. Personal income is taxed at rates ranging from 10 percent to 37 percent through 2025. The top rate rises to 39.6 percent in 2026; intermediate rates also increase, and brackets change so that more income will be taxed at higher rates (more details are in Table 1). Under the progressive tax rate structure, additional income earned over certain thresholds is subject to higher tax rates, so higher-income Americans pay substantially more of their income in taxes. High marginal income tax rates discourage work, leading some people (such as second earners or near retirees) to choose not to work and others to work fewer hours or work less productively.[52]

In addition to traditional wage earners, over 90 percent of businesses in the United States pass their income through from the entity level to the owners, where it is taxed as personal income at individual income tax rates. These "pass-through" businesses (S corporations, partnerships, LLCs, cooperatives, REITs) account for about half of business income and employment.[53]

An important goal of tax reform is to ensure that all businesses face similar tax rates regardless of how they are legally organized. Investments in pass-throughs face one layer of tax at individual income tax rates, and investments in C corporations face two layers: the corporate income tax and the capital gains or dividends tax. Because personal tax rates remained high, the TCJA created a new pass-through deduction (Sec. 199A) of up to 20 percent of qualifying business income, which expires at the end of 2025.

At 2024 tax rates, pass-throughs generally face similar or lower average and marginal tax rates as C corporations due in part to the 20 percent deduction.[54] The pass-through deduction is exceedingly complex, with rules that treat different industries, business structures, and income levels differently. Because of the pass-through deduction's complexity and uneven economic effects, Congress should not extend it. Doing so would reduce revenue by about $78 billion a year.[55] Instead of a complicated deduction,

pass-through businesses would be better off with a lower individual income tax rate.[56]

Extending the TCJA individual tax rates and brackets would reduce revenue by about $270 billion. The Cato proposal is to tax personal income at two rates: 12 percent and 25 percent (beginning at $168,600, where the Social Security payroll tax ends). This would reduce revenue by roughly $779 billion a year from current law.[57] When combined with payroll taxes, the 12 percent and 25 percent rates approximate a flat tax on wage income, creating a combined marginal tax rate of 27.3 percent for income in the lower bracket and 28.8 percent in the top bracket.[58]

A 25 percent top marginal rate for non-wage pass-through income would also create rough parity for corporate equity investments taxed at a 25.2 percent integrated tax rate (accounting for a 15 percent capital gains rate and 12 percent corporate income tax), as proposed below.[59] To ensure equal treatment between entity types, Congress should integrate the corporate and pass-through tax systems so that all business income falls under a single system.[60]

Keeping top marginal tax rates from rising above their current level is the most important TCJA personal income tax cut to maintain. If lawmakers want to reduce tax rates further, they should consolidate the current seven tax brackets, with the ultimate goal of reaching one low, flat tax rate for all taxpayers.

Capital gains and dividends. Corporate equity investments are taxed first by the corporate income tax at the entity level and a second time at the individual level. The current long-term capital gains and dividends tax rate is 20 percent. For taxpayers with adjusted gross income over $250,000 (for those who are married filing jointly) or $200,000 (for those filing single), capital gains, dividends, and certain types of other passive income, such as from pass-through businesses, are subject to an additional 3.8 percent net investment income tax (NIIT). Capital gains realized through corporate stock buybacks can also face an additional 1 percent excise tax assessed at the entity level.[61] Congress should repeal the NIIT and stock buyback tax and lower the long-term capital gains and dividends rate to 15 percent. Together, these three reforms would reduce revenue by $56 billion a year ($31 billion for NIIT, $16 billion for a 15 percent capital gains rate, and $9 billion for stock buyback tax).

Universal savings account. Special-purpose savings accounts, such as 401(k)s, individual retirement accounts (IRAs), and 529 plans for education, help alleviate some of the tax code's bias against saving by eliminating the capital gains tax on income held in the accounts. These accounts should be consolidated and simplified.[62]

Congress should also create a new universal savings account (USA) that operates like a special-purpose savings account—income saved in the account would be taxed only once—but without restrictions on when or how funds could be spent.[63] Taxpayers could save up to $10,000 a year for their own purposes without any withdrawal restrictions. Taxpayers, instead of politicians, would get to decide when to spend their savings. A Roth-style USA account with an annual contribution limit of $10,000 a year would reduce revenue by $4 billion a year.

Alternative minimum tax. The individual alternative minimum tax (AMT) is a parallel tax system that applies 26 percent and 28 percent tax rates to a broader definition of income after an income exemption. Taxpayers pay whichever is higher, the AMT or the regular income tax. The TCJA temporarily increased the AMT exemption and phaseout.

The AMT does its intended job inefficiently by burdening taxpayers with additional paperwork and not addressing the underlying problem of a tax code that has too many loopholes. Congress should repeal the individual AMT, which would lower revenue by $70 billion a year.

Estate tax. The estate and gift tax imposes a 40 percent tax on the transfer of wealth, either as a gift during a person's life or as an inheritance after death. The estate tax exempts $13.61 million per person in 2024 (falling to approximately $7.15 million in 2026). While on paper the estate tax applied to only about 2,500 estates in 2021 (under the temporarily higher exemption), millions of asset-rich families—families without a lot of cash on hand but with small businesses, farms, and other productive assets—are forced to engage in complex tax planning to ensure that their heirs are not forced to liquidate their life's work to pay a federal tax bill.[64] Like the capital gains tax, the estate tax is a second layer of tax on investment returns that should not face additional levies.

Congress should repeal the estate tax, which would lower revenue by $41 billion a year. Repeal should be paired with replacing the current law's stepped-up basis rules with carryover basis rules to ensure equal treatment with capital gains realized before death.[65] Repeal of the estate tax paired

with carryover basis would reduce revenue by $17 billion a year. Depending on economic growth and realization assumptions, pairing estate tax repeal with a policy of carryover basis is likely to be near revenue-neutral.[66]

Reforms That Raise Revenue and Improve the Tax Base

Congress could improve the tax base by repealing dozens of tax loopholes. The following section describes more than 50 reforms that would close some of the most budgetarily and economically costly tax subsidies and provide revenue to offset steep tax cuts.

Each loophole is a politically popular program with vocal constituencies who reap the benefits. The less vocal group is the tens of millions of Americans who have to pay higher tax rates and endure the economic distortions caused by each subsidy. Congress should repeal the following subsidies.

Business tax subsidies. The tax code contains $252 billion in business tax subsidies.[67] Repealing these credits and other preferences would allow consumers rather than Congress to drive the future of economic innovation and energy production. Table A2 includes an additional nine de minimis and expiring (under current law) provisions that should also be repealed.

Tax credits for the energy sector reduce revenue by $119 billion a year (Table 4). The Inflation Reduction Act (IRA) of 2022 marked a significant shift in US energy policy, pairing costly and complicated regulatory requirements with open-ended tax subsidies to manipulate consumer and producer incentives toward politically popular energy sources.[68] The tax code has included subsidies for wind and solar energy technologies for more than four decades.[69] Instead of temporary support for nascent industries, the federal subsidies—which are larger in 2024 than any past year—create sclerotic, dependent industries reliant on perpetual public money rather than consumer demand.[70]

Business tax credits and other preferences for other industries face similar challenges. Repealing them would raise $133 billion (Table 5). Place-based tax incentives for economic development or investment in targeted locations have 40 years of research showing they fail to meaningfully increase employment, raise wages, or advance general economic opportunity.[71] Other targeted credits, such as the low-income housing tax credit, are overly complex and corruption-prone while not actually inducing additional housing supply or lowering rental costs.[72] Even broadly available technology-neutral credits, such as the credit for general research and development, come with high administrative and economic efficiency costs that erode the

Table 4
Energy tax subsidies

Provision (IRC section)	Billions, annual
Energy production credit (45)	$36.9
Advanced manufacturing production credit (45X)	$27.2
Tax credits for clean vehicles and refueling (25E, 30C, 30D, 45W)	$15.1
Energy investment credit (48)	$13.3
Clean hydrogen production credit (45V)	$10.1
Carbon oxide sequestration credit (45Q)	$8.5
Credits for residential energy efficiency (25C, 25D, 45L)	$5.5
Clean fuel credits (45Z)	$1.2
Nuclear power production credits (45J, 45U)	$0.7
Advanced energy property credit (45C)	$0.5
Total	**$119.0**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes.

traditional academic case for such subsidies.[73] Repealing the state and local tax deduction for corporations would help level the playing field with pass-throughs and eliminate an inefficient federal subsidy for state and local governments.

Family and individual tax benefits. The tax code should provide a de minimis exemption to all taxpayers so that some income is exempt from federal tax. This could be done through a standard deduction for each tax filer—as is done under current law—or through a system that scales based on family size, such as the exemption system that will return in 2026. Any other work or family support should be distributed through purpose-built programs at the state and local levels of government.

The two largest subsidies are the child tax credit (CTC) and the earned income tax credit (EITC). The CTC reduces revenue by $38.8 billion a year after 2025 ($108.9 billion in 2024), most of which lowers taxes for middle-class families without changing total fertility rates or alleviating poverty.[74] Similarly, the $78 billion annual budgetary cost of the EITC and its economic distortions are likely larger than its benefits.[75] Both tax credits should be repealed.

Congress should repeal the other federal tax preferences for children, other dependents, childcare, adoption, and work (Table 6). Short of full repeal, Congress could standardize the definitions of "child" and "dependent" across the different benefit programs, better target the programs to those in need (while maintaining earned income requirements), and consolidate the multiple subsidies into one unified credit.[76]

Itemized deductions. The tax code offers taxpayers the choice of taking the standard deduction or 14 itemized deductions for specific expenses, such as mortgage interest, state and local taxes, and charitable giving.[77] Eliminating itemized deductions and moving all taxpayers to the standard deduction could raise revenue by $336 billion a year (Table 7).

The TCJA placed new limits on itemized deductions. The state and local tax (SALT) deduction is capped at $10,000. The interest paid on first- and second-home mortgages is deductible up to $750,000 of principal (previously, the cap was $1 million). The TCJA also imposed limits on deductions for personal casualty and theft loss, wagering losses, and other miscellaneous expenses. The limits to specific deductions replaced the overall limitation on itemized deductions (called the Pease limitation after the late Rep. Donald Pease [D-OH]), which reduces the value of a taxpayer's itemized deductions by 3 percent of income over a certain threshold. In 2026, the Pease limitation returns and the TCJA limits on specific deductions expire. Complicated limits are not necessary if Congress repeals the system of itemized deductions.

Table 5
General business tax subsidies

Provision (IRC section)	Billions, annual
State and local tax deduction for C corporations (164)	$50.6
Research and development tax credit (41)	$41.8
Low-income housing tax credit (42)	$17.0
Corporate charitable deduction (170)	$5.6
Orphan drug tax credit (45C)	$3.9
Credit union exemption (501(c)(14))	$3.8
Advanced semiconductor manufacturing credit (48D)	$3.1
Tax credit for employer Federal Insurance Contributions Act (FICA) taxes on employee tips (45B)	$2.2
Place-based tax preferences (45D, 1396)	$2.1
Historic rehabilitation tax credit (47)	$1.9
Blue Cross Blue Shield deduction (833)	$0.5
Total	**$132.5**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes.

Almost all itemized deductions are poorly targeted to meet their policy goals. For example, the SALT deduction subsidizes higher-income taxpayers in higher-tax states rather than efficiently supporting the provision of state services or alleviating double taxation.[78] The mortgage interest deduction is not associated with additional homeownership. Instead, it subsidizes larger houses for older, higher-income taxpayers.[79] If policymakers decide that a specific deduction is important enough to retain—such as deductions for charitable giving or loss of durable assets—it could be made generally available with annual limits to all taxpayers.[80]

Education tax subsidies. The tax code includes $37 billion in subsidies for the education system (Table 8). These subsidies contribute to inefficiently high levels of spending on higher education, significant student debt burdens, and demand for additional government subsidies.[81] Congress should repeal all of them.

Short of entirely repealing these subsidies, Congress could consolidate them into a single nonrefundable credit with one simple and easy-to-follow set of rules.[82] For example, a single education credit could be worth 25 percent of up to $10,000 of current-law lifetime learning credit expenses plus student loan interest, with current-law income limits. House Republicans proposed but never enacted a similar single education credit in 2017.[83]

Fringe benefits. Not all forms of employee pay are taxed

Table 6

Family and individual tax subsidies

Provision (IRC section)	Billions, annual
Earned income tax credit (32)	$78.2
Child tax credit (24)	$38.8
Head of household status (2(b))	$18.8
Additional deduction for elderly and blind (63(f))	$9.2
Credit for child and dependent care expenses (21)	$4.0
Saver's credit (25B, 45E)	$4.0
Adoption and foster care benefits (23, 131, 137)	$2.3
Employer-provided childcare credit and exclusion (45F, 129)	$1.5
Total	**$156.8**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes.

Table 7

Itemized deductions

Provision (IRC section)	Billions, annual
State and local tax deduction, individual (164)	$141.0
Charitable deduction (170)	$95.7
Mortgage interest deduction (163(h)(3))	$75.5
Medical expense deduction (213)	$21.2
Other	$3.0
Total	**$336.4**

Sources: Author's calculations, various sources. See note 43.
Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is an estimate for repealing all itemized deductions; individual provision estimates are scaled to the total in proportion to their independent values.

as wage income. Employers often provide compensation in the form of health insurance, meals, parking, transportation benefits, education assistance, and childcare.[84] Not taxing these employment benefits as wage income creates an incentive to compensate employees with tax-free fringe benefits, and the tax advantage is primarily used by higher-income workers who tend to have access to more comprehensive employment arrangements. Taxing these benefits as wage income would increase income tax revenue by $447 billion a year.

The Cato Institute's director of health policy studies, Michael Cannon, describes the exclusion of employer-provided health insurance as the "original sin" of US health policy.[85] The exclusion inflates health care costs and discriminates against the most vulnerable by allowing employers and insurance companies to control more than $1 trillion in annual employee compensation. In addition to the health insurance exclusion, the Affordable Care Act insurance marketplace tax credits further subsidize the insurance industry by an additional $82 billion a year. A larger credit is available to higher-income taxpayers through the end of 2025.

Policymakers may want to repeal the health care exclusion and premium assistance tax credits as part of broader health care policy reforms, such as creating universal health accounts by expanding existing health savings accounts (HSAs), as Cannon has proposed.[86] Universal health accounts would retain the tax subsidy for health care spending but could nonetheless improve incentives in the health care sector by giving consumers more market power.

All excluded compensation should be included in employee wages. The health insurance exclusion reduces income tax revenue by $398 billion a year and payroll tax revenue by $194 billion a year (for a total revenue reduction of $592 billion).[87] The remaining fringe benefits reduce income tax revenues by $49 billion a year.

Government benefits. Government benefits are generally not included in taxable income.[88] Exempting them understates the recipients' income and increases relative tax rates on labor-market income. Including government benefits, such as welfare benefits and some Social Security payments, in taxable income would increase revenue by $66 billion a year.

Taxation of interest. The current treatment of interest in the tax code is neither uniform nor ideal and requires holistic reform. If interest income is taxable, interest expenses should be fully deductible for individual and business borrowers. The tax system could also completely disregard interest by denying interest deductions to borrowers and exempting interest income from tax when earned by lenders. Disregarding interest in the tax code is more straightforward and could raise additional revenue by capturing currently exempt transactions by nontaxable lenders, including foreign governments, some foreign corporations, nonresident noncitizens, tax-exempt organizations, and retirement systems. Disregarding interest would eliminate the preference for debt in the tax code and stop a common method of shifting business profit overseas.[89] This change would also alleviate current preferences for

Table 8

Education tax subsidies

Provision (IRC section)	Billions, annual
Tax credits for post-secondary education (25A)	$14.7
Parental benefits for students age 19 or over (152(f)(2))	$7.4
Exclusion of scholarship and fellowship income (117)	$7.3
Deductibility of student loan interest (221)	$3.3
Exclusion of GI bill benefits (134)	$2.0
Exclusion of employer-provided educational assistance (127)	$1.8
Discharge of student loan indebtedness (108(f))	$0.3
Deduction for educator expenses (62(a)(2)(D))	$0.2
Total	**$37.0**

Sources: Author's calculations, various sources. See note 43.

Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes.

municipal bond interest, mortgage interest, student loan interest, and partial limits on corporate interest deductions.

Nonprofit sector. The nonprofit sector enjoys several tax breaks, including an exemption from income tax at the entity level, individual and corporate income tax deductions for donations, and an estate tax exemption.[90] Policymakers may want to support genuinely charitable endeavors that compete with government services and do not have a profit motive. Still, the tax-exempt sector has grown significantly beyond its narrow purposes. For example, program service revenues have been the largest and fastest-growing source of 501(c)(3) nonprofit revenues since 1980.[91] These nondonation, nongrant revenues totaled more than $1.8 trillion in 2019.

"Congress can and should cut spending to make tax reform deficit-neutral and permanent."

Nonprofit status should be eliminated for activities where there is a clear for-profit private-sector competitor. Televised sporting events that operate under the auspices of nonprofit entities such as the National Collegiate Athletic Association (NCAA) and the PGA Tour engage in billions of dollars of for-profit-like activities throughout the year, often competing directly with taxable entities performing similar services.[92] Not-for-profit hospitals also warrant a closer look. Despite a mandate to provide charity care, their operating model, billing, and collections are similar to their for-profit competitors.[93] Blue Cross Blue Shield's special nonprofit status should also be repealed (Table 5).

Congress should better tailor the not-for-profit tax exemptions to genuine charities and strengthen existing nonprofit unrelated business income tax (UBIT) rules. To strengthen the distinction between for-profit and not-for-profit businesses, the corporate deduction for charitable giving should be repealed ($5.6 billion). This would allow individuals to choose what to do with business profits after they are distributed.[94]

CONCLUSION

As significant automatic tax increases approach in 2026, Congress has an unprecedented opportunity to slash tax rates and eliminate loopholes. Spending cuts are the most effective way to facilitate sustainable tax cuts. In the absence of spending reforms, tax cuts could be paired with tax base reforms to prioritize simplification, economic growth, and fiscal responsibility. The TCJA made progress toward these goals, yet much work remains to reduce biases against investment and root out hundreds of billions of dollars in tax subsidies.

Cato's plan calls for Congress to repeal the $1.4 trillion in annual tax loopholes and:

- cut top marginal income tax rates to 25 percent for workers and small businesses;
- cut the corporate tax rate to 12 percent, making the United States the most competitive place in the world to do business;
- cut the capital gains and dividends tax rate to 15 percent;
- allow permanent full expensing for all investments;
- create universal savings accounts for nonretirement savings; and
- repeal all alternative minimum taxes, additional investment taxes, and the estate tax.

The Cato plan could be adopted without spending cuts. More modest reforms that remain constrained by the TCJA's framework would still face difficult trade-offs between maintaining politically popular tax loopholes and keeping tax rates from rising. Tax reform does not have to be revenue-neutral to be fiscally sustainable. Congress can and should also cut spending to make tax reform deficit-neutral and cut taxes further. Ultimately, keeping taxes low over the long term will require reforms to the spending-based drivers of America's fiscal imbalance.

Congress cannot tax its way back to fiscal health. However, deficit-neutral, pro-growth tax reform that increases economic growth will make necessary spending reforms a bit easier.

APPENDIX

Table A1

Tax reforms that raise revenue and improve the tax base

Provision	Billions, annual	IRC section
Exclusion of employer-provided insurance	$397.7	Sec. 105, 106, 134
Itemized deductions	$336.4	Sec. 62, 63(d), 211
Premium tax credits	$82.1	Sec. 36B
Earned income tax credit	$78.2	Sec. 32
Exclusion of government benefits	$66.0	Sec. 61, 86, 139A-I, 692
State and local tax deduction for C corporations	$50.6	Sec. 164
Research and development tax credit	$41.8	Sec. 41
Child tax credit	$38.8	Sec. 24
Muni bond interest deduction	$38.8	Sec. 103
Energy production credit	$36.9	Sec. 45
Advanced manufacturing production credit	$27.2	Sec. 45X
Exclusions for armed forces and federal employees abroad	$19.1	Sec. 911
Head of household status	$18.8	Sec. 2(b)
Low-income housing tax credit	$17.0	Sec. 42
Tax credits for clean vehicles and refueling	$15.1	Sec. 25E, 30C, 30D, 45W
Tax credits for post-secondary education	$14.7	Sec. 25A
Energy investment credit	$13.3	Sec. 48
Exclusion of meals, lodging, and parsonage	$11.1	Sec. 107, 119, 274
Clean hydrogen production credit	$10.1	Sec. 45V
Additional deduction for elderly and blind	$9.2	Sec. 63(f)
Exclusion for workers' compensation benefits	$8.8	Sec. 104
Carbon oxide sequestration credit	$8.5	Sec. 45Q
Parental benefits for students age 19 or over	$7.4	Sec. 152(f)(2)
Exclusion of scholarship and fellowship income	$7.3	Sec. 117
Exclusion of premiums on life, accident, and disability insurance	$7.0	Sec. 79, 106
Corporate charitable deduction	$5.6	Sec. 170
Credits for residential energy efficiency	$5.5	Sec. 25C, 25D, 45L
Credit for child and dependent care expenses	$4.0	Sec. 21
Saver's credit	$4.0	Sec. 25B, 45E
Orphan drug tax credit	$3.9	Sec. 45C
Credit union exemption	$3.8	Sec. 501(c)(14)
Deductibility of student loan interest	$3.3	Sec. 221
Advanced semiconductor manufacturing credit	$3.1	Sec. 48D
Exclusion of parking and transit	$2.9	Sec. 132
Adoption and foster care benefits	$2.3	Sec. 23, 131, 137
Tax credit for employer Federal Insurance Contributions Act (FICA) taxes on employee tips	$2.2	Sec. 45B
Place-based tax preferences	$2.1	Sec. 45D, 1396
Exclusion of GI bill benefits	$2.0	Sec. 134
Historic rehabilitation tax credit	$1.9	Sec. 47
Exclusion of employer-provided educational assistance	$1.8	Sec. 127
Employer-provided childcare credit and exclusion	$1.5	Sec. 45F, 129
Clean fuel credits	$1.2	Sec. 45Z
Rum cover-over	$0.7	Sec. 7652(e)
Nuclear power production credits	$0.7	Sec. 45J, 45U
Advanced energy property credit	$0.5	Sec. 48C
Blue Cross Blue Shield deduction	$0.5	Sec. 833
Discharge of student loan indebtedness	$0.3	Sec. 108(f)
Deduction for educator expenses	$0.2	Sec. 62(a)(2)(D)
Total:	**$1,416.0**	

Sources: Author's calculations, various sources. See note 43.

Notes: Revenue figures are annual post-2026 averages measured from a current law baseline. Estimates are not the product of a formal tax model and should be interpreted as rough approximations. Total is a straight sum and does not account for interactions between changes.

Table A2

Other expiring and de minimis tax subsidies to repeal

Provision	IRC section
Pass-through deduction	Sec. 199A
Paid family leave credit	Sec. 45S
Opportunity Zones	Subchapter Z
Railroad maintenance tax credit	Sec. 45G
Work opportunity tax credit	Sec. 51
Enhanced oil recovery credit	Sec. 43
Marginal wells credit	Sec. 45I
Small business tax credit for health benefits	Sec. 45R
Credit for disabled-access expenditures	Sec. 44

NOTES

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