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577,951,692,634 REASONS...AND COUNTING: WHY A FLAT TAX IS NEEDED TO REFORM THE IRS

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The Internal Revenue Service (IRS) is frequently cited as the most hated of all government agencies. This aversion goes well beyond a simple dislike of paying taxes. Many Americans feel the IRS uses its vast powers capriciously to enforce a tax code that is unfair and incomprehensible. Indeed, a 1990 magazine survey found that the most frightening words people could imagine hearing when they answered the phone were: "This is the IRS calling."¹ Although taxpayers have every right to be upset about the oppressive tax system, their anger should not be directed at the IRS. The vast majority of the problems with the tax system are the inevitable result of bad tax policy.

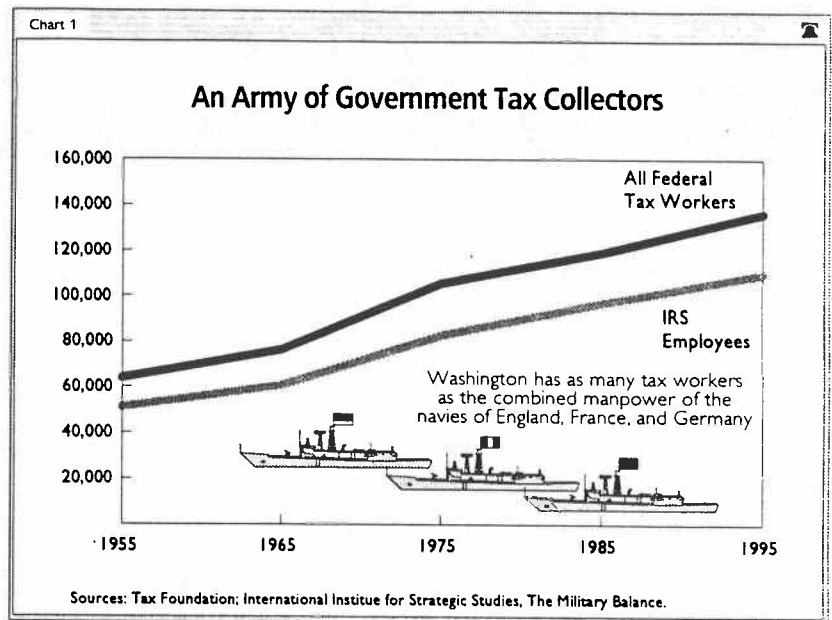
The way to reduce the public's hatred of the IRS is to enact a flat tax. By wiping out all the complicated, obscure, and convoluted provisions of the current tax code, a flat tax would dramatically lower compliance costs and ease the uncertainty and anguish that make April 15 the least favorite day of the year. Perhaps better than anyone else, former IRS commissioners and IRS workers themselves recognize that this tax reform is the answer. Former Commissioner Shirley Peterson, who headed the agency in 1992, noted that, "We have reached the point where further patchwork will only compound the problem. It is time to repeal the Internal Revenue Code and start over."² Her predecessor, Fred Goldberg, agrees, commenting, "Blaming the IRS is a lot like blaming the doctor when the patient dies from an incurable disease.... Tax reform—not IRS bashing—is the only way to liberate the American people from a system that is grotesquely burdensome

1 People Magazine Annual Readers' Poll, *People* magazine, January 8, 1990.

2 Shirley Peterson, "Death to the Tax Code," *The New York Times*, July 29, 1995.

and monstrous.”³ Finally, *The Wall Street Journal* recently reported that: “A recent survey of 275 IRS workers around the nation, done by a national IRS restructuring commission headed by Senator Kerrey of Nebraska and Representative Portman of Ohio, found overwhelming support within the IRS for simplifying the law.”⁴

Indeed, as the following astounding list demonstrates, almost all the numbers that are cited as arguments against the IRS really are arguments against the laws approved by politicians over the past 80 years, and arguments that favor implementing a flat tax.



THE FEDERAL GOVERNMENT: TAX GOLIATH

Not only is the IRS the most feared of government agencies, it is also one of the biggest and most expensive. The agency has more employees than the Central Intelligence Agency, Federal Bureau of Investigation, and Drug Enforcement Agency combined. Its budget makes it a bigger consumer of tax dollars than the Department of Commerce, the Department of State, or the Department of the Interior.

The Numbers Speak for Themselves

136,000 = The number of **employees at the IRS** and elsewhere in the government responsible for administering the tax laws.⁵ Because the number of employees is dictated by the complexity of the code, a flat tax will require fewer personnel to administer, and the resulting downsizing would save taxpayers a significant amount.

13,700,000,000 = The amount of **tax dollars (\$)** spent by the IRS and other agencies of government to enforce and oversee the tax code.⁶ Both taxpayers and the economy will benefit from spending reductions that are made possible by the flat tax.

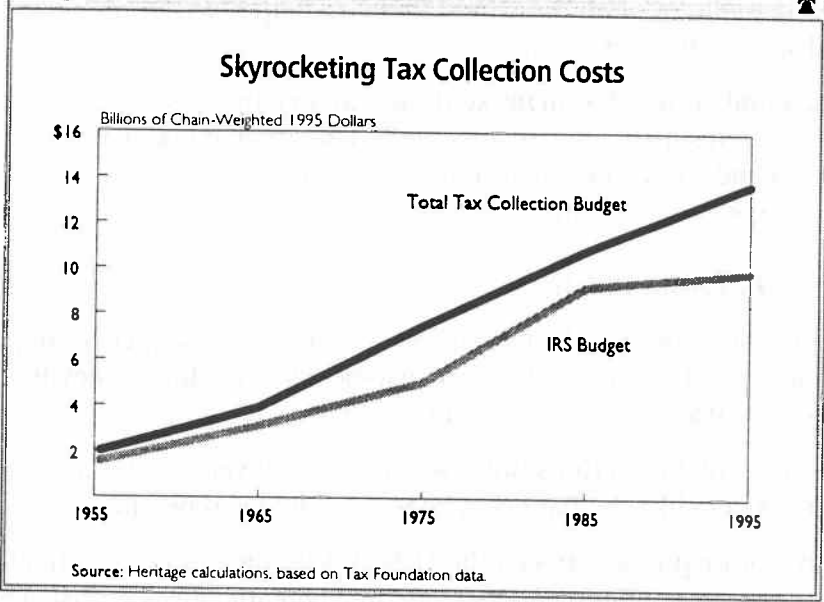
³ Fred Goldberg, facsimile statement to author, March 3, 1997.

⁴ “Tax Report: A Special Summary and Forecast of Federal and State Tax Developments,” *The Wall Street Journal*, March 26, 1997, p. A1.

⁵ Arthur P. Hall, “Growth of Federal Government Tax ‘Industry’ Parallels Growth of Federal Tax Code,” *Special Report* No. 39, Tax Foundation, September 1994.

⁶ *Ibid.*

Chart 2



17,000 = The number of **pages of IRS laws and regulations.**⁷ This number, which does not include the tax court decisions and IRS letter rulings, would be much smaller under a flat tax.

5,557,000 = The number of **words in income tax laws and regulations.**⁸ With a flat tax, there will be no need for a tax code that is nearly seven times longer than the Bible.

The IRS Paper Machine

With so many employees, so much money, and so many tax laws to enforce, it should come as no surprise that the agency is one of the country's biggest paper-pushers.

31 = The number of **pages of fine print in the instructions** accompanying the "easy" 1040EZ individual tax form.⁹ By contrast, individuals filing under a flat tax would need just one page of instructions to fill out a flat tax postcard.

480 = The number of **tax forms published** by the IRS. There are only two postcard-sized tax forms necessary under the flat tax,¹⁰ one for wages, salaries, and pensions, and the other for business income.

8,000,000,000 = The number of **pages of forms and instructions sent out** by the IRS every year. Under the flat tax, the two postcard-sized forms are virtually self-explanatory.¹¹

36 = The number of **times the paperwork received each year by the IRS would circle the Earth.**¹² Complexity and paperwork would almost vanish under a simple flat tax that treats all citizens equally.

293,760 = The number of **trees that must be cut down** each year to supply the 8 billion pages of paper needed for filing the country's income taxes.¹³ Could it be that a flat tax

7 Daniel J. Pilla, "Why You Can't Trust the IRS," *Policy Analysis* No. 222, Cato Institute, April 15, 1995.
 8 Arthur P. Hall, "Compliance Costs of Alternative Tax Systems," *Special Brief*, Tax Foundation, June 1995.
 9 Shirley Peterson, "Death to the Tax Code."
 10 Robert E. Hall and Alvin Rabushka, *The Flat Tax* (Stanford, Cal.: Hoover Institution Press, 1995).
 11 *Ibid.*
 12 Elizabeth McDonald, "Breakdown at the IRS," *Worth*, March 1995.
 13 Hall and Rabushka, *The Flat Tax*.

would not only save the lives of all these trees, but also help save the spotted owl and other endangered species from extinction?

1,000,000,000 = The number of **1099 forms sent out each year** to help the IRS track taxpayers who receive interest and dividend income.¹⁴ Under a flat tax, the one level of taxation on business and capital income is collected at the source, which would eliminate this paperwork conundrum.

Don't Stumble in the IRS Briar Patch

Much to the chagrin of taxpayers, the focus of the IRS is not solely generating paperwork. Tasked with the job of enforcing the cumbersome tax code, the agency has numerous unwelcome contacts with taxpayers every year.

10,000,000 = The number of **corrections notices** sent out each year by the IRS.¹⁵ With a simple and fair tax system like the flat tax, mistakes would become rare.

190,000 = The number of **disputes between the IRS and taxpayers** in 1990 that required legal action.¹⁶ In a flat tax environment, there are few potential areas of disagreement, and legal action would become scarce.

3,253,000 = The number of times the **IRS seized bank accounts or paychecks** in 1992.¹⁷

33,000,000 = The number of **penalty notices sent out by the IRS** in 1994.¹⁸ Because a flat tax eliminates the complex areas of the tax code, the number of disagreements between taxpayers and the agency would plummet.

Do As They Say, Not As They Do

The IRS is quite strict with taxpayers who make mistakes, but the following examples illustrate that the IRS would have a hard time living up to the standards imposed on taxpayers.

8,500,000 = The number of **times the IRS gave the wrong answer** to taxpayers seeking help complying with the tax code in 1993. (Taxpayers are still held responsible for errors resulting from bad IRS advice).¹⁹ The flat tax is so simple that taxpayers would rarely, if ever, need to call the IRS.

47 = The **percentage (%) of calls to the IRS that resulted in inaccurate information** according to a 1987 General Accounting Office study.²⁰ The flat tax would free IRS personnel from the impossible task of accurately deciphering the convoluted tax code.

14 *Ibid.*

15 Pilla, "Why You Can't Trust the IRS."

16 James L. Payne, "Unhappy Returns: The \$600 Billion Tax Ripoff," *Policy Review*, Winter 1992.

17 James Bovard, *Lost Rights: The Destruction of American Liberty* (New York: St. Martin's Press, 1994).

18 "33 Million Penalty Notices," *The Wall Street Journal*, April 17, 1995.

19 Pilla, "Why You Can't Trust the IRS."

20 Carl Horowitz, "The Hidden Cost of Higher Taxes," *Investors Business Daily*, September 16, 1993.



Tax Forms on a Postcard: The Arme-y-Shelby Flat Tax

Form 1		Individual Wage Tax		1999
Your first name and initial (if joint return, also give spouse's name and initial)		Last name	Your social security number	
Home address (number and street including apartment number or rural route)			Spouse's social security number	
City, town, or post office, state and ZIP code		Your occupation		
		Spouse's occupation		
1	Wages and salary and Pensions	1		
2	Personal allowance			
	(a) \$23,200 for married filing jointly	2(a)		
	(b) \$11,600 for single	2(b)		
	(c) \$14,850 for single head of household	2(c)		
3	Number of dependents, not including spouse	3		
4	Personal allowances for dependents (line 3 multiplied by \$5,300)	4		
5	Total personal allowances (line 2 plus line 4)	5		
6	Taxable wages (line 1 less line 5, if positive; otherwise zero)	6		
7	Tax (17% of line 6)	7		
8	Tax already paid	8		
9	Tax due (line 7 less line 8, if positive)	9		
10	Refund due (line 8 less line 7, if positive)	10		

Form 2		Business Tax		1999
Business name		Employer identification number		
Street address		County		
City, town, or post office, state and ZIP code		Principal product		
1	Gross revenue from sales	1		
2	Allowable costs			
	(a) Purchases of goods, services, and materials	2(a)		
	(b) Wages, salaries, and retirement benefits	2(b)		
	(c) Purchases of capital equipment and land	2(c)		
3	Total allowable costs (sum of lines 2(a), 2(b), and 2(c))	3		
4	Taxable income (line 1 less line 3)	4		
5	Tax (17% of line 4)	5		
6	Carry-forward from 1997	6		
7	Interest on carry-forward (6 percent of line 6)	7		
8	Carry-forward into 1998 (line 6 plus line 7)	8		
9	Tax due (line 5 less line 8, if positive)	9		
10	Carry forward to 1999 (line 8 less line 5, if positive)	10		

Source: Office of Representative Dick Arme-y.

- 5,000,000** = The number of **correction notices sent out by the IRS** each year that turn out to be wrong.²¹ An error rate of 50 percent would be impossible to achieve under a flat tax.
- 40** = The **percentage (%) of revenue that is returned** when taxpayers challenge penalties.²² Because, under a flat tax, there would rarely be any penalties, there would be fewer penalties incorrectly assessed.
- 5,000,000,000** = The number of **dollars (\$) that taxpayers were overcharged** for penalties in 1993.²³ After the flat tax goes into effect, such injustice would all but disappear.
- 3,000,000** = The number of **women who are improperly fined** each year because they have divorced or remarried.²⁴ Taxing income at the source under a flat tax eliminates this travesty.
- 10,000,000** = The number of **taxpayers who will receive lower Social Security benefits** because the IRS is failing to fully inform the Social Security Administration about tax payments.²⁵ A simple flat tax should free up adequate IRS time and resources to fix this problem.
- 200,000,000,000** = The amount in **dollars (\$) of misstated taxpayer payments** and refunds on the books of the IRS.²⁶ The IRS is no more capable than ordinary taxpayers of administering tax laws that defy logic. A flat tax would substantially eliminate this problem.
- 64** = The **percentage (%) of the IRS's own budget for which it could not account** in 1993, according to a General Accounting Office audit.²⁷
- 8,000,000,000** = The number of **dollars (\$) that the IRS spent** on the failed effort to upgrade its computer system.²⁸ Under the flat tax, this money would be saved; the IRS would no longer have to try to enforce an impossibly complex and unfair tax system.
- 23,000,000,000** = The total proposed **dollar (\$) price tag** needed by 2008 for the IRS's computerization and modernization plans.²⁹

Being Painfully Compliant and Miserable on April 15th

Sending huge amounts of money to Washington is never pleasant for taxpayers. Having to incur huge compliance costs for the privilege of paying taxes, however, really rubs salt in the tax wound.

21 Pilla, "Why You Can't Trust the IRS."

22 *Ibid.*

23 *Ibid.*

24 McDonald, "Breakdown at the IRS."

25 *Ibid.*

26 *Ibid.*

27 Pilla, "Why You Can't Trust the IRS."

28 Andrew Serwer, "The Taxman Cometh—Head for the Hills!" *Fortune*, March 3, 1997.

29 Shelley L. Davis, *Unbridled Power: Inside the Secret Culture of the IRS* (New York: Harper Business, 1997).

157,000,000,000 = The number of **dollars (\$)** spent by the private sector to comply with income tax laws.³⁰ Under a flat tax, these costs would drop by more than 90 percent.

7,240 = The **average compliance cost in dollars (\$)** incurred by all but the biggest 10 percent of corporations for every \$1,000 of taxes paid in 1992.³¹ The radical simplification achieved by the flat tax would be a boon for small businesses that quite often lack the legal and accounting staffs necessary to be in compliance with the tax code.

50 = The percentage (%) of **taxpayers who feel compelled to obtain assistance** filling out their taxes each year.³² Those in the tax preparation business would need to find alternative work if a flat tax is enacted.

5,400,000,000 = The number of **hours Americans spend complying** with federal tax forms.³³ With only two postcard-sized forms, compliance would take minutes rather than hours under a flat tax.

2,943,000 = The equivalent number of **full-time jobs** that would be needed to work the same amount of time Americans devote to all tax compliance efforts.³⁴ In the flat tax world, the cost of tax compliance would fall by more than 90 percent.

3,055,680,000 = The **market value (\$)** of the tax preparation firm **H&R Block, Inc.**, which opposes the flat tax.³⁵ The company's opposition is understandable since the flat tax will allow anyone to fill out a tax return without paying an expert.

Even the Experts Can't Figure Out the Forms

Jumping through all the tax hoops might not be so painful if taxpayers could at least be confident that the effort led to accuracy. The ultimate insult added to their injury, however, is that even "expert" advice is no guarantee of correct answers to tax code questions!

50 = The number of different answers that 50 tax experts gave *Money* magazine in 1988 when they were asked to estimate a hypothetical family's tax liability.³⁶ Under a flat tax, taxpayers would not need to consult tax preparers, much less run the risk of paying penalties for wrong answers.

50 = The number of different answers *Money* magazine received in 1989 when it asked 50 different tax experts to estimate a hypothetical family's tax liability.³⁷

30 Arthur P. Hall, "Compliance Costs of Alternative Tax Systems, II," *Special Brief*, Tax Foundation, March 1996.

31 *Ibid.*

32 Pilla, "Why You Can't Trust the IRS."

33 Arthur D. Little, "Development of Methodology for Estimating the Taxpayer Paperwork Burden," *Final Report to the Department of Treasury*, Internal Revenue Service, June 1988.

34 James L. Payne, "Unhappy Returns."

35 Based on stock price as of 2:40 p.m. on February 28, 1997.

36 Greg Anrig, Jr., "Even Seasoned Pros Are Confused This Year," *Money*, March 1988.

37 Greg Anrig, Jr., "The Pros Flunk Our New Tax-Return Test," *Money*, March 1989.

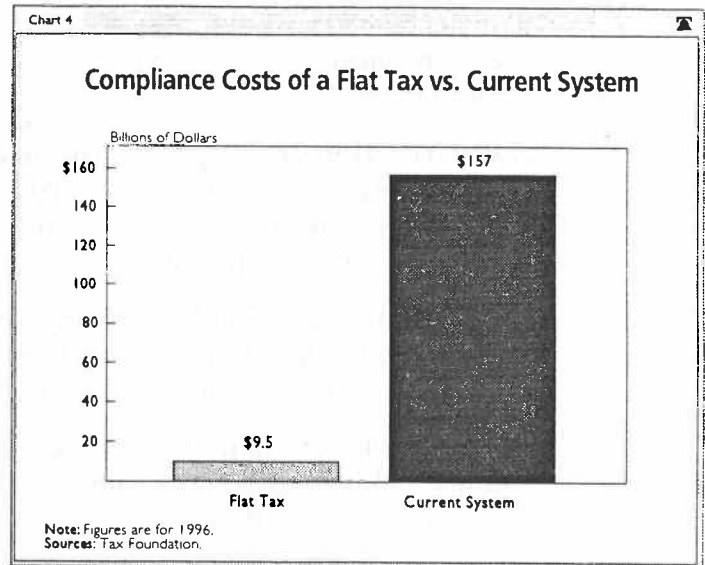
48 = The number of wrong answers *Money* magazine received in 1990 when it asked 50 different tax experts to estimate a hypothetical family's tax liability.³⁸

49 = The number of different answers *Money* magazine received in 1991 when it asked 50 different tax experts to estimate a hypothetical family's tax liability.³⁹

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41 = The number of wrong answers *Money* magazine received in 1993 when it asked 50 different tax experts to estimate a hypothetical family's tax liability. (Nine of the original volunteers did not even bother to respond.)⁴¹

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The Never-Ending Shell Game

Needless complexity in the cumbersome tax code helps explain why both the IRS and private tax experts frequently make mistakes. Another reason why taxpayers have a problem complying with the law is that politicians made the tax code a moving target.

878 = The number of times **major sections of the tax code have been amended** between 1955 and 1994.⁴² The flat tax would eliminate today's confusingly complex tax code with a simple system that eliminates constant tinkering and social engineering.

100 = The **increase in number of forms** between 1984 and 1994.⁴³ The flat tax would eliminate all 100 forms.

9,455 = The number of **tax code subsections** changed between 1981 and 1994.⁴⁴ A central premise of the flat tax is that politicians should not micromanage economic or social behavior through the tax code.

38 Denise M. Topolnicki, "The Pros Flub Our Third Annual Tax-Return Test," *Money*, March 1990.

39 Teresa Tritch and Deborah Lohse, "The Pros Flub Our Tax Test (Again)," *Money*, March 1991.

40 Teresa Tritch and Deborah Lohse, "Tax Payers, Start Worrying," *Money*, March 1992.

41 Teresa Tritch, "Keep an Eye on Your Tax Pro," *Money*, March 1993.

42 Arthur P. Hall, "The Cost of Unstable Tax Laws," *Special Report No. 41*, Tax Foundation, October 1994.

43 "33 Million Penalty Notices," *The Wall Street Journal*, April 17, 1995.

44 "Need for Ten Year Moratorium," Small Business Council of America, Bethesda, Md. (undated).

578 = The **percentage increase**, between 1954 and 1994, in the number of code sections dealing with major segments of tax law.⁴⁵ Endless changes in tax law would grind to a halt under a flat tax.

5,400 = The **cumulative number of changes in tax law** since the 1986 Tax Reform Act.⁴⁶ Most, if not all, of these changes add compliance costs to the economy—costs that would be substantially reduced or eliminated under a flat tax.

20,500,000,000 = The number of **dollars (\$) of lost income** the economy suffered in 1993 as a result of the economic uncertainty in the business community which is caused by the constant manipulation of the tax code.⁴⁷ To help block politicians from undermining business planning by constantly changing the tax laws, a flat tax would include a supermajority provision blocking tax rate increases.

The Augean Stables

The problem is not the IRS, but rather the politicians who created the incomprehensible tax code and those who refuse to reform the system. Unfortunately, the politicians are also about the only people in the country who benefit from a complex and constantly changing tax code.

413,072 = The average number of **dollars (\$) in political action committee (PAC)** contributions received by Members of the House of Representatives tax-writing committee during the 1994 election cycle.⁴⁸ The flat tax would reduce special-interest corruption in Washington and eliminate the ability of politicians to use the tax code to reward friends and punish enemies.

12,609 = The number of special interests officially represented by **congressional lobbyists**.⁴⁹ A flat tax wipes out all special preferences, loopholes, deductions, credits, and tax shelters.

3,200,000,000 = The total **dollar (\$) amount earned by Washington lobbyists** in 1993.⁵⁰ By taking away the playing field for special-interest tinkering, a flat tax would clean up political pollution.

2 = The number of **IRS offices in Washington** made available to Members of Congress and their staffs.⁵¹ With someone else doing their taxes—for free—it is little wonder Congress does not understand the public's support of a flat tax.

45 Hall, "Compliance Costs of Alternative Tax Systems."

46 Representative Richard K. Armey, "How Taxes Corrupt," *The Wall Street Journal*, June 19, 1996.

47 Hall, "The Cost of Unstable Tax Laws."

48 "1994 PAC Activity Shows Little Growth over 1992 Level, Final FEC Report Finds," Federal Election Commission press release, 1995.

49 Information from the U.S. House of Representatives Office of the Clerk.

50 Armey, "How Taxes Corrupt."

51 Pilla, "Why You Can't Trust the IRS."

Why Johnny Refuses to Pay

There comes a point when taxpayers simply give up. To some, the sheer complexity of the system drives them into the underground economy. Others conclude that an unfair tax code has no moral legitimacy, and they refuse to comply.

127,000,000,000 = The **dollar (\$)** amount of **taxes not paid** as a result of tax evasion.⁵²

A fair and simple flat tax would reduce tax evasion.

10,000,000 = The number of **people who unlawfully do not file** tax returns.⁵³ By reducing both the tax burden and compliance costs, the flat tax should bring people out of the underground economy.

3,500,000 = The number of people who do not file who would be **eligible for refunds**.⁵⁴ Perhaps more than any other number, the millions of people who fail to file in order to claim their tax refunds reveals just how intimidating the tax code has become.

4 = The number of times (counting the capital gains tax, corporate income tax, personal income tax, and death—or estate—tax) that a **single dollar of income can be taxed** under the current system.⁵⁵ By eliminating all forms of double taxation, the flat tax ensures that the government will treat all income equally and would end one of the biggest causes of tax evasion and complexity in the code.

100,000 = The number of **Internet sites** found by one search engine when queried for the phrase “tax shelter.”⁵⁶ Because a flat tax eliminates all discrimination in the tax code and allows people to keep a greater share of their income, tax shelters would almost vanish after reform.

Enough Is Enough

The damage caused by the tax code, both to the economy and to the body politic, is becoming a crisis. Insulated from the effects of their own handiwork, however, politicians very likely will be the last ones to understand just how indefensible the system has become. Perhaps these real examples of IRS abuse will help them to understand the problem:

46,806 = The dollar (\$) amount of **tax penalty** imposed on one taxpayer in 1993 for an alleged underpayment of 10 cents.⁵⁷

1,300 = The number of **IRS employees** investigated and/or disciplined for improperly viewing the tax returns of friends, neighbors, and others.⁵⁸

⁵² McDonald, “Breakdown at the IRS.”

⁵³ *Ibid.*

⁵⁴ Peterson, “Death to the Tax Code.”

⁵⁵ Daniel J. Mitchell, “Taxes, Deficits, and Economic Growth,” *Heritage Lecture No. 565*, June 17, 1996.

⁵⁶ <http://www.altavista.com/cgi-bin/query?pg=q&what=what=web&fmt=.&q=tax+shelter>

⁵⁷ Bovard, *Lost Rights*.

⁵⁸ Stephen Barr, “1,300 IRS Workers Accused of Snooping at Tax Returns: Employees Used Computers to Peek at Friends’ Files,” *The Washington Post*, July 19, 1994.

- 155** = The dollar (\$) amount of **penalty imposed** on a taxpayer in 1995 for an alleged underpayment of 1 cent.⁵⁹
- 50** = The percentage of top **IRS managers** who admitted they would use their position to intimidate personal enemies.⁶⁰
- 14,000** = The amount in **dollars (\$)** allegedly owed by a **day care center** that was raided by armed agents, who then refused to release the children until parents pledged to give the government money.⁶¹
- 80** = The number of **IRS agents referred for criminal investigation** on charges of taking kickbacks for fraudulent refund checks.⁶²
- 3,000,000,000** = The dollar (\$) assets of **Princeton/Newport**, an investment company that was forced into liquidation after 40 armed federal agents raided the company on suspicion of tax evasion, only to have the IRS later conclude that the company actually had overpaid its taxes.⁶³
- 10,000** = The **fine (\$)** imposed on a taxpayer for using a “12 pitch” typewriter to fill out his tax forms instead of a “10 pitch” typewriter.⁶⁴
- 109** = The number of **envelopes containing unprocessed tax information** found in a trash barrel at the IRS’s Philadelphia Service Center.⁶⁵

The grand total: More than 577 billion incredible-but-true reasons to simplify the tax code with a flat tax.

WHAT THESE NUMBERS REALLY MEAN

These horror stories and frightening statistics are not evidence that individual IRS agents are bad people, or that tax administrators want to violate people’s rights. Although examples of unwarranted behavior have been included in this discussion, the key problem they illustrate is that the tax law is so arbitrary and incomprehensible that even government agents in charge of enforcing the law cannot make sense of it.

The only way to address these problems is with fundamental reform. A flat tax will dramatically reduce the power of the IRS by eliminating the vast majority of possible conflicts. In a system where the only information individuals are obligated to provide is their total income and the size of their families, much of the uncertainty and fear regarding paying taxes would disappear. Although most individuals, thankfully, never have to experience the greater complexities of paying corporate income taxes, they can appreciate the fact that a flat tax system would generate equally dramatic savings for business. The money that businesses now spend to comply with the tax code would be freed up

⁵⁹ Taxpayer letter to The Heritage Foundation, February 7, 1996, accompanied by copy of IRS form 941.

⁶⁰ Serwer, “The Taxman Cometh!”

⁶¹ “IRS Invaded Day Care Center: Parents Claim Children ‘Held Hostage,’” *Dollars & Sense*, April 1985.

⁶² “Breach of Trust at the IRS,” *St. Petersburg Times*, August 8, 1993.

⁶³ Bovard, *Lost Rights*.

⁶⁴ *Ibid.*

⁶⁵ Davis, *Unbridled Power*.

under a flat tax for paying higher wages and making greater investments in their businesses, which would thus help America become more competitive.

More specifically, the flat tax achieves huge reductions in compliance costs by:

- **Taxing all income at one rate.** A single-rate, flat tax obviously reduces complexity in calculating tax liability, but this is not the most compelling reason that all taxpayers should be treated equally. With one low rate, as envisioned by supporters of the flat tax, the single-rate system would minimize the incentives that taxpayers and businesses currently have to hide, shelter, and underreport income. Moreover, one rate—applied across the board—eliminates opportunities for arbitrage since there would be no tax savings for those who shift the timing of income, the source of income, or the recipients of income.

- **Taxing all income one time.** Perhaps even more important than taxing income at one rate is taxing it only one time. Much of the complexity of the current system arises because politicians want to tax certain types of income again and again. Capital gains taxes and death (estate) taxes, for instance, are in fact a second (and sometimes third or fourth) layer of taxes placed on income that already has been taxed once. Under a flat tax, these complicated provisions disappear. Another advantage of taxing income just one time is that businesses and individuals are freed from the foreign tax quagmire. Any overseas income that is taxed by the government in the country in which it is earned would not be taxed again at home.

WHAT IS A FLAT TAX?

A flat tax contains three core features, each designed to fix a major problem with the current tax code. These key features can be summed up in a single sentence:

“All income should be taxed at one low rate and only one time, and the tax should be collected in the least intrusive way possible.”

- **A single flat rate.** Under the flat tax, income is taxed at one low rate. This ensures that taxpayers are treated equally while addressing the problem of high marginal tax rates. The one low rate in the flat tax will promote faster growth by minimizing the tax penalty against work, risk-taking, and entrepreneurship.
- **No bias against savings and investment.** A flat tax eliminates the current tax code’s bias against capital formation by ensuring that no income is taxed more than one time. Since double taxation of capital income is a pervasive problem under current law, this reform will stimulate higher incomes and faster growth by minimizing the tax penalty on savings and investment.
- **Simplification.** The flat tax eliminates provisions of the current code that result either in tax preferences or tax penalties on certain behaviors and activities. In addition, a large amount of income is taxed at the source rather than at the recipient level, dramatically lowering paperwork and compliance costs. These changes would solve the problem of complexity, allowing individual taxpayers to file a tax return on a postcard-size form; they would also ensure that the tax code affects everyone equally.

- **Taxing capital and business income at the source.** In a flat tax system, in which all income is to be taxed one time, substantial complexity is avoided by taxing the income at the source. The income earned by corporate investors, for instance, can be taxed either by imposing a tax on the corporation or by imposing a tax on dividends paid (but not at both levels as occurs under current law). Because any given corporation can have as many as 2 million shareholders, it is obviously much simpler to impose the single layer of tax at the business level. Similarly, it is far easier to tax interest income at the level of the financial institution than to require the government to track down the owner of every interest-bearing account.
- **Eliminating deductions, preferences, shelters, loopholes, and credits.** By discarding all the special provisions in the tax code, a flat tax makes the calculation of tax liability considerably simpler than it is today. Moreover, the level playing field created by the flat tax means that taxpayers no longer have any incentive to time their income and deductions in ways that minimize tax liability. As a result, business and personal decisions will be guided by consumer preference and economic efficiency rather than tax considerations.
- **Taxing business on a cash flow basis.** Although it is usually not a problem for individual taxpayers, a major source of complexity in the current code is the practice of taxing business income before it occurs or forcing companies to overstate their income. A good example is depreciation. Instead of being able to deduct investment expenses when they are incurred, the tax code allows those costs to be deducted only over a multi-year period. Not only does this force businesses to overstate income, but it also has created one of the most complex portions of the tax code. Another example is the tax treatment of income from car loans. Current law mandates that auto dealers immediately pay tax on payments the consumer has not yet made (and perhaps never will).

Thus, although the key principle of the flat tax is equality, it turns out that a system based on taxing all income just one time at one low rate promotes simplicity. To understand why introducing a flat tax would lead to such a dramatic reduction in tax code complexity and in compliance costs, consider the following numbers under a flat tax:

- Zero** = The number of taxpayers under a flat tax who would have to calculate depreciation schedules.
- Zero** = The number of taxpayers under a flat tax who would have to keep track of itemized deductions.
- Zero** = The number of taxpayers under a flat tax who would need to reveal their assets to the government.
- Zero** = The number of taxpayers under a flat tax who would lose their farms or businesses because of the death (estate) tax.
- Zero** = The number of taxpayers under a flat tax who would have to pay a double tax on their capital gains.
- Zero** = The number of taxpayers under a flat tax who would have to compute a phase-out of their personal exemption because their incomes are too high.

Zero = The number of taxpayers under a flat tax who would be subject to the alternative minimum tax and forced to calculate their tax bill two different ways, and then to pay the government the greater of the two amounts.

Zero = The number of taxpayers under a flat tax who would have to pay taxes on overseas income that already has been taxed by the government of the country in which the income was earned.

Zero = The number of taxpayers under a flat tax who would have to pay taxes on dividend income that already has been taxed at the business level.

Zero = The number of taxpayers under a flat tax who would be taxed on interest income that already has been taxed at the financial institution level.

CONCLUSION

Those who urge policymakers to “fix” the IRS should realize that condemning the agency itself will not solve the intractable problems of the tax code Goliath. Furthermore, enacting a “taxpayer bill of rights” will have little effect on the situation if the underlying problem provisions of the tax code are left in place. At least two versions of a “taxpayer bill of rights” previously enacted into law have had little effect thus far.

Americans are fast approaching the level of anger toward unfair, capricious, and oppressive taxation that gave rise to the Revolution in 1776. Their anger is directed at an immense and impersonal government agency that oftentimes operates outside the standards it imposes on taxpayers. Americans should be angry, but not at the IRS. It is the lawmakers that should be held responsible for enacting the laws that created today’s tax code.

The only effective way to enhance compliance and slash compliance costs while protecting the rights and freedoms of individual taxpayers is to scrap the current system entirely and replace it with a fair and simple flat tax.

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