

# Guidelines for Tax Reform: The Simple, Progressive Value- Added Consumption Tax

Presentation at AEI

Robert E. Hall  
Hoover Institution  
June 6, 2005

# Basics of the Tax

- Individuals and couples file Form 1, which puts a 19-percent tax on earnings above an exemption level, \$41,000 for a family of 4
- Families do not pay tax on interest, dividends, or capital gains—these are taxed at the source by the business tax
- Businesses file Form 2, which puts a 19-percent tax on business income with a write-off for investment
- The two forms together create an airtight 19-percent tax on consumption

**Form 1**

**Individual Wage Tax**

**2004**

Your first name and initial (if joint return, also give spouse's name and initial)	Last name	Your social security number
Present 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

<b>1</b> Wages and salary.....	<b>1</b>		
<b>2</b> Pension and retirement benefits.....	<b>2</b>		
<b>3</b> Total compensation ( <i>line 1 plus line 2</i> ).....	<b>3</b>		
<b>4</b> Personal allowance			
(a) <input type="checkbox"/> \$27,000 for married filing jointly.....	<b>4(a)</b>		
(b) <input type="checkbox"/> \$14,000 for single.....	<b>4(b)</b>		
(c) <input type="checkbox"/> \$24,000 for single head of household.....	<b>4(c)</b>		
<b>5</b> Number of dependents, not including spouse.....	<b>5</b>		
<b>6</b> Personal allowances for dependents ( <i>line 5 multiplied by \$7,000</i> ).....	<b>6</b>		
<b>7</b> Total personal allowances ( <i>line 4 plus line 6</i> ).....	<b>7</b>		
<b>8</b> Taxable compensation ( <i>line 3 less line 7, if positive; otherwise zero</i> ).....	<b>8</b>		
<b>9</b> Tax ( <i>19% of line 8</i> ).....	<b>9</b>		
<b>10</b> Tax withheld by employer.....	<b>10</b>		
<b>11</b> Tax due ( <i>line 9 less line 10, if positive</i> ).....	<b>11</b>		
<b>12</b> Refund due ( <i>line 10 less line 9, if positive</i> ).....	<b>12</b>		

**Form 2****Business Tax****2004**

Business name		Employer identification number
Street address		County
City, state, and ZIP code		Principal product
<b>1</b>	Gross revenue from sales.....	<b>1</b>
<b>2</b>	Allowable costs	
	(a) Purchases of goods, services, and materials.....	<b>2(a)</b>
	(b) Wages, salaries, and pensions.....	<b>2(b)</b>
	(c) Purchases of capital equipment, structures, and land.....	<b>2(c)</b>
<b>3</b>	Total allowable costs ( <i>sum of lines 2(a), 2(b), 2(c)</i> ).....	<b>3</b>
<b>4</b>	Taxable income ( <i>line 1 less line 3</i> ).....	<b>4</b>
<b>5</b>	Tax ( <i>19% of line 4</i> ).....	<b>5</b>
<b>6</b>	Carry-forward from 2003.....	<b>6</b>
<b>7</b>	Interest on carry-forward ( <i>3% of line 6</i> ).....	<b>7</b>
<b>8</b>	Carry-forward into 2004 ( <i>line 6 plus line 7</i> ).....	<b>8</b>
<b>9</b>	Tax due ( <i>line 5 less line 8, if positive</i> ).....	<b>9</b>
<b>10</b>	Carry-forward to 2005 ( <i>line 8 less line 5, if positive</i> ).....	<b>10</b>

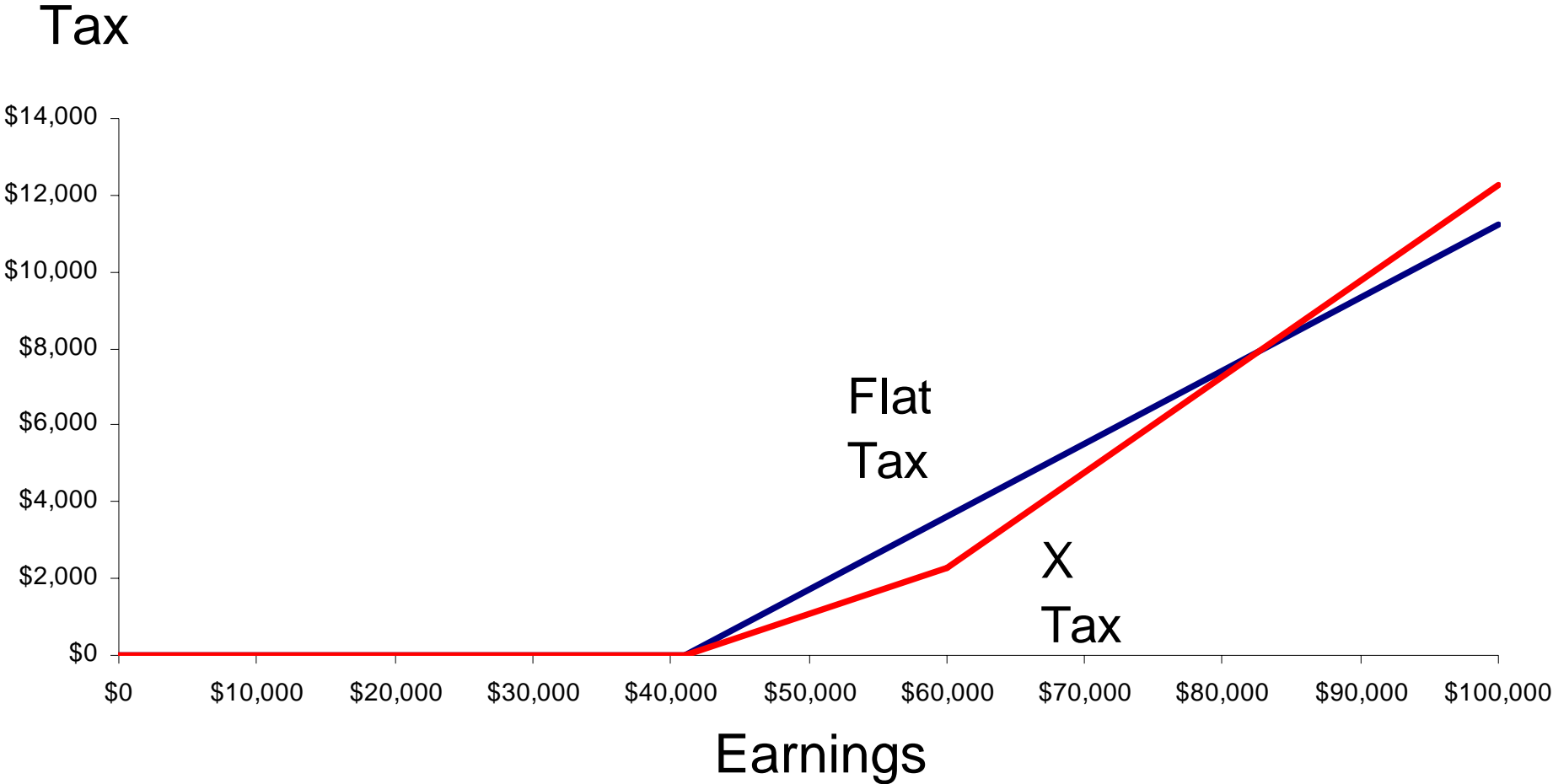
# Benefits of the Flat Tax

- Provides the right incentive for capital formation, through investment write-off
- Simple
- Easy to administer—low rate and simplicity reduce evasion
- Taxing business income at the source avoids more than a billion Form 1099s and reduces IRS cost
- 19-percent rate duplicates revenue from existing corporate and personal income taxes

# The X Tax

- Same structure as the flat tax: simple forms for family and business
- But the personal tax has more than one bracket
- Business tax rate is the same as the highest personal tax rate
- Reduced burden on middle-income families financed by higher business and top-bracket personal rates
- Example: 12-percent and 25-percent brackets, with higher bracket starting at \$60,000

# Comparison



# Distribution of Tax Burden

- Under current taxes, some high-income taxpayers pay huge amounts of federal income taxes, while others pay little
- Burden on the lower half of the income distribution is light
- The flat and X taxes would even out the burden across high-income taxpayers
- The burden on lower- and middle-income families can be adjusted by the exemption in the flat and X taxes and the brackets in the X tax

# Steps toward the Flat or X Taxes

- Move toward taxation of business income at the source
  - Lower personal taxation of dividends and capital gains accomplished in 2003
  - Push these rates to zero
  - Reduce and ultimately eliminate business deduction for interest, so this income is taxed at the source
  - Reduce personal tax rate on interest, ultimately to zero

# Steps toward the Flat or X Taxes

- Simplify the personal tax
  - Because of the AMT and generous standard deduction, few taxpayers actually deduct state and local income and property taxes—good time to remove this deduction
  - Phase out most other complications
  - Taxation of business income at the source makes the AMT and many other provisions of the personal tax unnecessary