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## A Flat Rate of Taxation

"Our federal tax system is a complete mess. It's not efficient. It's not fair. It's not simple. It's not even comprehensible. It fosters tax avoidance and cheating. It costs billions of dollars to administer. It costs taxpayers billions of dollars in time spent filling out tax forms and other forms of compliance. It costs the economy billions of dollars in lost output of goods and services from investments being made for tax rather than for economic purposes. It involves tens of thousands of lawyers and lobbyists getting tax benefits for their clients instead of performing productive work. It can't find ten serious economists to defend it. It's not worth saving." (Hall)

It's difficult to find anything good to say about our present tax code. It violates the American democratic principle of equal treatment under the law. It's a monstrosity over 55,000 pages in length, an atrocity, an abomination, and should be immediately ripped up and replaced with a simple flat tax.

The sixteenth amendment (1913) gave Congress the power to create the income tax. "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." (LII: Constitution) Since that meager beginning, our tax code has grown into a monster. Under our present system, taxpayers must comply with over 55,000 pages of ever-changing tax codes and regulations. Even the founding fathers of our country realized the dangers of having too many laws, laws that are too complicated to be understood, laws that are too lengthy, or laws that are constantly changing.

"It will be of little avail to the people, that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood; if they be repealed or revised before they're promulgated, or undergo such incessant changes that no man, who knows what the law is to-day, can guess what it will be to-morrow." (Alexander Hamilton, *The Federalist*, no. 62)

Today, even tax collectors don't understand what's in the tax code. Half the time, if you call the IRS and ask a question about the tax code, you'll get the wrong answer; but if you take the IRS's advice and it's wrong, you're held responsible for it. (Revitalizing the American Dream) Nobody understands the entire tax code - not tax attorneys, not tax accountants, and certainly not taxpayers. In addition, the tax code is the only portion of our laws where persons are considered guilty until they prove their innocence.

Taxpayers must spend billions of hours to complete required forms and comply with existing IRS requirements, or pay someone to do it for them. The tasks of record keeping and completing the individual tax return requires about 27 hours for the average taxpayer, or over 3 billion hours for all individual returns. (If Americans Really Understood)

High tax rates and a complicated IRS code encourage tax evasion and tax avoidance. Tax evasion is an illegal activity in which a taxpayer seeks to hide taxable

income or claim unauthorized tax deductions. Tax avoidance is the practice of paying as little tax as possible by claiming all allowable deductions from income. The Internal Revenue Service estimates that individuals illegally failed to pay 100 billion dollars in individual income taxes. The IRS also estimates that tax evasion has nearly doubled over the past twenty years. (If Americans Really Understood)

Raising taxes on real income to levels that are perceived as confiscatory increases the growth of all tax-exempt or sheltered parts of the economy at the expense of the taxable parts. The earners of taxable income must support an ever-growing mass of low-taxed and unproductive spending. According to George Gilder, there are four leading groups of beneficiaries: legitimate, illegal, real-estate, and nonprofit concerns - what might be termed the above-ground, underground, ground, and ungrounded economies. (Wealth and Poverty)

Billions of dollars are currently diverted to unproductive tax shelters rather than invested in productive outlets. Real estate is one of the most popular tax shelters. Taxpayers can deduct all of the mortgage interest and all of the property taxes on the real estate they own. This sucks trillions of dollars into non-productive real estate and out of our economy that could otherwise be used to create new businesses and fund productive activities.

Tax attorneys and lobbyists have created thousands of legal loopholes in the IRS code. Tens of thousands of lawyers and lobbyists spend their time to obtain special tax benefits for their clients rather than performing productive work. The tax system has become a test of legal brainpower in which tax attorneys and accountants conduct a treasure hunt for hidden deductions and tax breaks. (Revitalizing the American Dream)

Many Americans agree that our federal tax system needs major surgery and some have even proposed eliminating the IRS. Others constantly want to raise marginal tax rates to make the rich pay their "fair share". However, whenever Congress passes laws to make people pay their "fair share", the tax code often becomes more complex, and more loopholes are created that favor special interest groups. Under our present tax system, the wealthy will not passively wait to be fleeced by the IRS; when threatened by high tax rates, they have huge incentives to pay tax attorneys to find ways to shelter their income.

The existing tax code is the principal source of power in Washington. For a couple of generations now the favorite activity has been trading loopholes, trading favors for political support and contributions. The proof of this is that members of tax-writing committees receive far more in contributions compared to what the members on other committees in Congress get. The same thing is true of the state legislatures. The current tax code is the principal source of political pollution and corruption in Washington. (Revitalizing the American Dream)

The IRS employs 111,000 people to enforce the tax code. That is more people than work for the FBI; that is more people than work for the Border Patrol; that is more people than work for the Drug Enforcement Administration, the CIA, and the National Security Agency all combined. The power to tax is the power to destroy. (Revitalizing the American Dream)

Existing tax rates are too high. Because of double-taxation, the tax on dividends is 44.75 percent. There are several unintended consequences of high tax rates. Taxpayers will inevitably take advantage of legal loopholes in the tax code to avoid high taxes. This reduces entrepreneurial activities, and the entire society suffers consequently.

The Laffer curve indicates that there are normally two different tax rates that will bring in a particular amount of revenue. For example, a zero rate will bring in no revenue, and a 100 percent rate will also bring in nothing because it would halt taxable activity. Lower tax rates reduce the incentive to avoid taxes and encourage taxpayers to work and earn more. Income revenue normally increases when tax rates are reduced. (Wealth and Poverty) Politicians and some members of the public fail to consider this when they engage in their "soak the rich" arguments. If we adopt a flat tax with lower rates, we would obtain the following benefits.

- The IRS would cease to be the most feared government agency, and the Darth Vader-like bureaucracy could be brought under control.
- A flat tax would eliminate a lot of the class warfare we currently see, because everyone would know that they're all subject to the same simple set of rules and are all paying the same rate. This, combined with lower rates, would reduce the incentive for tax evasion and tax avoidance. The result would be increased tax revenue.
- The rich would actually bear a higher portion of the tax burden than they do now.
- A flat tax would encourage entrepreneurial activities.
- The tax return form could be reduced to the size of a postcard.
- The federal government would decrease in size.
- Thousands of low-income taxpayers could be removed from the tax rolls because of generous personal exemptions.
- Taxpayers wouldn't need to be bribed by the IRS to give money to charity.
- Under a flat tax, employees would save hundreds of dollars and self-employed taxpayers would save thousands of dollars in tax preparation costs.
- Taxpayers would save hundreds of hours that they currently waste in keeping records for tax purposes, and the stress involved with complying with an incomprehensible tax code would be eliminated.

The flat tax is a reasonable alternative to our present tax code. This year Americans will pay accountants and attorneys \$140 billion to help them navigate the over 55,000-page U.S. Tax Code. Under a flat tax, a little old lady on a home computer could do the work of thousands of IRS bureaucrats and tax accountants.

The concept of a flat tax isn't some weird utopian idea. Hong Kong was the first modern nation to acknowledge the benefits of this simple concept and implement a flat tax. Their economy is now one of the fastest growing in the world. The standard tax rate in Hong Kong is currently 15% and corporation profits are taxed at a rate of 16%. These rates are very low in comparison with those currently levied in other developed countries. Hong Kong also does not tax dividend income or capital gains. (Lipsher Accountancy) Hong Kong currently has the eighth-largest stock market and is the busiest shipping port in the world. (Hong Kong)

Today, Estonia, Lithuania, Latvia, Slovakia, Russia, Singapore, Ukraine, and Romania have a flat tax. In 1985, Robert E. Hall and Alvin Rabushka from Stanford University wrote a book entitled "The Flat Tax". They published a second edition of the book in 1995. Although the book has been largely ignored by the U.S. press, Alvin Rabushka, a senior fellow at Stanford's Hoover Institution who consults with countries all over the world on how to design a flat tax, can barely keep up with all the new adherents. Mr. Rabushka's book "The Flat Tax" has just been published in Chinese, with a preface by Lou Jiwei, the Chinese vice minister of finance. If China were to climb on board the

flat-tax train, more than a quarter of the world's population would be filling out their taxes on the back of a postcard. (High Taxes)

The U.S. has six tax brackets -- 10, 15, 25, 28, 33 and 35 percent. Since January 1, 2001, Russians have enjoyed a 13 percent flat tax. The majority of Russian taxpayers don't need to file forms. The 13 percent rate has exceeded expectations in terms of revenue, as real ruble revenue increased 28 percent. Three years ago, tax revenue equaled 9 to 10 percent of Russian gross domestic product. By last November that had grown to 16 percent as result following the Laffer Curve: lower marginal tax rates produce higher revenues. The new system has also greatly reduced the underground economy, where people were paid in goods rather than cash to facilitate tax evasion. As one observer has noted, V.I. Lenin, analyzing all this from his dacha in hell, must be stroking his beard in utter bewilderment. (Russia's Flat Tax)

Even in the United States, a flat rate of taxation isn't a novel idea. Flat rates are in wide use throughout the country. The best example is the Social Security tax, which levies one uniform rate on all employees and the self-employed. All workers are subject to a uniform tax rate for Medicare. The sales tax rate is the same for all consumers, rich and poor alike. Property tax rates on assessed valuations of real property are the same for all homeowners. All these tax rates are proportional to income, purchases, or property values. In general, government licenses and fees for government services are fixed regardless of income or wealth. Except for income taxes, flat-rate taxes are in wide use by, and supply most of the revenues for, all levels of government in the United States. (Hall)

Cutting tax rates causes the rich to pay a higher share of the tax burden. The 1980s provide the best evidence that lower tax rates increase the fairness of the tax system. The Tax Reform Act of 1986 reduced the top rate of 50 percent to 28 percent. How did the rich respond? The share of total individual income taxes paid by the top 1 percent (by adjusted gross income category) rose from 17.9 percent in 1981 to 25.6 percent in 1990. The share paid by the top 5 percent rose from 35.4 percent to 44 percent and by the top 10 percent from 48.2 percent to 55.7 percent. The bottom 50 percent reduced its contribution from 7.4 percent in 1981 to 5.7 percent in 1990. (Hall)

Although most people believe that higher tax rates increase revenues, the higher rates actually decrease revenues, because taxpayers will have more incentives to take advantage of loopholes in the tax code, evade taxes, or (in the case of sales tax) reduce purchasing the more heavily taxed items. A good illustration of this issue is the 1990 tax increase that imposed a 10 percent luxury tax on yachts. Potential boat buyers, unwilling to pay the additional luxury tax, postponed new purchases of yachts. By raising the price of yachts, the tax reduced demand, a predictable result following the law of demand, the most basic principle of elementary economics. Fewer sales forced layoffs and lower wages. The 10 percent luxury tax on yachts was borne largely by laid-off yacht workers. Unemployed yacht builders were not impressed with the attempt to make the rich pay more. The tax was repealed in 1993. (Hall)

When tax rates fall, upper-income households shift assets out of instruments that generate tax-exempt income, or from schemes that are designed primarily to shelter income, into productive and taxable economic activity. In 1986, federal tax expenditures, items that represent revenue lost from loopholes, amounted to \$500 billion. By 1990, the figure had fallen to \$400 billion. More than \$100 billion of activity was brought into the

tax net, largely by individuals in the former high brackets. Lower rates also curbed tax evasion. (Hall)

History shows us that tax revenues grow and "rich" taxpayers pay more tax when marginal tax rates are slashed. This results in lower income citizens bearing a lower share of the tax burden - a consequence that should lead class-warfare politicians to support lower tax rates. (The Historical Lesson)

Although virtually everyone agrees that the tax code needs to be reformed, there are three common arguments often used against the idea of a flat tax. One common technique used to refute any proposed change in our tax laws is to simply lie about the facts. While researching this topic, I Googled "Hong Kong tax rates" and found a high-ranking site that claims Hong Kong does not have a flat tax. This is false and, in fact, Hong Kong tax law allows any taxpayer to file under the flat tax provisions.

Some opponents to the flat tax say that the flat tax will hurt the lower and middle class by raising their taxes several thousand dollars. The logic they use in making that claim is they assume that there would be a flat 17 percent rate on all your income. They assume there would be no deductions; this is an argument that is repeated often, but it's absurd. The Hong Kong tax system allows the following deductions: charitable contributions; a residential care allowance up to \$7,700; home loan interest deduction up to \$12,800; pension allowance up to \$1,550; depreciation allowances; single persons allowance of \$13,850 or married persons allowance of \$27,700; child allowances of \$3,850 on the first and second child and \$1,925 thereafter; dependent relative allowance of \$3,850 each; dependent disabled persons allowance \$7,700; and an education allowance of \$3,850. The Hong Kong system clearly shows that exemptions and deductions can be easily incorporated into a flat tax.

Finally, critics ask why the flat tax concept hasn't been adopted in the United States if it's such a great idea. The answer is obvious: because the flat tax would threaten every special interest lobby group in the United States; from high-paid tax attorneys, to large insurance companies, Realtors®, and the multitude of other groups who presently benefit from the tax favors and loopholes that have been successfully carved out of the tax code for their benefit.

The home mortgage interest deduction and the charitable deduction are two of the most sacred cow tax write-offs in our tax code. Although a flat tax would be in the national interest, any attempt to reduce or eliminate these deductions would be met with stiff resistance by the special interest groups who currently benefit from them.

In conclusion, I feel that we should take our current monstrous tax code and drive a stake through it, bury it, and hope it never rises again to terrorize the American taxpayer. Until this is accomplished, we will not be free from this oppressive and tyrannical abomination. A flat tax would be a great improvement.

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