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Economy Watch

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The case for a flat tax -- and the arguments against



It's that time of year. And, by "that time," I mean, "time to talk about the flat tax again."

Thursday is tax day, and every year -- as regular as the cherry blossoms -- tax day causes another debate on replacing the United State's highly complicated and befuddling tax system with a simple flat tax.

No more itemized deductions. No more loopholes. No more pages and pages and pages of forms. No more tax attorneys(!) A lot fewer audits. A much less powerful IRS. (We can all agree on that, right?) The hope that individuals and businesses that have to pay less money in taxes will use that money to create jobs and prosperity.

Twenty-four countries now employ a flat tax but, to be fair, none of them has an economy that rivals the size and complexity of ours.

[Here's one way it could work, as proposed by Daniel Mitchell](#), senior fellow at the libertarian **Cato Institute**: the two-postcard system.

Families get one postcard, on which they write their labor income from their W-2 form. Then they subtract some amount of allowance based on family size. The remaining amount is taxable income. In Mitchell's system, they pay tax at a 17 percent rate.

Businesses get an equally simple postcard. They start with their total revenue, then subtract wage costs, input costs and investment costs. The IRS gets 17 percent of the remaining amount. Probably the most consistent, highest-profile advocate of a flat tax is former presidential candidate [Steve Forbes](#).

In a piece this week in **U.S. News & World Report**, Mitchell writes:

"The current system is a crapshoot riddled with corrupt provisions, and the tax treatment of upper-income households is a good example. Sometimes rich people are hit with punitive tax rates. This is not good for them, but it

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also hurts the rest of us by reducing investment and entrepreneurship. Many wealthy taxpayers, though, scam the system by using lawyers, lobbyists, and accountants. That also is bad for the rest of us since funds are allocated inefficiently. With a flat tax, by contrast, there are no special preferences or special penalties based on income. If **Bill Gates** has 100,000 times as much income as the average taxpayer, he'll pay 100,000 times as much tax. Not more, not less."

Flat-tax advocates argue that the current system, called a progressive system, is inherently unfair because wealthy people pay taxes at a higher rate than poor people. People who oppose the flat-tax oppose it for that very reason: they believe rich people should have a higher percentage of their income taxed, because they say it's the right thing to do. Conservatives and libertarians call this punitive taxation and government-directed redistribution of income.

Arguing against the flat tax in the same issue of USN&WR is **Clemson University** economics professor [Holley Ulbrich](#), a longtime foe of the flat-tax, who asks: how would you feel about losing your mortgage-interest deduction on your taxes? [She warns of:](#)

"...the disruptive effect of eliminating deductions, credits and exclusions that benefit the middle class as well as the rich and that play important roles in our lives—pension contributions, employer-provided healthcare, and deductions for mortgage interest, property taxes, and charitable contributions that support everything from soup kitchens to education to the arts. A flat tax would shift tax obligations from the rich to the poor, and especially the middle class, and eliminate desirable tax incentives for retirement savings, home ownership, and charitable contributions. Simple? Yes. Efficient and equitable? Not so much."

I don't know anyone who pays taxes who thinks, "Wow. This system is terrific! It's easy to figure out and fair to me, my family and my business!"

There is some movement underway to reform the U.S. tax code, even from non-flat-taxers. [Today, the Bipartisan Policy Group is hosting a seminar on the topic.](#) A flat tax should fairly be included in any reform discussion, and not simply discarded as the ravings of extremists.

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By Frank Ahrens | April 14, 2010; 12:54 PM ET

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