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The Alternative to ‘Alternative Taxes’

Jon N. Hall

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Ninety-one percent is a “fascist tax rate,” period. And it happened to be the top marginal rate for the federal personal income tax right here in America until the mid-1960s. True, no one actually paid 91 percent. But to avoid paying statutory rates, like 91 percent, we must do as our overlords want us to do. We must buy a house on credit and buy an electric car and dance like a Russian circus bear if we want to knock our effective tax rates down to something a little less fascistic.

Tax rates are high because Congress wants to control us and to get us to do what they deem is best. Congress does this by offering the taxpayer a vast array of exceptions: the adjustments, deductions, exemptions, write-offs, loopholes, and such in the Internal Revenue Code that allow us to pay less to the IRS. But the exceptions had become so numerous and so large that it had allowed some high-income Americans to pay income taxes at scandalously low rates.

That situation might have even embarrassed Congress, because in 1982 they enacted the alternative minimum tax, or AMT. According to Table 1 (line 208) at the IRS, in 2013 there were 3,940,304 returns that had AMTs totaling \$27.4B. The AMT was created for rich folks who took advantage of so many tax dodges, like tax-exempt municipal bonds, that in some cases they managed to entirely avoid paying income taxes. In other words, Congress created the AMT to counteract what Congress had created; i.e. the tons of exceptions in the tax code.

If you google “alternative minimum tax” in quote marks, you’re liable to get about 476,000 hits. However, if you google “alternative *maximum* tax,” you’ll only get about 922 hits. Why the disparity? It’s because the AMT is in the tax code, it’s in the law, whereas the alternative *maximum* tax isn’t. But the logic for the two is similar: just as taxpayers can be undertaxed, they can also be overtaxed.

Cato Institute has rerun a version of “The Alternative Maximum Tax” by Stephen Moore; it originally appeared on Jan. 14, 1997 in the *Wall Street Journal*. Moore’s article outlines what he calls the “MAXTAX,” which would be 25 percent for personal income taxes on the federal

level. Even if you have your own ideas about how to reform income taxes, Moore's article is well worth reading.

Like the AMT, the MAXTAX doesn't replace the Tax Code. And if one looks at Line 45 of Form 1040, one sees that the AMT isn't really an alternative to the regular income tax. Rather, it's an additional tax that one adds to the tax reported on Line 44. But the MAXTAX would be a true alternative; one would pay the MAXTAX *instead* of the regular income tax.

On April 14, 2013, "Alternative Maximum Tax" ran at the blog of economist John Cochrane; it ran the next day at the *Journal*. In 2013, the Federal Reserve Bank of Richmond interviewed Cochrane on many issues, including ours:

The alternative maximum tax is not my favorite nor a perfect tax code. It's a Band-Aid. Our current tax code is a chaotic mess and an invitation to cronyism, lobbying, and special breaks. The right thing is to scrap it. Taxes should raise money for the government in the least distortionary way possible. Don't try to mix the tax code with income transfers or support for alternative energy, farmers, mortgages, and the housing industry, and so on. [...] But it's a way to check that all of the creeping, extra things don't add up to a horribly distortionary tax code [...] We have an alternative minimum tax to make sure clever taxpayers don't exploit the insane complexity of the tax code and escape. Given that same insane complexity, why not have an alternative maximum too?

The MAXTAX, just like the AMT, leaves the Internal Revenue Code intact; it doesn't replace the Code; it's an alternative. But the only reason anyone would take such an alternative is to pay the IRS less. Which means the MAXTAX wouldn't be revenue-neutral.

During the 2016 campaign, at least two Republican presidential candidates were urging the adoption of a single tax rate for personal income taxes. In Jan. 2016, I pointed out that if it were engineered to be revenue-neutral, a single rate would impose a tax hike on 90 percent of Americans. The idea now is for three rates, which would soften the blow. But Congress cannot reduce the number of rates at all without causing some folks to pay more -- unless they impose new rates that are so low that they are not revenue-neutral and blow a hole in the budget.

Reducing the number of statutory tax rates, whether to one or to three, is the exact wrong tack to take in tax reform. Yet, some in the forefront of the current tax reform effort tout three rates as though it's some kind of magic elixir. A reduction in the number of tax rates by itself would do nothing to simplify taxes, nor would it make taxes fairer.

There is, however, a way to enact revenue-neutral tax reform whereby everyone would get a tax rate cut, and that's to set everyone's new statutory rate to whatever their current effective rate is. Since effective rates are the product of statutory rates and the exceptions taxpayers take, the substitution of their effective rates would mean that taxpayers could no longer take exceptions, but their tax bills would be the same. To be absolutely revenue-neutral, this substitution would also mean that the number of tax rates would be equal to the number of income tax returns, which is closing in on 150,000,000. Well, a new tax regime with nearly 150M statutory rates is

impractical, to say the least. Congress can't very well give every individual income taxpayer her own individualized rate; that's crazy talk.

The MAXTAX is a swell idea for as far as it goes, but it doesn't go very far. The MAXTAX, you see, is only for the swells, the evil One Percent. But there are taxpayers with modest incomes who are paying much more than others in their same bracket; what about those guys? Why not a MAXTAX for all taxpayers? Why can't all taxpayers choose to pay what everyone else is paying?

What everyone else is paying is, of course, the average. But if you allowed those who pay more than the average to start paying the average, that, too, just like the MAXTAX, would not be revenue-neutral; it would add to the deficit. The only way it could be revenue-neutral is if those who pay less than the average also started paying the average. But which average?

Congress could engineer a new tax rate regime that would be revenue-neutral and would keep folks paying close to what they're currently paying. The way to do that is to set new statutory rates to the average effective rates of income brackets that are much narrower than the current ones. That means more rates, not fewer. And it means ridding the tax code of all exceptions. Only by ending all exceptions can we have the lowest statutory tax rates for all taxpayers and still be revenue-neutral.

The very existence of an alternative tax, like the AMT, is evidence that there is something rotten about the Internal Revenue Code. The fetid stench is further evidenced by the glaring disparities one sees in what earners with the same incomes are paying in income taxes, which are more pronounced in the middle rungs of the income ladder than at the top. Alternative taxes aren't terrible ideas, but they would be utterly unnecessary in a decent tax system.

Jon N. Hall of Ultracon Opinion is a programmer/analyst from Kansas City.

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