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Text:

Published: April 15, 2010  
Updated: April 16, 2010 6:51 a.m.

# Daniel Mitchell: Replace nerve-wracking tax code with flat tax

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### Story Highlights

A simple post card would take the place of tax brackets and hundreds of complicated forms.

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Every April, Americans endure the misery of the [Internal Revenue Service](#) code. It is hopelessly complicated and nerve-wracking since the IRS has such immense powers to destroy people's lives. It is time to implement a simple and fair flat tax.

Instead of the hundreds of forms required by the IRS, the flat tax uses two simple postcards. Families use the household postcard, and all they need to know is their labor income, available on a W-2 form. They then subtract an allowance based on family size. The remaining amount is taxable income, and the tax bill is based on the flat rate. The business postcard is equally simple. All businesses, from [Microsoft](#) to a hot dog stand (as well as individuals with "Schedule C" income), start with total revenues, and then calculate taxable income by subtracting wage costs, input costs, and investment costs. The IRS then gets a flat percentage of that remaining amount.



MCT Illustration

The special interests hate the flat tax because it means no loopholes, no complexity, no shelters, and no special preferences. All income is treated equally. Some taxpayers may not like losing various deductions, but treating income equally also means that there is no double taxation, so the death tax and capital gains tax are abolished.

Tax reform may seem like an impossible dream, but it can happen.

Most Americans support tax reform because they want fairness. 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 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.

Economists like the flat tax since it would increase growth and job creation, while also making America more competitive. This is because a flat tax means a low tax rate. By replacing high tax rate with a low flat rate (probably 17 percent), the flat tax will encourage more productive behavior. Politicians understand that high tax rates on tobacco reduce smoking, so why don't they realize that high tax rates on work and entrepreneurship discourage growth?

A flat tax eliminates double taxation. By getting rid of the tax bias against saving and investment,

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the flat tax will encourage more capital formation. Every economic theory – even Marxism and socialism – acknowledges that saving and investment are needed to boost wages and living standards, yet the current system imposes extra taxes on people who set aside some of today's income to finance tomorrow's growth.

A flat tax reduces compliance costs. According to the Tax Foundation, dealing with the tax code – measured by the time, energy, money, and other resources that we devote to simply trying to figure out the right number to put on our tax returns – will cost us \$338 billion this year. This tax on paying taxes will fall by more than 90 percent with a flat tax.

Finally, a flat tax shrinks the IRS. The Internal Revenue Service has morphed into an enormous bureaucracy costing \$12 billion each year. The IRS employs more people than the FBI and CIA combined, and virtually all of this expense and bureaucracy could be wiped out under a flat tax.

We shouldn't blame the IRS, by the way, for today's awful tax system. All of the mess is the result of 97 years of social engineering by politicians. Both Republicans and Democrats the income tax was imposed back in 1913.

with flat tax  
20 minutes ago

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have been swapping loopholes for campaign cash ever since

Tax reform may seem like an impossible dream, but it can happen. Achieving a flat tax in America will not be easy. Everyone who benefits from the current system – politicians, accountants, bureaucrats, and lobbyists – will fight to keep the IRS. But if the American people get angry enough, anything is possible.

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tarchon wrote:

That's not a flat tax. The basic problem with this idea is that everybody has a different idea of what's fair and what's "flat". You for example wanted to propose a flat tax but you couldn't even bring yourself not to stick in an "allowance based on family size". I also note that you think only "labor" income should be taxed. Good luck with that.

The first US income taxes were in fact just about as simple as that, less the family-size allowance (they did have what was essentially a standard deduction of \$800, but it was unrelated to "family size", in the first 3% income tax of 1861), but obviously people in the past have tried those systems and inevitably been pulled to the idea that various adjustments and exceptions ought to be made, for instance for family size. Naively, some people, like you, think that all we need to do is specify a percentage and we're done, but the real world of taxation isn't that simple. Take your "labor" for example - what exactly would constitute labor anyway? Could a capital gain be attributed to the labor required to research the capital, to buy it, to sell it, to keep records, etc? If you hired someone else to do that for you, you would certainly have to pay them for the labor, so why isn't it labor if you're doing it for yourself? You might argue that it's only partially labor-based, but then you'd need some kind of rule system to figure out how much is "labor" (perhaps based on how much you'd have to pay someone to do it) and how much is some other non-taxable type of income. In our current system, we simplify that issue by picking an arbitrary but workable reduced percentage (the capital gains rate) which is less than the "labor" income rate. In a system like yours that had no capital gains category though, this is something that would have to be revisited. I'm sure you'll argue that, gosh darnit, labor is labor, but get real - if you did it that way, a very large part of the American labor force would find all sorts of creative and interesting ways to turn labor income into capital gains or some other kind of income that you don't think of as labor-derived. This is the another reason why taxes inevitably get complicated; the tax system has to keep up with all sorts of fiendishly devious tax-dodges.

There are all sorts of income types like that, and one role of the raft of credits and deductions in the tax code is to try account for how much of income is really income. This is why, for instance, state and local taxes are deductible, on the theory that the portion of money you make that you don't get to use because some other government takes it isn't really income, which seems pretty reasonable to me. Things like rent/mortgage deductions, medical expense deductions, and the standard deduction, like your "allowance" similarly derive from the notion that they're basic life expenses and thus offset income in the same way an investment expense offsets investment income.

The funny thing about the flat tax concept though, it's always seemed to me, is that there's nothing in the tax code that forces you to take umpteen deductions if you don't want them. I could finish my taxes in 10 minutes, if I wanted to skip thousands of dollars worth of credits and deductions. If this was all about simplicity, we wouldn't have 1/3 of taxpayers itemizing. We already have a tax system that can be pretty simple if you choose it to be, but many of us

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