A Proposal to Simplify Our Tax System

By Robert R. Hall and Alvin Rabushka

Despite recent progress in lowering rates, the tax system remains a disgrace. It is in dire need of simplification and reform. The tax system is an intimidating, bulky, filling volumes of codes, complicated by hundreds of credits, exemptions and special provisions. Many taxpayers need expensive professional help to fill out their returns. Each act of the Congress complicates the code further. A widespread evasion is apparent on interest, dividend and other forms of household or professional income. Tax shelters are commonplace. Estimates of the size of the underground economy range from tens of billions of dollars to several hundred billion. In short, we have a system that fosters appeals through the law, and simultaneously discourages productive economic activity.

We have recently worked out the details of a simple income tax, imposed at a low uniform rate on a comprehensive measure of income. The tax would be based on the following principles:

1. All income should be taxed only once, as close as possible to its source.
2. All types of income should be taxed at the same rate.
3. The poorest households should pay no income tax.
4. Tax returns for both households and businesses should be simplified, so that all people can fill them out on a postcard.

A major problem with the current system is its complex tax of businesses. Income is complicated first under the corporate tax and again under the personal tax on dividends. Income from proprietorships and partnerships often evades tax, or is taxed lightly. We propose a single business tax on all types of income other than wages.

The Current Range of Rates

A uniform rate of 19% would replace the current range of rates. The current rates now stretch from actual annual salary of $60000, with $20000 deducted for depreciation, to $1 million, which is imposed on income earned by stockholders.

The proposed new 19% business tax applies equally to all forms of business: corporate, partnership, professional, farm and rental and royalties. The base for the tax is gross revenue less purchases of goods and services and compensation paid to employees. In addition, a capital recovery allowance is deducted for investment in plant and equipment. No deductions are permitted for depreciation, interest or payments to owners in any form.

Even for a multibillion-dollar corporation, the business tax return would fit easily on a single page. It would look like this:

1. Gross revenue from sales
2. Costs
3. Purchases of goods and materials
4. Compensation paid to employees
5. Other direct costs
6. Total costs (lines 2, 3, and 4)
7. Net Revenue (line 1 less line 5)
8. Purchases of capital equipment and structures
9. Taxable income (line 6 less line 7)
10. Tax (19% of line 9)
11. Tax carry-forward from losses in previous years
12. Net tax (line 9 less line 10)
13. Tax paid (amount on line 11 if positive)
14. Carry-forward to next year (amount on line 11 if negative)

The tax rate would be 19% of the total tax return, which includes an allowance for depreciation and other deductions. The tax return would be a single page, and the computation of the tax would be straightforward. The tax would be collected by the IRS, and refunds would be issued in a timely manner.

In place of the hodge-podge of investment incentives in the tax system, we propose the use of straightforward first-year write-off of all business investment. First-year capital recovery is a great simplification of the complicated depreciation deductions and investment credits in present law.

The net revenue of U.S. business in 1980 was $233 billion. Under the new business tax, we propose, capital recovery is deductible for investment in plant and equipment. No deductions are permitted for depreciation, interest or payments to owners in any form.

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12. Refund due (line 10 less line 11 if negative)

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