FLAT-RATE TAX

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

SEPTEMBER 28 AND 29, 1982

PART 1 OF 2

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FLAT-RATE TAX

TUESDAY, SEPTEMBER 28, 1982

U.S. SENATE,
SENATE COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 9:10 a.m., in room 2221, Dirksen Senate Office Building, the Honorable Robert J. Dole (chairman) presiding.

Present: Senators Dole, Chafee, Symms, Grassley, Long, Byrd, Bentsen, Baucus, and Bradley.

Also present: Senators Quayle, Hart, Nickles, Helms, and DeConcini.

[The press release announcing the hearing, background information relating to broadening the base and lowering the rates of the income tax, and the prepared statements of Senators Dole, Bradley, Symms, and Wallop follow:]

[Press release No. 82-162, U.S. Senate, Committee on Finance, Aug. 27, 1982]

FINANCE COMMITTEE SETS HEARING DATES ON FLAT-RATE TAX AND MAJOR TAX REFORM PROPOSALS

Senator Robert J. Dole (R.-Kans.), chairman of the Senate Finance Committee, announced today that the Committee would hold hearings on proposals to move to a flat-rate or simplified tax system on September 27, 28, 29, 1982. The hearings will focus on proposals that have been set forth for a flat-rate income tax, or for a simplified income tax with lower rates and fewer exceptions from the general rate, and on alternative suggestions such as a tax on a consumption base, rather than on income base, or a gross income tax.

The hearings will begin each day at 9:30 a.m. in Room 2221 of the Dirksen Senate Office Building.

"Last May I indicated that the Finance Committee would undertake a thorough examination this year of flat-rate and other major tax simplification proposals. This is an issue that has attracted considerable attention, and is particularly timely in view of our action in 1981 to reduce tax rates across the board, and the measures to broaden the tax base in the Tax Equity and Fiscal Responsibility Act of 1982. There seems to be a growing consensus that lower tax rates, or a single rate, coupled with a broader tax base would be fairer to the taxpayer as well as better for the economy," Dole said.

Senator Dole indicated that the Finance Committee would examine the details of substantive proposals that have been made, and would be interested in receiving testimony on alternative tax proposals to achieve the goals of greater equity, simplicity, balance, and economic efficiency in the tax system. Senator Dole also indicated that a Treasury Department study of alternative tax systems was expected to be ready in time for the hearings.

"These hearings should serve to open a highly significant debate over the direction of tax policy in years ahead, and there are many difficult questions that need to be answered," Senator Dole stated. "We may agree on general goals for tax policy, but how you proceed makes a great deal of difference to the taxpayer and the economy. If we are serious about developing a truly equitable tax system, we must be prepared to answer these questions openly and honestly."

Among the major issues cited by Senator Dole that would be of concern to the Committee were the distributional impact of lowering tax rates while eliminating most tax preferences; the degree of progressivity desired in the system; the difficulty of making the transition to a new system when many taxpayers have made long-term economic decisions in reliance on the tax preferences and rate structure that now exist; and how to simplify taxation for both individuals and corporations, including the question of whether income should be taxed without regard to the form of business organization.

"If we are interested in undertaking a major overhaul of our tax system, we have to be attentive to the concerns of individuals and businesses who have planned their activities based on the present system. In particular, we cannot just address the way we tax individuals and ignore the effect that might have on those who have to decide whether to incorporate or operate as a proprietorship. The corporate side also must be addressed," Senator Dole stated. "Our interest as a Committee is in building a tax system that will be supported by a broad consensus so that the goals of equity and efficiency will not be undermined in the years ahead. We hope that our hearings will lay the groundwork for that effort."

[Revised press release No. 82-162a, U.S. Senate, Committee on Finance, Sept. 14, 1982]

Finance Committee Announces Revised Dates for Flat-Rate Tax Hearings

Senator Robert J. Dole (R.-Kans.), Chairman of the Senate Finance Committee, announced today that the Committee hearings on proposals to move to a flat-rate or simplified tax system would be held on September 28, 29, and 30, 1982, rather than on September 27, 28, 29 as previously announced (Press Release 82-162, August 27, 1982).

The hearing will begin at 9:00 a.m. on Tuesday, September 28, and at 10:00 a.m. on Wednesday, September 29 and Thursday, September 30 in Room 2221 of the Dirksen Senate Office Building.

STATEMENT OF SENATOR DOLE
FINANCE COMMITTEE HEARINGS ON THE FLAT-RATE TAX

TODAY THE FINANCE COMMITTEE BEGINS THOROUGH AND COMPREHENSIVE CONSIDERATION OF THE ISSUES RAISED BY PROPOSALS TO MOVE IN THE DIRECTION OF A FLAT-RATE, OR PROPORTIONAL, INCOME TAX SYSTEM. THESE INITIAL HEARINGS FOLLOW ON MY ANNOUNCEMENT LAST MAY THAT OUR COMMITTEE WOULD UNDERTAKE AN EXTENSIVE REVIEW OF THE FLAT-RATE CONCEPT AND RELATED ISSUES OF TAX, SOCIAL, AND ECONOMIC POLICY. THIS IS ONLY A BEGINNING: THERE ARE MANY INDIVIDUALS AND ORGANIZATIONS WHO WOULD LIKE TO BE HEARD ON THIS SUBJECT, AND WHILE WE CAN ACCOMODATE A SMALL NUMBER NOW, WE WILL DO OUR BEST IN FUTURE ROUNDS OF HEARINGS TO HEAR EVERYONE - WE NEED TO HEAR AS WIDE AS POSSIBLE A RANGE OF OPINIONS AND PERSPECTIVES ON THIS SUBJECT, BECAUSE WE ARE CONSIDERING FUNDAMENTAL CHANGE.

OVER THE NEXT THREE DAYS IT IS HOPED WE CAN BEGIN TO ESTABLISH A FRAMEWORK TO GUIDE FURTHER DELIBERATIONS ON RESTRUCTURING OUR TAX SYSTEM. WE CAN DO THAT BY CLEARLY FORMULATING THE BASIC OPTIONS, BY DEVELOPING THE FACTS AND FIGURES NECESSARY TO INFORMED DECISIONS, AND TO PINPOINT THE TECHNICAL AND PRACTICAL PROBLEMS THAT WILL HAVE TO BE DEALT WITH IF WE WANT TO MODIFY THE TAX SYSTEM IN A MAJOR WAY. OUR WITNESSES ARE PREPARED TO HELP US DO ALL OF THAT; IN PARTICULAR THE TREASURY DEPARTMENT HAS EXAMINED THE ISSUE IN SOME DETAIL, AND WHILE THEY ARE NOT PREPARED TO MAKE SPECIFIC RECOMMENDATIONS AT THIS TIME, I HOPE THAT WE WILL GET AN INDICATION OF HOW THE ADMINISTRATION THINKS WE OUGHT TO PROCEED, AND OF HOW THEY RANK THE ISSUES IN TERMS OF PRIORITIES. THIS MORNING'S TESTIMONY FROM ASSISTANT SECRETARY CHAPOTON SHOULD PROVIDE ABLE ASSISTANCE IN FORMULATING OPTIONS FOR FURTHER CONSIDERATION.

BASIC CHOICES

AT THE OUTSET, I WOULD LIKE TO OUTLINE SOME OF THE BASIC CHOICES WE HAVE BEFORE US IN CONNECTION WITH THE FLAT-RATE ISSUE. SOME OF THESE CHOICES ARE SIMPLY MATTERS OF TRYING TO FORMULATE THE BEST TAX POLICY; SOME OF THEM ARE PRIMARILY DECISIONS ABOUT ECONOMIC POLICY; AND OTHERS ARE REALLY POLITICAL DECISIONS, OR DECISIONS ABOUT WHAT IS BEST FOR OUR SOCIETY.

FOR EXAMPLE, WE HAVE TO DECIDE WHETHER SIGNIFICANT PROGRESSION IN RATES IS DESIRABLE--AS UNDER THE PRESENT SYSTEM--OR WHETHER EVERYONE SHOULD PAY THE SAME PROPORTION OF INCOME IN TAXES. THE ANSWER TO THIS QUESTION WILL DEPEND IN PART ON YOUR VIEW OF HOW IMPORTANT THE PRINCIPLE OF PROGRESSIVITY IS TO MAINTAINING POPULAR SUPPORT FOR THE TAX SYSTEM. THE ANSWER ALSO WILL DEPEND ON SOME SIMPLE FACTS: HOW PROGRESSIVE IS THE PRESENT SYSTEM, WHEN YOU TAKE INTO ACCOUNT THE DISTRIBUTION OF TAX PREFERENCES AVAILABLE UNDER PRESENT LAW, PARTICULARLY DEDUCTIONS THAT TEND TO FAVOR THOSE IN HIGHER RATE BRACKETS.

WE ALSO HAVE TO DETERMINE HOW MUCH A GAIN IN SIMPLICITY AND ECONOMIC EFFICIENCY CAN BE MADE BY MOVING TO A STREAMLINED LOW-RATE OR FLAT-RATE STRUCTURE. DEFINING INCOME WILL ALWAYS BE A SOURCE OF MAJOR COMPLEXITY, AND CUTTING OUT TAX PREFERENCES AS SUCH DOES NOT DEAL WITH THAT PROBLEM. A LARGE ZERO BRACKET, IF IT WERE ADOPTED AS PART OF A RESTRUCTURING OF OUR TAX SYSTEM, COULD PROVIDE SIGNIFICANT GAINS IN SIMPLICITY BE REDUCING THE NUMBER OF ITEMIZERS. AGAIN, HOWEVER, WE WOULD NEED TO EVALUATE THE IMPACT OF SUCH A CHANGE ON THE DISTRIBUTION OF THE TAX BURDEN AND IN TERMS OF ECONOMIC EFFICIENCY.

IN ADDITION, THERE ARE A NUMBER OF SPECIFIC WAYS IN WHICH A FLAT-RATE, OR LOWER-RATE, TAX SYSTEM MIGHT BE STRUCTURED. A SINGLE RATE COULD BE APPLIED, AS SOME PROPOSE, TO A COMPREHENSIVE INCOME BASE. THIS WOULD MEAN EVERYONE PAYING THE SAME PROPORTION OF INCOME IN TAX, WITH CHANGES IN THE TYPES OF THINGS WE HAVE USUALLY INCLUDED IN INCOME: ITEMS SUCH AS SOCIAL SECURITY AND RETIRMENT BENEFITS, AMONG OTHERS. ALTERNATIVELY, RATES COULD BE SIGNIFICANTLY REDUCED AND THE BASE BROADENED BY ELIMINATING A RANGE OF TAX PREFERENCES, BUT WITHOUT GOING ALL THE WAY TOWARD A SINGLE RATE WITH A COMPREHENSIVE BASE. THESE TWO BASIC OPTIONS CAN BE VARIED, IN ADDITION, BY INCLUDING IN EITHER A LARGE ZERO BRACKET: GUARANTEEING A DEGREE OF PROGRESSIVITY AND PROTECTION FOR LOWER-INCOME TAXPAYERS, WITH SOME GAIN IN SIMPLICITY AS WELL FROM REDUCING THE NUMBER OF ITEMIZERS, ASSUMING THE OPTION OF RETAINING SOME DEDUCTIONS IS CHOSEN. FINALLY, WE COULD CONSIDER A FLAT-RATE TAX ON A LESS COMPREHENSIVE INCOME BASE; PRESERVING SOME BASIC TAX PREFERENCES THAT HAVE WIDE SUPPORT, BUT AT THE SAME TIME PRESUMABLY REQUIRING A HIGHER RATE TO GENERATE THE NECESSARY AMOUNT OF REVENUE. THESE FIVE OPTIONS, AND A DISCUSSION OF SOME MAJOR ISSUES IN CORPORATE TAXATION THAT ARE RAISED BY THE FLAT-RATE DEBATE, ARE DISCUSSED IN MORE DETAIL IN A NARRATIVE OUTLINE AND MEMORANDUM ON CORPORATE ISSUES, WHICH I WILL INCLUDE IN THE RECORD FOLLOWING MY STATEMENT AND MAKE AVAILABLE TO THE MEMBERS FOR THEIR INFORMATION.

WHAT IT COMES DOWN TO IS A CHOICE OF WAYS TO PROCEED. EVERYONE WANTS GREATER EQUITY IN THE TAX CODE, AND A SIMPLER SYSTEM, AND A TAX SYSTEM THAT PROMOTES--OR AT LEAST DOES NOT INHIBIT--ECONOMIC ACTIVITY. CHOOSING THE SYSTEM THAT BEST BALANCES EACH OF THESE GOALS IS NOT EASY, HOWEVER: AND DECIDING HOW TO MOVE TOWARDS A BETTER SYSTEM MAY BE THE MOST DIFFICULT COICE OF ALL.

HOW TO PROCEED

THE WAYS IN WHICH WE MIGHT PROCEED SEEM, TO THIS SENATOR AT LEAST, TO BE FAIRLY STRAIGHTFORWARD. FIRST, WE COULD CONTINUE TO WORK THROUGH THE TAX CODE ON AN ITEM-BY-ITEM BASIS AND MAKE DECISIONS ABOUT WHAT SHOULD GO OR BE MODIFIED AND WHAT SHOULD BE PRESERVED: IN OTHER WORDS, FURTHER BASE-BROADENING AND TAX REFORM EFFORTS COMPARABLE TO THOSE INCLUDED IN THIS YEAR'S TAX EQUITY AND FISCAL RESPONSIBILITY ACT. THIS APPROACH COULD BRING SUBSTANTIAL GAINS IN EQUITY AND SIMPLICITY OVER TIME, BUT IT WOULD NOT NECESSARILY INVOLVE THE KIND OF FUNDAMENTAL RETHINKING OF OUR TAX STRUCTURE THAT MANY PEOPLE SEEM TO WANT.

INSTEAD, WE MIGHT DO AS SOME ARE URGING, AND AGREE ON A MAJOR REVISION OF THE TAX SYSTEM IN THE DIRECTION OF LOWER RATES AND A BROADER BASE, AND TAKE THE NECESSARY STEPS TO IMPLEMENT SUCH A SYSTEM. THIS WOULD MEAN AN EXPLICIT CHOICE OF A NEW APPROACH TO TAXES; COMPREHENSIVE AND CAREFULLY THOUGHT OUT; AND A DIFFICULT PERIOD OF TRANSITION TO RECONCILE THE NEW SYSTEM WITH THE OLD WHILE SAFEGUARDING THE ECONOMIC INTERESTS OF THOSE WHO HAVE MADE FINANCIAL DECISIONS BASED ON THE PRESENT SYSTEM. THE POTENTIAL PITFALLS WITH

THIS APPROACH ARE THAT IT REQUIRES LONG-RANGE PLANNING AND IMPLEMENTATION, AND THERE IS THE RISK THAT THE CONSENSUS BEHIND THE NEW SYSTEM COULD ERODE DURING THE LENGTHY COURSE OF IMPLEMENTATION. THAT COULD LEAVE US WITH A SYSTEM NO BETTER, OR EVEN WORSE, THAN PRESENT LAW.

FINALLY, WE MIGHT AGREE TO PROCEED, AGAIN ON A STEP-BY-STEP BASIS, TO COUPLE BASE-BROADENING MEASURES WITH RATE REDUCTIONS IN AN EFFORT TO SIMPLIFY THE SYSTEM AND REDUCE TAX-INDUCED DISTORTIONS OF ECONOMIC DECISION-MAKING. THE ADVANTAGES HERE WOULD BE THAT WE WOULD HAVE AN OPPORTUNITY TO THINK OUT EACH STEP AS IT IS TAKEN, AND TO BUILD A CONSENSUS ON THE DESIRABILITY OF THOSE STEPS. THE DISADVANTAGE IS THAT YOU WOULD NOT MAKE A SPECIFIC COMMITMENT TO A BOTTOM-LINE GOAL FOR OUR INCOME TAX POLICY.

MUCH TO BE DONE

JUST OUTLINING THE POLICY OPTIONS AND PROCEDURAL OPTIONS MAKES CLEAR HOW MUCH THERE IS TO BE DONE IF WE WANT TO REBUILD OUR TAX SYSTEM IN A WAY THAT IS FAIRER, SIMPLER, AND BETTER FOR THE ECONOMY. NO SYSTEM CAN BE SUSTAINED WITHOUT A STRONG POPULAR CONSENSUS: INDEED, A MAJOR REASON WE ARE CONSIDERING FUNDAMENTAL REFORMS IS THE INDICATION OF WEAKENING CONSENSUS BEHIND OUR PRESENT SYSTEM, AS DEMONSTRATED BY THE GROWING COMPLIANCE PROBLEM. WE DO NOT WANT TO HASTILY ADOPT A SYSTEM THAT CANNOT BE SUSTAINED OVER TIME, EITHER BECAUSE OF TECHNICAL FLAWS OR LACK OF POPULAR SUPPORT.

SO OUR TASK IS TO BEGIN TO SEARCH OUT THE KIND OF CONSENSUS NEEDED TO SUPPORT ANY FAR-REACHING CHANGE IN TAX POLICY. THE DIRECTION HAS BEEN SET, IN A WAY, BY THE RATE REDUCTIONS ADOPTED IN 1981 AND THE BASE-BROADENING AND COMPLIANCE MEASURES WE AGREED TO THIS YEAR. WE HAVE ALREADY MOVED TOWARDS LOWER RATES AND A BROADER BASE, AND HAVE PUT THE PRESSURE ON TO REEXAMINE THE TAX SYSTEM BY INDEXING INDIVIDUAL RATES TO END BRACKET CREEP. THERE DOES SEEM TO BE A GROWING CONSENSUS FOR FURTHER REDUCTION OF RATES AND BROADENING OF THE TAX BASE. WITH PROPER BALANCING OF THE GOALS OF EQUITY, EFFICIENCY, AND SIMPLICITY, THAT CONSENSUS CAN GROW, AND IT HAS THE POTENTIAL TO OPEN THE WAY TOWARDS THE FIRST MAJOR RESTRUCTURING OF TAXES IN YEARS. I HOPE THE WITNESSES THIS MORNING, AND OVER THE COURSE OF THESE HEARINGS, WILL SHED SOME LIGHT ON THE PROSPECTS FOR DRAMATIC CHANGE IN TAXATION AS WELL AS HELP CLARIFY OUR CHOICES.

ANALYSIS OF PROPOSALS
RELATING TO
BROADENING THE BASE AND LOWERING THE RATES OF THE INCOME TAX

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

This pamphlet has been prepared by the staff of the Joint Committee on Taxation in connection with the hearings scheduled for September 28–30, 1982, by the Senate Finance Committee on lowering tax rates and broadening the base of the income tax. Part I of the pamphlet discusses the general objectives of comprehensive tax reform. Part II describes the basic characteristics of the base broadening and rate reduction proposals. Part III analyzes some of the important issues that arise in considering major modifications to the income tax. Part IV deals with the problem of making a transition from the present system to a new system. An appendix summarizes the principal bills introduced in the 97th Congress that lower tax rates and significantly broaden the income tax base.

I. OBJECTIVES OF COMPREHENSIVE TAX REFORM PROPOSALS

Several criteria are commonly used when evaluating tax proposals, including equity, efficiency, and simplicity. Individuals often agree that the revenue which is raised by the tax system should be collected in a manner which is as fair as possible, which produces as little unintended distortion in the economy as possible, and which is as simple to administer and understand as possible. In addition, certain provisions of the tax system have been enacted to encourage specific activities which Congress has felt should be promoted. The questions of equity, efficiency, simplicity, and the encouragement of specific activities are central to the discussion of whether the present tax system should be changed by enacting one of the comprehensive tax proposals presently being discussed.

A. Equity

Horizontal equity and ability to pay taxes

A common assertion is that taxes, other than user fees collected from beneficiaries of specific programs, should be collected in accordance with a taxpayer's ability to pay taxes. Thus, taxpayers with equal ability to pay taxes should pay equal amounts of tax and, correspondingly, any taxpayer with a greater ability to pay should pay more tax. This concept is sometimes called horizontal equity. An additional dimension of equity, sometimes known as vertical equity, is the actual amount by which the tax liability of the taxpayer with the higher ability to pay exceeds that of the other taxpayer.

Income as a measure of ability-to-pay

To apply concepts of equity to the design of a tax system, it is necessary to measure each taxpayer's ability to pay taxes. In the United States, there is a tradition that a taxpayer's income is a valid measure of his or her ability to pay taxes. In this context, income is defined as the ability to provide oneself with goods and services, other than those goods and services which are necessary to earn the income. Thus, for this purpose, income is generally measured by subtracting from the sum of the gross receipts and appreciation in asset value of a taxpayer the amounts spent on goods or services which are costs of generating those gross receipts and that appreciation.

Although there are many problems obtaining all the information necessary to produce an accurate measure of income (some of the most important problems are discussed in the third part of this pamphlet), income is a commonly accepted measure of ability to pay taxes. It is often asserted that individuals with a relatively high ability to purchase goods and services which satisfy needs for private consumption also have a relatively high ability to purchase those goods and services which provide for public consumption needs, i.e., goods and services provided by the government. If it is then agreed that those with a relatively high ability to purchase these goods and services should also be required to make a relatively high contribution toward defraying their cost, then it follows that the revenues necessary to pay for government spending should be raised by an income tax.

On the other hand, several arguments may be put forth as to why income should not be relied on as the basic index of ability to pay taxes. First, some assert that actual consumption of goods and services, not potential consumption (i.e., income), is a fairer basis for taxation. This is consistent with the belief that taxation should be based on the actual satisfaction derived from goods and services, rather than the ability to purchase them, and actual satisfaction may be more closely related to expenditures for goods and services than to income.

Second, it can be argued that income may be misleading as a single index of ability to pay taxes because no account is taken of the time and effort expended on earning that income. Many would agree, for example, that someone who works 20 hours per week to earn a given amount of income should pay more tax than someone who works 40 hours per week to earn the same amount. This is because the former taxpayer has greater leisure time to enjoy the available goods and services and because one's leisure is itself valuable. Similarly, someone who works at a less pleasant job should pay less than someone with the same income who works in a more pleasant environment. Yet, under a tax system in which tax liability is based solely on income, no account is taken of these differences, and it would be extremely difficult to design a tax system that took these and similar problems into account.

A third problem is disagreement over what expenses should be subtracted from gross receipts as a cost of earning income. For example, questions have arisen about the extent to which business meals and entertainment should be deductible, and it can be argued that medical expenses should be deducted from the amount subject to tax because these expenses are the cost of maintaining health, which is necessary to earn income.

Vertical equity

In spite of these problems, in the U.S. income is commonly accepted as a basis for taxation. Thus, the horizontal equity concept requires that taxpayers with equal incomes should have equal tax liabilities. Vertical equity is much more subjective since it involves the comparison of ability to pay for taxpayers with different amounts of resources. Since there is no widely accepted yardstick for making these comparisons, the degree to which tax liability should vary with income is a value judgment.

The concept of progressivity is often discussed in this context. A progessive tax is one for which the ratio of tax liability to the tax base (e.g., income) rises as the tax base rises. Many argue that this is appropriate. On the other hand, others contend that the ratio of taxes to income should be constant (a proportional tax system) or should decline as income rises (a regressive system).

One argument for progressivity is that, if people examined the vertical equity question from the point of view of the very beginning of their lives, when they did not know exactly where they would end up in the income distribution, they would be willing to agree to laws under which government would mitigate, to some extent, whatever inequalities emerged from a market economy. Progressivity is attacked, however, by those who view a taxpayer's income as essentially the fruit of his own labor and resources. Under this view, the government should have very little role in equalizing the amounts which individuals are left with after taxes, since individuals are entitled to whatever income arises from their own labor or property. This view is, in turn, contested by those who contend that labor and property have value only because society establishes laws and regulations which allow each individual to engage in economic activity with relatively little interference from others. To be sustained, these laws and regulations must be accepted even by those who are relatively unsuccessful. Thus, because society establishes the framework which allows labor and property to be valuable resources, it can also establish a progressive tax system and other mechanisms to achieve an equitable distribution of income.

In sum, although equity is an integral part of tax policy, it involves subjective judgments over which there is likely to be considerable disagreement.

B. Efficiency

Another widely accepted goal of tax policy is that taxes should interfere as little as possible with the incentives to engage in specific types of economic activity, except to the extent that Congress intends such effects. This goal is known as economic efficiency.

Virtually any tax which meets accepted equity criteria creates some interference with economic incentives. In order to have no such effect, a tax would have to be determined on the basis of some characteristic over which an individual has no control. For example, a head tax equal to a specified, constant amount per person would have no incentive effects, since it could not be avoided, but it also would be regarded by many as extremely unfair. On the other hand, a tax which varies with income creates a disincentive for earning income. Even taxes on consumption create disincentives for earning income since they reduce the potential amount of goods and services which may be purchased with the income earned from a given amount of property or work effort.

Similar trade-offs may exist with respect to vertical equity and efficiency. For example, it has been argued that a progressive tax system creates considerable inefficiency by encumbering additional income with the imposition of a still higher tax rates. In the extreme case, a 100-percent tax on additional income would eliminate any incentive to earn that income. Yet, from the point of view of equity, many argue that progressive tax rates are essential to establish a proper relationship between tax burdens and ability to pay. Therefore, given the notions of horizontal and vertical equity that are commonly accepted, there is frequently a conflict between the efficiency and equity goals of tax policy. Balancing these competing considerations is one of the most difficult aspects of formulating a tax system.

The concept of economic efficiency uses as a benchmark the production of goods and services which would occur in a market economy in the absence of taxes. Economists generally regard this allocation of resources as a useful reference point because, under certain conditions, it insures that available economic resources are arrayed in such a way as to produce the highest possible amount of consumer satisfaction. Relative to this benchmark, taxes change the incentives to engage in various types of economic activity (e.g., work, investment, consumption of specific goods and services), which reduces the ability of the economy to satisfy consumer demands.

Thus, some inefficiency is inherent in virtually all taxes which are acceptable from the equity standpoint. However, a major goal of tax policy is to reduce this inefficiency to as low a level as possible.

C. Simplicity

A third goal of tax policy is simplicity. This is a serious concern for at least two basic reasons—compliance costs and the perception of equity.

First, a complicated tax system requires a large amount of resources to administer and understand. When the system has a large number of discrete provisions and mandates that many fine distinctions are to be made among types of income or expenses, a long series of complicated rules are necessary. The agency administering the system must have a large staff to formulate the rules and to insure that taxpayers calculate tax liability correctly. Taxpayers themselves must invest large amounts of time in understanding the rules so as to avoid overpaying their taxes, or alternatively, find that they are better off by paying for professional tax advice and preparation. This time and effort diverted from other activities is a source of inefficiency generated by the tax system in addition to the disincentive effects described in the previous section.

A second reason for a general preference for a simple tax system is that under a complicated system, similarly situated taxpayers may have different tax liabilities because they are not equal in their ability to understand the rules or pay for professional tax advice. This situation may undermine the perception that the tax system is horizontally equitable. Taxpayers may suspect that others are paying less tax not because they have lower ability to pay, but rather because they have better access to knowledge about the details of the system. If these feelings are widespread they may contribute to a feeling that the system is not fair.

A very simple tax system, however, may rank low from the equity and efficiency viewpoints. For example, a complete measure of income includes all fringe benefits. The failure to tax all fringes may lower the equity of the system by not imposing equal taxes on individuals with equal income; the efficiency of the system would be lowered because artificial incentives would be created for greater consumption of these benefits. However, it may be quite complex to define the rules necessary to tax certain forms of fringe benefits. Thus, as with other elements of tax policy, a balance must be struck among competing objectives.

D. Stimulating Other Activities

Some provisions of the tax law have been enacted to encourage particular activities rather than to promote the goals discussed above. For example, when Congress enacted tax credits for energy conservation expenditures, it did so not to increase the equity, efficiency, or simplicity of the tax system, but rather to increase spending on goods which reduce energy consumption. This subsidy could have been provided through a spending program, but, instead, the tax system was chosen as the means by which the subsidy was administered.

In certain cases, there are advantages to providing subsidies through the tax system, since it provides an administrative mechanism, already in place, reaching a large majority of the American public.

At the same time, providing the subsidy through the tax system rather than some other mechanism may tend to interfere with the equity of the tax system. These subsidies result in a system in which tax liability is not made equal for taxpayers with equal ability to pay, and they change the relationship of tax liabilities for taxpayers with different levels of ability to pay. Further, such subsidies make the system more complicated, and may raise questions of efficiency. Although the provision of these subsidies through another administrative mechanism also would involve similar issues of equity, efficiency, and simplicity, taxpayers' perceptions of the workings of the entire tax system may be affected when they are administered through a tax mechanism.

II. CHARACTERISTICS OF COMPREHENSIVE TAX PROPOSALS

The Appendix to this pamphlet provides a description of the comprehensive tax proposals which have been introduced in the 97th Congress. While the details of these bills vary substantially, it is useful to categorize into five groups the changes these bills would make in the present tax system:

(1) The bills generally would expand the tax base by repealing a variety of deductions, exclusions and credits in the present system.

(2) Marginal tax rates applied to the base would be lowered substantially.

(3) The degree of steepness in rate schedule, the rate at which marginal tax rates increased with income, would be reduced.

(4) The aggregate distribution of tax burdens by income class would be altered by some of the proposals.

(5) The total amount of revenue raised by the corporate and individual income taxes would be changed by some of the proposals.

This part of the pamphlet considers some of the features of the present income tax which are relevant to these issues and contains a general discussion of them.

A. Changes in the Tax Base

All of the proposals under discussion would make substantial changes in the tax base. In all cases, significant items not now subject to tax would be included in the base.

Many of the proposals appear to adopt a relatively comprehensive definition of income as the primary basis for taxation. The designers of most of the proposals appear to have made the judgment that income is the best measure of taxpaying capacity and that taxpayers with equal income should have equal tax liability. In addition, it appears that they believe that many of the exclusions, deductions, and credits in the present system are inequitable, inefficient, or complex, or at least have decided that the benefits that these provisions may have are outweighed by the advantages of the other changes made by the bills, such as reductions in marginal tax rates.

Important background for analyzing these base-broadening proposals is provided by comparison of the amount of income actually subject to tax under the present individual income tax and the income recorded in the national income and product accounts. Table 1 presents the relationship between gross national product and taxable income in the United States in 1980.

Gross national product was more than double the estimated individual income tax base—$2.6 trillion versus $1.0 trillion. The $1.6 trillion dollar difference is composed of two parts. First, about $0.2 trillion of income items are included in the tax base but not gross national product. These include government subsidies, certain interest income, transfer payments, capital gains and taxable pensions and income of subchapter S corporations. Although not included in GNP, many would argue that these are properly includible in an income tax base. In fact, substantial additional portions of transfer payments and capital gains would be subject to tax under the proposals.

TABLE 1. RECONCILIATION OF GNP AND TAXABLE INCOME, 1980

Item	*Amount ($ billions)*
Gross national product	2, 633. 1
−Depreciation	−293. 2
−Indirect business taxes	−213. 0
−Statistical discrepancy	−3. 9
+Government subsidies	+5. 5
−Corporate retained earnings	−125. 7
−Employer social insurance contributions	−115. 3
+Net interest paid by government and consumers	+75. 7
+Taxable government transfers	+21. 1
−Fringe benefits excluded from AGI	−125. 4
−Imputed income in GNP	−59. 3
−Investment income of insurance companies and pension funds	−45. 0
−Investment income of nonprofit organizations and fiduciaries	−18. 8
−Differences in accounting treatment between GNP and AGI	−12. 1
−Income of nonfilers and unreported income	−150. 8
−Other discrepancies between GNP and AGI	−25. 6
+Capital gains in AGI	+28. 5
+Taxable private pensions	+29. 4
+Subchapter S corporation income	+0. 9
Adjusted gross income	1, 606. 3
−AGI on nontaxable returns	−58. 9
−Medical deduction	−12. 4
−Tax deduction	−67. 3
−Interest deduction	−84. 7
−Charitable deductions	−24. 7
−Other deductions	−15. 2
+Floor under itemized deductions (zero bracket amount on itemizing returns)	+87. 0
−Personal exemptions	−185. 6
Taxable income on taxable returns (level deficits)	1, 244. 5
−Deduction equivalent of tax credits (estimated)	−27. 0
−Zero bracket amount	−212. 8
Tax base (estimated)	1, 004. 7
Income tax after credits	247. 5

Sources: *Survey of Current Business*, July 1982; *Statistics of Income: SOI Bulletin, Winter 1981–82;* Internal Revenue Service; and staff estimates.

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The second component of the difference between GNP and taxable income is approximately $1.8 trillion of income and deduction items which are included in GNP but not in the tax base. Much of this difference, however, would not be available for net base broadening under a revised income tax. First, approximately $0.5 trillion consists of depreciation and indirect business taxes, which may be considered as costs of earning income. (However, some of the bills described in the appendix appear to deny deductions for these items.) Second, $0.1 trillion of income is not reported; subjecting this amount to tax would depend on compliance measures rather than changes in the statutory tax base. Third, corporate retained earnings were approximately $0.1 trillion. This amount already is subject to tax at the corporate level, and thus a substantial portion of this may not be available for broadening the combined base of the corporate and individual taxes. Fourth, the $0.4 to $0.5 trillion accounted for by the zero bracket amount, personal exemptions, adjusted gross income on nontaxable returns, and income of nonfilers whose income is below the filing requirement is most usefully thought of as part of the rate structure. (Equity considerations lead the designers of all these proposals to exempt some amount of income from tax, using either a zero bracket amount, personal exemptions, tax credits or a combination of these approaches.) The total of these four amounts generally not available for base broadening is approximately $1.2 trillion. Thus, of the $1.8 trillion of items not included in the tax base under the present system, about $0.6 trillion could realistically be included in the base of a comprehensive tax on net income. This consists of about $0.4 trillion of fringe benefits, investment income of pension plans and nonprofit organizations, and other items not included in adjusted gross income, and about $0.2 trillion of itemized deductions and tax credits. If these items had been included in taxable income in 1980, the tax base would have been approximately 60 percent larger.

The proposals summarized in the appendix broaden the tax base considerably by increasing the amounts of capital gains, transfer payments, fringe benefits, investment income and other income items included in the tax base and reducing allowable deductions and credits. At this time, however, a quantitative analysis of the extent of this base broadening for each proposal is not available.

B. Lowering Marginal Tax Rates

In all of the proposals, marginal tax rates are substantially reduced. This reduction appears to be motivated by efficiency and equity considerations.

Efficiency

Many economists would agree that high marginal tax rates can cause considerable economic inefficiency, both by interfering with the incentives for work and saving, and by magnifying the effects caused by differences between the tax base which may be chosen purely for efficiency reasons and the base which actually is implemented in the law.

An individual's marginal tax rate is the rate applicable to the last or to the next dollar income received. If an individual is subject to a 25-percent marginal rate, then the return to additional work effort and saving is reduced by 25 percent. For example, if this individual is considering working on an overtime assignment which pays $40, then the after-tax reward to this work effort is $30. A higher marginal tax rate would reduce the return to this work effort even further, affecting the incentive to undertake the assignment. A similar point may be made with respect to investment decisions. If the individual with a 25-percent marginal rate invests in a security with a 10-percent return, the after-tax return would be 7.5 percent. Thus, the marginal tax rate affects the incentive to save rather than use the same resources for current consumption. The same reasoning may be used to show that marginal tax rates also influence the incentives to engage in activities which are heavily taxed versus those which are lightly taxed. With high marginal rates, for example, there is more incentive to invest in lightly taxed investments or to take jobs in which a high proportion of compensation is in the form of non-taxable fringe benefits than would be the case with low marginal rates.

Effect on labor supply

The effect of changes in marginal tax rates in distorting incentives is sometimes referred to as the "substitution effect." Most of the studies which have been performed on the effect of after-tax wage rates on work effort have found that the substitution effect of after-tax wage changes in hours worked is quite small for husbands but rather large for wives, especially wives with children. Since the substitution effect is measured by holding after-tax income constant, this is the proper measure of the incentive effect of a marginal rate reduction, as opposed to the "income" effects which would occur because of the income increase attributable to any tax reduction. This empirical finding is confirmed in one of the most recent and sophisticated studies,[1] except that a significant substitution effect is found for husbands, as well as wives. Thus, these studies indicate that if marginal tax rates were lowered, holding other factors (including after-tax income) constant, some individuals would be willing to work a larger number of hours. This could be manifested as greater willingness to work full-time instead of part-time, greater acceptance of overtime assignments, less absenteeism, and a larger number of individuals in the labor force.[2]

It should also be noted that there are several other possible impacts of marginal tax rates on work-related activities. First, it has been argued that reduction in marginal tax rates could improve compliance with the income tax, although there is little evidence which bears directly on this question. Second, it has been argued that high marginal tax rates have induced employees to demand a larger portion of their compensation in the form of tax-free fringe benefits, such as

[1] Jerry A. Hausman, "Labor Supply," in Henry J. Aaron and Joseph A. Pechman, eds., *How Taxes Affect Economic Behavior*, Brookings Institution, 1981.

[2] It should be noted that a tax proposal which raised after-tax income could have offsetting "income" effects because some individuals would respond to their additional income by taking more leisure time. Thus, the evidence of a significant substitution effect does not mean that a tax cut would increase labor supply, only that a cut in marginal tax rates offset by other changes in after-tax income would do so.

health insurance, than would be the case with lower marginal rates, and this substitution of fringe benefits for cash may reduce the efficiency with which the economy satisfies employees' needs. To the extent that such effects exist, they would be lessened if marginal tax rates were lowered.

Effect of marginal tax rates on saving

If an individual saves a dollar rather than spending it on current consumption, he or she generally will be able to have in excess of one dollar available for consumption in a future period. The amount of this excess depends on the return available for funds saved and on the marginal tax rate applicable to this return. The quantity of consumer goods which can be purchased in the future with a given amount of money will depend on the rate of inflation. Thus, the after-tax return (adjusted for inflation) determines the extra future consumption that a person can have by saving and thus sacrificing one dollar of current consumption. The lower the after-tax return, the more attractive is the option to consume now rather than save. As an important determinant of the after-tax return, the marginal tax rate is likely to affect this choice.

As in the above analysis of work effort, it is important to distinguish between the income and substitution effects of marginal tax rate changes on the choice between current and future consumption. Any tax reduction, including a reduction in marginal rates, will increase after-tax income and thus generally will lead to an increase in both current and future consumption. However, as discussed above, marginal tax rate reductions also would have incentive, or substitution, effects, because they change the rate at which the taxpayer can trade off between current and future consumption. This discussion emphasizes the substitution effects, which are unique to marginal tax rate reductions and which measure the economic inefficiency created by taxes.

Three distinct sources of concern with high marginal tax rates have been cited by economists who have analyzed the effects of the income tax on current and future consumption. The first concern is the effect of the marginal tax rates on individuals' incentives to consume in current rather than future periods; the second is the effect of marginal tax rates on aggregate saving, investment, and productivity; and the third involves the effect of the tax system on the composition of saving as a result of its effect on incentives to invest in lightly taxed versus heavily taxed activities and its incentive to borrow—the deduction for non-business interest.

The fact that the marginal tax rates implicit in the current income tax discourage future consumption creates a distortion (relative to a tax system with a marginal rate of zero, such as a *per capita* head tax). The importance of this distortion depends on the responsiveness of future consumption to a change in the after-tax rate of return on saving, holding income constant. Empirical studies of this sensitivity are much less numerous than those of labor supply response. The methodological difficulties of studying the responsiveness of consumption to the rate of return are greater because the expected real return (net of expected inflation) must be measured and because the statistical analysis must be performed using time series of observations on total U.S. income and consumption. This methodology requires the assumption that the quantitative relationships among the variables have been unchanged for a long period of time. In spite of these methodological problems, empirical studies do indicate that individuals' plans for future consumption are sensitive to the after-tax rate of return. The marginal tax rate on capital income also may affect the choice between labor and leisure, as well as the choice between present and future consumption. For example, a greater after-tax rate of return may make it more attractive for individuals to work for the purpose of increasing their consumption in retirement years. However, this sort of effect has not been firmly substantiated in empirical research.

The second major concern which has been raised concerning the effect of marginal tax rates on capital income has been their effect on aggregate savings and, thus, investment and productivity. For a variety of reasons, however, the link between aggregate investment and the marginal tax rates in the individual income tax is very uncertain. First, investment may be affected much more directly by other factors, such as the tax treatment of depreciation allowances. Second, the effect of income tax changes on private saving could be offset to the extent that there is a revenue loss, which leads to less government saving. Finally, even though it is likely that a higher after-tax return may increase future consumption, it is not clear as a theoretical matter that personal savings would increase simultaneously. This is the case because a higher return on savings actually lowers the amount which an individual needs to save in the current period in order to achieve any future consumption goal. Personal saving would increase in response to an increase in the after-tax rate of return only if desired future consumption increases sufficiently to offset this effect. Whether this is, in fact, the case can be determined only by empirical studies. Although these studies are extremely difficult to perform for the reasons discussed above, there is some indication that future consumption may be stimulated sufficiently by increasing the after-tax return that total personal saving may increase modestly in response to such a change.

The income tax also influences decisions about the particular forms in which taxpayers do their saving, which affects the allocation of capital in the economy. The first concern is that the income tax imposes heavier tax rates on some activities than others (e.g., tax shelters, owner-occupied housing, and precious metals). This provides an incentive to shift from the heavily taxed activities, which may be more productive, to lightly taxed activities. The size of this incentive depends on the marginal tax rate. Thus, it is argued, reducing the marginal tax rate may encourage individuals to shift from less productive to more productive forms of saving. The second concern relates to the present law deduction for non-business interest. Since this provision is, in effect, an encouragement for borrowing, i.e., dissaving, it is argued that reducing marginal tax rates could encourage saving by reducing the incentive to borrow. Finally, it is argued that because the income from assets subject to capital gains treatment is taxed only when the assets are sold, high marginal tax rates discourage sales and prevent these assets from being employed in their most efficient uses. Thus, lower marginal income tax rates could increase efficiency by reducing this "lock-in" effect.

The bills discussed here tend to take several approaches to improving saving incentives. All of the bills attempt to achieve greater uniformity in the tax treatment of saving and income from capital by reducing or eliminating preferential treatment for certain types of saving relative to others. Also, the bills reduce marginal tax rates, which reduces the adverse impact of whatever distortions remain. Some of the bills, however, go farther than this and attempt to structure a system in which the effective tax rate on saving is zero. (See S. 2147 and H.R. 6628).

Equity

From an equity perspective, reducing marginal tax rates also may be viewed as desirable. Many argue that it is unfair for a high portion of each additional dollar of income earned by an individual to be absorbed as increased tax liability. In passing the Economic Recovery Tax Act of 1981, Congress lowered the highest marginal rate in the tax schedules from 70 percent to 50 percent. Much of the discussion of this change involved the belief that a marginal tax rate as high as 70 percent caused undue interference with the incentives for efficient economic performance. However, another important source of support for this reduction was the feeling that it was unfair for the tax system to claim more than half of each additional dollar earned by taxpayers. Presumably, this indicates that one accepted equity objective of tax policy is to keep marginal tax rates below some threshold level.

C. Reducing the Progressivity of the Rate Schedules

The authors of the proposals appear to believe that it is desirable to reduce significantly the number of tax brackets in the rate schedules and to reduce the difference between the bottom and top rates of the income tax. Several of the proposals have one flat tax rate that applies to all income not exempt from taxation.

It is important to emphasize that the issue of the degree of progressivity in the rate schedules is to a large extent independent of the broad vertical equity issue of the relative distribution of tax burdens by income class. For example, during 1981 the Ways and Means Committee considered a proposal to reduce the number of brackets in the rate schedule, to widen the first bracket so that a majority of taxpayers were subject to the same tax rate, and to increase the personal exemption and zero bracket amount to offset the rate increases imposed on the lowest income taxpayers. These revised rate schedules produced approximately the same amount of progressivity as under prior law. Thus, some flattening of the rate schedule is possible even without large changes in the distribution of the tax burden.

There are several advantages to a flat or flattened rate schedule. For example, if taxpayers are more likely to be in the same tax bracket over a period of years, tax considerations would be less likely to influence the timing of transactions. This would reduce one of the sources of inefficiency of a progressive rate schedule. If most taxpayers faced the same tax rate, there would be less incentive to shift income to low bracket family members, which may improve the perception of equity in the system. The difference in tax treatment between married couples and single individuals would be reduced, since, in a system in which married couples may pool their income and file a joint return, this difference arises from the fact that the amount of income taxed at each rate depends on marital status. Finally, a flatter tax rate would allow a closer correspondence between amounts withheld and tax liability. In a system in which the tax rate did not depend on taxpayer's income, as is the case under the present social security payroll tax, withholding could be closer to tax liability in the vast majority of cases.[3]

It should be emphasized that although some flattening is compatible with a progressive distribution of tax burdens, that is, a system in which tax liability as a percentage of income increases as income rises, adopting a rate schedule with just one rate would impose strict limits on the degree of progressivity which could be obtained. Some progressivity could be attained by exempting some fixed amount of income from taxation for all individuals, but the pattern of progressivity in the present system (discussed below) probably could not be duplicated.

D. Changing the Distribution of Tax Burdens by Income Class

One of the central issues in analyzing an alternative proposal is the relationship of the tax burdens of taxpayers with different levels of income. Table 2 presents the average tax rate projected under present law for 1984. In preparing this table, taxpayers were sorted into categories according to their expanded income, a concept somewhat broader than the present definition of adjusted gross income. This is not a comprehensive definition of income, since it does not take account of many additional items which might be included in the tax base under alternative proposals or other possible changes in the measurements of income. In addition, it does not reflect the income and tax liability of the corporations in which individuals own shares. However, using expanded income probably provides a good indication of how progressive the system would appear if the tax base was more comprehensive.

As shown in Table 2, the present individual income tax system exhibits a substantial degree of progressivity. The average tax rate rises from a negative figure in the bottom class (owing to the refundable earned income tax credit) to about 25 percent in the highest class. The rate in the highest income class is approximately double the average tax rate.

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[3] Currently there is about $50 billion of overwithholding and $30 billion of underwithholding. A change that eliminated most of the overwithholding, especially if it did not reduce the underwithholding significantly, could have major effects on budget receipts in the year it first took effect unless it were phased in.

TABLE 2.—AVERAGE TAX RATE ON EXPANDED INCOME UNDER PRESENT LAW, 1984 [1]

[1981 Income Levels]

Expanded income [2] (thousands)	Expanded income (millions)	Tax liability [1] 1984 (millions)	Average tax rate (tax liability divided by income, percent)
Below $5	$17,502	−$252	−1.4
$5 to $10	98,683	4,736	4.8
$10 to $15	162,784	12,531	7.7
$15 to $20	188,211	17,523	9.3
$20 to $30	416,709	44,285	10.6
$30 to $50	509,658	64,344	12.6
$50 to $100	230,678	39,111	17.0
$100 to $200	83,904	18,931	22.6
$200 above	67,540	16,731	24.8
Total	1,775,669	217,938	12.3

[1] This is preliminary data. Tax liabilities include the refundable portion of the earned income credit, but do not include changes made to individual retirement account, ACRS and other provisions by the Economic Recovery Tax Act of 1981 for which tax return data are not available.

[2] Expanded income equals adjusted gross income plus excluded capital gains and various tax preference items less investment interest to the extent of investment income.

Choosing a pattern of distribution by income class depends primarily on the vertical equity considerations discussed above. As noted before, this is largely a matter of value judgment. Some argue that the present distribution pattern should be preserved in any alternative proposal while others may believe that the present distribution is either too progressive or not progressive enough. In addition, efficiency may be a consideration in the selection of the distribution of tax burdens, because the relatively high marginal tax rates on higher income taxpayers necessary to achieve the desired distribution may result in a significant increase in the inefficiency caused by the system.

E. Achieving Specified Revenue Targets

One of the key decisions which must be made in analyzing or designing a comprehensive tax proposal is the choice of a revenue target. Clearly, if there is substantial base broadening with no changes in marginal tax rates, total revenue will be increased, and if marginal tax rates are lowered without changing the tax base, total revenue will be reduced. Several of the proposals appear to be designed so that the new combination of tax rates and tax base would produce approximately the same revenue as is expected under present law for either 1983 or 1984. However, if a judgment is made that this level is either too low or too high, base broadening and tax rate decisions can be adjusted accordingly.

F. Conclusion

Each of the comprehensive tax proposals under discussion would make changes in at least several of the five areas discussed above. It certainly would be possible to achieve base broadening by itself, although this would change the total revenue raised and the pattern of distribution by income class. Similarly, a proposal could be designed to reduce progressivity in the rate schedules while leaving the tax base, the distribution by income class, and total revenue unchanged. Marginal rates could be reduced or increased, making no changes in the tax base, but total revenue obviously would change. Even though the five areas may be logically distinct, substantial changes in any one of these areas appears to bring into consideration other objectives. The balance among these objectives depends on the equity, efficiency, simplicity, and other tax policy consideration discussed in the first part of the pamphlet.

III. ISSUES IN DESIGNING THE TAX BASE

A. Overview

One definition of a person's income is the amount he could potentially consume over a period of time without reducing his wealth. Under this definition, income during a year would equal the person's actual consumption in the year plus the increase in his wealth (i.e., his savings) between the beginning and the end of the year. This, in turn, would equal the sum of wages, interest, dividends and other receipts, minus costs incurred in earning income, plus any appreciation, realized or unrealized, in the value of the person's wealth.

The present income tax base differs from this theoretical "accretion" concept of income in a number of respects. These can be divided into ways in which the basic tax structure fails to correspond to a pure income tax (structural tax issues) and specific tax provisions which are intended to provide incentives for taxpayers to engage in particular activities or to provide relief for particular types of taxpayers (tax expenditures).

B. Structural Tax Issues

Five of the principal structural income tax issues are the following:

(1) The definition of income from capital and the treatment of borrowing during periods of inflation.

(2) The taxation of corporate-source income, including the double taxation of dividends and the treatment of retained earnings.

(3) The treatment of noncash income.

(4) The treatment of unrealized income.

(5) Whether a tax on consumer expenditures would be more appropriate than an income tax.

This section of the pamphlet discusses these five structural issues.

Indexing the definition of income for inflation

Inflation creates a problem for an income tax because it increases the difficulty of defining taxable income from capital and of properly treating borrowing. A proper definition is necessary if ability to pay is judged to be measured by income and if efficiency considerations call for equal tax rates on income from various activities. This problem is most easily seen by considering a case in which a person buys an asset for $50,000, holds it for a period during which the general price level doubles, and sells that asset for $100,000. In reality, the taxpayer has experienced no real increase in his wealth and has no income from the sale of the house; the purchasing power sacrificed in order to buy the house is exactly equal to the purchasing power represented by the sale of the house. However, under present law, the taxpayer must report a long-term capital gain of $50,000, forty percent of which is included in adjusted gross income.

A similar problem arises in measuring depreciation. In theory, depreciation should be a measure of the real loss of value of an asset during a time period. If a taxpayer buys a building for $50,000, he is presently able to claim cost recovery deductions amounting to $50,000 over a 15-year period. However, if inflation occurs during that period, the purchasing power represented by the cumulative cost recovery deductions will be less than that sacrificed to purchase the building, and real income will not be measured exactly. The same problem arises in inventory accounting when businesses use the first-in, first-out (FIFO) method of accounting in periods of inflation, since increases in the value of inventory from inflation are treated as taxable income even though the increase does not result in any real increase in asset values.

The treatment of debt in periods of inflation also fails to conform to an exact measure of real income. Inflation enables the borrower to repay debt with less valuable dollars, which represents income to the borrower that currently goes untaxed. To the extent that interest payments rise to compensate for anticipated inflation, the additional interest is deductible. Conversely, the erosion of the real value of indebtedness is a cost to the lender that he is currently unable to deduct, even though any additional interest to compensate for artifical inflation is included in taxable income.

It should be noted that the issues discussed here relating to the definition of the income tax base are entirely separate from the effect of inflation in narrowing the real width of the tax brackets and reducing the real value of the personal exemption and the other fixed dollar amounts used to determine tax liability (so-called bracket creep). For the individual income tax for years after 1984, bracket creep was largely eliminated by the indexing provisions of the Economic Recovery Tax Act of 1981.

One way to deal with these definitional problems would be to enact a full-fledged indexing program in which the definition of income from capital and the treatment of debt would be adjusted for inflation so as to achieve an accurate measure of real income. This would involve the following specific changes: (1) indexing the basis of assets by the rate of inflation for purposes both of computing gain or loss on the sale or exchange of those assets and of computing depreciation, depletion and other capital cost recovery deductions, (2) adopting a new system of inventory accounting in which costs would be indexed for inflation, (3) requiring borrowers to include in taxable income the gain that results when inflation erodes the real value of their debt, and (4) allowing lenders to deduct the loss that results when inflation erodes the real value of debt.

While the tax-writing committees have never considered such a complete indexing program, there has been serious consideration of some of its elements. In its version of the Revenue Act of 1978, the House passed an indexing adjustment to basis for capital gains and losses on corporate stock, real estate, and tangible personal property. In its version of the Tax Equity and Fiscal Responsibility Act of 1982, the Senate passed a similar provision applying to corporate stock and real estate. Indexing basis for purposes of computing depreciation deductions was discussed in the context of depreciation reform in 1980 and 1981.

There is little disagreement that a comprehensive income tax would not reach an accurate definition of income without indexing. However, full-fledged, exact indexing would add a good deal of complexity to the tax system, particularly the exact indexing adjustments for inventory accounting, borrowing and lending. Thus, in practice the choice is probably between partial indexing, limited to capital cost recovery and measurement of gain and loss, and no indexing at all. Even such a program of partial indexing would add some complexity, which might not be worth the effort at sufficiently low rates of inflation.

In place of indexing the definition of income, Congress has adopted several *ad hoc* approaches to alleviating the distortions created by inflation. The last-in, first-out (LIFO) method of inventory accounting is, in most cases, an adequate substitute for a more complicated indexed system. The exclusion for 60 percent of long-term capital gains and the ACRS method of recovering the costs of equipment and structures were both motivated, in some degree, by a desire to offset some of the distortions in income measurement caused by inflation. Furthermore, the distortion caused by the failure of the present system to make inflation adjustments for debt is reduced by the fact that the adjustments made by the borrower and lender would, to some extent, offset each other (and would be completely offsetting if the two had identical marginal tax rates).

These *ad hoc* provisions, however, are themselves deviations from what would be appropriate in a comprehensive income tax and create some inequities and distortions which, to a degree, offset the benefits they provide in reducing the distortions created by inflation. For example, an *ad hoc* adjustment, like ACRS or the 60-percent capital gains deduction, will only be accurate at a single rate of inflation, and actual inflation rates are likely to be different.

Thus, there is no entirely satisfactory solution to the problem of properly defining the tax base in periods of inflation. Any solution involves trade-offs between complexity, equity, and various kinds of distortions. Of the bills discussed in the Appendix, only S. 2147 and H.R. 6628 address the inflation problem.

Taxation of corporate income

Corporate integration

Under present law, corporate-source income is taxed at the corporate level under the corporate income tax. In addition, dividend distributions are taxed under the individual income tax, and increases in the value of corporate stock that result from earnings retention are taxed as capital gains to the shareholder. Clearly, this system does violence to the principle that all income be taxed alike. Dividends may be subject to a combined corporate and individual tax burden as high as 73 percent.[1] Retained earnings bear a 46-percent corporate tax plus a capital gains tax when the shareholder sells his stock. Corporate-source income, therefore, will generally be taxed at the same marginal tax rate as other kinds of income only in the case of corporations with zero marginal tax rates (i.e., negative taxable income or excess credits)

[1] For example, consider $100 of corporate-source income before taxes. There will generally be a corporate income tax of $46. If the remaining $54 is distributed as a dividend to a taxpayer in the 50-percent bracket, the individual income tax will be $27, for a combined tax burden of $73.

who pay out all their earnings as dividends. In other cases, corporate-source income will be taxed more or less heavily than the shareholder's ordinary income.

The present system is held responsible for creating economic inefficiency by distorting several types of business decisions. Shareholders (especially those in relative low tax brackets) have an incentive to invest in assets other than corporate stock in order to avoid double taxation. Corporations have an incentive to finance their operations with debt rather than equity because interest payments are deductible (and hence not subject to double taxation). Corporations also have an incentive to retain earnings, rather than pay out dividends, to avoid double taxation if they can ultimately distribute that money to shareholders as part of a liquidation or in connection with a takeover, the proceeds from which are usually subject to tax at capital gains rates. These distortions caused by the present system of taxing corporations have been blamed for reducing capital formation and productivity growth, preventing the allocation of capital to its most efficient uses, weakening the nation's financial structure through excessive reliance on debt, and encouraging mergers and acquisitions.

One way to treat corporate-source income would be to tax all of it, dividends and retained earnings, as if it were earned directly by shareholders. This is essentially the way subchapter S corporations are treated today. The corporate income tax could be retained as a withholding tax, for which shareholders would receive a refundable credit on their own tax returns just as they do for the present withholding taxes on wages, interest and dividends.

Unfortunately, when applied to large corporations, this type of complete integration of the corporate and individual income taxes presents serious technical problems.[2] As a result, much more attention has focused on simply reducing or eliminating the double taxation of dividends, without modifying the treatment of retained earnings. This can be done either through the dividend deduction approach or the shareholder credit approach.

The dividend deduction approach is the simplest way to eliminate double taxation of dividends. Corporations simply deduct their dividends paid in determining taxable income, in effect exempting from the corporate income tax whatever income is distributed as dividends, leaving that income to be taxed once at the shareholder level.

Under the shareholder credit approach, a shareholder would make two adjustments. First, he would "gross-up" the amount of the dividend included in gross income by the amount of the corporate tax deemed paid with respect to that income. Second, he would claim a refundable tax credit for the amount of the gross-up. If the shareholder credits with respect to a corporation's dividends exceeded the amount of corporate tax actually paid by the corporation, it would have to pay an additional tax to make up the shortfall.[3]

[2] For example, consider the situations in which two corporations own stock in each other. Neither would know how much income to report until it had heard from the other how much were the other's retained earnings. Also, there would be problems in tracing audit adjustments at the corporate level through to each of the shareholders.

[3] Under many integration proposals, the amount of the gross-up would be determined by a simple arithmetic formula whereby the shareholder would multiply his dividend by 1.85 regardless of the amount of tax the corporation actually

A number of considerations are relevant in choosing between these two approaches. The dividends-paid deduction is simpler. However, the shareholder credit provides flexibility under which, for example, the credit can be denied to tax-exempt organizations and foreign shareholders for whom there is no U.S. double taxation. This would reduce the revenue impact.

The argument for relieving the double taxation of dividends is stronger to the extent that the corporate income tax base is broadened. One problem that arises with the present relatively narrow corporate tax base is that many profitable companies have zero or low marginal tax rates because they use tax preferences, while others are subject to the top 46-percent marginal tax rate. These differences create inequities and distortions between firms, which would be exacerbated if a new deduction for dividends paid or shareholder credit were added to the system. On the other hand, the arguments for relieving the double taxation of dividends is weaker to the extent that marginal tax rates in the individual and corporate income taxes are reduced from their present levels, since the size of the distortions caused by double taxation are directly related to these marginal rates. In addition, eliminating double taxation would narrow the tax base and thus preclude further opportunities for reducing marginal rates.

Of the bills discussed in the Appendix, only S. 2147, S. 2557 and H.R. 6628 eliminate double taxation of dividends. They exclude dividends from the individual tax and, except for S. 2557, set the corporate tax rate equal to the individual tax rate.

Consistent treatment of corporations and individuals

Another structural issue is the extent to which there should be consistency between the corporate and individual income taxes, both in terms of the tax bases and the tax rates. For example, if certain tax benefits are provided to corporations and not individuals, there may be an incentive to conduct business in the corporate form and there may be inequities and competitive advantages in favor of corporate business. Also, if the corporate tax rate exceeds the top individual tax rate and there is no double taxation of dividends, corporations will have an incentive to pay out earnings as dividends up to the point where their dividends-paid deduction exhausts their taxable income. This would represent a significant change in the pattern of corporate finance.

Noncash income

Income that is received in a form other than cash often presents problems in an income tax, particularly when the cash value of the income is hard to determine. The principal types of noncash income include compensation for services paid as fringe benefits and imputed rent on owner-occupied homes and consumer durables.

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paid. This is derived as follows: Assume $100 of corporate pre-tax income. The corporate income tax is $46, leaving $54 to be distributed as a dividend. Thus, if the shareholder multiplies his dividend by 1.85, he will include the full $100 in income ($54×1.85=100). The shareholder's credit, then, would be 85 percent of the dividend, or $46. If the corporation actually paid only $40 owing to tax preferences, it would have to pay an additional tax of $6.

Fringe benefits

Present law excludes certain statutory fringe benefits from gross income and, in theory, taxes all other fringe benefits.[4] In most cases, the statutory fringes were intended by Congress as tax incentives for employers to provide compensation in particular ways, and some of the statutory provisions contain restrictions designed to carry out Congress' intent that these fringe benefits should be widely available (e.g., coverage requirements for qualified pension plans).

Although the Internal Revenue Service has prescribed consistent rules for the treatment of some fringe benefits (e.g., an employee's personal use of a company car), many other fringe benefits, while theoretically subject to tax, have been treated haphazardly because employers and the IRS have difficulty valuing these benefits and attributing them to particular employees. Thus, precisely what nonstatutory fringes are actually taxed and how they are valued may vary from one IRS district to another, and Congress has enacted riders on appropriations bills and statutory changes to block the Service's attempt to issue regulations to create greater uniformity.

Under the bills discussed here, the tax base would be broadened by repealing some of the present exclusions for fringe benefits. These benefits, including the nonstatutory fringes discussed above, may be difficult to tax for several reasons. First, how are the benefits to be valued? When an airline provides free travel to its employees, for example, what airfare is to be used in determining the employee's income, given that the passengers on the plane may be paying several different fares and that the employee may be flying on a standby basis with a lower priority than any of the regular passengers? Are the fringes to be valued based on the employer's cost (which may be very low in the case of standby travel) or the fair market value of the benefits? Second, how are benefits made available to employees as a group (such as term insurance or a tennis court) to be allocated to the individual employees?[5] In selecting the treatment of fringe benefits, the problems of inexact and complex valuations would have to be balanced against the equity and efficiency advantages of a broader tax base.

Imputed income

The two principal types of imputed income are rent on owner-occupied homes and consumer durables. In a pure income tax, a homeowner would be treated as someone in the business of renting his house. He would report as income the fair market rental on the house (imputed rent) and deduct all the costs associated with the house, including interest, taxes, utilities and depreciation. Under present law, imputed rent is not taxed, deductions are allowed for interest and taxes,

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[4] The statutory fringe benefits excluded from gross income are meals and lodging furnished for the convenience of the employer (sec. 119), educational assistance (sec. 127), prepaid legal services (sec. 120), child care (sec. 129), accident and health premiums (sec. 106), qualified pension plans (sec. 401), group-term life insurance (sec. 79), a $5,000 death benefit exclusion (sec. 101(g)), the rental value of parsonages (sec. 107), and incentive stock options (sec. 422A). However, the employer is denied a deduction for the bargain element of incentive stock options.

[5] Allocation would not be necessary in a flat-rate system with the corporate tax rate equal to the individual rate because businesses could simply be denied a deduction for certain fringe benefits, which could be excluded at the individual level.

and deductions are denied for utilities, depreciation and most other costs associated with homeownership. Thus, the tax preference for homeownership equals the imputed rent minus the nondeductible costs.[6] Consumer durables are treated the same way; no imputed rent is included, but a deduction is allowed for "consumer" interest and taxes.

Few people seriously propose taxing imputed rent on owner-occupied homes or consumer durables because valuing the rentals would be extremely complicated and there is a public policy to encourage homeownership.[7] Rather, proposals to scale back the homeowner and consumer durable preferences generally take the form of limits on, or repeal of, the mortgage or consumer interest and property tax deductions. Like most *ad hoc* approaches, however, these are not entirely free from problems of their own. Unless it were accompanied by repeal of the deduction for other nonbusiness taxes, repeal of the property tax deduction would be viewed as discriminating against those States and localities that rely disproportionately on the property tax. Limits on, or repeal of, the mortgage and consumer interest deductions tend to cut back the preference in proportion to the extent that the taxpayer finances his home or durables with debt, rather than equity, and such a nonuniform scaling back of preferences may make the system less, rather than more, equitable. Furthermore, there is a practical problem that money is fungible and that there is no real economic distinction between mortgage and consumer interest, on the one hand, and other kinds of interest that are legitimate deductions in a tax on net income, on the other.

These types of considerations lead to other proposals for reducing the distortions and inequities associated with the treatment of interest and homeownership. Some have proposed that taxpayers who rent their home receive a tax benefit designed to put them on more equal footing with homeowners. Also, it has been suggested that all interest deductions be limited to investment income. None of the bills discussed in the Appendix attempt to tax imputed rent on homes or durables; however, several repeal or limit interest and tax deductions, and S. 2817, H.R. 6944, and S. 2887 limit the nonmortgage interest deduction to investment income.

Unrealized income

Some types of income consist of increases in the value of assets prior to the time when the taxpayer actually receives the income, such as by selling or exchanging the assets. Taxing such unrealized income would present two problems: (1) in some cases, it may be difficult to value the asset in order to measure the income properly; and (2) the taxpayer may not have access to cash with which to pay his tax.

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[6] This is not the way homeowner preferences are treated in the annual tax expediture budgets published by OMB, CBO, and the Joint Committee staff. In those documents, the tax expenditure for homeownership is defined as the mortgage interest and property tax deductions, on the assumption that taxing imputed rent is not a serious possibility. Only for a house which is entirely debt-financed and whose value is equal to its purchase price will the two measures of the preference be similar.

[7] However, it should be noted that the United Kingdom taxed imputed rent on homes for over a century—from the beginning of its income tax to 1963. By that date, the property-value assessments on which the determination of imputed rent was based had been rendered obsolete by inflation, and the U.K. decided to exempt imputed rent rather than update the assessments.

Capital gains and losses is the area where unrealized income creates the most serious problems. Assuming that taxing gains and deducting losses as they accrue is ruled out because of the valuation and liquidity problems,[8] the only alternative is to tax them when realized; that is, when the asset is sold or exchanged or some other recognition event occurs. Because selling an asset is generally within the taxpayer's discretion, a tax on realized gains gives taxpayers an incentive to defer realization in order to postpone the tax.[9] This, in turn, has been a justification for providing preferential treatment for long-term capital gains, the argument being that full taxation of such gains at high ordinary rates would discourage sales of appreciated property to such an extent that it would be counterproductive. Moreover, the fact that realization of gains and losses is discretionary has been the justification for imposing *ad hoc* limits on the deductibility of capital losses.[10] Without such limits, taxpayers who own a variety of assets could realize their losses and defer their gains, thereby escaping tax despite the fact that they had substantial real income. Thus, the treatment of capital gains deviates in a number of respects from what would exist in a pure income tax.

In recent years, Congress has moved towards taxing some unrealized income, generally in areas where the valuation and liquidity problems were not significant, the income tended to be received by sophisticated taxpayers, and there was serious potential for tax avoidance. In 1969, Congress required periodic inclusions of discount income on corporate original issue discount bonds.[11] In 1981, Congress adopted a market-to-market system of accrual taxation for commodity futures contracts.

Tax treatment of saving and borrowing

A number of analysts believe that the individual income tax should be replaced by a tax on consumer spending, which could be a progressive tax just like the income tax. To convert the income tax into a tax on consumer expenditures, it would not be necessary for taxpayers to add up all their purchases of consumer goods and services. Rather, a consumption tax could be implemented through several modifications of the income tax, which make use of the arithmetical result that a person's after-tax income is either spent on consumption or saved. Thus, a consumption tax base could be implemented by starting with an income tax base, allowing taxpayers to deduct all purchases of assets during the year, all tax payments, and all repayment of debt, and requiring them to add to the tax base the proceeds from all sales of assets and from all borrowing.

[8] Some also believe that there would be a constitutional problem with taxing unrealized gains.

[9] Furthermore, the present rule under which an heir steps up the basis of inherited assets to the fair market value for estate tax purposes means that holding onto appreciated property can ultimately result in escaping any income tax on the appreciation.

[10] Currently, individuals may deduct capital losses against capital gains and up to $3,000 of ordinary income. Unused capital losses may be carried forward. Corporations may not deduct capital losses against ordinary income. Their carryforward is limited to 5 years, but they get a 3-year carryback.

[11] In the Tax Equity and Fiscal Responsibility Act of 1982, the inclusion formula was revised and periodic inclusion was extended to noncorporate bonds and stripped coupon bonds.

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Effect on incentives

Proponents of the consumption tax base argue that the income tax, by taxing income from capital, encourages taxpayers to consume their income now rather than save for future consumption and that a consumption tax would not distort this decision. Advocates of the income tax do not generally dispute this proposition but argue that the effect is not large enough to justify a change, that society can increase its saving by reducing government budget deficits and that other economic inefficiencies would be caused by the high marginal tax rates which would be necessary if saving were excluded from the tax base.

Equity

Advocates of the consumption tax also argue that such a tax would be more equitable. Consider a simple example in which two taxpayers each earn $100. One consumes his after-tax income immediately, while the other invests it at 10 percent and consumes the proceeds the next year. Under an income tax with a 50-percent rate, both taxpayers would pay $50 in the first year, but the saver would pay an additional $2.50 on his $5 of investment income in the second year. Under a consumption tax, the taxpayer who spends in the first year would pay $50 that year, while the saver would pay $55 in the second year; that is, the present value of their tax burden would be the same. (Under an income tax limited to personal service income, they both would pay $50 in the first year, so that their tax burdens would be identical in both years.) Proponents of a consumption tax argue that these two taxpayers are similarly situated because they have exactly the same opportunities over the two-year period and that it is equitable for them to pay the same tax either directly (as in an income tax on personal service income) or in present value terms (as in a consumption tax).

Critics of the consumption tax approach argue that a year-by-year comparison is more appropriate than a lifetime perspective and that, from this standpoint, the two taxpayers are only similarly situated in the first year, with the saver better off in the second year and, hence, able to pay more tax that year. They also argue that the equity argument in favor of the consumption tax hinges on treating bequests as consumption and taxing them as such when a person dies. This, however, would be a controversial aspect of any consumption tax, since the bequests would be taxed again when consumed by the heirs. Moreover, taxpayers who are consuming more than their income because they are facing hard times, like the unemployed, would fare worse under a consumption tax than under an income tax, which may not be considered a fair result. Other taxpayers whose burdens would be higher under a consumption tax would include the elderly and parents putting their children through college.

Problems with the income tax

One argument for a consumption tax is that it would moot many of the questions that make it difficult to structure an income tax. A consumption tax would require no special rules for indexing the definition of income from capital and borrowing for inflation, capital gains and losses, depreciation, inventory accounting, or unrealized income. However, some structural problems with the income tax, like the treatment of many fringe benefits and of imputed income, would remain; and the consumption tax would create some new problems, like the treatment of gifts and bequests.

Marginal tax rates

A consumption base would be narrower than a comprehensive income base (although not necessarily narrower than the present income tax base), and higher-income people tend to save a larger percentage of their income than others. Therefore, to raise a given amount of revenue with a given degree of progressivity, the consumption base would require higher marginal tax rates than an income base. These higher rates would increase the ill effects of whatever distortions remained in the consumption tax system.

Transition issues

There would be difficulties in effecting a transition from an income tax to a consumption tax. It would be unfair, for example, to tax consumption out of wealth which had been accumulated out of after-tax income under the prior income tax. A transition rule to prevent such double taxation, however, such as allowing taxpayers to deduct the basis of assets held on the effective date of the consumption tax in order to grandfather consumption out of previously taxed income, would have a large revenue loss in the early years of the tax and would virtually exempt many wealthy people from tax for a period of years.

C. Tax Expenditure Provisions

In addition to addressing the structural problems outlined above, a thorough review of the income tax would have to confront the variety of special provisions that have been added to the law over the years to provide incentive for particular kinds of activities or to provide relief to particular kinds of taxpayers. There are about 100 such tax expnditure provisions, more than one-quarter of which have been enacted since 1976. They include exclusions for certain kinds of income, deductions for costs other than the costs of earning income, tax credits, and tax deferral provisions.

In this regard, there are several important considerations. Tax expenditures have the advantage that they can be plugged into an administrative mechanism through which the government already communicates with a large number of its citizens. Tax expenditures do not generally require separate or detailed application forms, and they are received relatively quickly. On the other hand, most tax expenditures make the tax system more complex for the taxpayer and also reduce the extent to which the public perceives the system to be equitable. In addition, if the tax expenditure takes the form of an exclusion or deduction in a system with progressive rates, it provides a higher rate of subsidy to high-income than to low-income taxpayers, a result which may be undesirable. Unless the tax expenditure is refundable, it will not be available to taxpayers with no tax liability, and if such taxpayers are corporations, they may have a purely tax-motivated incentive to merge with taxpaying units. Tax expenditures may also cause administrative problems for the agency administering the tax system, which may be required to deal with policy issues outside its normal area of expertise. Tax expenditures have also been criticized for being, in effect, entitlement programs which are not reviewed each year as part of the appropriations process and not subject to the controls which the budget process imposes on new entitlement authority. (However, in recent years Congress has tended to put termination dates on many new tax expenditure provisions to encourage periodic review of them.)

Analysis of tax expenditures generally involves two issues. First, whether the nontax policy goal accomplished by the tax expenditure is worth the lost revenue and whatever other tax policy goals are being sacrificed must be decided. This is likely to be based on efficiency (benefit-cost), distributional, and administrative considerations similar to those discussed in the first part of this pamphlet. The second decision is whether other approaches to achieve the nontax policy goal, such as spending or regulation, would be preferable. After reviewing tax expenditure provisions as part of an overhual of the income tax, Congress could decide that the nontax policy goals of certain tax expenditures should be accomplished with spending programs, in which case not all the revenue raised by broadening the tax base would be available to finance tax rate reductions. For example, if the charitable deduction were repealed, Congress might want to enact a spending program under which the Federal Government matches private contributions to charitable organizations. Conceivably, this matching grant program would cost as much as the revenue loss from the deduction.

Most of the bills discussed in the Appendix repeal all, or most, of the tax expenditure provisions and use the resulting revenue gain to finance tax rate reductions.

IV. ISSUES IN TRANSITION TO A NEW SYSTEM

A. General Transition Issues

Hypothetically, if a comprehensive income tax bill were enacted and made effective overnight, taxpayers would experience sharp swings in after-tax income, wealth, and cashflow. Contracts and investments which were profitable under the old tax rules could be rendered unprofitable. Taxpayers who made tax-preferred investments under the old rules would experience an abrupt decline in current (after-tax) income and in wealth—the capitalized value of future income—relative to taxpayers holding ordinary investments. This reduction in taxpayer wealth might be regarded as particularly inequitable when the shelter was designed and encouraged by Congress in order to achieve certain social or economic objectives, as in the case of tax-free municipal bonds. On the other hand, windfall losses due to the elimination of abusive tax shelters would not necessarily be viewed as undesirable tax policy.

Suddn changes in taxpayers' incomes may also create a perception of inequity because taxpayers may find it difficult to adjust their spending patterns to sudden changes in their after-tax income. This is particularly true of changes which affect low- and moderate-income taxpayers.

B. General Transition Rule Options

The goals of wealth protection and time-to-adjust can be achieved by two general types of transition rules: (1) grandfather clauses and (2) phase-in provisions. Grandfather clauses permit (or require) contracts and investments, initiated under the old tax rules, to be governed by the old law. If the grandfather clause is available on an elective basis, the taxpayer can avoid being made worse off as a result of the tax change; while if the clause requires old-law tax treatment, then some windfall gains, due to the tax law change, are also eliminated. A grandfathering provision may apply to all eligible investments or be limited to owner of the investment at the time the change in tax rules was first considered or enacted. If the clause is limited to the original owner, then taxpayers may not be protected against windfall losses if the investment is sold to another, ineligible, investor. If the investment, rather than the owner, is grandfathered, then the owner is protected against a windfall loss even if the investment is sold after the tax law change; indeed, since the grandfather clause creates a limited supply of old-law investments, original owners may reap windfall gains under such a rule. Also, if a tax change has been widely anticipated for a long time prior to enactment, asset values may reflect the likelihood of the change, and a grandfather rule may lead to windfall increases in asset values.

Phase-in provisions may be used to delay the effect of new tax rules on both existing and new investments. With respect to existing investments, a phase-in rule provides temporary and partial protection of asset values compared to an elective grandfather clause. The longer and more gradual a phase-in rule, the more similar it is to a grandfather clause. In the limit, if the new tax rules are only phased-in after existing investments are scrapped, then the phase-in provision is precisely equivalent to a grandfather clause for existing investments. However, since may investments, such as homes, last 30 years or more, very long phase-in rules would be required to effectively grandfather all existing investments. With respect to new assets, the effect of a phase-in period is primarily to slow the rate of transition, thereby allowing taxpayers adequate time to adjust. Phase-in provisions may gradually change tax laws or simply provide a grace period in advance of a major change in rules. Both a gradual phase-in and a grace period moderate wealth changes on existing assets and provide taxpayers time to adjust.

Three criteria for selecting between the alternative grandfathering and phase-in approaches are: (1) effectiveness in achieving the twin goals of moderating adverse wealth effects and providing taxpayers adequate time to adjust, (2) absence of perverse incentives for taxpayers to make non-economic, tax-motivated investments during the transition period, and (3) simplicity of transition rules. It is unlikely that any one transition rule best satisfies all three criteria, so that the choice among alternatives requires judgment about the relative importance of these objectives.

C. Specific Issues in the Transition to a Comprehensive Income Tax

This section surveys some of the specific transition problems associated with eliminating some of the major exclusions and deductions.

Exclusions.—Some of the most important exclusions in the individual income tax are the exclusions for: (1) transfer payments like social security and public assistance, (2) fringe benefits, and (3) 60 percent of capital gains. Including transfer payments in taxable income would reduce the benefit from these payments to recipients whose income exceeds the level at which people begin to pay tax. It would be possible to readjust benefit schedules to compensate for inclusion in taxable income for taxpayers with a particular marginal tax rate, but this could take Federal and State governments a period of several years. To allow for such legislation, it may be appropriate to delay the effective date of repeal of the exclusion for transfer payments or to phase it in. To the extent benefits are not readjusted for inclusion or the taxpayer's marginal tax rate is higher than the rate on which the benefit readjustment was based, current and future recipients would be adversely affected. This could create a problem, such as for people who have already retired or expect soon to retire on the basis of a certain level of tax-exempt retirement benefits (like social security). One possible response to this problem would be to grandfather retirement benefits that accrued prior to the change in the law. The drawback of grandfathering accrued retireemnt benefits is the difficulty in distinguishing retirement benefits accrued before the law change from those accruing afterward. For this reason it might be simpler to tax a gradually rising percentage of retirement benefits. This phase-in approach would tax least the benefits of those taxpayers nearest to retirement.

Including fringe benefits in taxable income would reduce the effective salary of employees now benefiting from fringes. Taxpayers presumably would respond by substituting cash wages for some of the less desirable fringes, but this could take time (e.g., to renegotiate labor contracts). Moreover, there will be many cases in which workers have accrued fringe benefits where realization has not take place. The simplest transition rule would be to allow a grace period of one or more years in which realization of accrued fringe benefits could take place under the old tax law and taxpayers would have time to modify compensation arrangements.

Including 100 percent of capital gains in taxable income (without reducing tax rates) would reduce the value of many assets. The reduction in value would be largest for assets whose return is disproportionately in the form of capital gains (e.g., gold, discount bonds, and homes). While accrued but unrealized capital gains could be grandfathered by applying the new rules only to appreciation occurring after the effective date (a fresh start), this would require the segregation of assets acquired prior to the law change, and measurement of the market value of these assets. This approach was used when the original income tax was enacted in 1913 and when carryover of basis was enacted in 1976, but it created difficulties each time. An alternative approach would be to provide a grace period during which accrued capital gains could be realized under the present tax law. This, however, would give taxpayers an incentive to sell assets during the grace period, thereby distorting decisions. A third approach would be to retain existing law for assets owned on the effective date, but this could discourage sales of those assets. Under any of these options, the inclusion of capital gains in taxable income of future owners would lower the price at which some assets could be resold, so that some of the transition rule would eliminate the decline in wealth due to the full inclusion of capital gains. If tax rates are substantially lowered at the same time the capital gains exclusion is eliminated, the effective rate of tax on capital gains may not increase as a result of comprehensive income tax reform, which may reduce the need for transition rules; however, there still could be declines in the values of assets whose return consists disproportionately of capital gains.

Itemized deductions.—The most important itemized deductions in the individual income tax are the deductions for interest, state and local taxes paid, charitable contributions, and medical expenses.

Eliminating the deduction for mortgage interest would significantly increase the tax liability of most homeowners as well as reducing the market value of most homes. Grandfathering interest paid on existing home mortgages would protect recent homebuyers from an increase in tax liability but would not prevent the present owners of the housing stock from suffering a loss in property value. To fully protect homeowners, old-law treatment would have to be accorded to the existing stock of housing in perpetuity. The transition problems associated with housing are especially difficult because housing is extremely durable and repreesnts a large portion of taxpayer wealth. One possible transition rule would be to allow existing homeowners to take a deduction or credit for the estimated reduction in property value due to the tax law change. While this would compensate the losers from eliminating the mortgage interest deduction, it would be difficult to estimate accurately the monetary loss. Alternatively, a phase-in could moderate the decline in home prices.

Elimination of the deduction against Federal income tax for certain kinds of State and local taxes paid would increase the tax liabilities of itemizing taxpayers who pay high State and local taxes. This would put some pressure on State and local governments to change their mix on tax revenues. Therefore, a grace period would give State legislatures time to make the appropriate adjustments.

Elimination of the charitable contribution deduction would reduce the level of charitable giving, perhaps substantially. This would reduce the revenue of organizations that rely on charitable contributions and force a reduction in their programs and outlays. A phase-in period would provide time for charitable organizations to develop alternative sources of revenues and to bring expenditure plans in line with income.

Elimination of the medical expense deduction would increase the tax liability of itemizing taxpayers whose unreimbursed medical expenses exceed 5 percent of adjusted gross income. A phase-in or grace period could be helpful to allow taxpayers time to raise their medical insurance coverage.

The number of transition problems which arise in the adoption of a new tax system are numerous and often are different for the different provisions being changed. These transition problems should be considered one-by-one comprehensive income tax bill. None of the bills discussed in the Appendix addresses transition issues, although some have delayed effective dates for the bills as a whole.

APPENDIX

DESCRIPTION OF COMPREHENSIVE INCOME TAX BILLS IN THE 97TH CONGRESS

Twelve bills (7 in the House and 5 in the Senate) have been introduced in the 97th Congress which address the issues of comprehensive income tax reform. Generally, these bills broaden the income tax base by repealing or modifying tax expenditures and lower and flatten the individual income tax rate schedule. A number of these legislative initiatives also address structural issues in the current income tax system including the marriage penalty, the treatment of saving, the effect of inflation in defining income from capital, and the relationship between the corporate and individual income taxes. These comprehensive income tax bills range along a spectrum from those with a very broad base and a low flat rate to more narrowly based taxes with moderately progressive rates. A brief description of these bills follows, proceeding from the pure flat rate to the progressive rate proposals.

Eight of the twelve comprehensive income tax reform bills are proportional tax plans. These flat-rate proposals eliminate progressivity at the upper income range, while retaining some progressivity in the lower range depending on the level of personal exemptions for taxpayers, spouses, and dependents. The reduction in progressivity is accompanied by a more uniform tax burden among taxpayers with equal incomes.

Proportional tax bills

H.R. 5513 (Rep. Crane) and S. 2200 (Sen. Helms), the "Flat Rate Tax Act of 1982," repeal all exemptions, exclusions, credits, and deductions other than a personal exemption of $2,000. A flat rate of 10 percent is imposed on gross income of individuals (including estates and trusts). The bill does not address corporate income taxation.

H.R. 6352 (Rep. Paul), the "Flat Rate Tax Act of 1982," is similar to the Helms/Crane bill except that the personal exemption is a flat $10,000 per tax return.

H.R. 6741 (Rep. Dreier), the "Flat Tax Act of 1982," is identical to the Helms/Crane bill except the individual income tax rate is 14 percent rather than 10 percent.

H.R. 4821 (Rep. Hansen), the "Tax Simplification Act," is similar to the Helms/Crane bill except that the personal exemption is kept at $1,000, the tax rate is 14 percent, and some deductions and exclusions are retained. Rep. Hansen's bill retains the exclusions for: (1) life insurance proceeds payable by reason of death and the $5,000 exclusion for employee death benefits, (2) gifts and inheritances, (3) income from the discharge of indebtednes, (4) income from the recovery of bad debts, and (5) contributions in aid of construction. It retains all deductions in arriving at adjusted gross income except for: (1) moving expenses, (2) individual retirement accounts and certain other retirement plans, (3) two-earner couples, and (4) 60 percent of long-term capital gains. Also, the Hansen proposal retains the itemized deductions for: (1) business or investment expenses, (2) charitable contributions to churches, and (3) medical expenses in excess of 10 percent of AGI. The alimony deduction is made an itemized deduction.

H.R. 6070 (Rep. Panetta), the "Income Tax Simplification Act of 1982," broadens both the individual and corporate income tax bases and converts the personal exemption into a credit. H.R. 6070 eliminates all other tax credits and all exclusions except for gifts and inheritances. In addition, H.R. 6070 eliminates all itemized deductions except: (1) trade or business expenses, (2) losses other than from wagering, and (3) expenses for producing income. The special rules for travel expense deductions of State legislators are repealed. The computation of taxable for business income is revised to allow deductions only (1) trade or business expenses, (2) losses, (3) amortization of construction period interest and taxes, (4) contributions to black lung benefit trust funds, and (5) business startup costs. Deductions for business entertainment are repealed. Insurance companies are made subject to the general corporate tax rules. The alternative capital gains tax rate for corporations is repealed. The $1,000 personal exemption for taxpayers and dependents is converted from a deduction to a credit of $1,000 for taxpayers and a credit of $200 for dependents. The extra exemptions for age and blindness are also converted to $200 credits. (At a 19-percent tax rate, a $1,000 credit is equivalent to a $5,263 personal exemption deduction, and a $200 credit is equivalent to a $1,053 deduction.) H.R. 6070 also imposes a low graduated tax on corporate income, ranging from 3 to 15 percent.

Senator DeConcini (S. 2147) and Rep. Dannemeyer (H.R. 6628) have introduced flat-rate bills which instruct the Treasury to create a tax system based on a tax reform proposal designed by Robert Hall and Alvin Rabushka of the Hoover Institution. The bills differ only with respect to the tax rate which is "not to exceed 20 percent" in S. 2147 and is "not exceed 15 percent" in H.R. 6628. Essentially, the bills tax all income at a single flat rate. However, immediate expensing is allowed for all capital expenditures. Rules are provided to prevent double taxation of corporate-source income; that is, income is taxed either to a business or to an individual but not to both. (With a single flat rate applying to both corporations and individuals, it does not really matter where the income is taxed.) Exemptions are provided to relieve the tax burden from poor households.

Progressive rate bills

In contrast to the pure flat-rate tax bills, Senators Quayle, Bradley, and Mitchell, and Rep. Gephardt have introduced broad based tax reform bills with progressive rate schedules. These bills are designed to reap the advantages of a broader base income tax without giving up some tax rate progression.

S. 2557 (Sen. Quayle), the "SELF—Tax Plan Act of 1982," taxes individual income at a graduated rate ranging up to 25 percent, and corporate income at a flat 20 percent. It also significantly broadens the individual and corporate income tax bases. It establishes the following principles to govern base broadening: (1) deductions shall be allowed for ordinary and necessary business expenses, (2) there should be no tax on dividends, interest or gain from the sale of a business, (3) the marriage penalty shall be eliminated, and (4) social security and other retirement benefits should not be taxed twice.

Senator Bradley (S. 2817) and Rep. Gephardt (H.R. 6944) have introduced the "Fair Tax Act of 1982." The Bradley/Gephardt bill is a progressive-broad based bill. It does not address the corporate income tax. The individual income tax is converted to a flat 14-percent normal tax on taxable income and a surtax, with rates between 6 and 14 percent, on adjusted gross income in excess of $25,000 for single persons and $40,000 for married couples. The Bradley-Gephardt bill repeals the exclusions for income earned abroad; interest on industrial development or housing bonds; interest and dividends; reinvested dividends from public utility stock; interest on life insurance saving, scholarship and fellowship income in excess of tuition; one-third of employer-provided health insurance premiums; employer-provided child care, educational assistance, group-term life insurance, and prepaid legal services: unemployment compensation; and disability pay. It repeals all nonrefundable tax credits except the foreign tax credit. It repeals the deductions for expensed intangible drilling costs, percentage depletion, amortization of reforestation expenditures and pollution control facilities, 60 percent of net long-term capital gains, second earners, expensed construction period interest and taxes, casualty and theft losses, adoption expenses, nonmortgage interest in excess of investment income, State and local taxes other than income and real property taxes, medical expenses below 10 percent of AGI, and the charitable deduction for nonitemizers. The personal exemption is increased to $1,500 for each taxpayer and $1,750 for a single head-of-household. The zero bracket amount is increased to $4,600 for married couples. The child care credit is converted into an itemized deduction. The exclusion of up to $125,000 of gain on the sale of a home by a person aged 55 or over would apply to the normal tax but not the surtax. A 14-percent tax would be imposed on the investment income of pension plans, IRAs and H.R. 10 plans. The proposal is designed to mirror the present law distribution of the income tax burden by income class.

S. 2887 (Sen. Mitchell) the "Personal Income Tax Reform Act of 1982," is identical to the Bradley/Gephardt bill except the rates are more progressive (12 percent normal tax and 8 to 24 percent surtax), the business meal deduction is repealed, and the medical expense deduction is the same as present law (i.e., excess over 5 percent of AGI is deductible).

O

Bill Bradley
U.S. SENATOR
Democrat/New Jersey

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FOR IMMEDIATE RELEASE THURSDAY AUGUST 5, 1982

WASHINGTON -- Calling it "The Fair Tax Act," Sen. Bill Bradley and Rep. Richard Gephardt today introduced legislation designed to make the federal income tax more equitable, simple and efficient by lowering tax rates and eliminating many tax deductions, credits and exclusions.

Bradley, D-N.J., is a member of the Senate Finance Committee and head of the "Economic Advisory Group" for Senate Democrats. Gephardt, D-Mo., serves on the House Ways and Means Committee and is chairman of the House Democratic Economic Task Force.

Below are prepared floor statements by Bradley and Gephardt, plus a "fact sheet" on the legislation.

Mr. Bradley. Mr. President, for generations Americans have been looking to the future wuth the expectation that a growing economy would offer them opportunity to improve their position in life and could bring their children even greater prosperity.

We are now in the worst recession in half a century. More than 10 million people are out of work. Bankruptcy is almost commonplace. Planned investment is being held back. Economic growth dwindles.

No one can claim to have all the answers today, for we are entering a new era with new problems. It is clear, though, that in the short term we cannot make any real progress toward economic stability until we redress the current imbalance in our fiscal and monetary policies.

Maintaining growth over the long haul will be even more challenging. We face increasing competition in the world's markets at a time when we must adjust continually to rapid technological change and when our economy is evolving into one based more on knowledge than on physical labor.

In government and in the private sector, we must adjust with bold initiative. We should:

-- Restructure and simplify the Federal Income Tax Code.
-- Consolidate all forms of government spending into a unified Federal budget.
-- Recognize that we are inextricably tied to the world economy.
-- Expand research and development, pure and applied.
-- Foster cooperation in the workplaces of America.

THE ROLE OF GOVERNMENT WILL BE IMPORTANT IN DETERMINING HOW WE ACCOMPLISH ECONOMIC REVITALIZATION. GOVERNMENT MUST SET FAIR RULES.

UNFORTUNATELY, WE'RE AT A POINT WHEN, ACCORDING TO A PUBLIC OPINION SURVEY, FOUR OUT OF FIVE AMERICANS BELIEVE THAT THEY WON'T GET AHEAD IF THEY FOLLOW THE RULES. NOWHERE IS THIS MORE EVIDENT THAN IN THE AREA OF TAX RULES.

OUR TAX CODE IS FAR TOO COMPLEX AS A RESULT OF REPEATED ATTEMPTS TO USE IT AS A VEHICLE FOR POLITICAL FAVORITISM AND SOCIAL ENGINEERING. THE AVERAGE TAXPAYER MUST CONTEND WITH PAGES AND PAGES OF INTIMIDATING FORMS AND INSTRUCTIONS. EVEN LAWYERS AND ACCOUNTANTS OFTEN CANNOT MAKE SENSE OUT OF THE MAZE OF DEDUCTIONS, EXCLUSIONS AND CREDITS IN THE CODE.

THE AVAILABILITY OF SO MANY TAX PREFERENCES ALSO REDUCES THE SIZE OF THE TAX BASE. MAINTAINING HIGH TAX RATES IS NO REMEDY. HIGH TAX RATES ONLY SERVE TO LIMIT INCENTIVES TO WORK MORE, TO SAVE MORE AND TO INVEST MORE. IN ADDITION, TAX PREFERENCES ENCOURAGE PEOPLE TO INVEST IN ENTERPRISES OR ACTIVITIES WITH RATES OF RETURN WHICH ARE INFLATED BY THE TAX CODE. THIS CAUSES INEFFICIENT ALLOCATION OF OUR ECONOMY'S RESOURCES AND IMPEDES GROWTH. BUT, TO GET A DRAMATIC REDUCTION IN TAX RATES, WE MUST ELIMINATE MANY TAX PREFERENCES.

FINALLY, A MAJORITY OF THE NATION'S 103 MILLION TAXPAYERS BELIEVE THE TAX CODE IS UNFAIR. I THINK THEY ARE SAYING THAT CERTAIN GROUPS AVOID PAYING THEIR FAIR SHARE AND THAT SOMEBODY ELSE WITH THE SAME INCOME IS DOING BETTER BY THE TAX CODE THAN THEY ARE. MANY, IN FACT, ARE LOSING RESPECT FOR THE INTEGRITY OF THE TAX LAWS.

IN VIEW OF THESE PROBLEMS, I THINK IT IS TIME TO RESTRUCTURE THE TAX CODE -- INCREASING FAIRNESS, SIMPLICITY AND EFFICIENCY.

WE SHOULD HAVE A TAX CODE IN WHICH ALL CITIZENS WITH EQUAL INCOMES ARE TREATED ESSENTIALLY THE SAME WAY. WE SHOULD HAVE A TAX CODE THAT IS SIMPLE ENOUGH FOR ALL CITIZENS TO HAVE AT LEAST A BASIC UNDERSTANDING OF HOW THE SYSTEM WORKS AND HOW THEIR OWN TAX OBLIGATIONS ARE DETERMINED. WE SHOULD HAVE A TAX CODE WHICH ALLOWS TAXPAYERS TO MAKE THEIR ECONOMIC DECISIONS ON THE BASIS OF REAL VALUE IN THE MARKETPLACE -- WITH LITTLE, IF ANY, REGARD FOR THE TAX IMPLICATIONS.

THE BEST WAY TO ACHIEVE THESE GOALS IS TO LOWER THE TAX RATES AND BROADEN THE TAX BASE.

SPECIFICALLY, I PROPOSE THAT WE DROP THE TAX RATE TO 14% FOR SINGLE TAXPAYERS WITH INCOMES UP TO $25,000 AND FOR COUPLES WITH INCOMES UP TO $40,000, AND THAT WE APPLY A PROGRESSIVE SURTAX RANGING FROM 6% TO 14% FOR INCOMES ABOVE THOSE LEVELS. THIS WOULD REDUCE THE MAXIMUM TAX RATE TO 28% FROM THE CURRENT TOP OF 50%.

TO MAKE SURE THAT WE HAVE SUFFICIENT REVENUES FROM THESE REDUCED TAX RATES, I PROPOSE THAT WE ELIMINATE MOST TAX CREDITS, EXCLUSIONS AND DEDUCTIONS EXCEPT FOR THE FEW CLAIMED OVER MANY YEARS BY THE MAJORITY OF TAXPAYERS OR THOSE NEEDED TO ALLEVIATE GENUINE HARDSHIP. THESE ARE CHARITABLE GIVING, HOME MORTGAGE INTEREST, SOME MEDICAL EXPENSES, STATE AND LOCAL INCOME AND PROPERTY TAXES, AND SOCIAL SECURITY AND VETERANS' BENEFITS. INTEREST EARNED ON STATE AND MUNICIPAL GENERAL OBLIGATION BONDS ALSO SHOULD REMAIN TAX-EXEMPT TO FACILITATE RAISING REVENUES FOR APPROPRIATE PUBLIC PURPOSES.

TO ENSURE FAIRNESS FOR TAXPAYERS AT THE LOW END OF THE INCOME SCALE, PART OF THE RATE REDUCTION SHOULD BE ACCOMPLISHED BY INCREASING THE PERSONAL EXEMPTION FROM THE CURRENT $1,000 TO $1,500 AND BY LIFTING THE ZERO BRACKET AMOUNT FOR JOINT RETURNS FROM THE CURRENT $3,400 TO $4,600.

ALONG WITH REP. RICHARD GEPHARDT, D-MO., I AM TODAY INTRODUCING THE FAIR TAX ACT OF 1982 TO IMPLEMENT THIS PROPOSAL, AND I BELIEVE THE SAME BASIC APPROACH CAN BE APPLIED TO CORPORATE TAXES AS WELL. IN GENERAL, I AM CALLING FOR SUBSTANTIAL IMPROVEMENTS OF OUR CURRENT INCOME TAX SYSTEM, RATHER THAN A RADICALLY DIFFERENT KIND OF TAX THAT WOULD REQUIRE A LONG TRANSITION AND LEARNING PROCESS. AND THIS PROPOSAL WOULD MAINTAIN THE CURRENT LAW'S DISTRIBUTION OF TAX LIABILITIES BY INCOME GROUP, RATHER THAN CAUSE A REDISTRIBUTION OF THE INCOME TAX BURDEN, ALTHOUGH 60% TO 70% OF THE TAXPAYERS WOULD BE PAYING LESS TAX.

SOME BENEFITS OF THIS TAX SYSTEM ARE OBVIOUS. TAX COMPUTATION WOULD BE EASIER FOR ALL TAXPAYERS, ESPECIALLY THOSE IN THE LOW AND MIDDLE INCOME BRACKETS. MARGINAL TAX RATES WOULD DROP FOR NEARLY ALL TAXPAYERS. REPEAL OF MANY SPECIAL PROVISIONS WOULD SIMPLIFY THE FORMS AND THE INSTRUCTIONS. BY REDUCING THE NUMBER OF TAX BRACKETS, WE WOULD VIRTUALLY ELIMINATE "BRACKET CREEP" DUE TO INFLATION. FOR THE SAME REASON, THE SO-CALLED MARRIAGE PENALTY WOULD BE

CUT SUBSTANTIALLY.

BUT BECAUSE WE WOULD BE COLLECTING THE SAME AMOUNT OF REVENUES IN A DIFFERENT WAY, SOME PEOPLE WOULD END UP PAYING LESS IN TAXES AND OTHERS WOULD HAVE TO PAY MORE. UNDER THIS SYSTEM, MOST OF THE NATION'S 60 MILLION TAXPAYERS CLAIMING THE STANDARD DEDUCTION INSTEAD OF ITEMIZING WILL PAY LESS THAN THEY WOULD UNDER EXISTING LAW SIMPLY BECAUSE THEIR RATES WILL BE LOWER. CITIZENS CLAIMING RELATIVELY FEW ITEMIZED DEDUCTIONS EITHER WILL BE BETTER OFF UNDER THE PROPOSED SYSTEM, OR, AT WORST, SEE THEIR TAX BURDEN REMAIN ABOUT THE SAME AS IT WOULD BE UNDER EXISTING LAW. THOSE WITH THE MOST SIGNIFICANTLY INCREASED TAXLIABILITIES UNDER THE PROPOSED SYSTEM WOULD BE THE TAXPAYERS WHO MAKE THE GREATEST USE OF DEDUCTIONS, CREDITS AND EXCLUSIONS IN THE PRESENT LAW. AND, MANY OF THESE TAXPAYERS WOULD GIVE UP THEIR PREFERENCES, ALONG WITH THE HEADACHES AND TIME SPENT TRYING TO AVOID TAXES, IN EXCHANGE FOR A LOWER MARGINAL RATE.

IF WE TAKE THIS APPROACH, WE WOULD BE CORRECTING STRUCTURAL PROBLEMS IN THE CURRENT CODE -- NOT PAPERING OVER THOSE PROBLEMS, AS CONGRESS DID LAST YEAR BY APPROVING THE ADMINISTRATION'S REQUEST FOR A 25% ACROSS-THE-BOARD RATE CUT FOR INDIVIDUALS. THAT 1981 TAX-CUT LEGISLATION ACTUALLY COMPOUNDS THE UNFAIRNESS, INEFFICIENCY AND THE COMPLEXITY OF OUR TAX SYSTEM. IT IS ONE REASON WHY I VOTED AGAINST THE BILL. TO GENERATE AN INVESTMENT BOOM WITH DRAMATICALLY REDUCED MARGINAL RATES, WE MUST RECOGNIZE THAT IT IS NOT JUST CUTTING TAXES THAT IS IMPORTANT. WHAT MATTERS MOST IS THE WAY WE CUT TAXES. THERE IS NO FREE LUNCH. WE CANNOT AFFORD TO LOWER TAXES UNLESS WE CLOSE LOOPHOLES AT THE SAME TIME. THAT IS THE LESSON OF THIS YEAR'S RECORD BUDGET DEFICIT. IT IS ALSO THE LESSON OF THE BIGGEST TAX INCREASE IN HISTORY CURRENTLY BEFORE THE CONGRESS.

UNLESS WE REVERSE THE TREND SET IN THE 1981 TAX CUT, THE ONLY PEOPLE PAYING INCOME TAXES IN THE FUTURE WILL BE THOSE WHOSE WAGES AND SALARIES WILL BE SUBJECT TO WITHHOLDING. THAT PROSPECT IS SIMPLY UNACCEPTABLE IN A DEMOCRACY.

ON THE OTHER HAND, IF WE LOWER TAX RATES AND BROADEN THE TAX BASE, I THINK WE CAN HAVE A TAX SYSTEM THAT REALLY ENCOURAGES THE PRODUCTIVE WORK AND INVESTMENT NEEDED FOR SUSTAINED ECONOMIC GROWTH.

# # # #

MR. GEPHARDT. MR. SPEAKER, YESTERDAY WAS THE FIRST ANNIVERSARY OF THE LARGEST TAX RATE REDUCTION IN HISTORY. TODAY, HOUSE AND SENATE CONFEREES ARE WORKING ON THE LARGEST TAX INCREASE IN HISTORY TO CLOSE THE LOOPHOLES AND RECOUP WHAT WAS GIVEN AWAY LAST YEAR. I THINK IT IS ABOUT TIME THAT WE MAKE TAX POLICY IN A RATIONAL WAY, REDUCING TAX RATES AND CLOSING LOOPHOLES AT THE SAME TIME -- RATHER THAN USING THIS SCHIZOPHRENIC APPROACH OF RECENT YEARS.

THE "FAIR TAX ACT OF 1982" WHICH I AM INTRODUCING TODAY WOULD DO JUST THAT. FIRST, IT WOULD REDUCE HIGH MARGINAL RATES WHICH DISTORT ECONOMIC BEHAVIOR. IT WOULD PROVIDE THAT MOST AMERICANS WOULD PAY AT A 14% RATE AND REPLACE THE CURRENT 50% MAXIMUM RATE WITH A 28% RATE. AND SECOND, IT WOULD ELIMINATE MOST OF THE TAX PREFERENCES, CREDITS AND DEDUCTIONS WHICH HAVE MADE THE TAX SYSTEM SO COMPLEX AND INCOMPREHENSIBLE. BUT IT WOULD RETAIN THOSE FEW DEDUCTIONS NEEDED TO MEASURE INCOME AND ALLEVIATE GENUINE HARDSHIP.

SENATOR BILL BRADLEY IS INTRODUCING AN IDENTICAL BILL IN THE SENATE TODAY. OUR BILL IS NOT FLAT -- IT IS FAIR. AND EQUALLY IMPORTANT, I THINK IT WOULD GAIN THE SUPPORT OF THOSE PEOPLE DISILLUSIONED BY TODAY'S MAZE OF CREDITS AND LOOPHOLES BECAUSE THEY COULD ACTUALLY UNDERSTAND IT.

I WOULD LIKE PERMISSION TO EXTEND MY REMARKS FOR THE RECORD SO THAT I CAN SUMMARIZE THE MAJOR PROVISIONS OF THE "FAIR TAX ACT."

# # # #

FACT SHEET ON THE BRADLEY-GEPHARDT

FAIR TAX ACT OF 1982

THE CONCEPT

This legislation lowers marginal rates and broadens the tax base for non-corporate taxpayers by repealing and modifying most exclusions, deductions and credits available under current law.

It is designed to take effect in 1984, at which time it will raise approximately the same amount of revenues as existing law without any significant change in the income distribution.

The top tax rate is reduced from 50% to 28%. For 70% to 80% of non-corporate taxpayers, the top rate will be 14%. The only deductions, credits and exclusions retained are those which are generally available to most taxpayers or those which are needed to measure income or alleviate genuine hardship.

At the same time, the Fair Tax Act increases personal exemptions and the zero bracket amount for joint returns to provide more generous relief to low-income families.

By reducing marginal rates, repealing the investment tax credit and taxing all income the same way, the Fair Tax Act creates neutral tax laws which do not make judgments about the quality of investments. This will permit investors, workers and business executives to be more responsive to new trends and opportunities in the market. The new tax policy, therefore, will encourage more productive work, saving and investment as well as enhance incentives for risk-taking and innovation. It also will reduce disparities in effective tax rates among different industries and assets that exist under the current system. This will substantially improve the allocation of resources throughout the economy and facilitate economic adjustment.

The Fair Tax's simplified rate structure also will largely eliminate the problems of bracket creep and the mariage penalty, which have remained insoluable under the existing system.

THE STRUCTURE

The Fair Tax consists of:
-- A Basic tax of 14% on taxable income
-- A progressive surtax on total income (adjusted gross income)

The rate schedules for the Fair Tax are as follows:

SINGLE RETURNS

Adjusted Gross Income	Surtax Rate	Combined Tax Rate (Surtax plus 14% basic tax)
Below $25,000	No tax	14%
$25,000 to $30,000	6%	20%
$30,000 to $37,000	11%	25%
Over $37,000	14%	28%

JOINT RETURNS

Adjusted Gross Income	Surtax Rate	Combined Tax Rate (Surtax plus 14% basic tax)
Below $40,000	No tax	14%
$40,000 to $55,000	6%	20%
$55,000 to $65,000	11%	25%
Over $65,000	14%	28%

Only about 20% of all taxpayers will be subject to the surtax.

The following provisions in the Internal Revenue Service Code are retained:
-- The zero bracket amount, which is increased from $3,400 to $4,600 for joint returns.
-- The taxpayer exemption, which is increased from $1,000 to $1,500 for single returns; from $2,000 to $3,000 for joint returns; and from $1,000 to $1,750 for single heads of households.
-- The deduction for employee business expenses.
-- The deduction for home mortgage interest
-- The deduction for charitable contributions
-- The deduction for state and local income and real property taxes
-- The exclusion for Social Security and Veterans' benefits
-- The exemption for interest on general obligation bonds

The following provisions are repealed:

-- The exclusion for income earned abroad by U.S. citizens or residents.
-- Expensing of intangible drilling costs for oil, gas and geothermal wells.
-- Percentage depletion.
-- The tax exemption for industrial development or housing bonds issued after December 31, 1983.
-- Seven-year amortization for reforestation expenditures.
-- Five year amortization for pollution control facilities.
-- The general exclusions for interest and dividends and the exclusion for reinvested dividends from public utility stock.
-- The exclusion for interest on life insurance savings.
-- The deduction for 60% of net long-term capital gains.
-- The exclusion for employer-provided educational assistance, child care and group legal services.
-- The exclusion for unemployment compensation benefits.
-- The exclusion for disability pay.
-- The exclusion for employer-provided premiums on group term life insurance.
-- The deduction for second earners.
-- The regular investment tax credit.
-- The research and development credit.
-- The credit for rehabilitation of buildings.
-- The energy tax credits.
-- The elderly tax credit.
-- The political contribution tax credit.
-- The deduction for casualty and theft losses.
-- The deduction for adoption expenses.
-- The deduction for nonmortgage interest and other investment interest in excess of investment income.
-- The deduction for state and local taxes other than income and real property taxes.

The following provisions are modified:

-- The child care credit is converted to a deduction.
-- The exclusion for employer-provided health insurance is reduced by one-third.
-- The exclusion for up to $125,000 of gain on the sale of a house by a person aged 55 or over is retained for the normal tax, but not for the surtax (i.e., the gain would be taxed at a rate ranging from 6% to 14%)
-- The deduction for medical expenses is limited to expenses in excess of 10% of adjusted gross income. The separate deduction for up to $150 of health insurance is repealed.
-- A 14% tax is applied to the investment income of pension plans, individual retirement accounts and H.R. 10 plans.

# # #

SINGLE TAXPAYER #1

	1984 Law	Proposal
Income: Salary	15,000	15,000
Plus: Employer paid health	--	400
Employer paid life	--	150
Equals: ADJUSTED GROSS INCOME	15,000	15,550
Less: Exemption	1,000	1,500
Equals: TAXABLE INCOME	14,000	14,050
TAX	1,801*	1,645**
Marginal tax rate	20%	14%

* From 1984 law tax rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent tax rate

MARRIED TAXPAYER #1

	1984 Law	Proposal
Income: Salary	15,000*	15,000
Less: Two earner deduction	500	--
Plus: Employer paid life insurance	--	400
Employer paid health insurance	--	150
Equals: ADJUSTED GROSS INCOME	14,500	15,550
Less: Exemptions	4,000	5,000
Equals: TAXABLE INCOME	10,500	10,550
TAX	889**	833***
Marginal tax rate	14%	14%

*Assumed $10,000 earned by one spouse, $5,000 by other

** From 1984 law rate tables

*** Taxable income less $4,600 zero bracket amount times 14 percent tax rate

SINGLE TAXPAYER #2

	1984 Law	Proposal
Income: Salary	30,000	30,000
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	300
Equals: ADJUSTED GROSS INCOME	30,000	30,700
Less: Exemption	1,000	1,500
Equals: TAXABLE INCOME	29,000	29,200
TAX	5,773*	4,143**
Marginal tax rate	34%	25%

* From 1984 law rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent rate, plus surtax (6 percent of AGI from $25,000 to $30,000, 11 percent of AGI over $30,000).

MARRIED TAXPAYER #2

	1984 Law	Proposal
Income: Salary	30,000*	30,000*
Less: Two earner deduction	1,000	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	300
Equals: ADJUSTED GROSS INCOME	29,000	30,700
Less: Exemptions	4,000	5,000
Child Care deduction		2,000
Equals: TAXABLE INCOME	25,000	23,700
TAX BEFORE CREDIT	3,565**	2,674***
Less: Child Care Credit	400	--
Equals: TAX AFTER CREDIT	3,165	2,674
Marginal tax rate	25%	14%

*Assumed $20,000 earned by one spouse, $10,000 by the other

** From 1984 law rate tables

*** Taxable income less $4,600 zero bracket amount times 14 percent tax rate

SINGLE TAXPAYER #3

		1984 Law	Proposal
Income: Salary		30,000	30,000
Plus: Employer paid health insurance		--	400
Employer paid life insurance		--	300
Equals: ADJUSTED GROSS INCOME		30,000	30,700
Itemized deductions:	Mortgage inrerest	3,000	3,000
	Property taxes	1,000	1,000
	Sales taxes	250	--
	Income taxes	1,200	1,200
	Medical insurance	150	--
	Charitable contributions	500	500
	TOTAL	6,100	5,700
Less:	Zero bracket amount	2,300	2,300
Equals:	EXCESS ITEMIZED DEDUCTIONS	3,800	3,400
AGI		30,000	30,700
Less: Exemptions		1,000	1,500
Less: Excess itemized deductions		3,800	3,400
Equals: TAXABLE INCOME		25,200	25,800
TAX		4,625*	3,667**
Marginal tax rate		30%	25%

* From 1984 law rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent tax rate, plus surtax (6 percent of AGI from $25,000 to $30,000, 11 percent of AGI over $30,000)

SINGLE TAXPAYER #4

	1984 Law	Proposal
Income: Salary	60,000	60,000
Dividends	200	200
Less: Dividend exclusion	200	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	600
Equals: ADJUSTED GROSS INCOME	60,000	61,200
Itemized deductions:		
Mortgage interest	4,800	4,800
Property taxes	2,000	2,000
Sales taxes	700	--
Income taxes	3,000	3,000
Medical insurance	150	--
Charitable contributions	1,500	1,500
TOTAL	12,150	11,300
Less: Zero bracket amount	2,300	2,300
Equals: EXCESS ITEMIZED DEDUCTIONS	9,850	9,000
AGI	60,000	61,200
Less: Exemption	1,000	1,500
Excess itemized deductions	9,850	9,000
Equals: TAXABLE INCOME	49,150	50,700
TAX	13,532*	11,234**
Marginal tax rate	42%	28%

* From 1984 law rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent, plus surtax (6 percent of AGI from $25,000 to $30,000, 11 percent of AGI from $30,000 to $37,000, and 14 percent of AGI in excess of $37,000)

SINGLE TAXPAYER #4

	1984 Law	Proposal
Income: Salary	60,000	60,000
Dividends	200	200
Less: Dividend exclusion	200	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	600
Equals: ADJUSTED GROSS INCOME	60,000	61,200
Itemized deductions:		
Mortgage interest	4,800	4,800
Property taxes	2,000	2,000
Sales taxes	700	--
Income taxes	3,000	3,000
Medical insurance	150	--
Charitable contributions	1,500	1,500
TOTAL	12,150	11,300
Less: Zero bracket amount	2,300	2,300
Equals: EXCESS ITEMIZED DEDUCTIONS	9,850	9,000
AGI	60,000	61,200
Less: Exemption	1,000	1,500
Excess itemized deductions	9,850	9,000
Equals: TAXABLE INCOME	49,150	50,700
TAX	13,532*	11,234**
Marginal tax rate	42%	28%

* From 1984 law rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent, plus surtax (6 percent of AGI from $25,000 to $30,000, 11 percent of AGI from $30,000 to $37,000, and 14 percent of AGI in excess of $37,000)

MARRIED TAXPAYER #4

	1984 Law	Proposal
Income: Salary	60,000	60,000
Dividends	400	400
Less: Dividend exclusion	400	--
Two earner couple deduction	2,000	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	600
Equals: ADJUSTED GROSS INCOME	58,000	61,400
Itemized deductions:		
Mortgage interest	4,800	4,800
Property taxes	2,000	2,000
Sales taxes	800	--
Income taxes	2,400	2,400
Medical insurance	150	--
Charitable contributions	1,500	1,500
TOTAL	11,650	10,700
Less: Zero bracket amount	3,400	4,600
Equals: EXCESS ITEMIZED DEDUCTIONS	8,250	6,100
AGI	58,000	61,400
Less: Exemptions	4,000	5,000
Excess itemized deductions	8,250	6,100
Child care deduction	--	3,000
Equals: TAXABLE INCOME	45,750	47,300
TAX BEFORE CREDIT	9,755*	7,582**
Less Child care credit	600	--
Equals: TAX AFTER CREDIT	9,155	7,582
Marginal tax rate	33%	25%

* From 1984 law rate tables

** Taxable income less $4,600 zero bracket amount times 14 percent tax rate, plus surtax (6 percent of AGI from $40,000 to $55,000, 11 percent of AGI in excess of $55,000)

SINGLE TAXPAYER #5

	1984 Law	Proposal
Income: Salary	60,000	60,000
Long term capital gains	40,000	40,000
Interest and Dividends	20,000	20,000
TOTAL	120,000	120,000
Less: Capital gain exclusion	24,000	--
Dividend exclusion	200	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	600
Equals: Adjusted Gross Income	95,800	121,000
Itemized deductions:		
Mortgage interest	5,000	5,000
Other interest	5,000	2,500
Property tax	3,000	3,000
Sales tax	1,000	--
Income tax	7,500	7,500
Medical Insurance	150	--
Charity	5,000	5,000
TOTAL	26,650	23,000
Zero bracket amount	2,300	2,300
Excess itemized deductions	24,350	20,700
AGI	95,800	121,000
Less: Exemption	1,000	1,500
Less: Excess Itemized deductions	24,350	20,700
Equals: TAXABLE INCOME	70,450	98,800
TAX:	23,387*	26,340**
Marginal tax rate: ordinary income	48%	28%
capital gains	19.2%	28%

* From 1984 law rate tables

** Taxable income less $2,300 zero bracket amount times 14 percent tax rate, plus surtax (6 percent of AGI from $25,000 to $30,000, 11 percent of AGI from $30,000 to $37,000, and 14 percent of AGI in excess of $37,000)

MARRIED TAXPAYER #5

	1984 Law	Proposal
Income: Salary	60,000*	60,000*
Long term capital gains	40,000	40,000
Interest and dividends	20,000	20,000
TOTAL	120,000	120,000
Less: Capital Gain exclusion	24,000	--
Dividend exclusion	400	--
2 earner deduction	3,000	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	600
Equals: Adjusted Gross Income	92,600	121,000
Itemized Deductions:		
Mortgage interest	5,000	5,000
Other interest	5,000	2,500
Property tax	3,000	3,000
Sales tax	1,200	--
Income tax	7,000	7,000
Medical insurance	150	--
Charity	5,000	5,000
TOTAL	26,350	22,500
Less: Zero Bracket amount	3,400	4,600
Equals: EXCESS ITEMIZED DEUDCTION	22,950	17,900
AGI	92,600	121,000
Less: Exemptions	4,000	5,000
Excess Itemized Deductions	22,950	17,900
Child Care Deduction	--	4,000
Equals: TAXABLE INCOME	65,650	94,100
TAX BEFORE CREDIT	17,541**	22,370***
Child care credit	800	--
TAX	16,741	22,370
Marginal tax rate:		
ordinary income	42%	28%
capital gains	16.8%	28%

*Assumed $40,000 earned by one spouse, $20,000 by the other
**From 1984 law rate tables
***Taxable income less $1,600 zero bracket amount times 14 percent tax rate, plus surtax (6 percent of AGI from $40,000 to $55,000, 11 percent of AGI from $55,000 to $65,000, and 14 percent of AGI in excess of $65,000)

MARRIED TAXPAYER #6

	1984 Law	Proposal
Income: Salary	200,000*	200,000*
Long term capital gain	400,000	400,000
Interest and dividends	400,000	400,000
TOTAL	1,000,000	1,000,000
Less: Capital Gain exclusion	240,000	--
Dividend exclusion	400	--
2 earner deduction	3,000	--
Plus: Employer paid health insurance	--	400
Employer paid life insurance	--	2,000
Equals: ADJUSTED GROSS INCOME	756,600	1,002,400
Itemized deductions: Mortgage interest	10,000	10,000
other interest	100,000	50,000
property tax	10,000	10,000
sales tax	4,000	--
income tax	100,000	100,000
medical insurance	150	--
charity	50,000	50,000
TOTAL		220,000
Less: Zero bracket amount	3,400	4,600
Equals: EXCESS ITEMIZED DEDUCTIONS	270,750	215,400
AGI	756,600	1,002,400
Less: Exemptions	4,000	5,000
Excess itemized deductions	270,750	215,400
Child care deduction	--	[illegible]
Equals: TAXABLE INCOME	481,850	773,000
TAX BEFORE CREDIT:	222,325**	241,512***
Child care credit	960	--
TAX AFTER CREDIT	221,365	241,512
Marginal Tax Rate:		
Ordinary income	50%	28%
Capital gains	20%	28%

*Assumed at least $30,000 earned by lesser earning spouse

** From 1984 law rate tables

*** Taxable income less $4,600 zero bracket amount times [illegible] percent tax rate, plus surtax (6 percent of AGI from $40,000 to $55,000, 11 percent of AGI from $55,000 to $65,000, and 14 percent of AGI in excess of $65,000)

MARRIED TAXPAYER #7

	1984 Law	Proposal
Income: Salary	200,000*	200,000*
Interest and Dividends	800,000	800,000
TOTAL	1,000,000	1,000,000
Less: Dividend exclusion	400	--
Two earner deduction	3,000	--
Plus: Employer paid health insurance	--	100
Employer paid life insurance	--	2,000
Equals: ADJUSTED GROSS INCOME	996,000	1,002,100
Itemized deductions: Mortgage interest	10,000	10,000
Other interest	100,000	50,000
Property taxes	10,000	10,000
Sales taxes	4,000	--
Income taxes	100,000	100,000
Medical insurance	150	--
Charitable contributions	50,000	50,000
TOTAL	274,150	220,000
Less: Zero bracket amount	3,400	4,600
Equals: EXCESS ITEMIZED DEDUCTIONS	270,750	215,400
AGI	996,600	1,002,400
Less: Exemptions	4,000	5,000
Excess Itemized deductions	270,750	215,400
Child care deduction	--	4,000
Equals: TAXABLE INCOME	721,850	778,000
TAX BEFORE CREDIT	342,325**	241,512***
Child care credit	960	--
TAX AFTER CREDIT	341,365	241,512
Marginal tax rate:		
Ordinary income:	50%	28%
Capital gains:	20%	28%

*Assumed at least $30,000 earned by lesser earning spouse
** From 1984 law rate tables
*** Taxable income less $4,600 zero bracket amount times 14 percent tax rate, plus surtax (6 percent of AGI from $40,000 to $55,000, 11 percent of AGI from $55,000 to $65,000, and 14 percent of AGI in excess of $65,000)

MARRIED TAXPAYER #8

		1981 Law	Proposal
Income:	Salary	200,000*	200,000*
	Interest and dividends	800,000	800,000
	Oil and gas partnership revenues	100,000	100,000
	Less: Intangible drilling costs	1,000,000	100,000
	Depletion	65,000	10,000
	TOTAL	35,000	990,000
Less:	Dividend exclusion	400	--
	Two earner deduction	3,000	--
Plus:	Employer paid health insurance:	--	400
	Employer paid life insurance	--	2,000
Equals:	Adjusted Gross Income	31,600	992,400
Itemized deductions:	Mortgage interest	10,000	10,000
	Other interest	100,000	50,000
	Property taxes	10,000	10,000
	Sales taxes	4,000	--
	Income taxes	100,000	100,000
	Medical insurance	150	--
	Charitable contributions	50,000	50,000
	TOTAL	274,150	220,000
	Less: Zero bracket amount	3,400	4,600
		270,750	215,400
	Equals: EXCESS ITEMIZED DEDUCTIONS		
		31,600	992,400
AGI			
Less:	Exemptions	4,000	5,000
	Excess itemized deductions	270,750	215,400
	Child care deduction	--	4,000
Equals:	TAXABLE INCOME	-0-	768,000
TAX BEFORE CREDIT		-0-	238,712
Child care credit		960	--
TAX AFTER CREDIT		-0-	238,712
MINIMUM TAX		158,250	--
Child care credit		960	--
TOTAL TAX		157,290	238,712

MARRIED TAXPAYER #9

		1984 Law	Proposal
Income: Salary		30,000*	30,000*
Less: Two earner deduction		1,000	--
Plus: Employer paid health insurance		--	400
Employer paid life insurance		--	300
Equals: ADJUSTED GROSS INCOME		29,000	30,700
Itemized deductions:	Mortgage interest	5,000	5,000
	Property taxes	1,500	1,500
	Sales taxes	400	--
	Income taxes	1,000	1,000
	Medical insurance	150	--
	Charitable contributions	500	500
	TOTAL	8,550	8,000
Less: ZeroBracket amount		3,400	4,600
Equals: EXCESS ITEMIZED DEDUCTIONS		5,150	3,400
AGI		29,000	30,700
Less: Exemptions		4,000	5,000
Excess itemized deductions		5,150	3,400
Child care deduction		--	2,000
Equals: TAXABLE INCOME		19,850	20,300
TAX BEFORE CREDIT		2,434**	2,198***
Less: Child care credit		400	--
Equals: TAX AFTER CREDIT		2,034	2,198
Marginal tax rate		18%	14%

BusinessWeek/Harris poll

A loss of faith in the progressive tax

Support for the concept of a progressive income tax—for much of this century a touchstone of tax policy in the U.S.—has all but collapsed among the American people, which has lost faith in the ability of the tax system to operate equitably. This is a principal finding of a public opinion survey commissioned by BUSINESS WEEK and conducted in mid-August by Louis Harris & Associates Inc. The alternative, a nonprogressive, "flat" tax that eliminates many deductions from taxable income, is supported almost 2-to-1 (table).

But proponents in Congress of the flat tax would do well to examine the results of the poll with some care. The reason: The public essentially is supporting an abstraction. When it comes to giving up treasured tax breaks, Americans change their tune drastically. For example, virtually no one is willing to surrender the deduction for medical expenses, which suggests that the public is not likely to be happy with the provision of the new tax law that raises the exclusion of medical-expense deductions from 3% to 5% of adjusted gross income. Similarly, more than 70% of Americans want to keep the mortgage-interest deduction—even if it makes an across-the-board drop in tax rates harder to achieve.

Americans are willing to give up their cherished tax deductions only where the sacrifice is perceived to be minor (state and local sales and other excise taxes, interest on installment debt) or where the current benefit is available only to a relatively small group within the economy (oil and gas drilling costs, employee business expenses). Moreover, people are not willing to be taxed on some items that currently are tax-free, even if the trade-off is a lower tax rate.

Unwilling to tinker. For example, an overwhelming 86% of Americans believe that Social Security and veterans' benefits should remain tax-free. And under current tax law, up to $1,000 per year of interest earnings on a life-insurance death benefit paid to a beneficiary in installments is free of federal tax. Two-thirds of the public are unwilling to tinker with this tax break.

Some current tax exclusions are vulnerable, of course. For one thing, the venerable institution of tax exemption for interest payments on debt securities issued by state and local governments could be in trouble. The public supports the exclusion by a slender margin: 49% to 42%. And most people—69% to be exact—are willing to reverse the tax break on some of the income earned by U.S. citizens abroad.

The likely beneficiary of the public's desire to have it both ways is the bill introduced in Congress by Senator Bill Bradley (D-N.J.) and Representative Richard A. Gephardt (D-Mo.). In Bradley and Gephardt's "fair tax" bill, as pollster Lou Harris points out, the political compromises inevitable before a flat tax becomes law simply have been made up front: A two-tier simplified tax system is combined with retention of the most politically sensitive deductions.

Smart politics. In the BUSINESS WEEK/Harris survey, Americans were presented with a tax proposal much like the fair-tax proposal: a flat, 14% tax rate on returns up to $25,000 gross income; retention of itemized deductions for employee business expenses, home mortgage interest, charitable contributions, and real estate taxes; a progressive tax rate on incomes over $25,000, to a maximum of 28%. The response: 58% favorable, 32% opposed.

The retention by Bradley and Gephardt of some progressive features at the higher end of the income scale may prove to be smart politics. According to the Harris survey, the American public's substantial desertion of the progressive tax system is rooted in resentment of what people perceive to be the tax advantages enjoyed by the well-to-do. When Harris' interviewers asked members of the survey sample whether everyone should pay the same percentage of income in taxes, the response was favorable, 48% to 42%. But a substantial minority is reluctant to let higher-income taxpayers off the hook of progressive tax rates. In fact, the lowest-income group narrowly favors retaining the present system.

"People don't think there is any equity left in the system," comments Harris. And his view is confirmed by the responses to two key questions in the survey. When asked whether they believe that the traditional progressive tax system is "fair and equitable," the public divided down the middle on the issue: 47% said "yes," 45% said "no." Exactly a year ago, when the Harris organization asked the same question of a similar sample of Americans, 58% declared that the system is both fair and equitable. In short, confidence in the tax system has deteriorated markedly.

One reason is that people believe that the well-to-do can buy a better deal than everyone else. When asked for an opinion on the proposition that "while most lower- and middle-income people now pay their federal tax by taking standard deductions, most higher-income people get out of paying much of their taxes by hiring clever tax accountants and lawyers who show them how to use loopholes in the tax law," an astounding 86% agreed that this "tends to happen." It remains to be seen whether the modest efforts in the new tax act to improve tax equity will turn popular opinion around.

A simplified tax plan is fine in theory...

Q. *Do you favor a single, 14% tax rate for everyone, eliminating nearly all deductions people take so that more of their income is taxable?*

A.

	Percent
Favor	62%
Oppose	25
Not sure	13

...but don't take away all those deductions

Q. *Would you favor keeping these deductions or scrapping them to make it possible to lower the tax rate to 14%?*

A.

	Keep	Scrap	Not sure
Medical expenses	80%	18%	2%
Home mortgage interest	71	24	5
Charitable contributions	66	30	4
State and local income and property taxes	64	29	7
Casualty and theft losses	63	29	8
State and local sales taxes	53	37	10
Employee business expenses	47	43	10
Installment loan and credit card interest	47	47	6
Political contributions	38	57	5
Oil and gas drilling costs	34	51	15

Data: Louis Harris & Associates Inc. for BUSINESS WEEK

Sept. 6, 1982

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The New York Times

Founded in 1851

ADOLPH S. OCHS, Publisher 1896-1935
ARTHUR HAYS SULZBERGER, Publisher 1935-1961
ORVIL E. DRYFOOS, Publisher 1961-1963

SUNDAY, JUNE 6, 1982

Yes, There Is a Better Income Tax

As many Americans keep saying, it's a poison in the body politic. Who can respect an income tax system that allows many wealthy citizens to pay little or no tax yet claims close to half the marginal earnings of the middle class? Who can defend a tax code so complicated that even the most educated family needs a professional to decide how much it owes?

Unpopular as it is, however, the income tax system has been remarkably resistant to improvement. President Reagan's tax package will eventually roll back rates to the level of the late 1970's, but it will not simplify the code or rid it of provisions that penalize hard work and reward unproductive investment. No wonder that skeptical politicians rank serious tax reform with gun control and free world trade — as worthy causes unworthy of the time of realists.

The skeptics may yet be proved wrong. The obstacles to reform are no less daunting than they were a decade ago. But Congress is beginning to see that the public's tolerance is not unlimited; disaffection is great, cheating has increased. If any reform has a chance, it is the fresh start proposed by Senator Bradley of New Jersey and Representative Gephardt of Missouri.

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Federal income taxes now claim only 12 percent of all personal income. But the income base that is taxed has been so eroded by exceptions and preferences that the rates on what is left to tax must be kept high. Thus, the tax on an extra dollar of income for a typical family earning $20,000 is 28 percent and progressively higher for the more affluent. The urge for reform, therefore, usually attacks the most egregious exemptions in the code, to exploit popular resentments and to enlarge the tax base.

But a diffused public outrage has been no match for well-funded special interests. So a new generation of reformers aims to rebuild the income tax base from scratch. It hopes to simplify the tax code and sharply lower the marginal tax rates for all.

The most dramatic fresh start, without changing the total amount collected, would be a flat-rate tax levied on a greatly broadened income base. Senator Helms of North Carolina would rid the law of virtually every tax preference and tax all income at about 12 percent. Representative Panetta of California would retain a few preferences and tax at a flat 19 percent. Either approach would greatly improve the efficiency of the system, simplifying calculations and increasing the incentive to earn. But the price of simplicity in such a flat-rate tax is an enormous redistribution of income.

According to the Congressional Budget Office, Mr. Helms's plan would raise the burden on those earning $5,000 to $10,000 by 147 percent — while decreasing the total paid by families in the $100,000 to $200,000 range by 47 percent. Mr. Panetta would fully protect the poor but would still be increasing the burden on middle-income families.

Lacking this radical simplicity, but preserving the present balance of pain, is the Bradley-Gephardt plan. It would continue to permit a few politically sensitive deductions, like home mortgage interest and contributions to charity. But more affluent families would pay a surcharge on these preference items. Also, the marginal tax rate would increase with income, topping out at 28 percent for those earning more than $37,000.

Unlike a flat tax, Bradley-Gephardt would thus not mix tax reform with redistribution: no income class would benefit at the expense of any other. But dozens of tax exemptions would be eliminated; most would pay tax on almost all types of income. The average citizen could thus figure his own taxes and figure that his neighbor was also paying a fair share.

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Neither a flat tax, nor a sophisticated hybrid like Bradley-Gephardt, would be easy to enact. Hardly anyone objects to the idea of simplification; but almost every voter aims to protect a favorite piece of tax-exempt turf. Investors want preferences for capital gains; working parents want deductions for child care; Americans abroad want foreign income exclusions, and so on. All exclusions can find their justification. But by cumulatively narrowing the tax base, all contribute to making the income tax code a disaster.

The issue, then, is whether Congress can muster the vision to look to the common interest. The hurdles are formidable, but so are the potential benefits: a return to fairness and faith in a system that lies at the heart of responsible government.

Newsweek

JULY 19, 1982

The 'Flat Tax' Bandwagon

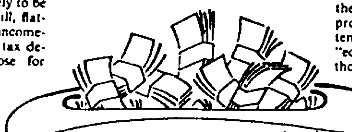
Supply-side economist Paul Craig Roberts likes it. Senate Finance Committee chairman Robert Dole is interested and some liberal Democrats have good things to say about it. Last week even President Reagan seemed to jump on the bandwagon for a flat-rate tax system. "Let me just say we support looking at that," said the President. "It is a very tempting thing."

Reagan was speaking for a lot of people. The purpose of the tax would be to simplify the nation's byzantine income-tax structure, and legislators are debating the virtues of at least six different flat-rate proposals on Capitol Hill. None is likely to be enacted into law soon—if ever. Still, flattening out the nation's progressive income-tax system and eliminating many tax deductions, possibly including those for home mortgages and charitable contributions, is getting its most serious discussion in decades. "There's a lot of movement for [the flat tax] at the grass roots," says Iowa Sen. Charles Grassley. "As usual, Congress is years behind the times."

There is no pure flat-rate tax bill as such. Theoretically, the simplest—and probably least practicable—would impose a tax of from 10 to 15 percent on all income earners, banishing all deductions and exemptions from the tax code. The proposals before Congress are more complex. A bill sponsored by Arizona Sen. Dennis DeConcini calls for a 20 percent flat tax on corporations and individuals, but would still allow for limited personal and generous business deductions. California Rep. Leon Panetta is proposing a 19 percent rate for individuals and a graduated 3 to 15 percent rate for corporations, while retaining special personal exemptions for blind and elderly taxpayers. Critics of the idea argue that there is little "flatness" in them at all. "You begin making exceptions to the exceptions," says New York Rep. Barber Conable Jr., "and pretty soon you're right back where you started."

Deductions: The chief problem is that most so-called flat-tax proposals would tend to penalize middle-income taxpayers, while leaving somewhat more in the pockets of those in both upper- and lower-income brackets. Generous standard deductions embodied in the plans would exempt the poor and many low-income workers from paying higher taxes, while middle-income earners would lose home-mortgage interest deductions and other tax benefits. To combat that problem, New Jersey Sen. Bill Bradley and Missouri Rep. Richard Gephardt plan to introduce a bill that would retain many major tax deductions, including those for mortgage interest, income from social-security and veterans' benefits, state and local tax payments and donations to charity. Their proposal also retains some progressivity: approximately 70 to 80 percent of all taxpayers would pay a flat 14 percent tax rate, while those in the uppermost brackets would pay a graduated rate up to a maximum 28 percent (the current ceiling is 50 percent). As a result, Bradley figures that many taxpayers would pay less tax than under the current code (chart). But since favorable tax treatment of unearned income, including capital gains, most interest and dividends, would be abolished, some rich people would pay more.

According to its proponents, a flat-rate tax would have several important benefits. A low tax rate would discourage investment in nonproductive tax shelters. Substituting a single across-the-board rate for the current maze of multiple tax brackets and rates would also dramatically simplify filing procedures for taxpayers—and perhaps even allow the entire tax form to be printed on a single postcard. A flat-rate tax that eliminated many deductions would be fairer than the current tax code, widely believed to allow wealthy taxpayers too much leeway to dodge high taxes through legal loopholes. And most importantly, backers argue that a low flat rate could ultimately increase the flow of tax revenue to the U.S. Treasury's coffers by encouraging better compliance by taxpayers.



A LEVEL LEVY

One flat-rate tax proposal for 1984 would benefit middle-income earners but hurt those with investment income

Single income	Tax under existing law	Flat-tax proposal†
$15,000	$1,801	$1,645
30,000	5,773	4,143
120,000*	23,387	26,340

Family of four income**	Tax under existing law	Flat-tax proposal†
$15,000	$889	$833
30,000	3,165	2,874
120,000*	16,741	22,370

†Bradley-Gephardt Comprehensive Individual Income Tax Proposal

*Assumes $60,000 in "unearned" or investment income and roughly $26,500 in itemized deductions under existing law

**Two wage earners

Christoph Blumrich, Nancy Ewing—Newsweek

Some economists believe the talk of revamping the tax is unsettling. Massive new tax-law changes are "exactly what the economy does not need right now," says Citibank economist Arthur Gandolfi. Mere talk of eliminating the deductibility of home-mortgage interest expenses might further damage the ailing housing industry and thwart the already weak economic recovery. And opponents worry that the flat-rate proposals may simply divert attention from the graver issue at hand: reducing government spending as a share of the gross national product.

Both Republicans and Democrats plan to make the flat-rate tax proposals an issue in the November elections. Senator Dole has promised to hold hearings on them in September and last week vowed to introduce an "equity tax" bill of his own by then. Although Reagan Administration budget director David Stockman has suggested some components of a flat tax could be introduced in the fiscal 1984 budget, many experts wonder whether the issue will even survive the fall campaign. Given its complications—and the opposition arrayed against all but the most watered-down versions—the flat-rate tax may be an idea that sounds too good to ever come true.

SUSAN DENTZER with CHRISTOPHER MA and HOWARD FINEMAN in Washington and ERIK IPSEN in New York

Reach Out—And See Someone

An AT&T executive predicts the Picturephone will be "one of the most innovative and worthwhile business tools of the decade," and if the initial corporate response is any indication, he may be right. Even before Ma Bell offered its two-way audio-visual Picturephone Meeting Service to the public last week, the telecommunications giant had already persuaded buyers across the country to install private Picturephone rooms at a total of 230 locations.

The new system gives a caller a color TV picture of both the people in his own room and the people he's talking to. Bell has been in the city-to-city teleconference business for seventeen years. But the Picturephone cuts the cost of an hour-long coast-to-coast conference from more than $10,000 to $2,380. Private companies can now hook into the proposed 42-city network, installing their own Picturephone rooms for just over $100,000. Although it remains expensive, participating companies expect to cut their executives' travel expenses. And since many managers spend half their time in meetings, Ma Bell salesmen believe the Picturephone will provide a productivity dividend. "It adds a crispness of purpose to meetings," says marketing manager Bill Carter. "It makes for minimal chitchat."

FORTUNE

TAXES

The Flatter-Tax Movement Picks Up Steam

by RICHARD I KIRKLAND JR

Wouldn't it be terrific if we could scrap our Byzantine federal-income-tax system, with it's increasingly chaotic jumble of exclusions, credits, and deductions, and rely instead on a simple low-rate tax on all income? In recent months versions of that modest-sounding but radical proposal have received support across the political spectrum, from conservative Senator Jesse Helms of North Carolina to liberals such as Senator Bill Bradley of New Jersey and Ralph Nader. Budget Director David A. Stockman recently said "The President is highly sympathetic to the flat rate broad-based tax idea." Prominent supply-siders, including Arthur Laffer and former Assistant Secretary of the Treasury for Economic Policy Paul Craig Roberts, have hailed the flat tax as a way to rescue Reaganomics from its budgetary doldrums. The general idea has even won the editorial backing of such non-supply-siders as the *New York Times* and the *Washington Post*.

Two weeks ago in Philadelphia the Democratic party put itself on record in favor of a flatter tax-rate structure and a simplified tax code. Both Democrats and Republicans have advanced bills to close off various avenues for avoiding federal income taxes—everything from the more exotic sorts of shelter deals to the basic deductions for home mortgages and charitable contributions to the exclusions for long-term capital gains and Social Security and other transfer payments. Many benefits now taken for granted—such as employer-paid health and life insurance, even free parking spaces—could become taxable. Broadening the definition of taxable income would make it possible to cut tax rates, which now rise in 12 stages from 14% to 50%, either to a single rate below 20% or to a much narrower and flatter band of rates.

Despite its sudden efflorescence, this latest movement for tax reform retains a distinctly hothouse quality. For almost a year Congress has been paralyzed by division and indecision, reluctant to cut spending and unlikely now, for fear of offending someone in an election year, to make good its paper promise to raise $20 billion in new taxes. The notion that this ponderously deliberative body might suddenly break its stalemate by pursuing an infinitely more arduous and revolutionary course seems at least doubtful.

When pressed, many congressional proponents of flatter-rate tax legislation admit that they are more than happy just to generate debate on the topic. They concede that their bills are little more than what's known on Capitol Hill as "talking points." All the talk has prompted Robert Dole, chairman of the Senate Finance Committee, to promise hearings on the subject this fall. But economist Milton Friedman, who has advocated a single flat tax on income for more than two decades, draws little comfort from the resurgence of interest in his proposal. What are the chances, FORTUNE asked him recently, that any of the current crop of tax proposals will see daylight? Friedman's reply: "Zero."

"The end of our rope"

Still, popular disaffection with the complexity and inequity of the personal income tax is growing. The IRS estimates it loses some $95 billion annually in taxes—almost one-quarter of the total actually collected from individuals and corporations—on income that disappears into the "underground" economy. Most of that income is legally earned but not reported.

"Unless we make some major changes, we're endangering the voluntary basis of our tax system," asserts Howard Segermark, a top aide to Senator Helms. Adds Representative William Brodhead, a liberal Democrat from Michigan, "Congress is increasingly aware we're reaching the end of our rope. Either we raise rates or broaden the tax base, and there's no question that broadening the base, which would enable us to bring down the top rates, is the way to go."

The chief appeal of the flat tax has always been seductive simplicity. Wiping out tax preferences also eliminates the motivation for millions of taxpayers to spend millions of dollars annually for the services of lawyers and accountants. About 40% of all taxpayers now pay someone to prepare their returns. While the vast majority of citizens would not find their individual contributions to the federal till going down much under a flat rate—indeed, many people's taxes might well increase—all could at least pay up with the assurance that everyone was forking over a fair share.

No longer would the truly wealthy be able to get a free ride, as billionaire Bunker Hunt appeared to between 1975 and 1977, when he paid at most $9.65 in taxes. No longer would neighbors with equal wealth arbitrarily enjoy different after-tax incomes because one happened to own a home rather than rent, or pay his bills by borrowing, or be privy to particularly savvy tax advice. In a flat-rate world everyone would be able to busy himself earning additional income without fear that his efforts would be punished by steadily higher marginal tax rates.

The major problem with going to a flat-tax system, however, has always been getting from here to there. Eliminating all tax preferences and making everyone pay the same rate generally implies a tax increase for those below a certain income level, roughly $30,000, and a tax cut for those

continued

above that point. In addition, taxpayers who currently pay significantly less than the effective tax rate for their income group could face substantial hikes in their tax bills. That last group would include not only heavy itemizers but also those countless others who profit from such untaxed income as Social Security, disability, or veterans' benefits.

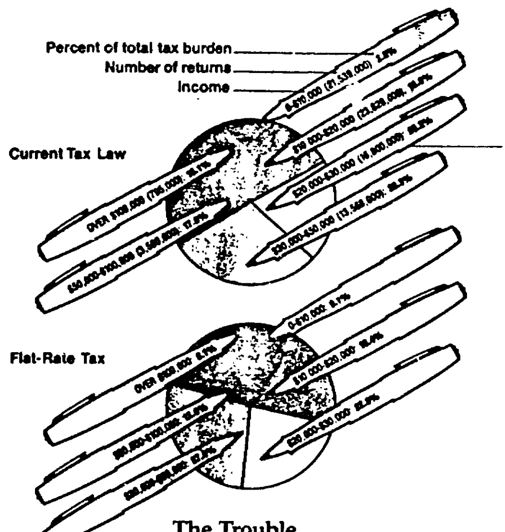
For taxpayers who bought houses or apartments in recent years, loss of their deductions could mean more than just a heftier tax bite. Without the mortgage deduction to solace purchasers, the value of real estate would drop; for some owners of high-priced property, the decline might wipe out their net worth. To these individual cries, of course, would be added a chorus of howls from the innumerable industries and institutions—housing, charities, oil and gas, municipal governments, and Wall Street—that had previously benefited from tax-code subsidies.

Until Congress begins to pay serious attention to solving the transitional problems posed by going to a flat tax—and they could be solved—the idea will remain no more than a utopian speculation. But some tax flatteners seem unaware of the problems. For example, George Hansen, a conservative Republican Congressman from Idaho and founder of a new group favoring tax reform whose members call themselves the honeybees—they aim to sweeten the pot, you see—insists he hasn't uncovered a single citizen who wouldn't be left better off under his proposal to levy a flat tax of 15% on income. The Congressman can't have looked hard.

A true flat tax would also run into opposition from those unwilling to abandon the traditional argument for progressive taxation—the principle that tax rates should be higher for those better able to pay. That could be a sizable group. In a poll taken after last summer's tax bill was passed, the Louis Harris organization asked respondents whether they felt "the principle that higher-income people not only have to pay more in taxes but must pay a greater percentage of their income in taxes" was "fair and equitable." The response was unambiguous: 58% agreed it was fair; 38% did not. By a larger margin, that same group favored maintaining progressivity instead of going to a flat tax.

Combining a comprehensive income base with a single rate is likely to foist a greater share of the tax burden upon lower-income groups (see chart). For that reason Ralph Nader and other liberal reformers—including Brookings Institution economists Joseph Pechman and Henry Aaron, and Robert McIntyre, tax specialist with Citizens for Tax Justice, a lobby financed by organized labor—insist on retaining some degree of progressivity even in a simple system with no deductions. Rather than one flat rate, they support lowering the top rate from 50% to around 30% and replacing the 12 existing income brackets with only three or four.

The tax-flattening proposal that goes furthest toward meeting the theoretical and practical objections to major reform may be the legislation cosponsored by Senator Bradley and a fellow Democrat, Representative Richard Gephardt of Missouri. They propose keeping five or six of



The Trouble with the Flat Tax

Using actual returns filed with the IRS last year (but only those showing taxable income), Joseph J. Minarik, an economist with the Congressional Budget Office, has projected (upper chart) what the distribution of tax liabilities would look like in 1984, assuming the law isn't changed between now and then. Minarik applied various hypothetical flat-tax schemes—all designed to produce roughly the same amount of revenue—to that same 1981 income base. The lower chart assumes a flat 11.8% tax rate with no exemptions and illustrates the trouble with the true flat tax—it punishes the poor. All flat-tax proposals before Congress retain or increase certain exemptions to minimize the shift in the tax burden.

the most politically sensitive deductions—for home mortgages, charitable contributions, major medical expenses, and state and local property taxes—as well as the standard exemption for the poor that is common to all flat-tax schemes.

The two Democrats believe they've structured a rate-flattening proposal that maintains the present distribution of tax liabilities among income groups, while raising the same amount of revenue. They do this by imposing a flat rate of 14% on individuals with incomes up to \$25,000 and couples with incomes up to \$40,000; they would tack on a sliding surtax of 6%, 11%, and 14% on additional earnings, for a maximum tax rate of 28%.

A legislative stampede

Even Bradley's plan would entail a lot of ox-goring; for one thing it would increase capital-gains taxes, now at a maximum of 20%. And skeptics, such as New York's Barber Conable, ranking Republican on the House Ways and Means Committee, point out that permitting any exemptions would encourage a legislative stampede by other special-interest groups for similar treatment.

It's a familiar litany. Radical reform is too radical to be realistic, realistic compromises too compromising. But the recent boomlet of interest in a flat- or flatter-rate tax system shouldn't be treated like just another bulletin from the Flat Earth Society. It is at the very least an encouraging sign that the turn taken by congressional tax policy in recent years—away from a system that punishes individual savings and investment and toward one that encourages those activities—will continue.

The one major issue left unaddressed in last summer's landmark tax bill was the need to broaden the tax base. Since that involves taking away as well as handing out, Congress naturally hesitates to face up to the task, but the budget bind may make such a course inevitable. Soak-the-rich rhetoric is notably absent from the debate over the flat tax—heartening evidence that the long-term trend continues to be toward encouraging capital formation.

The Washington Post

Democrats Endorse Budget Plan, Modified Flat-Rate Income Tax

By Paul Taylor
Washington Post Staff Writer

PHILADELPHIA, June 26—The Democratic Party, breaking with traditional approaches, today endorsed in general terms both an overhaul of the federal personal income tax system and a pay-as-you-go approach to congressional budget-making.

The two proposals, both adopted as unanimous voice vote amendments to the party's draft statement on the economy, were among the first concrete signs on the economic front of a party moving beyond a posture of vague generalities peppered with broadsides against the Reagan administration.

"I think people are going to come away from this conference with a sense of the ferment and the rethink that is going on in the party," said Rep. Richard A. Gephardt (D-Mo.), coauthor with Sen. Bill Bradley (D-N.J.) of a tax-streamlining bill that, in the process of eliminating many tax loopholes used by the wealthy, would set a flat rate for most taxpayers and a modified graduated rate for those in higher brackets.

Specifically, the bill would drop the rate to a flat 14 percent for single taxpayers with incomes up to $25,000 and for couples with incomes up to $40,000. A graduated surtax ranging from 6 percent to 14 percent would be applied to incomes above those levels.

Those changes would have the effect of reducing the maximum rate from the 50 percent it is now to 28 percent. To alleviate the burden on taxpayers at the low end of the scale, the personal exemption would go up from the current $1,000 to $1,500 and the zero bracket amount for joint returns would rise from $3,400 to $4,600.

To offset the revenue loss, the bill would eliminate most tax credits, exclusions and deductions except some of those claimed by the majority of the taxpayers. The exceptions include charitable giving, home mortgage interest, certain medical expenses, state and local taxes, Social Security and veterans' benefits and interest on municipal bonds.

"Over the years the tax code has become a vehicle for political favoritism and social engineering," said Bradley, chairman of today's workshop on economic growth. "It is now far too complex. It is blatantly unfair." Under his proposal, most of the 60 million taxpayers who use the standard deduction will pay less than now, he said.

Rep. Henry S. Reuss (D-Wis.), said the beauty of the Bradley-Gephardt bill, which is to be formally introduced in Congress within a few weeks, is that it avoids the perennial pitfall of taking on tax reform piecemeal. "Many of us have been stubbing our toes for 20 years trying to plug those loopholes."

"Everyone is for tax reform but no one wants to give up his or her special loophole," added Sen. Gary Hart (D-Colo.). "To really reform, you've got to get outside the system and start all over again. This bill goes a long way toward putting the party back on track in terms of leading the economic debate."

The workshop did not specifically endorse the bill, but adopted language tailored to the proposals in it by embracing the goals it is designed to achieve.

Similarly, the workshop adopted an amendment offered by Sen. Christopher J. Dodd (D-Conn.) that, though broadly worded, was intended to give a boost to a pay-as-you-go approach to congressional budgeting that was offered on the floor of the House last month by Rep. George Miller (D-Calif.)

Under the Miller bill, Congress, before it can authorize any new spending, must also provide up-front the new sources of funds to pay for it.

Because the plan would freeze spending at current levels and require budget cuts and/or new revenues to fund any new programs, it raised some eyebrows among those who think the current mix in the federal budget is tilted too much in favor of guns over butter. But debate was brief, and little opposition surfaced.

Among the other key amendments to the economic policy paper adopted yesterday were resolutions rejecting a constitutional balanced budget amendment, calling for a cap of $700 per taxpayer on the fiscal year 1982 and 1983 tax cuts and proposing elimination of the so-called tax leasing provisions adopted last year. The workshop also approved a block of amendments promoting the idea of equal pay for women for work of comparable value.

While the economic panel was flirting with new ideas, it did not stint on attack. Most of the draft report on the economy was a bill of horrors against a Republican economic program that "has drawn a safety net around a small, wealthy minority while working families, the elderly poor, children from disadvantaged homes and members of minority groups have fallen through the holes."

Nowhere was the attack mode more in evidence today, however, than in a panel on energy and the environment. Party leaders there spent the day celebrating their opportunity to "capture the center of American thought," in the words of Rep. Albert A. Gore Jr. (D-Tenn.).

Before they met formally, they heard pollster Peter Hart tell them that by a margin of 67 percent to 18 percent, Americans favor more stringent laws protecting the environment; that by a margin of 64 to 14 they believe the Democrats are commited to those goals and that by 53 to 27 they believe that the Republicans support relaxing the regulations.

"(Interior Secretary James) Watt is the Kryptonite around the neck of the Republican Party," Hart said.

"The Republican policies on the environment aren't moderate and they aren't conservative, they're violently radical," former vice-president Walter F. Mondale told the environment workshop. "Don't just pick on Watt . . . pick on the guy who went all over the country to find him."

The policy statement on energy and the environment dismisses the Reagan policies as aberrational and calls for a return to what it described as the bipartisan consensus that existed in those areas before 1981.

The New York Times

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IN THE NATION

Fair's Fair But What's Fair?

By Tom Wicker

Kenneth Sims, a defensive lineman who was the top choice in this year's National Football League draft, now has signed a contract that his agent says will yield him more than "any major executive at any major company will be making."

Few Americans will begrudge Mr. Sims, 22, such an income or the investments that Witt Stewart, the agent, says will make him "set for life" financially. Some people may well be angered, however, by Mr. Stewart's further disclosure that the lineman should not have to pay taxes for at least seven years "if everything goes well," and not much after that.

"You get him in good depreciable real estate, put him in municipal bonds and let it sit there," Mr. Stewart told wire service reporters when the contract with the New England Patriots was signed. "He shouldn't really have to pay taxes."

Unfortunately, not everyone is good at sacking quarterbacks or hitting home runs or playing rock music, or has the opportunity to dig oil wells or make big bucks in business. And only those who do can be "set for life" through the kind of investments on which little or no tax has to be paid — "tax preferences" if you have them, "loopholes" if you don't.

Public resentment of the spectacle of big incomes — individual or corporate — on which virtually no tax need be paid is one thing driving new political interest in tax reform. Another is the annual lost weekend or more that the small but honest taxpayer now has to devote to figuring out his Federal income tax. With all due respect to H. & R. Block, why should the tax code be more complicated than Einstein's theory? That complexity, together with the pervasive national sense that big money gets off lightly, probably also contributes to the growing problem of outright tax evasion.

For all these reasons, there's growing interest, even among some liberals, in the "flat-rate" tax proposals of supply-siders and conservatives. The $21 billion tax increase for 1983 just voted by the Senate Finance Committee reflects that interest, and budget director David Stockman recently told reporters that President Reagan "is highly sympathetic to the flat-rate, broad-based tax idea."

He would not be surprised, he said, "if it was part of next year's budget" — although he is alone, so far, in that speculation.

At their mid-term conference, Democrats also declared for a "fairer, simpler and more efficient" tax code, but advocated, instead of the flat tax, "a broad-based, low-rate" tax retaining some progressivity for upper income groups.

The main problem with a real flat-rate tax is that it abandons that long-held principle of progressive taxation — that the rich, with more ability to pay, should pay at higher rates. The result would be a massive redistribution of income, with more of the tax burden shifted from the rich to the poor and middle class.

A flat-rate tax would eliminate exemptions or deductions of any kind, thus all "loopholes" — but that would be a disaster for the housing industry and for charitable contributions. Social Security and veterans' benefits would be taxed. On the other hand, a flat-tax also would eliminate "bracket creep," the marriage penalty and the ability of the rich to shelter income; it might even reduce tax evasion, due to its simplicity and appearance of equity.

That's why two of the most attractive younger Democrats — Senator Bill Bradley of New Jersey and Representative Rich Gephardt of Missouri — may have a winner in a new tax reform proposal that appears to combine the best features of the present and proposed systems:

- It adopts the simple flat-rate idea yet preserves progressivity.
- It saves the most popular deductions and exemptions yet kills the most notorious loopholes for the rich.

It would do the former by providing a flat 14 percent rate for all taxpayers earning up to $25,000, or $40,000 for married couples, and imposing progressive surcharges on those earning more, up to a maximum tax rate of 28 percent — compared to 50 percent now.

And it would do the latter by allowing exemptions for Social Security and veterans' benefits, and deductions for charitable contributions, home mortgage interest, state and local taxes and little else.

Senator Bradley, who plans a similar reform for the corporate tax, says revenues under the Bradley-Gephardt plan would be about the same as those under the Reagan tax bill enacted last year. Yet, he claims, 65 percent of all taxpayers would get an even larger tax cut.

If all this sounds too good to be true, it probably is. The plan apparently would not address the current deficit problem. Powerful lobbies will oppose, perhaps prevent, elimination of such loopholes as the deduction for intangible drilling costs — as well as most others. And, in fact, it's not easy to decide what's a "loophole" and what's a legitimate deduction that ought to be preserved.

Sorting *that* out could be the downfall of any bill that seeks a compromise between present complexity and promised simplicity.

WALL STREET JOURNAL

THURSDAY, JULY 8, 1982 WHITE OAK MARYLAND

Level Levy?

Idea of Flat-Rate Tax Is Gaining, but Passage Appears to Be Unlikely

'Bracket Creep' Would End, Backers Say, but Foes See Benefits for Well-to-Do

'It's Fun to Talk About but . . .'

By CHRISTOPHER CONTE
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – Some politicians here consider people like Melba Deever the vanguard of the next phase of the national tax revolt. With her family in financial trouble and not yet feeling much relief from tax cuts, she has latched on to the latest hot idea for overhauling the income tax system.

"For the past 10 years we have been the so-called middle-class Americans, paying more taxes than any of the rich, who can afford the tax shelters and the high-priced lawyers to beat the system," the Albany, Ore., woman wrote to Republican Sen. Mark Hatfield. "Why can't this country have a flat 15% income tax on all people gainfully employed, with no deductions?"

A surprising number of people, including politicians from both parties, agree with Mrs. Deever. Despite enactment last year of President Reagan's three year 25% cut in individual income-tax rates, letters like hers have been streaming into congressional offices. Scrap the whole complicated panoply of tax deductions, credits and exclusions, they say, and instead set a single low rate for everybody.

Lurking Complications

A flat rate tax, most experts agree, remains a long shot. Behind its apparent simplicity lies a thicket of potential complications. Opponents argue that in its simplest form, it would mainly benefit the well-to-do. And skeptics say the idea's broad backing could easily dissolve if policy makers ever get down to eliminating specific tax deductions.

"It's fun to talk about it, but it would be impossible to implement," says John Nolan, a Washington attorney and former Treasury Department tax specialist.

Nevertheless, the idea is gathering support from a growing number of politicians. Lawmakers of both parties have started floating flat rate proposals. The Democratic Party at its recent conference in Philadelphia said a flat rate or gross income tax system should be considered, because "common sense dictates that this convoluted system be dramatically simplified." And President Reagan, after being cool to the idea initially, this week called it "a very tempting thing" that should be considered.

Proponents contend that by eliminating all or most tax preferences, the government could raise with a relatively low tax rate the same amount of revenue as now. A single rate would greatly simplify the task of filling out tax returns and calculating taxes. It would reduce the incentive to try to shelter income, advocates argue, and it would ensure that taxpayers with the same income pay the same amount in taxes.

A flat-rate tax, its backers say, also would resolve some of the worst anomalies that arise from progressive tax rates. One of these is "bracket creep," the increase in tax burdens that results when salaries, ballooned by inflation, push taxpayers into higher "marginal" tax brackets. Another anomaly is the "marriage penalty," the jump in the tax bite when couples combine their incomes and move into a higher tax bracket as a result.

Moreover, many economists contend that a flat rate system without deductions would lead to a more efficient economic performance, because spending and investment decisions wouldn't be distorted by tax considerations. The flat rate tax, concludes one congressional aide, "is the dream of every tax expert."

Some Republicans, such as Sen. Hatfield, support the flat-rate idea as a way to get the government out of the business of using the tax code for social engineering. "By attempting to solve every social and economic problem through the tax code," he complains, "we have put a greater and greater burden on the average taxpayer."

Support From the Right

Much of the current enthusiasm for the flat rate idea is coming from conservatives, who seem to be most concerned about ending the progressive features of the current income tax. A coalition of flat tax advocates includes conservative Republican Sen. Jesse Helms of North Carolina, Chairman Terry Dolan of the National Conservative Political Action Committee, author George Gilder and Richard Viguerie, the publisher of Conservative Digest.

Some conservatives see the flat-rate tax as a way of furthering "supply side" economics. David Hale, the chief economist for Kemper Financial Services, argues in a Heritage Foundation article entitled "Rescuing Reaganomics" that the president's tax cuts really fulfilled the supply side promise of increasing incentives to work and invest only for the very wealthy. Their top tax rate was slashed last year to 50% from 70%. Mr. Hale maintains that a flat rate system would provide similar cuts in marginal rates for middle-income taxpayers, whose top rates haven't been reduced so substantially.

"For the overwhelming majority of taxpayers between now and 1985, the Reagan program provides tax relief rather than far-reaching structural reform," he concludes.

Many supply siders fear that the marginal rate cuts they helped engineer last year are jeopardized by the current drive in Congress to find more revenues to narrow projected federal deficits. If new revenues need to be found, they argue, it would be better to raise them by eliminating tax preferences than by increasing marginal rates again.

Some liberals are wary of such arguments. They contend that a flat-rate system would merely transfer more of the tax burden from the wealthy to middle- and low-income people. A low flat rate, say 20%, would reduce taxes for most people in higher brackets while raising them for people in lower brackets, they argue.

"There's no question that the effect is to raise taxes for low and middle-income people," says Jerome Kurtz, President Carter's Internal Revenue Service commissioner. "As the debate on this gets serious, support from the liberal community will evaporate."

Other liberals believe that many goals of a flat-rate tax could be accomplished without changing the current distribution of tax burdens. Democratic Sen. Bill Bradley of New Jersey and Democratic Rep. Richard Gephardt of Missouri have proposed abolishing most tax preferences and establishing a simple, four rate progressive tax structure.

Under their plan, there would be a flat 14% rate for all taxpayers with adjusted gross incomes below $25,000, or $40,000 for joint returns. That would cover 80% of taxpayers. But the rates would rise in three steps on incomes above $25,000, reaching a top rate of 28% on income over $37,000, or $65,000 on joint returns.

The proposal also would raise the floor for low income people who wouldn't be required to pay taxes. And it would retain a few tax preferences including home mortgage interest deductions.

Sen. Bradley estimates that most of the 60 million taxpayers who claim the standard deduction would end up paying lower taxes under his proposal. Taxpayers claiming relatively few deductions would pay about the same as before, or slightly less, but with less paper work. Taxpayers who take large deductions would pay more.

He cites the example of a married taxpayer who reports $30,000 income and who doesn't claim many deductions. He would pay $3,165 in taxes in 1984 under current law and $2,674 under the Bradley-Gephardt proposal. A taxpayer with the same income who claims many deductions would pay $2,570, in 1984 under current law, compared with $2,548 under the proposal.

Beneath the Simplicity

Despite the apparent simplicity of the flat rate idea, specialists say, the plan has various complexities. One problem involves defining income. Most proposals suggest applying a flat rate to some form of "total income." That would involve taxing many forms of income that currently are exempt—such as Social Security payments. Some theorists even believe that homeowners should be taxed for the "rent" they implicitly pay themselves for their own homes.

One key to winning public support may be whether specific flat rate schemes actually offer significant improvement over the current system. In words strikingly similar to Mrs. Deever's, the recently formed conservative Coalition for a Flat-Rate Tax asserts that the present tax system "places an unfair tax burden on the vast majority of working middle class Americans while allowing people in the upper-income brackets, who can afford to hire expensive lawyers and accountants, to take advantage of countless loopholes to avoid their fair share of the tax burden." Some go even further. William Safire, a New York Times columnist, asserts that the current tax system, because of loopholes, isn't progressive at all.

Many tax analysts dispute such assertions, however. The non partisan congressional Joint Committee on Taxation estimates that even after considering the effects of various tax preferences, average tax liability rates rise from about 6% for people with incomes between $5,000 and $10,000 to a high of about 25% for people with income over $200,000.

Nor is it true that tax preferences benefit only the wealthy. A 1977 Brookings Institution study concluded that the benefits are di vided fairly evenly among all income groups. While upper-income people do benefit from such provisions as the 60% exclusion of capital gains, low-income people are helped by other provisions such as the nontaxability of transfer payments. And a variety of other tax preferences, such as deductibility of mortgage interest and of state and local taxes, provide considerable relief to middle-income groups. One analysis by Joseph Minarik, an economist with the Congressional Budget Office, suggests that a flat-rate system would wind up transferring more of the tax burden to middle-income groups.

Support for Simplification

It is far from certain that simplifying the tax system is by itself a strong enough issue to drive such a sweeping change through Congress. Despite frequent complaints about the complexity of the income tax, H&R Block Inc., the tax-assistance company, says its polls show that taxpayer support for simplifying the tax system is quite weak. H&R Block's business, of course, is to help taxpayers deal with complicated tax forms. But its poll results may be explained in part by the fact that about 70% of all taxpayers avoid the major complexities of the system by using the standard deduction.

"There is no organized constituency for simplification of the income tax," concludes Mr. Kurtz, the former IRS commissioner.

Compared with the amorphous support for tidying up the tax system, the beneficiaries (including tax lawyers and accountants) of special tax provisions that might be wiped away by simplification are highly organized and vocal. Many tax analysts also believe that wiping the slate clean of all special tax revisions would have too unsettling an effect on the nation's social structure.

There currently are over 100 special tax provisions, called "tax expenditures" by Congress. The combined benefits provided by them have been estimated very roughly at $253 billion. And they are growing rapidly. By 1987, the Senate Budget Committee estimates, the benefits will rise to almost $440 billion.

The Rocking Boats

— "Too many social and economic institutions are already interwoven into the tax system" to allow for quick and easy changes, says Mr. Nolan, the former Treasury tax official. Adds Donald Lubick, a Washington attorney who fought to close some tax "loopholes" as a Treasury official during the Carter administration, "Once you start assessing the implications of doing away with them, you see there would be too many rocking boats."

Some old Washington hands conclude that the only way to get Congress to enact such a sweeping change as a flat rate tax, or a variant of it, would be as part of a large overall tax cut. That way, the repeal of cherished tax preferences could be buried in a general reduction of everyone's taxes. "It's awful hard to get any tax reform without putting sweetening in it," says Charls Walker, a seasoned Washington tax lobbyist.

But with Congress facing the prospect of $100-billion-a year deficits for the foreseeable future, most lawmakers are looking for ways to increase revenues rather than cut them further. Unless there is a change in the politics of tax reform, that doesn't bode well for either the flat rate tax or similar proposals.

"In tax reform, you have to have enough money to buy off the losers," explains economist Barry Bosworth. "But Congress has already given away all of its revenues for some years to come, and more."

The Philadelphia Inquirer
review & opinion
Sunday, June 20, 1982

Sen. Bradley has a better idea for the Democrats

By Edwin Guthman
Editor of The Inquirer

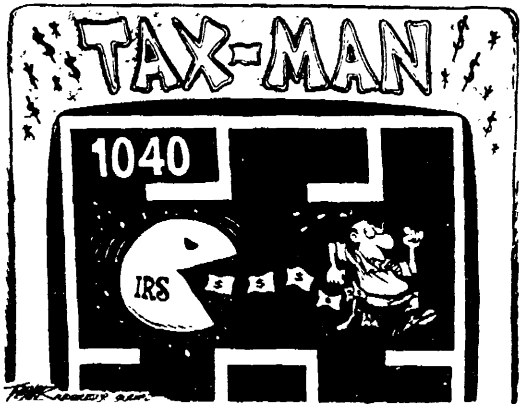
Almost all the big name Democrats except Jimmy Carter (he'll be in Canada on a fishing trip) will be in Philadelphia this week for the party's four-day mid-term convention beginning Thursday and New Jersey's Sen. Bill Bradley plans to make them an offer that maybe they'll refuse. But maybe not.

The offer Go to the voters in the congressional election this fall — and looking ahead to the 1984 presidential election — with a definite, detailed plan to simplify the Federal Income Tax Code, eliminating most exclusions deductions and loopholes and lowering the tax rates for from 60 to 70 percent of the nation's 103 million taxpayers

Bradley and Rep Richard A Gephardt (D, Mo) unveiled just such a plan a few weeks ago based on 14 months of diligent research They are not wedded to every detail of it, but believe they have drafted a proposal that has a realistic chance of developing a broadly based consensus for reform and they plan shortly to introduce legislation in Congress to have it go in effect in 1984

"The winners essentially would be people now on salary who claim relatively few itemized deductions," Bradley said in meeting with The Inquirer Editorial Board recently "The losers would be the people who have been taking advantage of tax shelters

"If the Democrats are looking for a new idea, this is what we've traditionally stood for and it meets a yearning that is out there "



Bradley doesn't claim that the idea of simplifying the tax code is new It has been bandied about for 20 years or more Carter in campaigning for the presidency in 1976 repeatedly called the tax code a "disgrace to the human race" and promised to do something about it, but Congress turned him down

An acquaintance of mine, John H Hall, a Los Angeles tax lawyer, took a post in the Treasury Department in the Nixon administration as deputy assistant secretary for tax policy with the single purpose of reducing tax rates and hacking at the maze of loopholes and deductions But President Nixon shied away from the strenuous political fight that was certain to ensue and before long a frustrated Hall was back in Los Angeles

The Bradley-Gephardt plan if not new at its roots, is different in detail from previous proposals Also it would retain a progressive tax rate at a time when an increasing number of political leaders including Sen Robert Dole, (R Kan) chairman of the powerful-tax-writing Senate Finance Committee, are warming up to the idea of replacing the present code with a flat-rate tax that would have fewer deductions

An obvious problem with any flat rate tax is that over not too long a period of time it would favor the very rich by allowing accumulation of wealth recreating the old concentration of wealth in a few families whose power the progressive income tax was designed to weaken

However, any plan to make tax forms simple enough so that people who can add and subtract could fill them out without professional help, much less cut through the tax code's labyrinth of confusing rules and regulations, is going to run into a storm of special interest hornets on Capitol Hill.

And if you consider that the lawyers and accountants who devise the tax shelters and figure out the loopholes for wealthy clients form one of the special interest groups that would be hit the hardest and that lawyers predominate in the Congress, well, it doesn't seem that the Bradley-Gephardt proposal or any other effort to reform the tax code stands a ghost of a chance of being enacted

But there's no question that most Americans perceive that the tax code is too complicated and unfair and that it increasingly nourishes an underground economy In announcing their plan, Bradley and Gephardt voiced concern that the people are losing respect for the integrity of the tax laws

"The most important ingredient of our tax system is voluntary compliance," Gephardt said. "The recent cards and letters I have been getting in connection with the budget debate make me wonder if anyone thinks the system is fair If people can understand the system — which they certainly can't today — they will be more likely to support it. And with the growing size of the cash or underground economy, we need a system which has widespread support "

Bradley asserted that unless the trend set by President Reagan's 1981 tax cut is reversed, "the only people paying income taxes in the future will be those whose wages and salaries will be subject to withholding That prospect is simply unacceptable in a democracy

"On the other hand, if we lower tax rates and broaden the tax base, I think we have a tax system that really encourages the productive work and investment needed for sustained economic growth."

Their proposal will not please purists who would abolish all deductions, exclusions and loopholes They don't pretend that any reform plan that would do that has a realistic chance of enactment, so they would retain deductions which have strong public support — those for charitable giving, home mortgage interest, some medical expenses, state and local income and property taxes and Social Security and veterans' benefits They also would continue to exempt income from investment in municipal bonds

Specifically, their plan would drop the tax rate to a flat 14 percent for single taxpayers with incomes up to $25,000 and for couples earning $40,000. A progressive surtax ranging from 6 to 14 percent would be levied on incomes above those levels. That would reduce the maximum rate from the current top of 50 percent to 28 percent

It would raise the same total revenue as the present system, drawing the same amount of taxes from the same income brackets, but, as Bradley pointed out, while the majority of taxpayers would be better off, many high income earners would pay more.

Bradley believes, however, that many of them would give up their tax shelters and loopholes, "along with the headaches and time spent trying to avoid taxes," in exchange for a lower marginal rate

Reforming the tax code won't ease the nation's mounting budget deficit or correct the deeper weaknesses in the economy, but it would be fairer and it sure would make life easier as April 15 comes around each year

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Toward a fair federal tax code

David Stockman, President Reagan's director of the Office of Management and Budget, says he wouldn't be surprised to see Mr. Reagan propose, in his next budget, getting rid of the progressive income tax and replacing it with a flat-rate tax in which all taxpayers would pay about the same percentage of their income. "It's very much our intention to move in that direction," Mr. Stockman told a group of reporters in Washington. "The President is highly sympathetic to the flat-rate, broad-based tax idea."

As a matter of fact, the administration already has begun moving in that direction with a Treasury study of the idea, which Treasury Secretary Donald T. Regan has described as "maybe the fairest tax of all."

Maybe, and maybe not. One classic definition of fairness was formulated in doggerel a few years ago by Sen. Russell Long of Louisiana, then chairman, now ranking Democrat, on the Senate Finance Committee:

"Don't tax you, don't tax me, tax that fellow under the tree."

To most Americans, though, the principle upon which taxation ought to be based is ability to pay, and the flat tax certainly flouts that. How can it be fair for the millionaire to pay the same rate, say 12 or 15 percent of his income, as a widow working to support herself and her two children at the current minimum wage of $3.35 an hour? How can it be fair for the heir to a great fortune, who never worked a day in his life, to pay the same rate as the coal miner, the shoe salesman in a store, the busboy and so on?

None of which is to say that the present system of federal taxation (or state and local taxation, for that matter) is a thing of beauty and a joy forever. To the contrary, more and more Americans are coming to realize that it is, as President Jimmy Carter described it, "a disgrace to the human race," and even more now than it was then, with the supply-side economic theory (or "trickle-down theory," as Mr. Stockman allowed himself to be quoted in that celebrated Atlantic Monthly article) embodied in Mr. Reagan's first budget, and his second.

Before Reaganomics the federal tax code was riddled with loopholes and jerry-built with shelters. The 1981 Economic Recovery Tax Act added more loopholes and built more shelters. Those, for the most part, gave the wealthy new ways to avoid paying their fair share of the tax burden, and, to make things more unfair for the average taxpayer, it is the upper-income people who gained the most out of those celebrated tax cuts.

Plainly, the system begs for reform, and more and more Americans are demanding it, but in what direction should reform move? Toward simplicity, yes — to the average American, wrestling with his Form 1040 is like wrestling with an octopus — but also toward fairness.

Sen. Bill Bradley (D., N.J.) and Rep. Richard Gephardt (D., Mo.) have worked out a plan that does go in the right direction. The Bradley-Gephardt plan would eliminate almost all tax preferences, such as those oil and gas gimmicks that allowed Attorney General William French Smith to shelter a large part of his income. It would keep such socially useful (and politically sensitive) deductions as those for home mortgage interest, some medical expenses, state and local income and property taxes, and Social Security and veterans benefits.

It also would allow the maximum tax rate to drop from 50 percent to 28 percent, encouraging productive investments to be made, and made on the basis of real value in the marketplace rather than the tax implications. For two-thirds of Americans, it would mean lower taxes.

Those who call themselves political realists may scoff, comparing the pursuit of fairness in the tax code to the pursuit of the Holy Grail — an adventure upon which idealists may embark but a goal never to be achieved. It is true that there are lots of dragons in the way, the special interests who benefit from all those loopholes and shelters and exemptions and gimmicks can always advance arguments to justify them and contribute through political action committees to the politicians who will protect them.

Yet if, as Sen. Bradley says, most of the nation's 103 million taxpayers believe the tax code is unfair and many "are losing respect for the integrity of the tax laws," that is a reality to which political realists who want to get elected, or re-elected, would do well to respond.

The New York Times

Overhaul: 1. Taxes 2. Budget

By Bill Bradley

WASHINGTON — Even if the recession were to vanish tomorrow, bold initiatives will be required to achieve sustained economic growth in an era of technological change and increasing competition in world markets.

The Federal Government's role will be important. The Government must set fair rules — especially when, according to the pollster Daniel Yankelovich,

First of two articles

four out of five Americans believe they won't get ahead by following the rules. Americans must insist on improved Government efficiency — particularly since one in every three jobs involves employment or expenditure at some level of government. The Government, however, should intervene in the economy only when the private sector's capacity to respond for the long term is inherently limited.

In a national effort to generate economic growth, we should take these steps: restructure and simplify the Federal income tax code; consolidate all forms of Federal spending into a unified budget; recognize that we are tied to an interdependent world economy; expand research and development; upgrade the workforce's skills and improve labor-management relations.

First, America needs a fairer tax policy that encourages more productivity and more savings and investment. The tax code has become a vehicle for social engineering and political favoritism, and in the process has grown far too complex. It distorts responses to new economic circumstances, impedes efforts to make America more competitive, and is rightly considered unfair by most of the 163 million taxpayers.

Major improvements can be made and the Government can still collect virtually the same amount of revenue that it does under existing law if we introduce these changes:

- Drop the tax rate to a flat 14 percent for single taxpayers with incomes up to $25,000 and for couples with incomes up to $40,000 and apply a progressive surtax ranging from 6 to 14 percent for incomes above those levels. This would reduce the maximum tax rate from 50 percent to 28 percent.
- Eliminate most tax credits, exclusions and deductions except for the few long claimed by most taxpayers: contributions to charity, interest on home mortgages, some medical expenses, state and local income and property taxes, and Social Security and veterans' benefits;
- Increase the personal exemption from $1,000 to $1,500 and the standard deduction from $3,400 per couple to $4,000.

If this plan took effect in 1984, about 75 percent of all taxpayers would pay no more than a 14 percent rate. About 65 percent would get a cut greater than that provided by the 1981 tax act.

The same general approach should be followed for corporations, which now, because of tax preferences, have rates that range in effect to 37 percent on services and trade and to minus 11 percent on motor vehicles.

With a dramatically lower tax rate, people participating in the "underground economy" or who evade taxes might be lured back to the legitimate economy. The same incentives would move capital away from tax shelters and toward productive investment.

Under neutral tax laws, people would make investments based on real value in the marketplace, not on rates of return artificially inflated by the tax code. With fewer special provisions and loopholes, more taxpayers would be treated equally. People would see that "the rules" no longer capriciously benefit special interests for purposes that are narrow and at costs unknown. An entire tax return might be small enough to fit on one page.

We should also move to a unified Federal budget for a more rational process of determining how tax revenue is spent. The budget's purpose is to give the public and decision-makers in Washington a clear, complete set of spending priorities. A full accounting is important because the budget is more than a one-year document; it sets directions in spending for years to come.

At present, the budget omits nearly 20 percent of what the Government spends. Tax dollars spent on such operations as the Postal Service and the Rural Electrification Administration and for oil for the strategic petroleum reserve do not officially contribute to the deficit. They are placed in an "off-budget" category that in fiscal 1981 totaled $30 billion. But that was small compared to the $253 billion that the Government will not collect in fiscal 1982 because of loopholes that are actually budgetary items.

To make well-informed choices in allocating tax revenues, we must shift to a unified budget that encompasses all "off-budget" spending and all tax subsidies. The public could then see where its dollars go and could more intelligently decide how much should be spent for education, oil exploration and other purposes.

This is the beginning of an agenda for economic revitalization and restored public confidence in government.

Bill Bradley, Democrat of New Jersey, is a member of the Senate Finance Committee.

JUNE 23, 1982

An Economic Agenda

By Bill Bradley

WASHINGTON — A steadily increasing flow of products, people and money across borders has created complex interdependence among national economies. The implications for our economy are enormous. International trade accounts for twice as much of our gross national product as in the 1950's. Exports generate one in six manufacturing jobs and keep one of every three acres of farmland productive. Foreigners' savings in America help finance our capital stock.

Neither our domestic economic policy nor our foreign policy consistently take this interdependence into account.

Second of two articles

Worse, there is a disturbing American drift toward neo-isolationism, and toward protectionism by our most important trading partners.

America should lead in negotiating agreements to reduce restrictions on trade, investment, services and access to markets, particularly among industrialized countries. We will realize an advantage over other countries if we increase investment and employment in our high-technology industries and promote the export of their products.

We must expand exports to the developing countries of Asia, Africa and Latin America, to which major centers of the global marketplace are shifting.

How well we compete in international markets will determine our prosperity. We must take the following steps:

- Pursue a more subtle foreign policy, with more emphasis on development aid to the third world and economic coordination with our industrialized trading partners.
- Find new ways for government, business and labor to cooperate in promoting our exports and in harmonizing our domestic and international economic policies.
- Adopt a fairer, more efficient tax code to make us more competitive faster.

Research and development are essential for a successful export strategy. Private industry spent about $34 billion last year on it; the Government spent about $40 billion, mostly in the defense sector. The nation cannot afford to do less and should try to do more in this period of transition to an economy based more on knowledge than physical labor. We must preserve the indispensable research base in colleges and universities. We should encourage companies to combine research and development resources and share the results broadly. Antitrust laws should be modified if they unnecessarily block cooperation among firms encountering stiff competition from abroad.

Workers will have to command a constantly growing supply of information. Some jobs will be created, others will disappear. Today, 30 percent of the G.N.P. comes from manufacturing. In the year 2000, that percentage will be the same, but it will be achieved with 15 million fewer workers because of increased use of technology that will make production more efficient, easier, cleaner and safer.

We can prepare for this advance by helping workers upgrade their skills and gain additional education. One way might be to create an insurance program under which workers displaced by technology or foreign competition could cash in their policies and use the money to acquire new skills.

Our educational system must meet the growing demand for technical expertise while instilling humane, democratic values. The Government can join business and educational institutions in establishing scholarships for students preparing to teach critical skills such as math, science and foreign languages.

As technology takes over manual work, employees will be most effective as managers of the production process. They should increasingly participate in management and ownership of companies. Quality-of-work circles, membership on boards of directors, and various forms of profit-sharing will affirm to workers their value to their companies. Employee stock ownership plans offer a true prospect of democratic capitalism. No such innovations can succeed unless management and labor, working as a team, treat them as opportunities instead of threats.

The interests of investors who seek stability, and the concerns of working families who seek economic fairness, converge in simplification and restructuring of the tax code. The frustrations of people who believe that their tax dollars are wasted, and the anger of others who believe that special interests control Washington, converge in a desire for a full and fair accounting of what Government spends. The fears of the salesman whose gasoline costs have quadrupled, and the hopes of farmers whose biggest customers are overseas, converge in the recognition of global interdependence. The interests of the executive who has worked for six companies, and the union leader who has seen membership dwindle as plants closed, converge in the search for a new loyalty between labor and management.

It is time to find unity within our national diversity and to rally around a new agenda for the 1980's, and beyond.

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OPINION•BUSINESS

A sweeping tax proposal by Bradley

By TIM O'BRIEN

For 14 months Sen. Bill Bradley had huddled with tax experts, talked with Wall Street and Washington sages, and had pored over Treasury Department and Brookings Institute numbers and formulas.

When done, the New Jersey Democrat announced his conclusions and recommendations: The federal income tax codes for persons and corporations are unfair, inefficient, too complicated and foster widespread cheating and disrespect. The solution? A complete overhaul of the tax structure.

But although there is no political action committee (PAC) opposing fairness, simplicity and efficiency, tax reform movements have in the past proved quixotic. Like Pandora, when reformers open the box, everything comes

See editorial 'Tax magic' in Viewpoint column on next page.

out, usually in the form of dozens of riders offering deductions, credits, allowances and exclusions, all in the name of the betterment of society and the boosting of the economy.

Bill Bradley, who chairs the Democratic Economic Policy Committee, of course, knows all this. He was sitting on the Senate Finance Committee last year when President Reagan's "clean" tax cut bill was sent to Congress. Reagan got his 25 per cent tax slash — he wanted 30 per cent — but he also got 121 other sections added onto the bill that revised almost every tax category. When the Joint Committee on Taxation wrote its "general explanation" of the law, it ran 411 pages.

"I have no doubt that when we hold hearings on this, 35 special interest groups will show up on the first day and testify sincerely that if their particular provision is eliminated, the country will immediately fall into a depression,"

said the state's senior senator, who since floating his proposal at a May 28 Washington Press Club luncheon has embarked on a summer sales campaign.

Essentially his concept calls for dramatic reductions in the corporate and individual tax rates, coupled with the elimination of all but the most widely used deductions, resulting in the taxing of a substantially broader base and therefore raising of the same amount of revenue.

Bradley also knows, though, that in addition to the special interest opposition, he will have support from many quarters, including not just the poor and middle income, but also some of the rich who now spend countless hours and dollars having their lawyers and accountants find ways to shelter their earnings.

The maximum personal income tax rate was 70 per cent when Bradley went to Washington, but was dropped to 50 per cent in the 1981 tax bill, partially on the argument that no one was paying those high rates anyway. It was, in fact, Treasury Secretary and fellow Jerseyan Donald Regan who made the best argument, telling the senators that when he was guiding Merrill Lynch & Co., the nation's largest investment house, he "invented" a tax loophole so complex that when committed to paper the diagram resembled a butterfly, ergo, its name, the "butterfly commodities straddle."

Said Bradley this week: "The high tax rate is an illusion. The wealthy are not paying 50 per cent."

What's worse, Bradley explained, is that the quest for tax shelters inevitably leads wealth away from where it would otherwise go and into "investments" that produce no income or profit but instead cause an inefficient allocation of the economy's resources and impedes growth.

In other words, instead of the rich "straddling" soybean options, or putting their surpluses into race horses, apricot groves, geothermal wells and wildcat oil drilling, Bradley says he wants to see those dollars "move to qu[illegible] to investments that stimulate production and growth — perhaps, for instance, as venture capital for a small company working on a cancer cure."

This is the "efficient" part of the sweeping proposal by Bradley and his co-sponsor in the House, Rep. Richard Gephardt (D-Mo.), and the part likely to attract conservative support. Rep. Jack Kemp (R-N.Y.), the champion of "supply-side" economics and the Kemp-Roth tax cut, said in fact that he applauds Sen. Bradley for trying to lower the rates for individuals, and for trying to bring people from the sheltered economy into the productive and tax paying economy.

"This is exactly what supply side, or production-oriented economics, is all about."

But the cornerstone of the Bradley-Gephardt package is the "fairness" issue, the attempt to correct longstanding inequities built into the tax system over decades by lawmakers trying to stimulate the economy or play social engineer.

"Unfortunately, we're at a point when [illegible] four out of five Americans believe that they can't get ahead if they follow the rules, especially the tax rules," said Bradley, adding: "A majority of the 103 million taxpayers are saying the tax code is unfair. [illegible] They're saying that certain groups avoid paying their fair share and that somebody else with the same income is doing better by the code than they are."

Gephardt, who sits on the House Ways and Means Committee, is even more direct, saying: "The most important ingredient of our tax system is voluntary compliance. I believe a willingness to pay is directly proportionate to a public perception that the tax system is fair and equitable to all. The recent cards and letters I have been getting during the budget debates makes me wonder if anyone thinks the current tax system is fair."

Finally, the new package, called the Comprehensive Income Tax proposal, is being offered for its simplicity. "In my travels and in my discussions with people, including those in the financial community, I find that no one has a total grasp on the current code. It's too complex, and it causes the wealthy to spend an inordinate amount of energy, and time and money with their law firm to figure out how to reduce their tax exposure," said Bradley.

Again, like fairness, there is little opposition to simplicity, and many in Congress are making similar claims — that those who attach a half dozen schedules to their "long form" every April are ready and willing to trade in the bulk of their write-offs in return for a big drop in their marginal tax rate.

Sen. Robert Dole (R-Kan.), for instance, said earlier this month, "I think the people out there are crying out for simplicity on their taxes." Dole, who chairs the Senate Finance Committee, pointed to the simplest of tax structures, the several "flat rate" proposals that have been put forth by Sens. Jesse Helms (R-N.C.), Dennis DeConcini (D-Ariz.) and Dan Quayle (R-Ind.), and by others, including unsuccessful GOP senate candidate Jeff Bell.

These schemes call for a flat tax rate on virtually all income, with but a few exclusions, ranging from 10 per cent in one case to 19 per cent in others. They differ from the Bradley-Gephardt proposal, which retains the progressiveness of the current system, but which offers only four brackets, 14, 20, 25, and 28 per cent.

The Bradley-Gephardt package to date is only half complete, as the corporate tax proposals are still being developed. Bradley said two companion bills will be filed together, probably in late fall. Dole has set time aside in November for the Finance Committee to conduct hearings on the flat rate bills, and on the Bradley plan.

Bradley's proposal drops the tax rate to a flat 14 per cent for single taxpayers with incomes up to $25,000 and for couples with incomes up to $40,000. A progressive surtax ranging from 6 to 14 per cent would be applied to income above those levels, thus reducing the maximum rate to 28 per cent.

The tax rate would rise in increments for incomes above the minimum levels, reaching the maximum 28 per cent rate at $37,000 for single taxpayers and $65,000 for couples.

The poor and near-poor would be protected by having the personal exemption increased from the current $1,000 to $1,500, and by lifting the zero bracket amount for joint returns from the present $3,400 to $4,600. So, a family of four would pay nothing if they earn up to $10,600 ($4,600 plus four exemptions totaling $6,000).

To make up for the reduced rates and generate the same revenues, Bradley proposes "that we eliminate most tax credits, exclusions and deductions except for the few claimed over the years by the majority of taxpayers, or those needed to alleviate genuine hardship."

The "few" deductions that survive, though, are indeed those claimed by most. They are the deductions for home mortgage interest, for all state and local income and property taxes, and for charitable contributions. Also surviving would be the exclusion for Social Security and veterans' benefits, the exemption for interest on general obligation bonds, and the deduction for employe business expenses, the so-called "three martini lunch" write-off that President Carter tried in vain to kill.

Bradley candidly concedes that these exceptions are chosen, at least in part, on "political considerations," saying he is less interested in a "pure" bill than in a good bill "that has a chance to pass." Offering an example, the senator said, "You should be at a Finance Committee session when a vote comes up that might cut back on Social Security; all hands go up (voting no), and everybody says, 'Recorded vote, recorded vote.'"

All other loopholes would be gone or modified under the plan. Taxed would be Dividends, all other interest, including interest earned on life insurance savings and on industrial development or housing bonds; income earned overseas, dividends reinvested in utility stocks, scholarship and fellowship income in excess of tuition, and employer fringe benefits such as child care, tuition and legal services.

Taxes would be paid on unemployment compensation and on disability pay, while eliminated would be the deductions for casualty and theft losses, for adoption expenses, and for state sales taxes.

Gone would be the credits for political contributions, for the cost of rehabilitating a building, and the energy tax credit that allows homeowners to take off the cost of storm windows and the like. There would be no more elderly tax credit, either.

Also gone would be the plethora of business tax benefits used by the self-employed, by partnerships and small corporations, as well as by both big companies and individuals. These include the regular investment tax credit (a 10 per cent write-off for capital equipment), the five year amortization of the cost of pollution control facilities, the expensing of intangible drilling costs for oil and gas, and the depreciation for "reforestation."

Medical expenses would only be tax deductible when they exceed 10 per cent of adjusted gross income, and even the current deduction for up to $150 in health insurance would be repealed.

"All income would essentially be treated the same," said Bradley.

The net result of all this, said the senator, would be that those at the lower end would pay less taxes, those considered middle and upper middle income families would pay slightly less or the same, while the "losers" would be the top 15 per cent of America's earners, although, he insisted, they would not lose much if they have been getting good tax advice. Bradley estimated that more than 65 per cent of all taxpayers would pay less, and he calls this reshuffling a "realignment within groups," saying "It's not a redistribution."

Another hoped for result, of course, is a major dent in the "underground economy," the euphemism to cover everyone who uses cash transactions to cheat Uncle Sam, from the hardened criminal to "your friendly gardener who takes cash." Bradley elaborated, "This plan will be a major way of driving them back into the tax paying economy . . . with a lower rate there's a different calculation when they measure the risk (of not reporting) against the gain, which will be considerably smaller."

A final benefit would be the elimination of "bracket creep" as there are only four brackets.

The Bradley-Gephardt tax team is now working on a similar streamlining and revamping of the corporate tax structure, again with the goal of not producing more revenue, but of creating equity.

His plan, he said, is not designed necessarily to shift the ratio between corporate and personal taxpayers, a ratio that has been sliding in favor of corporations for several years, and, say many tax experts, will continue to slide in that direction thanks to the provision in the 1981 tax law known as the Accelerated Cost Recovery System (ACRS).

Essentially, ACRS, also known as "10-5-3," eliminated the old business depreciation tables, which based tax breaks on how long a new piece of equipment was expected to last, and in effect "accelerated" the deductions. ACRS reduces the old 130 depreciation schedules to three schedules of 10 years, five years or three years, and not only allows companies to write-off the cost of capital purchases quicker, but even allows that shortened schedule to be accelerated, rather than spread out evenly.

Staffers for Bradley and Gephardt say their corporate reforms will modify ACRS, but they say it is too premature to discuss details of the corporate side of the proposal.

In fiscal 1981, corporations in America paid only 11 per cent of all revenues collected by Uncle Sam, down from 14 per cent just four years earlier, and down from 24 per cent in 1960, according to the Internal Revenue Service, which also reports that because of depreciation, investment credits, interest payment deductions, deductions for operating losses, lack of profits, and a variety of other write-offs, nearly half of the nation's corporations pay no taxes.

But Bradley knows that, like the personal tax reforms, there will be strenuous arguments to keep in place every loophole.

Sen. Dole said, "When it comes to a comprehensive tax base, everyone has his favorite exemption they want to protect." He called the several proposals being presented as "intriguing," but has held off any specific comment pending the latest figures his committee has asked for from the Treasury Department.

The finance committee's ranking Democrat, Sen. Russell Long (D-La.), has expressed similar anxieties about getting hundreds of special interest groups to go along with the elimination of most deductions, but the retaining of a few no matter how popular. Long, in fact, sponsored some of the provisions inserted in the 1981 bill.

For his part, Bradley, to press his point, has taken to quoting the proverb created by Long many years ago:

"Don't tax him, don't tax me, tax that man behind that tree."

Long's press aide, Ralph Bermudez, echoing his boss's wisdom on tax reform said of Bradley's proposal, "It sounds like he's opening up the gates of hell."

HONORABLE STEVEN D. SYMMS - COMMITTEE ON FINANCE - SEPTEMBER 27, 1982

Good morning. I would like to compliment the Chairman of this Committee for beginning a process which will hopefully lead to the constructive reform of cur current tax system.

Careful analysis and planning are required in developing a new system which conforms to the objectives of our national tax policy. One major objective of our tax policy should be simplicity. The time and energy consumed in dealing with highly complex and sometimes inscrutable tax forms is reason enough to switch to a simplified system. The enormous amount of money spent on compliance, however, makes the argument for simplicity overwhelming.

In 1954, 18% of the American taxpayers employed professional assistance in preparing their tax returns. In 1981, 52% of all 1040 forms were prepared by specialists. Peter Brimelow of Barron's said that in 1981 an estimated $60 billion was spent by people complying with or taking advantage of IRS regulations. Administration and enforcement of these laws accounts for almost half of all federal government paperwork. In addition, the IRS spends millions of dollars investigating and prosecuting the mushrooming number of taxpayers who are using protest schemes to avoid paying their taxes.

William J. Anderson, Director of the General Government Division of the General Accounting Office portends, "Now more than ever before, the illegal tax protest movement poses a threat to our country's voluntary compliance tax system." More and more, taxpayers are turning to untraceable cash transactions and bartering in order to decrease their tax burden.

By simplifying the tax system and lowering the rate, the flat tax approach would encourage many people who are now avoiding taxes to enter into the regular economy. Tax evaders will find it more cost effective to comply than to spend time and money hiding their wealth. More importantly, large sums of money now spent on both complying and avoiding could be put into productive economic use. The present tax structure with its steeply progressive rates and numerous loopholes, leads to the misdirection of economic resources away from productive investment and consumption and towards purely tax-attractive activity.

A flat tax system would encourage decisions about economic activity to be based on prospects for productive market returns rather than on the arcificial benefits given to it by tax policy. The four out of every ten taxpayers who hire professionals to prepare their tax forms could spend that money more productively under a flat tax system. Persons who sink money into depreciating investments and property in order to claim a loss and reduce their tax liability would begin to sue their money in ways which would promote economic growth, and more jobs. But most importantly, the flat tax will encourage greater compliance and thereby absorb much of the underground economy which now evades accountability.

Besides simplicity, our tax policy should be to adopt a system which does not discourage economic advance, upward mobility in pay or social scales, and increased productivity. Our objective should be to foster productive economic activity and encourage people to seek higher wages rather than spend their time and money looking for loopholes. It requires little more than common sense analysis to conclude that the flat rate system will do far more than our present system to encourage economic productivity.

A flat rate tax would largely abolish the current disincentives for working harder to command a higher salary. The simple tax would be damaging to those who have concentrated on avoiding taxes, and a reward for those who work hard. It would offer a much greater prospect for upward mobility to lower income earners. The current progressive schedule of taxation distorts economic decision-making to a far greater extent than an evenly distributed, flat rate tax would. The current system of marginal graduation of taxation makes it more costly for the income earner to increase his or her income.

Finally, it must be kept in mind that the purpose of taxing citizens is to provide revenue for government services not adequately provided by the private sector. Our tax policy should be designed to produce revenues in the most efficient way possible for the operation of government, rather than enforcing a particular social policy or distributing wealth. As columnist William Safire stated, "That way we know how much each social policy costs each year, and we are more inclined to curtail tax expenditures that presently go on and on, unexamined." A flat rate system without credits and exclusions except for a personal deduction, would be a neutral tax system which does not interfere with personal choices in the market place and does not advance one particular social ideology over another.

A flat rate tax will achieve fairness, not by increasing taxes, but by lowering them.

STATEMENT OF SENATOR MALCOLM WALLOP
BEFORE THE SENATE FINANCE COMMITTEE

SEPTEMBER 28, 1982

Malcolm Wallop

Mr. Chairman I welcome the start of these hearings on tax code simplification and reform, and more particularly on the so-called "flat-rate" tax proposals. I would note that these hearings are by no means the start of the process of tax code reform. In reality, we started 20 months ago when we began consideration of what is now known as the Economic Recovery Tax Act of 1981. With that bill we provided the American taxpayers with long-overdue relief from a tax burden which swelled faster than the double-digit inflation they were trying to keep pace with. The federal revenue windfall brought on by "bracket creep" will finally be repatriated by July of next year when the last installment of the President's 25% across-the-board cut in marginal rates is put in place. This year, fiscal necessity required that we look not only to the budget, but also to the tax code to trim away provisions we could no longer afford. The elimination of these obsolete provisions, or tax loopholes, marked our second step in improving the efficiency and equity of the tax code.

The generation of this year's tax bill also highlighted what is generally referred to as the "compliance gap". A full 30% of the revenue which will be generated by TEFRA will come from increased taxpayer compliance. But even with those measures, billions of tax dollars which are rightfully owed the federal government will go uncollected. Clearly, you can only require so much withholding and hire so many additional IRS agents. Right now many taxpayers already feel they should be entitled to a dependency exemption for the time and effort they spend with

IRS agents. The message is clear, taxpayer compliance is not the problem, it is but the aggravating symptom of an increasingly complicated tax code that has done more to accomodate special interests than implement a fair and equitable system of taxation. Any tax code which is expected to be efficient and effective must rely on voluntary compliance. When the tax code is, or is perceived as being, inequitable -- taxpayers are going to find ways to hide their income from the reach of the IRS. Quite frankly, it is hard to blame them. It is all too obvious that we are losing the compliance battle with our present tax code. And while we should direct some of our energies toward collecting those lost revenues, our more important goal must be to make the changes in our tax code which are necessary to assure that the tax burden is distributed fairly and understandably.

The answer to many is found in the concept of a "flat-rate" tax. In its simplest form it means that the taxpayer will have no deductions and will pay a flat rate of tax on his or her income. To date, there has been no pure "flat-rate" tax proposal introduced in the Congress, and my colleague from Lousianna Senator Long will tell you that such a proposal means just one thing - a tax hike for low and middle income Americans and a tax cut for the rich. The various proposals which have been introduced under the moniker of the "flat-rate" tax call for a limited amount of deductions or a fewer number of progressive rates, or both. They are what this hearing is all about, tax simplification and reform.

While recognizing the attraction of simplicity, we must also recognize that our present tax code has been used to achieve some very worthwhile economic and social ends. We have provided a deduction for home mortgage interest to encourage home ownership. That provision, with the rising cost of housing, is more important now than it has ever been. Similarly, we have offered a charitable deduction for gifts to hospitals, charities, and schools. Another deduction which may be as important now as it has ever been. Last year we broadened the scope of individual retirement accounts to encourage all taxpayers to put away money for their retirement. Energy tax credits are available to encourage taxpayers to invest in energy efficiency. You would be hard pressed to find someone who honestly believes that these are not worthwhile endeavors. And I am sure that as we progress with our efforts in tax simplification a steady stream of visitors to my office will point out other tax provisions which are just as worthwhile and just as worthy of preservation.

I do support the concept that changes must be made to the tax code to make it simpler, more equitable, and more efficient. However, I will not support those efforts at tax code simplification which have the effect of increasing the tax burden of middle and low income Americans who already shoulder the brunt of the tax load. The "flat-rate" tax has become the battle cry of the American taxpayer whose frustration with our tax code has reached epidemic proportions. The demand is for an equitable, understandable tax code. And what ever we call it, I will support them in that effort.

The CHAIRMAN. Let me first welcome Senator Quayle, who will be our first witness.

I think before we start, Senator Quayle, maybe the members would like to say a few words, because we are starting some very extensive hearings the next 3 days. There are literally pages of witnesses who will not be appearing in these first 3 days, and we want to let all of those people know that we are going to have additional hearings. But it seemed to us, rather than see how many witnesses we could squeeze in each morning, it made more sense to give a little more time to those who were appearing.

I am certain this matter will be of interest—the so-called flat-rate or proportional tax—for many months to come, and we hope to have not only hearings here but field hearings.

But we do need to begin a thorough and comprehensive consideration of the issues raised by proposals to move in the direction of a flat-rate or proportional income tax system.

These initial hearings follow my announcement last May that our committee would undertake an extensive review of the flat-rate concept and related issues of tax, social, and economic policy. This is only a beginning. There are many individuals and organizations, as I have indicated, who would like to be heard on this subject, and we have to accommodate a smaller number now; but we hope everyone who wishes to testify or be heard will be heard before we complete hearings on this matter.

Over the next 3 days it is hoped that we can begin to establish a framework to guide further deliberations on restructuring our tax system. We can do that by clearly formulating the basic options, by developing the facts and figures necessary to informed decisions, and to pinpoint the technical and practical problems that will have to be dealt with if we want to modify the tax system in a major way. Our witnesses are prepared to help us do all of that; in particular, the Treasury Department has examined the issue in some detail, and while they are not prepared to make specific recommendations this time, I hope they will give an indication of how the administration thinks we ought to proceed, and of how they rank the issues in terms of priorities. This morning's testimony from Assistant Secretary Chapoton should provide able assistance in formulating options for further consideration.

At the outset, I would like to outline some of the basic choices we have before us in connection with the flat-rate issue. Some of these choices are simply matters of trying to formulate the best tax policy; some of them are primarily decisions about economic policy; and others are really political decisions or decisions about what is best for our society.

For example, we have to decide whether significant progression in rates is desirable—as under the present system—or whether everyone should pay the same proportion of income in taxes. The answer to this question will depend in part on your view of how important the principle of progressivity is to maintaining popular support for the tax system. The answer will also depend on some simple facts: How progressive is the present system, when you take into account the distribution of tax preferences available under present law, particularly deductions that tend to favor those in higher rate brackets.

We also have to determine how much a gain in simplicity and economic efficiency can be made by moving to a streamlined low-rate or flat-rate structure. Defining income will always be a source of major complexity, and cutting out tax preferences as such does not deal with that problem. A large zero bracket, if it were adopted as a part of a restructuring of our tax system, could provide significant gains in simplicity by reducing the number of itemizers. Again, however, we would need to evaluate the impact of such a change on the distribution of the tax burden and in terms of economic efficiency.

In addition, there are a number of specific ways in which a flat-rate or lower rate tax system might be structured. A single rate could be applied, as some propose, to a comprehensive income base. This would mean everyone paying the same proportion of income in tax, with changes in types of things we have usually included in income: Items such as social security and retirement benefits, among others.

Alternatively, rates could be significantly reduced and the base broadened by eliminating a range of tax preferences.

I might say, in that regard, that I have for distribution a breakdown of the 12 bills that have been introduced—7 in the House and 5 in the Senate. We believe they break down into five different categories of proposals, five generic options: One, a broadbased flat rate with standard personal exemptions; two, a broadbased flat rate with high personal exemptions; three, a modified broadbased flat rate; four, a broadbased progressive rate; and five, a modified broadbased progressive rate.

We have tried to describe each of the five options, then starting on page 5 we begin to list the tax preferences that might be repealed. I think we have most of them. There are 70 in that category, including capital gains deduction and intangible drilling costs, percentage depletion, gasohol credit, dividend exclusion, net interest exclusion, deductions for taxes, rollover of capital gains on homes. There are a number of rather sensitive areas, I might suggest, as we get into these specifics—medical expense deduction, marriage penalty deduction, targeted jobs credit, exclusion for social security benefits, exclusion for unemployment compensation, Keogh plans, IRA's, and the list goes on and on. Those are listed so that we might know that when we start considering the options, as we will, that if in fact we reach that point there will be a number of very difficult decisions that we will need to make in the Congress. So I wouldn't hold your breath on the theory that anything might happen this year.

We also address, in the rather lengthy option paper, if in fact we are going to have a flat rate or a lower rate, a proportional rate tax for individuals, how do we address the business side? Because I find that none of the 12 bills that have been introduced so far really focus on how we would address the business side once we have addressed the individual side.

The corporate income tax structure contains the attributes of high maximum marginal rates and a multitude of deductions and credits, limiting the tax base, the same features that have subjected the individual income tax to criticism. So if we are going to revise the individual tax system, then I assume we are going to have a similar revision for corporate income taxes. I have tried to outline some of the areas there and some of the areas that we would have to consider, and some of the very tough decisions that will have to be made if we are going to address that.

Finally, on how to proceed, it seems to me that we could continue to work through the Tax Code on an item-by-item basis, and make decisions about what should be modified and what should be preserved; in other words, further base broadening and tax reform efforts comparable to those included in this year's Tax Equity and Fiscal Responsibility Act.

I believe this approach could bring substantial gains in equity and simplicity and fairness; but of course it is going to involve a lot of review and a lot of time. Instead, we might do as some are urging and agree on one major revision of the tax system in the direction of lower rates and a broader base, and take the necessary steps to implement such a system. This would mean an explicit choice of a new approach to taxes—comprehensive and carefully thought out—and a difficult period of transition to reconcile the new system with the old while safeguarding the economic interests of those who have made financial decisions based on the present system.

So I guess what I am trying to suggest—and we might also agree to proceed on a step-by-step basis—is to couple a base-broadening measure with rate reductions in an effort to simplify the system and reduce tax-induced distortions of economic decisionmaking.

I would hope this is not trying to overstate the problem or overstate the challenge, but it is a very difficult wide-ranging area that we are now about to explore. In my view, it is certainly worth the effort.

We will spend, as I said, three mornings this week; there will be additional hearings, hopefully some field hearings, in the next few months. At that time other witnesses will be permitted to testify.

Under the early-bird rule I think Senator Grassley is next, and then Senator Bentsen and Senator Chafee, then Senator Quayle.

STATEMENT OF HON. CHARLES E. GRASSLEY, U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Thank you, Mr. Chairman.

Mr. Chairman, these hearings on tax reform are being held because it is widely recognized that the Tax Code is in bad need of an overhaul. Our shrinking tax base cannot generate enough revenues to keep up with our spending goals, even after spending cuts have been made.

The problem is a structural one. To solve the problem we must either expand the tax base or we must raise the tax rates on the existing base.

Our present Tax Code has become the symbol of inefficiency and inequality in our economy. Economic distortions have resulted from the many tax preferences that riddle this Tax Code. Individuals are treated differently in the same tax brackets. The complexity of the tax system has made it necessary to spend billions and billions of dollars to hire tax experts, thus locking up otherwise productive capital and human resources.

All of these inherent problems in the Tax Code have forced taxpayers into an ever-growing underground economy. The present Tax Code has lost all credibility, and something must be done if we are to preserve the integrity of our tax system.

I commend you, Mr. Chairman, for having recognized the needs for fundamental tax reform and for proceeding with these hearings. There will be many questions answered here, while other questions will require further study. Progressivity of tax rates, for instance, is a very important theoretical and practical question. It isn't likely that we will resolve that question here today in these hearings. Other practical questions involve the best method of taxation, whether or not businesses and individuals should be taxed in the same manner, and what the size and extent of the tax base should be.

But there are other more basic questions to be answered. It seems to me that the primary objective of these hearings should be to define the goals of tax reform. What are we trying to accomplish? Where are we intending to go? Should we simply repair the damaged parts of the Tax Code? Or should we trade it in for a whole new model?

We can best answer these questions if we understand how the Tax Code impacts upon the economy. We have seen the distortions resulting from the present code. Most economic activity has been in consumption, and that at the expense of savings and production. What can we do to eliminate this bias?

Once we have determined the goals of tax reform, we must then determine how we are going to get from where we are today to where we hope to be in a better world in the future. If we are to simply repair the present code, what can we do this coming year to move toward that goal?

Perhaps, as the chairman suggested in the past, we should continue to close certain loopholes while further lowering marginal tax rates, and perhaps we can eliminate the tax on savings.

Or perhaps we should choose to replace the code with a new one. With this approach, however, there are serious transitional problems. Industries and households alike have become dependent upon certain tax preferences, and the wholesale elimination of them would cause major dislocation.

Mr. Chairman, as you and other members of the committee have pointed out, there are many questions which must be answered before we undertake this tax reform, and I hope that in the process of both asking and answering these questions that we will remain mindful of our chief economic goal: To maximize efficiency of production, to create capital to finance economic growth, and to increase the real per capita income of our citizens.

Thank you.

The CHAIRMAN. Senator Bentsen?

STATEMENT OF HON. LLOYD BENTSEN, U.S. SENATOR FROM THE STATE OF TEXAS

Senator BENTSEN. Thank you very much, Mr. Chairman.

One of the great strengths of this country has been voluntary tax compliance. But now we are seeing a situation where people earn the same amount of income, and thev pay a substantially different amount of taxes. There is a growing feeling of unfairness about the tax system, and the public is absolutely right about that.

You have seen 35 Congresses that have had a bewildering array of social and economic objectives piled on top of the tax system, and now what we need is a major reform of the whole tax system—not necessarily just a flat rate, but a simplification of that tax system so people can understand it and we restore fairness to the system.

The thing that is the most disliked about the whole Federal system is the Federal Income Tax and the feeling of unfairness taking place in it. So I think that a major objective of the new Congress has to be a massive reform of the tax system to make it fair.

It is going to take the wisdom of Solomon, Mr. Chairman, but I am confident you are going to face up to that challenge in this new Congress, and I am looking forward to working with you on it.

The CHAIRMAN. Thank you, Senator Bentsen.

Senator Chafee?

STATEMENT OF HON. JOHN H. CHAFEE, U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator CHAFEE. Thank you, Mr. Chairman.

First of all, I want to commend you for holding these hearings. I think what we are talking about, as has been mentioned, is tax reform. This is a subject that is of extreme interest not only to the Senators but to the population as a whole. Out in the hustings there is constantly raised the problems about the income tax and the so-called flat-rate tax.

I, for one, would like to make it clear that I am not subscribing to any flat-rate tax. I can't believe that this Congress is going to go into any flat-rate tax. We may have tax reform; but certainly, in my own judgment anyway—and this perhaps is prejudging the situation a bit—we have to stay with a graduated progressive income tax in the United States.

But clearly reform is required, because we do have the situation where people perceive inequities in the system when two taxpayers with the same amount of income are paying widely different taxes.

As the chairman mentioned, as we delve into this it becomes increasingly complicated. What about the individual exemptions? Well, most people say we will keep those. How about for those over 65? Yes. How about if you are blind? Yes.

Then you go along, each step: What about catastrophic losses? Are they deductible? Well, yes. What about home mortgage interest? Well, most people agree to that. And so it goes. And I might say that we haven't demonstrated much restraint on these ourselves. As a matter of fact, I was a great pusher for the deductibility of the IRA's, and now we have those—the individual retirement accounts that are deductible up to $2,000.

So this presents a monumental challenge to us; but I think the goal is worthwhile, with the objective being reform so we can achieve simplicity and greater fairness in the existing code.

So, thank you, Mr. Chairman, and I congratulate you on what you are doing.

The CHAIRMAN. Thank you, Senator Chafee.

Senator Long?

STATEMENT OF HON. RUSSELL B. LONG, U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator LONG. Mr. Chairman, I want to commend you for holding these hearings to explore the good and bad points about the flat income tax.

Many people have asked me what I think about the proposals to replace a progressive tax structure with the so-called flat income tax. My answer to them is simple: If you are rich, you'll love it. If you are not rich, look out.

Mr. Chairman and members, the fact is that just about any flat-tax system will give a big tax cut to the rich, and they would finance that tax cut with substantial tax increases on lower and middle-income Americans.

I am concerned that many ordinary working people are attracted to the "flat tax" slogan because of their feeling that the rich aren't paying their fair share and because of their frustration with the complexity of the tax system. What these working people should be aware of is that these "flat tax" slogans are being used to promote a tax program that will raise their taxes. I predict that this fact will become more and more apparent as the flat tax continues to be discussed and debated. And as that happens, you will see more and more people climbing off the flat-tax bandwagon. My experience is that every time you try to simplify the tax system by increasing somebody's taxes, that person tends to lose interest in tax simplification at that point.

I do want to emphasize that having a simplified, fair, and well-respected tax system should be a top priority, as Senator Chafee just stated, and particularly for this committee. What I am talking about now, though, is the idea of a flat-tax rate versus the progressive rate structure, and that argument has precious little to do with tax simplification.

I wrote a letter about the flat tax that appeared in the Washington Post on July 13 and was picked up by several of the newspapers around the country. Several people have taken exceptions to the statements I made in that editorial, but it still is correct in my judgment. Here is what I said:

> Justice and fairness require that those who make large amounts of money should pay a higher rate of tax on income than middle and low income families. It seems totally unfair to have a person earning $15,000 a year paying as much as someone making a million dollars a year.

I will ask that the remainder of my statement appear in the record at this point, Mr. Chairman. Let me make just one further point: The income tax, of course, is not the only tax we have. Our other principal source of revenue, which raises about 60 or 70 percent as much as income tax, is the social security tax—as thoroughly regressive, as burdensome on the low income and poor, as any tax the mind of man has ever conceived. That's how almost half of the rest of the money is being raised, and that which is not covered by that is being raised in the main by excise taxes, which are a tax on consumption.

Now, contrary to what some would have us believe, the very rich in this country are not paying as much as they would like to suggest to us. Our previous Chairman of the Council of Economic Advisors appeared before us some time ago—before he became the chairman—and gave me the figures on the Treasury study: On expanded income, those making over $200,000 a year, at that point, were paying 42 percent of their income in income tax. Now, since that time, that particular group has had their rate cut from a top of 70 percent to a top rate of 50 percent. A great deal of their income comes from capital gain, and that has been reduced from 28 percent down to 20 percent.

Now, you make those adjustments, and that would appear to me that the present tax being paid by those making over $200,000 a year is only about 30 percent, and maybe somewhat less than that.

Now, that presents a somewhat different picture than we might think of when one thinks of the enormous amount of expenditures that those people are paying. And those of them who are making investments are doing the kind of things that we sought to encourage—to create jobs and employment opportunities. They are paying a lot less than that, because we passed laws to reward that kind of conduct.

I do favor simplification, and I strongly support what you have done in that area and what I believe you have in mind and what other members have in mind, to move in that direction; but I think it would be a mistake for us to proceed on the theory that we can afford to have another giant tax cut for the very wealthy at the expense of the middle income people of America.

[The prepared statement of Senator Long follows:]

STATEMENT OF THE HONORABLE RUSSELL B. LONG
AT THE COMMITTEE ON FINANCE HEARING
ON FLAT-RATE TAX PROPOSALS

Tuesday, September 28, 1982

Mr. Chairman, I want to commend you for holding these hearings to explore the good and bad points of a flat rate income tax. Many people have asked me what I think about proposals to replace our progressive income tax with a so-called flat rate income tax. My answer to them is simple: "If you're rich, you'll love it; it you're <u>not</u> rich, look out!"

Mr. Chairman, the fact is that just about any flat tax system would give a big tax cut to the rich and finance it with a substantial tax increase on lower and middle income Americans. I am concerned that many ordinary working people are attracted to the flat tax slogans because of their feeling that the rich aren't paying their fair share and because of their frustration with the complexity of the tax system. What these working people should be aware of is that these flat tax slogans are being used to promote a tax program that will raise their taxes. Mr. Chairman, I predict that this fact will become more and more apparent as the flat tax continues to be discussed and debated, and as that happens, you will see more and more people climbing off the flat tax bandwagon. My experience is that every time you try to simplify the tax system by increasing somebody's taxes, that person just tends to lose interest in tax simplification at that point.

I do want to emphasize that having a simplified, fair and well respected tax system should be a top priority for the

Congress, and particularly for this Committee. What I am talking about right now, though, is the idea of a flat tax rate versus a progressive rate structure, and that argument has precious little to do with tax simplification.

I wrote an editorial on the flat rate tax that appeared in the Washington Post on July 13, 1982 and was picked up by several other papers around the country. Several people have taken exception to one of the statements I made in that editorial, but I still believe the statement is right. What I said was the following:

> "Justice and fairness require that those who make large amounts of money should pay a higher rate of tax on income than middle- and low-income families. It seems totally unfair to have a person earning $15,000 a year pay the same rate as someone making $1 million."

Some people have written to me expressing the opinion that it is actually immoral to impose a higher rate of tax on the one millionth dollar of income than on the fifteen thousandth dollar. They see the progressive rate system as unfair discrimination against the well-to-do.

One interesting thing, however, is that these same people who see a flat rate as an absolute requirement also say that you would have to have a generous personal exemption or standard deduction to ease the impact of the system on very low-income people. What they are correctly acknowledging is that you have to consider ability to pay in order for the system to be fair. Once you have a personal exemption or standard deduction, you can't really say that an across-the-board flat rate is absolutely required, because you've abandoned the purity of the system. You've acknowledged that ability to pay should be at least a small factor, so the argument then becomes how much you should consider ability to pay.

Our current system takes ability to pay into some degree of consideration by providing tax rates that range from 12 percent to 50 percent. Before 1981, the top rate was 70 percent, and the Congress decided -- correctly, in my view -- that the 70 percent rate represented too great a degree of progressivity. The flat tax proposals would consider ability to pay to a substantially lesser degree than our current system, and many proposals would come fairly close to not considering it at all.

Mr. Chairman, I think it would be wrong to ignore ability to pay when we are designing our tax system. When you have a low income, you use just about all of it merely to keep clothes on your back, food on your table, and a roof over your head. When you have a high income, you have got something left over after you have purchased your basic requirements.

I have heard some well-to-do people complain that a higher percentage of their income goes to taxes than in the case of lower-income people; but I never hear these people say they have any problem with the fact that lower income people have to spend a higher percentage of their incomes for food, shelter, and clothing. Mr. Chairman, our tax system would not be fair or well-respected if it were designed to be a crushing burden on low- and middle-income families, and a relatively light burden on the well-to-do. It should instead be a manageable burden for all, and that is why we should have a progressive rate structure.

I don't necessarily mean that we should retain the current rates. If we can make appropriate changes that allow us to lower rates, let us do that, but let us do as Senator Bradley has suggested, and lower rates in a manner that respects ability to pay and preserves the progressive rate system.

Mr. Chairman, I want to make a few comments on the subjects of simplification and broadening the tax base before I conclude. I agree that we should scrutinize very carefully any proposals for new tax incentives. In particular, we should always consider the following questions: Does this proposal simplify or complicate the tax system? Will it increase or decrease the public's perception of the fairness of the tax system? Will it cause substanial revenue losses through erosion of the tax base? And finally, do these considerations outweigh the other merits of the proposal?

I believe that the same type of questions can and should be asked about current provisions of the tax code. In fact, such oversight of existing tax programs is an important part of the work of this Committee.

However, I do want to disagree with those who would have us adopt a tax based exclusively on a theoretically pure concept of economic income. While taxation of real economic net income should be the benchmark, it is occasionally necessary to depart from the pure concept in order that the system be fair and have the support of the taxpaying public.

First of all, the tax system should not press for a pure economic concept of "income" when that would seriously conflict with the layman's concept of "income." For example, in the fringe benefit area, the government can destroy the taxpayers' respect for the system if it presses too hard for the theoretician's view that all employee benefits represent taxable income. The ordinary taxpayer just doesn't think that his parking space at the plant or his free coffee at the office is taxable income, and the tax system ought to respect such common-sense views. Of course, when fringe benefits are lavish and are provided in lieu of cash salary, the common sense view begins to agree with the theoretician's view, and most people will acknowledge that taxation is appropriate.

In addition, liquidity considerations must sometimes override pure theory in determining what should and should not be taxable income. For example, under our system, unrealized gains are generally not taxed and taxation is deferred on several types of exchange transactions where no cash is received. It seems to me that these provisions are helpful in enhancing the public's respect for our tax system by limiting the number of cases where cash taxes have to be paid on non-cash income.

Finally, the government might hinder the achievement of national goals and create disrespect for the tax system if it imposed a full tax on all income from all activities, including activities the government wished to encourage. For example, there is a lower tax burden on income devoted to charitable endeavors, to home ownership, to retirement savings, and to a number of other worthy activities. The theoretician would call these loopholes or tax expenditures, but it seems to me that when the public can plainly see that an activity is worth encouraging, the Congress will increase the public's respect for the tax system if it reduces taxes on that activity in a fair and responsible fashion. After all, we spend hundreds of billions of dollars every year to accomplish our national goals; it seems only appropriate that we remember what those goals are when we are collecting that money.

Mr. Chairman, I think that we must use our common sense and our basic ideas of fairness when we are thinking about changing our tax system. Intellectual theories about tax policy can give us some good ideas and point us in some good new directions. However, in this Committee, we are ultimately not talking about theory, we're talking about what people pay and what they see their neighbors pay. When we are making those kinds of decisions, Mr. Chairman, simple good judgement will serve us better than anyone's theory.

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The CHAIRMAN. Thank you.
Senator Baucus?

STATEMENT OF HON. MAX BAUCUS, U.S. SENATOR FROM THE STATE OF MONTANA

Senator BAUCUS. Thank you, Mr. Chairman. I too want to commend you for holding these hearings.

Tax fairness is an issue that has always been with us and probably will always be with us; nevertheless, I think this surprising tide against the perceived and actual unfairness of our Tax Code has reached such proportions that hearings of this kind are essential. I also feel—after some examination—it will take, I would guess, some months and maybe a couple of years to restore more simplicity to the code.

Mr. Chairman, I think that most Americans are fed up with our tax system. Their message is really quite simple: The taxpayers don't think the system is fair.

Middle-income Americans rightfully believe that they are shouldering most of the tax burden, whereas the wealthy have taken advantage of the present system. Tax forms are also more and more complicated—40 percent of all taxpayers today use specialists in preparing their tax returns.

In addition, tax cheating is reaching epidemic proportions and the underground economy is rising. According to the IRS, cheating cost the Treasury about $23 billion a decade ago, and we all know the figure is about $100 billion today with tax cheating; that is, Americans who are not paying their income taxes.

Beyond that, the Tax Code is littered with so many loopholes and deductions, credits, that they cost the Treasury $270 billion this last year, and by 1987 the estimate is that it will cost the Treasury $450 billion in tax expenditures, loopholes, deductions, credits, and so forth.

So I believe that the time has not only come, the time has been with us for a long time that we should have addressed this. I feel that the solution lies somewhere along the lines of the bill introduced by Senator Bradley and Congressman Gephart—that is, a modified flat-tax proposal that keeps some of the most basic deductions that will stimulate certain policies that we in the Congress think are important, and at the same time eliminate a lot of the other deductions, credits, loopholes that probably in the long run cause more problems than they solve.

We are never going to come up with a system that is going to satisfy everyone. There will always be some people who will be a little bit disappointed, because, after all, we have a pluralistic society, we are not homogenous, we have different people in different situations, different circumstances; nevertheless, I think that we can reach some consensus in finding some changes in the system which are more fair than what we have at present.

So I commend you very much for holding these hearings. I hope that we keep at this problem and burrow down into it so that we come up with a system that is better than we now have.

The CHAIRMAN. Thank you, Senator Baucus.

I am reminded that we will meet at 2 this afternoon, where I hope we keep in mind what we have all said this morning. There will be a loophole-closing meeting at 2.

Senator Bradley?

STATEMENT OF HON. BILL BRADLEY, U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator BRADLEY. Mr. Chairman, I would like to compliment you for holding these hearings. I think that they are important hearings, and I understand that you said this morning that nothing would pass this year. I think that that is probably wise, because it is important that we look very carefully at the concepts that are before us.

I don't know about you, but I have talked to enough citizens of New Jersey to know that last April 15, when they were filling out their tax returns, subtracting line 18 from line 17 and carrying it over to line 32A, and wondering if they could claim their mother-in-law as a dependent if she lived with them or in the house next door, or if they could find that piece of paper that had a record of their capital loss carryforward from last year, that a lot of them were thinking "somebody else is getting a better deal out of this system than I am."

I think it is that sentiment that has led to these hearings and also has led to a reevaluation of our present tax system. It is that sentiment that conveys that people feel the system is not fair, that it is overly complex, and that it leads to an inefficient allocation of capital.

I believe that we can simplify this system while retaining its progressive elements. I hope these hearings will draw a real distinction between the flat tax and the fair tax—which is what Congressman Gephart and I call the bill we have introduced—"the Fair Tax Act of 1982." The flat tax redistributes income from the lower and middle-income person to the upper income person whereas the fair tax keeps the present income distribution. The flat tax eliminates all of the deductions that are used by the bulk of the American people whereas the fair tax keeps those that are used by the bulk of the middle-income American public.

Mr. Chairman, I think that these hearings could very well be the first step along the path of finally coming to grips with a tax system that has become cumbersome and increasingly unfair.

The CHAIRMAN. Thank you, Senator Bradley, and I want to thank you for your interest, and every other member of this committee. I think we will make some progress. I am not certain where we may finally come out, but I am convinced that this committee and the members of this committee are committed to doing our best to not only simplify the code but to bring about more equity and fairness.

Senator BRADLEY. Mr. Chairman, may I submit a statement to the record?

The CHAIRMAN. Sure.

We appreciate your patience.

Senator Quayle?

Senator QUAYLE. Thank you, Mr. Chairman. I have a statement that I ask be inserted in the record.

The CHAIRMAN. It will be inserted in the record in full.

STATEMENT OF HON. DAN QUAYLE, U.S. SENATOR FROM THE STATE OF INDIANA

Senator QUAYLE. Mr. Chairman, as has been said by the members of this committee, basically what we are searching for is tax reform. Quite frankly, I believe the American people would agree, that the Tax Code has become too complex, too confusing. The perception is that there is inequity, and the Tax Code must be simplified.

I would like to join those on the so-called flat-tax proposal in rejecting just a flat tax. I hope this doesn't become some sort of red herring where everyone says, "OK, we have to be against flat tax," and end up against tax simplification. I am for tax simplification. All of the flat-tax proposals you have before your committee, Mr. Chairman, retain some progressivity. They all have at least a deduction in there, so that's an element of progressivity.

My proposal retains progressivity; as a matter of fact, it has three brackets. We do not have any tax from zero to $17,500, and from $17,500 to $50,000 we have a tax rate of 18 percent, and over $50,000 we have a tax rate of 25 percent.

But the issue of progressivity I think is in the Tax Code right now and is going to be retained in the Tax Code.

I would like to just briefly turn your attention to table 3 on page 18 of my statement that I inserted in the record, if you have that before you, where we talk about the marginal tax rates for 4-person families.

If you see the gap of progressivity in tax rates, in 1965 and families at the one-half median income paid a rate of 14 percent, families at the median income rate paid 17 percent, and families at twice the median income paid 22 percent. Now, that's not much of a gap between 14 and 22 percent.

But if you go to 1980 and look at that gap from the one-half median income rate of 18 percent now, to twice the median income tax rate of 43 percent.

Now then, under the new Economic Recovery Tax Act, we have moved in the direction of lowering the gap of progressivity, and by 1984 it will be 16 percent and 38 percent. So in 1981 we lowered the progressivity rates. Under my proposal and under Senator Bradley's proposal, we are talking about lowering the top tax rates again. I believe, Senator, yours goes to 28 percent as the high rate, and mine goes to 25 percent.

We are talking about narrowing that gap of progressivity; we are not talking about eliminating progressivity altogether. And I think it goes back to Chairman Dole's question: How much progressivity do we want? And where do we want to come down? I think that is the issue before the committee, and that is something that you are going to certainly get into, and I commend you for it.

But I don't want to join this chorus that we are going to have a flat-tax rate and do away with all of the deductions. As Senator Long pointed out, that is going to take it out of the middle-income people, and as soon as they find out a so-called absolute flat-tax rate is going to take more money out of their pockets, they are not going to be for it.

Mr. Chairman, I would like to share with you just a small story that happened to me at a Colgate plant in New Albany, Ind.

I explained to a member of the UAW my self-tax proposal, which is obviously very simple and in most cases could be filed on a postcard. I explained it to him basically like I explained it to you here today. In his response to me he said, "Well, you know something, Dan?" He said, "That makes too much sense. It would never get through Washington." Well, I am sure that we will be able to prove him wrong, and that we can move forward to get into the issue of tax simplification.

As Senator Baucus pointed out, the tax expenditures by the year 1987 are going to be $450 billion; they are now $270 or $275 billion this year. We are talking about how we are going to expand the revenue base. We are going to have to take a look. We are going to have to take a look at so-called tax expenditures, loopholes, or whatever you want to call them. And I think that is the beauty of tax simplification, and that's what my proposal really puts on the table—a discussion of serious tax simplification. We do eliminate all of the deductions. We only retain a $600 deduction per individual.

I am also cognizant of the fact that any Gallup poll, or any poll, shows that about 70 percent of the people favor a so-called flat tax or tax simplification; but then, 70 percent of the people also favor retaining that mortgage deduction. And that's certainly a challenge that you have, Mr. Chairman, before your committee.

One final note—and, Mr. Chairman, you brought this out—and it is really the toughest one: How do we deal with the business side of tax simplification? My proposal tries to get into those dangerous waters to some degree, and I will have to admit that we are a bit murky as far as being specific on how we are going to deal with it; but basically what we do is to have a flat rate of 20 percent, allow normal business expenses and a Capital Cost Recovery Act.

In conclusion, I would like to point to table 5 page 25 of my statement, to show what we are talking about when people talk about "basic inequity," or "basic unfairness."

Look at the effective corporate tax rate by industry and you will see that an effective corporate tax rate by industry goes from a minus 12.6 percent to a plus 39.7 percent.

The CHAIRMAN. What page is that on?

Senator QUAYLE. It is table 5 on page 25 of my prepared statement.

We have an effective corporate tax rate by industry, a percentage of net income paid in tax, U.S. rate on U.S. income.

When you look at that, you have a minus 12.6 percent to a 39.7 percent. Now, that's just a statistic. We can talk about those statistics any way we want to; but I think this is some of the inequity that a lot of the small business people are talking about. They say, "Well, you know, I can't get all of those deductions," and therefore, if you are able to hire a sophisticated enough counsel and have enough so-called clout, you are going to be able to take care of yourself.

Mr. Chairman, I want to join the chorus and the members of this committee that expressed today the need to have tax reform, to have tax simplification. I believe that you have really moved us in that direction—not only with the lower tax rate of 1981 but also tax simplification, which you included in the revenue bill that was just passed.

My bill essentially is a self-tax proposal. We nicknamed it "SELF": S for simplicity, E for efficiency, L for lower taxes, and F for fairness, and we certainly believe that those are the hallmarks of a serious tax reform that would be fitting to get into in 1982. I have no illusions that we are going to pass it this year, as you have pointed out, but it is certainly something that is going to be with us as you look at those huge deficits out there; we need to get the revenues, as Senator Grassley pointed out, to run the Government. I think tax simplification offers a good road to that goal that we want to achieve.

Thank you very much.

The CHAIRMAN. Thank you very much, Senator Quayle. Your entire statement will be made a part of the record.

[The prepared statement of Senator Quayle follows:]

STATEMENT BY SENATOR DAN QUAYLE

FLAT-RATE AND MAJOR TAX REFORM PROPOSALS

Mr. Chairman, millions of Americans are today fed up with the complexity of our income tax code. Every year complaints proliferate about the difficulty of preparing the individual tax return. Taxpayer compliance is declining while the underground economy is growing rapidly.

I believe we must restructure the tax code to eliminate its complexity and restore its credibility. For these reasons, I have introduced in the Senate the SELF-tax Plan Act of 1982 (S.2557), a moderately progressive low-rate individual tax coupled with a flat-rate business tax.

I believe the time has come to seriously consider restructuring our federal tax system. The American people demand it and our economic health requires it.

My testimony today consists of a statement explaining the principles and purposes of the SELF-tax Plan Act of 1982, along with an appendix which presents some relevant recent data and trends. I ask that these be printed in the record.

Failures of the Current Tax System

Henry Simons, writing in his classic study, Personal Income Taxation, insisted that an income tax, if it was to be an improvement over payroll or excise taxes,

> "should be progressive, it should be levied according to simple general rules or principles. . .and it should be as equitable as possible among individuals. Thus, it must proceed from a clear and workable conception of personal income; and it must be constructed in such manner as to minimize the possibilities, both of lawful avoidance. . .and of successful evasion through false declaration."

Our current tax system retains an officially progressive rate structure, but in every other respect fails to meet the primary requirements of a fair tax system. These requirements are: Simplicity, Efficiency, Low tax rates and Fairness (SELF). Our tax system, taking into account all the exceptions and preferences built into the law, is also not even very progressive.

A. Simplicity

A "simple" tax system is one in which the tax code is relatively simple to understand and administer. Regulations, forms and instructions should be easily understood by taxpayers and tax administrators alike.

Today, our tax structure is more complex than it has ever been. In 1954, only 18 percent of taxpayers used tax return preparers; over 80 percent filled out their tax forms personally. In 1981, 52.4% of all 1040 forms were prepared by specialists as were 16.9% of all 1040A forms -- an average of almost 40% overall.

In addition, in 1953, even though most Americans filled out their own tax forms, only 3.2 percent of 1040 and 1040A returns had mathematical errors. In 1976, 8.8 percent of these forms had such errors, and in 1980 the error rate was 7.4 percent.

The Commissioner of Internal Revenue, in 1977, summarized the difficulty clearly when he stated that the basic filing requirements for U.S. tax returns are "beyond the comprehension of a large portion of the adult population."

B. Efficiency

An efficient tax system is "neutral:" it allows personal and business decisions to be made on the basis of their perceived value, apart from tax considerations. It does not induce individuals and businesses to engage in uneconomic activity in order that they receive specific tax breaks.

Clearly the U.S. tax system has been a major factor influencing recent U.S. patterns in trade, investment, research and development. The tax structure has promoted consumption and over-investment in such items as residential housing and race horses, while it has discouraged business modernization. It has been a major factor contributing to our recent decline in productivity growth.

An efficient tax system is also one which can collect necessary revenues with relatively simple enforcement procedures, made possible by public support and cooperation. Thus, an efficient tax system must be perceived as basically fair and worthy of support.

There was a time when Americans were proud to pay their income tax. Efficiency of collection surpassed the efforts of most other nations, with relatively few tax collectors and special enforcement mechanisms. Today, this situation is dramatically different.

More Americans each year are taking advantage of the available tax loopholes. For every year since 1976 a smaller percentage of American tax returns have chosen to take the standard deduction while a higher percentage has chosen to itemize. Also, the average American taxpayer who itemizes no longer fills out his own tax form; a clear majority of those who itemize have their returns filled out by professionals. American business also has taken advantage of the tax preferences; it is now estimated that nearly half of all American businesses, as a result of the complex collection of available business tax provisions, will pay no corporate income tax in FY 83.

Enforcement of the tax laws has become extremely costly to government. Nearly half of all government-created paperwork stems from different tax forms, requiring an estimated expenditure of 650 billion man-hours annually. The system, rather than inducing cooperation, has angered the average taxpayer who is beginning to turn away from the system altogether. It is now estimated that 15 percent of income goes unreported, probably the highest percentage in the history of the Internal Revenue Code.

On August 19, Congress adopted provisions that would reform the tax compliance system. Mr. Chairman, you have estimated that the income tax compliance gap for both individual and corporate income taxes (the difference between what the Federal Government is owed and what it collects) grew from $21 billion in 1973 to $76 billion in 1981. The Tax Equity and Fiscal Responsibility Act of 1982, which I supported, will require stiffer reporting, higher penalties for noncompliance, and a beefing-up of IRS resources.

The regulatory cost of the present tax system is staggering. Today IRS regulations contained in Title 26 of the Internal Revenue Code fill some 10,000 pages. The IRS employs more than fifty attorneys who spend 65 percent of their time writing new regulations, generally specifically authorized by Congress. Rather than attempting to cut down on these regulations, we are now considering expanding and enforcing them more effectively. This can only serve to anger the average taxpayer even more.

C. Low Tax Rates

The profusion of tax preferences in the present code substantially redistributes the federal tax burden and renders it considerably less progressive than the published tax rates. Also, by excluding substantial amounts of income from the tax base, rates imposed on the remainder must be kept high so the necessary amount of revenue can be raised.

For example, in 1961 only 10 percent of U.S. tax returns had a positive marginal tax rate other than 20-22 percent. In that year we had almost a flat, rather than progressive schedule of tax rates. Today, in comparison, published tax rate schedules are much more progressive than they were in 1961, but we also have enacted a profusion of tax expenditures.

The result has been, in spite of all the changes in the tax laws over the last thirty years, average tax rates as a percent of personal income have gradually increased, despite passage of the 1964 and 1981 tax laws which both substantially lowered maximum tax rates (from 91% to 70% in 1964; from 70% to 50% in 1981). Between 1951 and 1981 the average tax rate as a percentage of personal income increased from 9.2 percent in 1951 to 12.1 percent in 1981.

D. Fairness

A tax system is fair if it is based on the basic principle of ability of pay. All income should be treated equally as part of the tax base, and people with the same income should pay the same tax.

Clearly this does not describe the current American tax system. In 1982, U.S. individual income tax rates ranged from zero to 50 percent. However, U.S. law also provides for well over a hundred separate exclusions, exemptions, deductions, preferential tax rates, credits and tax deferrals which allow for relief or exemption from current taxes. These so-called "tax expenditures" either reduce taxable income or reduce taxes by applying lower rates, credits or delays in tax payment. The total revenue lost to all tax expenditures will be over $250 billion in FY82, well over twice the size of the federal budget deficit projected for that year.

Because of the complexity in the tax law, substantial equity has been lost; different taxpayers with roughly the same income pay far different rates of tax depending on their eligibility for different tax preferences. Tax expenditures have rendered the otherwise progressive rate structure less progressive, partly because tax preferences are most prevalently used by wealthy taxpayers to reduce their tax burden: these are the taxpayers who can afford to hire specialists to take advantage of the tax code's complexity.

A New Approach to Raising Revenues: The SELF-Tax Plan

I believe we need to reexamine the fundamental structure of our tax system. We must reestablish SELF as the overriding principle in taxation: Simplicity, Efficiency, Low tax rates, and Fairness. These principles entail the following:

- People should be able to understand the basic requirements of the tax law and to file their returns by themselves, without the need for professional assistance.
- All income should be taxed equally. People who earn the same income should pay the same tax.
- The poor should not be taxed at all, and we should be careful to establish this standard fairly generously.
- Specific preferences and subsidies should be removed from the tax code; economic policy should be addressed directly and not through incomprehensible tax manipulations.

What I am advocating is a return to a simple, mildly progressive, but low-rate tax schedule. While a single flat rate would be simplest to administer, for reasons of equity I would advocate retaining at least some progressivity in the tax structure. I would exempt from all taxes persons earning $17,500 per year or less. However, I would include all sources of income in computation of each individual's tax-base.

My plan would eliminate almost all special tax exemptions from the code. Government benefits would be counted as income. This would include, for example, unemployment insurance, employers' contributions to health benefits, credits for child care expenses, the exclusion of employee meals, food stamp benefits, and basic retirement benefits. I would include a provision to ensure that persons receiving Social Security should not be taxed twice on their Social Security contribution.

Currently the officially defined poverty level is about $9,000 per year for a family of four. The value of transfer payments received for the same size family is now estimated to equal about $5,000 per year. I believe that with a $17,500 limitation per individual taxpayer, no poor person by current definitions would be required to pay any tax. In addition, the lowest income recipients among the non-poor population would also be exempt from individual income taxation.

In addition, I believe the wealthiest taxpayers should pay a somewhat higher rate than the average taxpayer. Thus, I would advocate a top rate of 25 percent on incomes above $50,000 per year. Incomes between $17,500 and $50,000 would be taxed at an 18 percent rate. This would add an element of progressivity to the system and should provide sufficient revenue to conduct the activities of the Federal government.

I would permit a dependents' allowance of $600 per person to recognize the costs of raising children. I would end the current system which applies different tax rates to single individuals and married persons, thus eliminating the marriage penalty and singles bonus.

With respect to business taxes, I would establish a flat 20 percent rate that would apply to all forms of business, including corporations, partnerships, and farms. Business would be taxed on the base of gross earnings, less the amount paid for goods, services and employee compensation. I would permit a capital recovery allowance to encourage investment in plant and equipment and allow deductions for such normal costs of business as depreciation.

As with the individual income tax base, I would repeal the current morass of deductions from the numerous specific business subsidies in the present tax code. Businesses would not be taxed on earnings received from ownership of other businesses, provided the owned business files its own tax return.

I would tax business income only once, with the business tax. I would therefore not tax individuals for earnings from dividends and capital gains, since this income would already have been taxed via the business tax. The effect of removing the current double taxation of business income should be to encourage investment in productive enterprise and to simplify investment decisions.

Under this general plan, then, all official tax rates would be reduced substantially. The top individual tax rate would drop from 50 percent to 25 percent. The top business tax rate would be reduced from 46 percent to 20 percent.

Table I

INCOME TAX REVENUES COLLECTED BY THE FEDERAL GOVERNMENT

FOR FY '82 -- 1981 TAX LAW COMPARED TO QUAYLE SELF-TAX PLAN

	1981 TAX LAW (1982 Estimate)		QUAYLE SELF-TAX PLAN[1]	
	Billions of Dollars	% of Total Fed. Revenue Collected	Billions of Dollars	% of Total Fed. Rev. Collected
A. Individual Income Taxes (per year)	$300.0	47.8	$267.0	40.7
Taxpayers:				
Under $17,500	34.5	5.5	0	0
$17,500-$50,000	198.3	31.6	182.0[2]	27.7
Over $50,000	67.2	10.7	85.0	13.0
B. Business Income Tax	50.0	8.0	112.0	17.1
TOTAL	$350.0	55.8	$379.0	57.8

Source: U.S. Department of the Treasury Office of Tax Analysis, reported in A Program for Economic Recovery, White House report, (Feb. 1981).

[1]Assumes revenues collected from other than income taxes will not be changed (social insurance, excise, estate and gift taxes, custom duties, and miscellaneous receipts) - a total of $277.1 billion.

[2]The $600 dependents allowance (an estimated revenue loss of $6 billion) is attributed entirely to the $17,500 - $50,000 income bracket.

The IRS could devise a post-card on which every taxpayer could compute his own tax. Paperwork for business would be cut very radically, as it would for government. Lower rates would be made possible by a fairly broad expansion of the tax base. The poorest individuals would pay no tax, and we would retain a slightly progressive rate schedule. In addition, business would pay its fair share of the tax burden.

The estimated effects of my proposed plan are summarized in Table I.

As can be seen from the Table (which is based on data produced by the Treasury Department in 1981), if my plan were in effect for the current fiscal year, the Federal government would collect about $29 billion more in revenue than under current law.

The different income groups would be affected differently by the proposed system. The poor and near-poor would pay no tax. In 1982, this group paid $34.5 billion in Federal Income Taxes.

The middle group ($17,500-$50,000) would pay about $16.3 billion less in tax than they pay under current law, providing a somewhat lower percentage of total Federal taxes collected. The $17,500-$50,000 income group would provide 27.7% of total Federal revenues compared to 31.6% under current law.

The wealthiest group of taxpayers (over $50,000 per year) would pay $17.8 billion more in individual income taxes under the SELF plan than under current law. The highest income group would also provide a higher proportion of Federal revenues collected than they do now (13 percent compared to 10.7 percent).

Under my proposed SELF plan, business income taxes would provide \$62 billion more in Federal tax revenues than at present. Business would provide 17.1 percent of total Federal revenues - not a high proportion by historic standards. This would reverse the recent trend of eliminating business taxes. In 1982, business income taxes will provide only 8.0% of total Federal revenues. It should be noted, however, that while revenues from direct business income taxes would be increased under the SELF plan, capital gains and interest income would be taxed only at the business and not the individual level. There would therefore be a compensatory reduction in tax burden to individuals with business interests compared to present law.

Necessity for Dealing with the Tax Problem Now

The present tax structure, including its numerous preferences and loopholes, is no longer able to raise sufficient revenues for the operation of the Federal government. If we do nothing to raise revenues we cannot avoid large budget deficits. Such deficits frighten businessmen and investors, causing interest rates to remain very high. This weakens the prospects for a healthy economic recovery. It is clear that Congress must address the issue of long-term revenues if the Federal deficit is to be reduced.

The need to simplify the tax structure is widely recognized. Several bills in addition to my own have already been introduced in both the Senate and the House which would order the Treasury Secretary to propose legislation or to draft changes in regulations to provide for massive simplification of the tax code.

If a serious approach to increasing the tax base is not soon adopted, we will face the prospect of either raising rates or adding new taxes. I believe we will all be better off if we took the path of reform. If we do not, we will be perpetuating the present inequities and inefficiencies in the system.

Many advantages would ensue from a program of tax simplification. Americans could once again compute their own taxes. They no longer would have to employ tax preparers to wade through a jungle of incomprehensible regulations. The ease of dealing with the tax system should result in an increase in income reported, and the underground economy would begin to shrink.

With a low-rate simplified tax structure Americans would have substantially increased incentives to work and be productive. This is because most members of the labor force would be able to keep a much larger share of any additional earnings than under current law. At the lowest income levels, the incentives to earn would be greatly increased since income would not be taxed at all below the $17,500 level. Also, with low marginal rates for the middle and higher income groups there would be little need for tax shelters. Productive behavior would become rational and efficient from both the individual and business viewpoints. The recent decline in rates of national productivity growth might well be reversed.

The system would also be much fairer. People with the same income would pay the same level of tax. There would be no reward to employing high priced tax specialists to gain special benefits by manipulating confusing rules and regulations; there would be relatively few regulations to manipulate. Everyone who pays tax would do so on the same, straightforward basis. This should reduce taxpayer anger and restore basic public respect for the total system.

The system would also be more equitable and more efficient. The poor would not pay anything, the wealthy would pay a higher rate than anyone else, and business would pay its fair share. A substantial burden in paperwork would be lifted from business, government and individuals alike. Tax considerations would no longer be the driving force behind specific business decisions; the economy would be freer to respond to normal market forces. The result should be higher economic growth and productivity. Overall long-term benefits from such tax reform can be very great, and I believe we should begin to consider the issue seriously.

APPENDIX*

CURRENT REVENUE LOSSES DUE TO TAX EXPENDITURES AND TRENDS IN FEDERAL INCOME TAX COLLECTIONS

This appendix presents some data on tax expenditure revenue losses and recent trends in the federal income tax structure. These data show (1) the Federal government currently foregoes collection of substantial revenue due to current individual and corporate tax expenditures. From a tax viewpoint the effect of these tax expenditures is to reduce the tax base; revenues foregone to tax expenditures are now projected to increase further, even with passage of H.R. 4961, the Tax Equity and Fiscal Responsibility Act of 1982. (2) Individual income tax rates today are higher for all income groups than they were in 1965; the tax structure is also much more progressive than it was fifteen years ago; and (3) revenues from the corporate income tax have radically declined in recent years implying that much could be gained in efficiency and fairness by simplification and rate reduction in the corporate income tax.

I. Projected Revenue losses due to Tax Expenditures

Table I compares estimated Federal Income Tax Collections and Federal tax expenditures for the fiscal years 1981-1987. As can be seen from the table, before passage of the Tax Equity and Fiscal Responsibility Act of 1982 (H.R. 4961) total tax revenues foregone by the Federal government was estimated to increase from $228.6 billion in FY 81 to $439.4 billion in FY 87. This represents a gradual increase from 40% to 46% of total taxes foregone over this seven year period.

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*This appendix was prepared with the assistance of Barbara N. McLennan of my legislative staff, Allen Unsworth of the minority staff of the House Budget Committee and Peter Davis of the staff of the Senate Budget Committee.

TABLE 1

FEDERAL INCOME TAX COLLECTIONS
AND FEDERAL TAX EXPENDITURES
FY1981-FY1987
($-Billions)

	FY1981	FY1982	FY1983	FY1984	FY1985	FY1986	FY1987
Corporate Tax Collections	$ 61.1	$ 46.7	$ 56.2	$ 67.7	$ 73.3	$ 69.1	$ 64.9
Corporate Tax Expenditures	48.8	55.1	64.0	80.4	96.3	110.7	122.0
Percent of Corporate Taxes Foregone through Tax Expenditures	79.9	118.0	113.9	118.8	131.4	160.2	188.0
Individual Tax Collections	$285.9	$298.6	$304.5	$322.9	$362.0	$401.5	$445.7
Individual Tax Expenditures	179.8	198.4	209.1	225.6	251.5	285.3	317.4
Percent of Individual Taxes Foregone through Tax Expenditures	62.9	66.4	68.7	69.9	69.5	71.1	71.2
Total Income Tax Collections	$347.0	$345.3	$360.7	$390.5	$435.3	$470.6	$510.6
Total Tax Expenditures	228.6	253.5	273.1	306.0	347.8	396.0	439.4
Percent of Total Income Taxes Fore-gone through Tax Expenditures	65.9	73.4	75.7	78.4	79.9	84.1	86.1

SOURCES: Data on projected tax collections is from the Budget of the U.S. Government, Fiscal Year 1983. Data on projected tax expenditures is from the Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 1982-1987 (March 8, 1982) and Estimates of Federal Tax Expenditures for Fiscal Years 1981-1986 (March 16, 1981). All figures assume continuation of 1981 tax policies, and do not reflect effects of H.R. 4961, the 1982 tax bill.

As can be seen from the table, before passage of H.R. 4961, corporate tax expenditures by FY 87 would have increased from $48.8 billion to $122 billion. In FY 81 corporate tax expenditures were nearly equal to 80 percent of total corporate taxes collected; by 1987, corporate tax expenditures would have risen to nearly double the amount collected by the corporate tax (188 percent). Table I also indicates that in FY 81 individual tax expenditures equalled $179.8 billion -- about 63 percent of total individual taxes collected; by 1987 the amount of individual taxes foregone would have risen to $317.4 billion, over 71% of total individual taxes collected.

As a result of H.R. 4961, much of the previously projected increase in corporate tax expenditures will be substantially reduced. Table 2 presents the estimates of revenue effects of H.R. 4961. As can be seen from the table, business tax provisions will raise over $5 billion in revenues in 1983, rising to more than $40 billion by 1987. As a result, revenue losses due to business tax expenditures will be much less than under ERTA, although the combined effect of both laws is still to reduce the corporate tax burden.

II. The Individual Income Tax

The Treasury Department is currently analyzing the individual income tax base but those data are not yet avilable. Table 3 presents a comparison of marginal tax rates for four-person families from 1965-1984, as estimated after passage of the Economic Recovery Tax Act of 1981.

TABLE 2

Summary of Estimated Revenue Effects of Tax Provisions of H.R. 4961 as Agreed to by the Conference Committee, Fiscal Years 1983-1987

(In millions of dollars)

Provision	1983	1984	1985	1986	1987
Individual income tax provisions	272	3,113	3,106	3,336	3,556
Business tax provisions	5,422	13,292	16,497	28,042	40,116
Compliance provisions	3,365	8,869	8,660	10,174	11,217
Pension provisions	194	780	870	970	1,058
Life insurance and annuities	1,942	2,155	2,920	3,138	3,370
Employment tax provisions	1,904	3,083	3,577	2,853	2,572
Excise tax provisions	2,798	4,009	4,702	2,054	1,472
Miscellaneous provisions	-38	-37	-34	-32	-30
Total, tax provisions	15,859	35,264	40,298	50,535	63,331
Revenue gain resulting from additional IRS enforcement personnel	2,100	2,400	2,400	1,300	600
Grant total, all provisions	17,959	37,664	42,698	51,835	63,931

Source: Tax Equity & Fiscal Responsibility Act of 1982, Conference Report (August 17, 1982). p. 691.

TABLE 3

Marginal Tax Rates for Four-Person Families[1/]
1965-1984

Year	One-Half Median Income $	Tax Rate	Median Income $	Tax Rate	Twice Median Income $	Tax Rate
1965	$3,900	14%	$7,800	17%	$15,600	22%
1970	5,582	15	11,165	20	22,330	26
1975	7,924	17	15,848	22	31,696	32
1977	9,162	16	18,723	22	37,446	36
1978	10,214	19	20,428	25	40,856	39
1979	11,211	18	22,422	24	44,844	43
1980	12,722	18	25,443	24	50,886	43
			The Economic Recovery Act of 1981 Under (P.L. 97-34)[2/]			
1981	14,100	18	28,100	28	56,200	43
1982	15,100	16	30,100	25	60,300	44
1983	16,000	17	31,900	23	63,900	40
1984	16,800	16	33,600	24	67,200	38

1/ Assumes itemized deductions equal to 23% of income.
2/ Rate changes only, assumes inflation of 8.7% in fiscal 1982 trending down to 5.0% in fiscal 1986 and same increases in median income.

Source: Office of Tax Analysis, Department of the Treasury. Does not reflect effect of H.R. 4967, The Tax Equity & Fiscal Responsibility Act of 1982.

As can be seen from Table 3, in 1965 we had a very much "flatter" individual income tax rate structure than we have today. In that year, four-person families with one-half median income paid an average tax rate of 14%; families at the median income paid 17%; families at twice the median income level paid 22%. Over the ensuing fifteen years, the rate structure became very much more progressive. By 1980, families in the one-half median income group paid an 18% rate; median income families paid 24%; families at the twice median income level paid 43%. Rates for all groups increased because of real economic growth combined with inflation, resulting in "bracket creep" -- the pushing of all taxpayers into higher tax brackets because of higher nominal incomes.

The effect of the 1981 Economic Recovery Tax Act was to reduce rates proportionally for all income groups. By 1984, it is estimated that families with one half median income will pay 16%; families at the median income level will pay 24%; families at the twice median level will pay 38%. This represents a reversal of the previous fifteen year trend. However, in 1984 the individual tax rate structure will still be far more progressive than it was in 1965; also, families at all income levels will pay higher rates of tax than they did in 1965.

III. Reforming the Corporate Income Tax

The most important benefit of the broader-based, lower-rate corporate income tax would be greater economic efficiency. Increased efficiency in the allocation of economic resources would result both from the reduction in the marginal corporate tax rate, and from the elimination of most tax preferences.

The corporate tax is essentially a tax on capital. The existence of such a tax implies that there will be less than the optimal amount of resources devoted to capital investment. It follows that a reduction in the marginal rate of corporate tax will reduce the underinvestment in capital equipment. Roger H. Gordon and Burton G. Malkiel have estimated that the efficiency gain resulting from a small cut in the corporation income tax is about 40 percent larger than the revenue loss (assuming no change in corporate tax preferences.)[1]

The SELF-tax Plan Act (S.2557), which mandates a 20 percent across-the-board tax rate on all net corporate income, and at the same time would eliminate most special tax preferences, would provide a significant reduction in marginal tax rate reduction on corporate income. At the same time SELF-tax would not result in any revenue loss because of the elimination of most special preferences and interest cost deductions. Thus the average effective tax rate on corporate income would approximate the 20 percent marginal rate. The current (1981) effective corporate tax rate is 20.5 percent (see Table 2) which is considerably less than the current marginal rate of 46 percent largely because of the myriad of tax preferences contained in the current law. The SELF-tax will, therefore, lead to the efficiency gains outlined and estimated in Gordon and Malkiel without the offsetting revenue losses.

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[1] Roger H. Gordon and Burton G. Malkiel, "Corporation Finance" in Henry J. Aaron and Joseph A. Pechman (eds.) <u>How Taxes Affect Economic Behavior</u>, Washington, D.C.: The Brookings Institution, 1981.

In addition to increasing economic efficiency by reducing the marginal corporate tax rate, the SELF-tax will improve the allocation of resources by eliminating the wide disparity of effective tax rates across industries which have resulted from the host of tax preferences which have been added to the tax code over the years. Table 4 summarizes the major tax preferences, and Table 5 illustrates the effects of these tax preferences on the effective tax rates by industry.

As can be seen from Table 5, under current (1981) law effective tax rates range from -12.6 percent on commercial banks to 39.7 percent on apparel companies. This dispersion of 52.3 percentage points in the tax burden imposed on different industries is far from the neutral corporate tax which would minimize the economic inefficiency of the tax system.

Each of the tax expenditures in the current law were added to meet a specific felt national need at the time of enactment. Unfortunately, the net result of all of these preferences taken together has been to reduce the effective tax rates imposed upon corporations in a haphazard way. Some of these tax expenditures apply only to particular industries such as the expensing and depletion provisions for mineral extraction industries. Other tax expenditures apply generally, such as the investment tax credit and accelerated depreciation, but even these provisions differentially favor those industries that differentially favor industries that happen to use relatively more depreciable capital.

Capital responds to this preferential tax treatment by flowing to the most tax-favored industries, where the after-tax rates of return are greater. This flow continues until after-tax returns in the tax-preferred industries are bid down to equality with those industries that are more heavily taxed. The result is that the Nation's capital stock is misallocated; there is too much investment in the tax-favored industries, and not enough in the others. The value of our total income is therefore reduced; we would produce more output according to society's valuation if there were no tax preferences, and tax rates were equal across industries: In that circumstance, capital would be reallocated until pre-tax returns were equal, and so output in society's view would be maximized.

The problems with the current tax system, and the corresponding benefits from streamlining the law, show up in different ways. Corporate tax expenditures reduce the amount of revenue collected at any given statutory tax rate, and therefore force tax rates up. That means that undertaking any non-taxed preferred activity is less profitable and, therefore, in all likelihood less activity will take place.

The need for higher tax rates imposed by the tax expenditures creates a vicious cycle. The higher the statutory tax rates, the greater must be the incentive to take advantage of preferences and shelters. Over time, there will be ever-increasing pressure for the creation of new tax expenditures. Eliminating most tax preferences and reducing the tax rate both cut this vicious cycle.

Finally, the present tax system, by allowing interest expense deductability and the double taxation of dividends, creates a bias towards debt versus equity finance, increasing firm's exposure to the risks of bankruptcy and society to the economic loss this creates. The SELF-tax, by eliminating interest deductions and double taxation of corporate income would remove this source of economic inefficiency.

TABLE 4
IMPORTANT TAX PREFERENCES FOR
SELECTED INDUSTRY GROUPINGS, 1981
(Preferences in Descending Order of Importance)

Aerospace Companies
Long-term contracts, investment tax credit, DISC

Apparel Companies
Investment tax credit, possessions corporations, accelerated depreciation

Automotive Companies
Investment tax credit, accelerated depreciation, DISC

Beverage Companies
Investment tax credit, accelerated depreciation, intangible drilling costs

Chemical Companies
Accelerated depreciation, investment tax credit, intangible drilling costs

Commercial Banks
Tax-exempt income, accelerated depreciation, investment tax credit

Diversified Service Industries
Investment tax credit, accelerated depreciation, long-term contracts

Electronics and Appliance Companies
Investment tax credit, accelerated depreciation, DISC

Food Processors
Investment tax credit, accelerated depreciation, DISC

Glass, Concrete, Abrasives and Gypsum Companies
Accelerated depreciation, investment tax credit, depletion

Industrial and Farm Equipment Companies
Investment tax credit, accelerated depreciation, DISC

Instrument Companies
Investment tax credit, accelerated depreciation, possessions corporations

Life Insurance Companies (Stock)
Special insurance deductions, tax-exempt income, deferred acquisitions costs

Metal Manufacturing Companies
Investment tax credit, accelerated depreciation, depletion

Metal Products Companies
Investment tax credit, accelerated depreciation, long-term contracts

Mining and Crude Oil Production Companies
Accelerated depreciation, investment tax credit, intangible drilling costs

Musical Instruments, Toy, and Sporting Goods Companies
Investment tax credit, accelerated depreciation, long-term contracts

Office Equipment Companies
Investment tax credit, DISC, accelerated depreciation

Oil and Refining Companies
Accelerated depreciation, investment tax credit, intangible drilling costs

Paper, Fiber, and Wood Products Companies
Accelerated depreciation, investment tax credit, capital gains

Pharmaceutical Companies
Possessions corporations, investment credit, accelerated depreciation

Publishing and Printing Companies
Investment tax credit, accelerated depreciation, capital gains

Food Retailers
Investment tax credit, accelerated depreciation, capital gains

Non-Food Retailers
Accelerated depreciation, investment tax credit, tax-exempt income

Rubber, Plastics, and Leather Products Companies
Investment tax credit, accelerated depreciation, long-term contracts

Shipbuilding, Railroad, and Transportation Equipment Companies
Accelerated depreciation, investment tax credit, long-term contracts

Soap and Cosmetics Companies
Accelerated depreciation, investment tax credit, possession corporations

Textile and Vinyl Flooring Companies
Investment tax credit, accelerated depreciation, depletion

Tobacco Companies
Accelerated depreciation, investment tax credit, tax-exempt income

Transportation Companies
Accelerated depreciation, investment tax credit, capital gains

Utilities
Capitalized interest and construction costs, investment tax credit, accelerated depreciation

SOURCE: Congressional Budget Office

TABLE 5
EFFECTIVE CORPORATE TAX RATES BY INDUSTRY - 1981
(Percentage of Net Income Paid in Tax --
U.S. Rate on U.S. Income)

Industry	Tax Rate (Percent)
Commercial Banks	-12.6
Transportation Companies	-4.8
Shipbuilding, Railroad, and Transportation Equipment Companies	-1.2
Paper, Fiber, and Wood Products Companies	4.0
Mining and Crude Oil Production Companies	9.4
Metal Manufacturing Companies	10.1
Utilities	11.5
Life Insurance Companies (Stock)	13.0
Aerospace Companies	13.5
Chemical Companies	13.6
Automotive Companies	19.1
Glass, Concrete, Abrasives, and Gypsum Companies	19.8
AVERAGE RATE FOR ALL INDUSTRIES	20.5
Oil and Refining Companies	21.4
Non-Food Retailers	22.0
Rubber, Plastics, and Leather Products Companies	23.4
Metal Products Companies	24.1
Office Equipment Companies	26.7
Instrument Companies	26.8
Diversified Service Industries	27.8
Pharmaceutical Companies	28.5
Beverage Companies	28.6
Industrial and Farm Equipment ~~Companies~~	28.8
Electronics and Appliance Companies	29.3
Food Retailers	30.8
Tobacco Companies	31.4
Textiles and Vinyl Flooring Companies	31.9
Food Processors	33.6
Musical Instruments, Toy, and Sporting Goods Companies	34.5
Publishing and Printing Companies	36.3
Soap and Cosmetics Companies	39.4
Apparel Companies	39.7

SOURCE: Tax Notes

Effective tax rates are based on a sample of firms and therefore are subject to sampling variation.

The CHAIRMAN. Senator Grassley, do you have questions?

Senator GRASSLEY. Senator Quayle, thank you for your statements, and thank you for your work on this important project. I read your proposal. Over a period of time your written comments have been published and disseminated widely.

One of the things I would like to ask all of our witnesses is: have you given any thought about the best transition from our current tax system to the one you propose? Should it be phased in quickly or over a period of time, in your judgment?

Senator QUAYLE. Well, I suppose you should not have an abrupt change, whether you have a year transition or what.

The big question that a lot of people are talking about, is the "notch" problem, particularly in the flat-tax proposals.

Basically the way to solve that is to just phase it in. The IRS could come up with tables to show whatever tax rate you are going to be in, how much taxes you are going to owe; therefore, we would never want to get into a situation where someone who earns more money would actually be worse off because of the tax burden; that's the "notch" problem.

But, as far as the actual transition, I am sure that we can work out a transition period so that this is not going to cause chaos, whether it be business, industry, or individuals. I am confident we can work that detail out.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Thank you, Senator Grassley.

Senator Bentsen?

Senator BENTSEN. Well, I would just like to touch on that same point again, and I think the chairman touched on it earlier.

You have got a fellow who has put a mortgage on his home, to buy it, to own it, and rear his family, and he is right up to here in debt. And then suddenly we talk about doing away with the economic objectives that are in the tax system and doing away with the deduction on interest on home mortgages, and he says, "There is no way I can cut it if you do that. That throws my budget so far out of line that I just can't make it." What kind of an adjustment do you allow in that, or do you leave that type of deduction?

Senator QUAYLE. I did not leave that deduction in my proposal; but I am a realist and know full well that the home mortgage deduction is one of the so-called sacred cows and something that was put into the Tax Code for a very good reason. I am sure that as we deliberate tax simplification that will be one of the first items to come up. You will talk about that, and you will also talk about charity.

Senator BENTSEN. Well, I'll tell you what will happen, Senator, and you know that. If you start putting this system in effect, the first fellow that comes up to you is that fellow, and he is going to say, "Now, surely, Senator Quayle, you didn't mean to knock out my deduction on interest on home mortgage; surely you didn't mean to do that." And then after you answer that one, the next one that will come up to you will be the mayor and the city councilman. He is going to say, "Are you going to tell me that you are going to start taxing the interest on municipal bonds? If you do that, how am I going to sell those bonds and pave those streets and build those sewers?" And the next one that is going to come up to you will be the preacher, and he is going to say, "Now, my son, you don't really mean to tell me that you are going to knock out the deductibility on contributions to my church, now are you?" And about that time someone is going to say, "Now, who in the world thought up this idea, anyway?"

Senator QUAYLE. Well, I am sure that you are going to hear from the mayors and the preachers and the homebuilders during this testimony. And I am sure that, as we move toward tax simplification, all of their concerns are going to be taken into mind. I also have no illusions that you are going to wipe out all of the deductions. But I do believe, as a starting point of the discussions, we ought to talk about getting a handle on so-called tax expenditures.

Tax expenditures, as already pointed out, by 1987 will total $450 billion, and we have to start talking about that. Now, how we deal with that on a fair, equitable basis is what this committee is about to pursue, and I commend you for it. I believe that the points you bring up are very well taken.

I would only point out that under my proposal, when you look at the individual, the people who are earning $50,000 and less will be paying less taxes and will have more disposable income under this proposal. I believe that is a goal that we want to achieve—at least, I would like to see it achieved—but how we do that, with all the proper mix and taking into account the items that you bring up, is something that we are going to be talking about not only today but in the weeks ahead.

I hope as we move forward we will come to grips with the complexities, the confusion, and the inequity that is presently in the Tax Code. Now, how we actually do that is something I have tried to work out. I put a proposal on the table. We have had a lot of comments about it, quite frankly, but I believe it is a proposal that merits thought. It goes along with the philosophy and the intent of what these hearings are all about.

I will join with you, as we go through this very long and arduous process, to find out what kind of tax simplification we can politically afford and what kind of tax simplification will be necessary to generate the revenues to pay for national defense and the other programs.

Senator BENTSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Right.

Senator GRASSLEY. Would you yield to me just a second on the point of charitable deductions, as long as it was brought up here?

The CHAIRMAN. Yes.

Senator GRASSLEY. I think that maybe one of the things that will come out in hearings like this is some of the arguments and statistics that can back up certain arguments. One of them is on charitable giving. Only one-third of charitable givers itemize their deductions. People must realize that every dollar given to charity is not given for a tax deduction. There are other reasons, obvious reasons, that people give other than to deduct from their income tax.

Senator BENTSEN. Mr. Chairman, I might comment and say that I hope that, as I face up to these problems, that it will be at the beginning of a new 6-year term. [Laughter.]

The CHAIRMAN. You don't want to go today? One way to have a big turnover, I think, would be to have a vote today. [Laughter.]

No, I think, Senator Quayle, if we are going to wilt because every special-interest group is going to come in and say, "Don't touch me," then we aren't going to make any progress.

Let's take mortgage interest—I'm not advocating doing anything about that—that's $36 billion this year, just on owner-occupied homes. So it's a big, big item that is going up. There will have to be some transition rules, or you would have to demonstrate that in your proposal or whichever proposal we might seriously look at, that assuming that deduction was denied, that you still had a better deal because of the lower rate.

I think the big concern is that so-called middle income. I don't know where you start it, but if you go from $10,000 to $50,000, based on 1981, I think they pay about 60 percent of the taxes. We have to make certain that we don't burden that group any more.

Well, I think Senator Long is next.

Senator LONG. Thank you for a very thoughtful statement, Senator Quayle. Let me ask you this question: If we are going to proceed along the line that you have in mind, wouldn't it be a good idea if we quit creating more loopholes in the tax law?

Senator QUAYLE. I would agree with that.

Senator LONG. Well, it seems to me that if we are going to be creating loopholes one day and then trying to get rid of loopholes the next day, we are not going to achieve what the objective is.

Now, are you familiar with what this committee reported out last week?

Senator QUAYLE. On the bill?

Senator LONG. Are you familiar with the proposal that we reported out to fix it up so that audits and authors who make a lot of money will have a tax loophole to fix it so that they need not pay any taxes at all by way of income tax?

Are you aware of the fact that we just reported out of this committee last week a proposal to fix it so a wealthy painter who makes just tons of money can give some of his paintings—mind you, not at the wholesale price—if he sells them through any of the galleries that you see around here that put them on display for that purpose? They would charge him 50 percent for selling it for him. So let's say he had a painting that he sells for $10,000; it would only be $5,000 net to him. But he can give that to any university or to any museum, or any sort of a nonprofit outfit that claims charity—I assume it could even be a nursing home, provided it was nonprofit—and he can deduct the whole $10,000. Now, against the 50 percent tax bracket, that's worth $5,000 to him, which is what he would net anyway. He would make more money giving them away than he would in selling them, in some cases.

Now, we just reported that out last week. I would like to suggest to you that I was a lone Senator up here, fighting to try to save the Treasury. Don't you think it would be a good idea, before the committee goes to work creating more loopholes, that we at least decide we want to do something along the line you advocate and that we stand firm, draw the line on the tax loopholes we have created already?

Senator QUAYLE. I would say this, Senator. I certainly agree with you that if we are really concerned about tax simplification and dealing with the so-called tax incentives, that the momentum ought to be perhaps in the other direction: Instead of just adding more credits or deductions, or finding out whatever some particular group favors—in this case, the artists—maybe we ought to say, OK, let's just put a moratorium for 1 or 2 years on all new tax credits or tax deductions, and go back and figure out what we have right now. I think that would be a reasonable approach.

Senator LONG. Well, take a look at what we reported out this last year. As I understand it, those people wouldn't even owe the minimum tax. We just got through fixing it up so that those who make lots of money, as painters, sculptors, and writers—do you recall how Richard Nixon got in all that trouble about getting a deduction for those papers? Well, you could just say, "All of these are authors, and I can give the manuscript." Now, I guess if that were the original manuscript on the Bible, or something like that, I would be willing to give them a tax advantage if they were going to turn that over to us. [Laughter.]

But as far as the manuscript on the ordinary paperback "shoot-em-up" that you see out there on the newsstand, I wouldn't be willing to give it. I couldn't care less if I never saw the manuscript; and I didn't know anybody else cared to see the manuscript of it.

It seems to me if you are really sincere—and I believe you are—that you ought to line up with some of us who think we have enough tax expenditures; we ought to just hold the line where we are.

Senator QUAYLE. You know, you make a very convincing case. I am not familiar with the specifics of that, but if we are going to vote on that on the floor I may vote with Senator Long.

The CHAIRMAN. I think you may be.

Senator QUAYLE. I may have to take a good close look at this.

Senator LONG. I didn't know that we were going to vote on this in the last few days of this Congress.

The CHAIRMAN. I doubt if we will.

Senator LONG. I would suggest, at least for this Congress, that you sign up with this beleagured minority of one who is trying to keep us from creating more tax expenditures and more loopholes, for the time being.

Senator QUAYLE. As of now, I am convinced. [Laughter.]

The CHAIRMAN. Well, we are going to have another little loophole meeting this afternoon, so you don't want to miss that one either. [Laughter.]

As Senator Grassley has said, the more loopholes you have, the more pressure there is for a flat-rate tax. So this really may be a blessing.

So, Senator Baucus, since that's your bill, "the artists' bill" [laughter]——

Senator BAUCUS. Senator Quayle, let me now unconvince you. [Laughter.]

Senator LONG. It seems that if you and I are effective in our pursuit to close some of these loopholes and some of these deductions and some of these credits—that is, some of these expenditures that you talked about—that we focus in on the biggest, the ones that take the most revenue away from the felled Treasury.

Wouldn't you agree with me that one of the bigger tax expenditures is intangible drilling cost and percentage depletion rather than an artists' bill?

Let me give you some figures: The artist bills, according to Treasury, lose about $15 million a year; whereas, if you add the intangible drilling costs and the oil and gas depletion allowance, that is about $7 billion a year. Don't you think we should focus in on the biggest ones, the biggest revenue losers?

Senator QUAYLE. Senator Long, I want to tell you, I like artists but I don't know if I like big oil companies.

I don't think, Senator Baucus, we should exclude looking at any deduction or any tax credit. I think the purpose of this is to force ourselves to look at all the so-called tax expenditures. So if we want to get into the intangible oil drilling costs, that's fine, let's have at it. That's the business side of it, and as Chairman Dole said, that's the really tough one. Quite frankly, my suggestions on that are not as specific as I would like them to be.

Now, most of the so-called flat tax or tax simplification proposals—they don't even deal with business at all; they just say, "OK, it's the individual side. Let's talk about lowering taxes."

So I would certainly join with you to have tax simplification, not only for the individual but for corporations, partnerships, and the corporate side of the ledger.

Senator BAUCUS. Let me ask a more serious question. How many of the present deductions would you keep? I'm sorry, I was absent for most of your testimony.

Senator QUAYLE. Under my proposal, we don't keep any on the individual side, except for the——

Senator BAUCUS. The home mortgage interest, for example, you would eliminate?

Senator QUAYLE. We don't do any of that. You see, we don't begin our tax until $17,500. Now, I can read the polls, and I know exactly how——

Senator BAUCUS. Is it your view, in the ideal world, that we in the Congress would not pass any deductions or credits for personal income?

Senator QUAYLE. No. I believe that the ultimate bill would have some exclusions, some deductions. But I believe as a starting point—I put forth a proposal in an abstract sense. If you want to look at it and just do away with it, that is your privilege. I think it has a lot of merit, because it leads us back to what Senator Bentsen was talking about: Well, what about the homeowners and the mayors, and people like that?

Senator BAUCUS. Well, I understand, as a practical matter——

Senator QUAYLE. You have to draw the line somewhere.

Senator BAUCUS. I am not addressing the practical side of this; I am asking your opinion as to ideally, forgetting the practical side of it, ideally should Congress not enact deductions for personal income tax?

Senator QUAYLE. I believe, if you take a completely abstract situation which would be simplest, fairest and most efficient, I would like to come to a proposal which we could agree on in which everyone would pay the same tax.

But now the problem is, when we get into that, you are going to retain progressivity, so not everybody is going to be paying the same tax. That is the debate we have had for years. Some may argue against progressivity; I am not. I think my bill retains some progressivity.

I believe we should have a discussion of what would be the effect of eliminating all deductions. Now, let's find out how this really affects somebody who has a home mortgage if they don't pay taxes on the first $17,500; the people who earn under $50,000, at least from the economic data we have run, would end up having more disposable income than under current law. They just might be willing to give up that home mortgage deduction if they are going to have more disposable income.

Now, Senator Bradley has about four or five deductions. He went through the code and said, "OK, we have to have some." I am saying that you can talk about not having any. Let's deal with the political will and see where we come out with our hearings.

I am not completely wedded to an abstract position, but I think it would be beneficial for starting the discussion.

Senator BAUCUS. Well, remember the words of the oft-quoted journalist H. L. Mencken—Senator Mathias often quotes Mencken. One of the quotes is: "For every complicated problem, there is a simple solution and that's usually wrong." But I think that applies here; that is, for every complicated problem—that is, the complexity of the Tax Code—some think there is a simple solution: Pure flat tax. And that's wrong. It is wrong for some of the reasons that have been indicated; we want some progressivity, and probably we want to keep some deductions. There are some strong public policy arguments for home ownership, for example, as well as other arguments for various deductions that are in the present code.

But on the other hand, we do want simplicity. We want more simplicity than we now have. It seems to me that in the real world and in a complicated society such as ours—on the one hand we want simplicity, and on the other hand we want to satisfy certain social goals and aims—that we should try to make the code much more simple than it is now so that there is more understanding of the code and therefore a greater perception of fairness. On the other hand, times change. Through the years we are going to want to encourage some social programs or some other programs, but not some others; but we should somehow strike that right balance. It is going to be difficult, and not everybody is going to be satisfied. So we can't have a pure flat system.

Senator QUAYLE. And mine is not a flat tax, and I do not advocate a flat tax; I do advocate tax simplification.

Thank you.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you, Mr. Chairman.

Senator Quayle, I think you have made a very important point when you complimented Senator Dole on the Tax Simplification Act of 1982, and then complimented him on the 1981 Tax Act.

The important point to make, and I think you were heading in that direction, is that any tax rate reduction does not generate economic growth.

In 1981 we gave the biggest tax cut in history. Some of us said, "Watch out for the deficits." The deficits came, we got into a very deep recession, and 1 year later we had the largest income tax increase in our Nation's history—60 percent of which was closing loopholes.

There is a lesson to be learned, I think, from those two tax bills, and that is, if you cut tax rates and close loopholes, do it at the same time and thereby avoid the great drain on the Treasury. I think that is a lesson that the committee has learned and I hope the Senate has learned, and if anything comes from these hearings I hope it will be the general agreement that the way you cut tax rates is to do it simultaneously with loophole closing.

Let me say also that you found yourself in the buzz saw here. Aren't you glad you're the first witness?

Senator QUAYLE. Yes. I will stick around to find out what else you will say.

Senator BRADLEY. I'm sure others will have to answer the questions about home mortgage interest and charitable contributions and interest on State and local general obligation bonds and I think it is important to say that some of us have kind of gone down that road, and that is specifically why, in the Fair Tax Act of 1982 that Senator Gephart and I have introduced, we keep the deductions for interest on home mortgages and charitable contributions, and the exclusion for interest on general obligation bonds.

Thank you for your testimony.

Senator QUAYLE. Thank you.

The CHAIRMAN. Thank you, Senator Quayle. We appreciate it very much. I would hope in the months to come, because it will take a long time, that you may come back to our committee and see how we are progressing.

Senator QUAYLE. Thank you very much.

The CHAIRMAN. I might indicate we still have seven witnesses, although I am not trying to cut anybody off.

We would now like to hear from Senator Hart, followed by Senator Nickles, Senator Helms, and Senator DeConcini.

Senator Hart?

Senator HART. Mr. Chairman, I would like to ask unanimous consent to insert my remarks in the record at this point, or at the proper point.

The CHAIRMAN. Fine.

Let's insert Senator Symms' comments following other comments of the members of the committee earlier on this morning.

Senator Hart, you may proceed in any way you wish. Your entire statement will be made a part of the record, and we are pleased to have you here this morning.

STATEMENT OF HON. GARY HART, U.S. SENATOR FROM THE STATE OF COLORADO

Senator HART. Thank you, Mr. Chairman. I appreciate the opportunity to be here, and I congratulate you and the other members of this committee on undertaking perhaps what is one of the most formidable tasks that any committee of the Congress can undertake, and that is to approach the idea of simplification of our tax laws.

I have been involved, I guess, in every so-called tax reform effort that has gone on around here for the last 7½ years, and there has been no exercise that I have participated in that has been more frustrating than that. I think we are all aware of the gap between political rhetoric about wanting simple and fair tax laws and the exercise that I think probably every Member of the Congress goes through in trying to keep some particular loophole open or exception available for one or more of our constituents. So I congratulate you on undertaking the effort.

I want to suggest, if I may, very briefly, as one Member of the Senate, what I think the ground rules might be that would lead us where we all claim we want to go.

I think the enactment of the so-called Tax Equity and Fiscal Responsibility Act of this year and the apparent ground swell, again, of public interest in fundamental tax reform appeared to represent a change in direction and to offer an opportunity for a complete overhaul of our tax system—hopefully. I think all of us or most of us welcome this movement, and I would like to suggest, Mr. Chairman, if I may, a few criteria which we might use in seeking true tax reform in the very near future.

Mr. Chairman, in my view there are three basic principles which should govern our tax reform efforts. First, our tax system must be fair. Any proposals which would result in even heavier tax burdens on the working people of this country I think clearly must be rejected. True progressivity must be the hallmark of our tax system.

Second, a program of tax reform should dramatically simplify the system. The people of the country are rightly fed up with the ever-increasing complexity of the tax laws, and they are now demanding relief.

Third, I think a program should help reduce the economic distortions created by the current system, so that we can return to a general reliance on market forces rather than tax advantages to guide individual and business economic choices.

Mr. Chairman, fairness and progressivity, simplicity and efficiency—these criteria may seem vague and general, but if we got agreement on them we would quickly narrow our range of alternatives for what a system might be that would comply with all of those criteria. For example, if we agree on these criteria, then we can quickly put on the back shelf, where I think they belong, most of the flat-rate tax proposals. We can do this because the flat-rate proposals are clearly and undeniably unfair.

I would like to be very clear on this point, because I think it stands at the very heart of these hearings. Any flat-rate tax proposal which has rates between 10 and 20 percent and which provides reasonable allowances for the poor will inevitably bring higher taxes, often substantially higher, on middle-income taxpayers. Wealthy taxpayers currently have an effective tax rate of about 25 percent. If this is reduced to a flat rate of 10 or 15 or even 20 percent, obviously the wealthiest people in this country will be paying less taxes.

Now, since most flat rate proposals have some allowances for the poor, as they should, so that their share will remain either the same or hopefully be reduced, it is clear who would have to make up the taxes that the wealthy would shed—the middle-class taxpayers, and particularly homeowners, would see their taxes increase by 25 or even 50 percent under most of these so-called flat-rate schemes.

Indeed, the designer of one of the flat-rate tax proposals recently admitted that his proposal, which has a relatively high—19 percent—rate, would raise taxes by as much as $1,500 a year for families earning $30,000 a year, while cutting taxes by two-thirds or more for the wealthier individual taxpayers in our society.

Now, it would seem to me, given these fundamental facts, that it would be clear that most flat-tax advocates are not concerned so much with simplicity as they are with substantially reducing taxes for the wealthy. If they were not seeking this objective, then we would have seen flat-tax proposals not with rates of 10 to 20 percent but of perhaps 28 to 30 percent.

I had asked the Brookings Institution to do some studies on this. They did some computer runs with flat rates at this level of approximately 28 to 30 percent and generous personal exemptions. The resulting distribution of tax burdens was remarkably close to the present one with some lowering of the burden for lower income taxpayers and some raising of the burden for the wealthy. Thus, it seems to me a flat-rate tax can be made progressive if that is the goal; but it cannot be done at a rate of 10 to 20 percent.

Mr. Chairman, it seems to me the choice is clear for flat-tax advocates: Stay where they are with low rates and a major redistribution of the tax burden from the rich to the middle class, or move to higher rates and retain the fundamental progressive distribution of tax burdens we more or less have today.

Once these facts become known to the American people, the flat-rate tax movement will die a quick and very deserved natural death.

In fact, Mr. Chairman, the three principles that I have suggested are so effective at weeding out unacceptable approaches that, of all the comprehensive proposals which have been put forward, I can see only two which qualify: The first is the so-called fair tax proposal advocated by Senator Bradley and Representative Gephart. This bill would eliminate most special deductions and credits and dramatically lower tax rates. It would clearly advance the cause of fairness, simplicity, and economic efficiency.

In addition to that, the other alternative which satisfies those three fundamental criteria is the so-called progressive expenditure tax—I might call it a progressive prosaving income tax, because that is what it really is. This is tax reform of a different nature than we have considered up to this point. Both the flat tax and the "fair tax" are basically simplified forms of our current system; while the so-called expenditure tax—some have called it a consumption tax—uses a different base for taxation: only the portion of income that is consumed would be taxed; that is to say, income not saved or productively invested.

Thus, any income that would be saved or productively invested, including investment in education and training, would not be taxed—at least at the time it was put into savings or investments. This idea is based on an idea that goes as far back as Thomas Hobbes, over 300 years ago.

Mr. Chairman, again, I think the tax reform process is likely to be slower than some of us would like. But I believe that the American people want it.

I believe this committee is beginning to move in that direction, and I would only cite the statement that Will Rogers once made: "People want just taxes more than they want lower taxes." They want to know that everyone is paying his proportionate share according to his wealth.

Thank you very much.

The CHAIRMAN. Thank you, Senator Hart.

[The prepared statement of Senator Hart follows:]

Testimony by Senator Gary Hart
Before the Senate Finance Committee
September 28, 1982

Mr. Chairman, distinguished members of the Finance Committee. Since I came to the Senate in 1975, I have been championing the cause of tax reform, both by sponsoring and supporting various particular reform measures and by putting forward for discussion a comprehensive program for restructuring the tax code.

Until recently, my efforts, and those of many others pressing for major reform, had seemed largely in vain. The forces of special interest power and partisan politics were almost inexorably leading the tax code further and further away from the kind of tax system any of us wants. The tax laws were becoming more and more complicated, less and less fair, and increasingly destructive of economic efficiency and prosperity.

The enactment of the Tax Equity and Fiscal Responsibility Act of 1982 and the apparent groundswell of public interest in fundamental tax reform, however, appear to represent a change in direction -- and to offer the opportunity for a complete overhaul of our tax system. I welcome this new movement, and today would like to put before the Committee a set of criteria which I propose we use in judging current and future tax reform proposals.

In my view, there are three basic principles which should govern our tax reform efforts. First, our tax system must be fair. Any proposal which would result in even heavier tax burdens on the working people of America must be rejected. Second, a program should dramatically simplify the system. The people of this country are rightfully fed up with the ever-increasing complexity of the tax laws, and they are demanding relief. And third, a program should help reduce the economic distortions created by the current system, so that we can return to a general reliance on market forces, rather than tax advantages, to guide individual and business economic choices.

This Committee hardly needs to be reminded that the current Internal Revenue Code fails to satisfy any of these conditions for an acceptable tax system.

The complexity of the existing tax laws is a national disgrace. Over half the individual taxpayers in our nation find it necessary to seek professional help in filling out their returns. And waiting to assist them is a veritable army of accountants, lawyers, and tax return preparers. One estimate is that the tax return-preparing industry consumes $64 billion a year of our national product -- more than we collect in corporate tax revenues, more than the interest on the national debt in 1980, and almost half of the entire nondefense discretionary Federal budget. Such complexity not only unfairly burdens our citizens and breeds contempt for government, it also wastes the often prodigious talents of the participants in the private tax industry, talents which put to productive use could add substantially to our economic well-being.

The tax code's unfairness is also almost unbelievable. We have cluttered the tax laws with so many special provisions in hopes of serving this or that good cause that the inevitable result has been to undercut the ability-to-pay principle which supposedly underlies the system. For individuals earning over $200,000 a year, for example, the average effective rate is about 24 percent, but the range is from virtually zero up to close to 50 percent. And, of course, although the statutory corporate rate is 46 percent, close to half the profitable corporations in the country paying nothing at all.

Finally, the economic inefficiency of our tax laws is staggering. With effective tax rates on profits from various kinds of investment ranging from as high as 40 percent to sharply negative rates on some tax shelters, we have made a shambles of market-oriented capital allocation.

Fairness, simplicity, and efficiency. These criteria may seem vague and general, yet agreement on them will not only provide us with a basis upon which to proceed, it will also quickly narrow our range of alternatives.

For example, if we agree on these criteria, then we can quickly put back on the shelf, where they belong, most of the flat rate tax proposals. We can do this because the flat rate proposals are clearly and undeniably unfair.

I want to be very clear on this point for it stands at the heart of these hearings:

<u>Any flat rate tax proposal which has rates between 10 and 20 percent and which provides reasonable allowances for the poor will inevitably bring higher taxes, often substantially higher, on middle income taxpayers.</u>

Once again -- just as with the Reagan economic program involving the largest tax cut in history combined with the largest defense spending increase in history -- it is a matter of simple arithmetic.

Wealthy taxpayers currently have an effective tax rate of around 25 percent. If this is reduced to a flat 10,15 or even 20 percent, they will be paying less taxes. Since most flat rate proposals have some allowance for the poor so their share will either remain the same or be reduced, it is clear who must make up the taxes the wealthy have shed. Middle class taxpayers and partiuclarly homeowners -- could see their taxes increase by 25 or even <u>50</u> percent under such a scheme.

Indeed, the designer of one flat-rate tax proposal recently admitted that his proposal -- which has a relatively high 19 percent rate -- would raise taxes by as much as $1,500 a year for families earning $30,000 while <u>cutting</u> taxes by two-thirds or more for the wealthiest individuals.

By now it should be clear that most flat tax advocates are not concerned as much with simplicity as they are with substantially reducing taxes for the wealthy. If they were not seeking this objective, then we would have seen flat tax proposals -- not with rates of 10 to 20 percent -- but of 28-30 percent.

At my request, the Brookings Institution did a number of computer runs with flat rates at this level and generous income allowances. The resulting distribution of tax burdens was remarkably close to the current one, with some lowering of the burden for lower income taxpayers and some raising of the burden for the wealthy. Thus, a flat rate tax <u>can</u> be made progressive -- <u>if</u> that is the goal.

The choice is clear for flat tax advocates: stay where you are with low rates and major redistribution of tax burden from rich to middle class <u>or</u> move to higher rates and retain the progressive distribution of tax burdens we have today.

Once these facts become known to the American people, I predict flat tax movement will die a quick and very deserved natural death.

In fact, the three principles I have set forward are so effective at weeding out unacceptable approaches that, of all the comprehensive proposals which have been put forward, I see only two which qualify. The first is the "Fair Tax" proposal advocated by Senator Bradley and Representative Gephardt. This bill would eliminate most special deductions and credits and dramatically lower tax rates. It would clearly advance the cause of fairness, simplicity, and economic efficiency.

Its defects consist largely of failing to go far enough:

First, it does not address the corporate side of the tax equation, where economic efficiency and fairness demand that steps be taken.

Second, it would continue several individual tax preferences which complicate the tax laws -- although I can appreciate the sponsors' reluctance to try to draft the careful transition rules which would be required if these provisions were to be phased out.

And finally, and most importantly, the bill retains an insufficient level of progressivity. In essence, it ratifies the regressive redistribution of the individual tax burden accomplished in 1981.

Despite these shortcomings, however, the Bradley-Gehpardt approach is a giant step toward a more ideal tax system. I urge the Committee to work on improving this legislation and making it the basis for our tax reform efforts next year.

There is another alternative reform which satisfies the fairness, simplicity, and efficiency criteria -- the progressive expenditure tax.

This is tax reform of a different nature than I have discussed up to this point. Both the flat tax and the "fair tax" are basically simplified forms of the current system, while the expenditure tax uses a different base for taxation -- only the portion of our income that is consumed would be taxed. Hence, any income that is saved or invested -- including investment in education and training -- would not be taxed. This is based on an idea Thomas Hobbes argued over 300 years ago -- that we should tax people on what they take out of the economic pie, not what they put in.

An expenditure tax is completely different from a national sales tax or a value-added tax, both of which are collected at the cash register. With an expenditure tax, we'd report our income once a year, just as we do now. The amount to be taxed would be income minus the net amount saved or productively invested that year. Every taxpayer would be permitted a large standard deduction -- $10,000 to $15,000 -- to allow for reasonable living expenses and to protect the poor. This allowance would be more than adequate to cover most home mortgage interest deductions. Above the standard deduction, tax rates would increase progressively with the amount of consumption.

There are several advantages to this proposal. First an expenditure tax would provide the greatest possible incentive for saving and productive investment -- it would not tax it. For example, a taxpayer who earned $1,000 and put the money in a savings account would report $1,000 income -- but he would also have a $1,000 deduction. No taxes would be paid on this income. Second, by encouraging investment and saving at all levels, this reform would increase America's capital base and this will increase our productivity. Third, this reform alternative will maintain our commitment to a progressive tax system. By allowing a large single exemption and then taxing consumption -- the difference between gross income and savings -- at progressive rates, this expenditure tax can be as progressive as the income tax was intended to be. Finally, this reform will be simpler to understand and administer. No longer will scores of exemptions for capital income complicate the tax code and distort investors' choices. Instead of investing in projects where a tax advantage exists as under the present system, investors will choose projects with the highest potential yield.

There are some disadvantages with this approach, and we must address them. First, since the progressive expenditure tax would remove savings and investment from the tax base, higher rates would be required than under a comprehensive income tax approach. The top tax rate, in particular, would have to be far higher than the 28 percent rate provided in the Bradley-Gephardt program in order to maintain the same degree of progressivity. Another problem involves implementation. The transition from the current tax code to a progressive expenditure tax would be a difficult one. Although I believe the expenditure tax would probably be simpler in the long run, the complexities of the transition are a serious problem.

Third, this system could lead to the potential problem of non-taxed accumulation of capital leading to concentrated holdings. It could, however, be dealt with through strong estate and gift tax reform.

Clearly, this alternative needs further study. But since it meets fully all three criteria and has the further advantage relative to the other two alternatives of providing a strong incentive for increased savings and investment, I would urge that it be more fully explored in the debate over major tax reform.

Indeed, if we were designing our tax system from scratch, there's a good possibility that this would be considered the best tax system. And who knows -- maybe public sentiment will demand that we start from scratch.

The tax reform process is likely to be slower than some of us would like. But I believe it's what the American people want. For as Will Rogers once said:

> People want just taxes more than they want lower taxes. They want to know that every man is paying his proportionate share according to his wealth.

The CHAIRMAN. Senator Grassley?

[No response.]

The CHAIRMAN. Senator Long?

Senator LONG. I think you raised an interesting point there that is definitely worth considering in this area, and that is, in addition to the idea of a lower tax rate, we ought to consider a uniform type deduction on what some persons can claim. So when people make investments that put people to work and help do things that are good for the country rather than spending it on their own personal consumption, they are entitled to a better tax treatment than where they are just doing that which tends to aggrandize themselves without particularly benefiting society.

Even in the area that you are discussing, Senator Hart, if a person makes a lot of money and does invest it but merely invests in buying real estate, which just tends to bid up the price, without putting that real estate to use—he buys land and attempts to move up the land prices that someone else who would like to use it would have to pay—he is not serving society. If he buys the same land and puts it to very active use, he is serving society—creating jobs, providing opportunities. In that case I think we would be well advised to try to make the deduction uniform. Where it is something that is going to advance the national interest, he would get the credit for making the investment, however you want to do it, whether you do it by an IRA, or whatever. But if he is not investing that money in ways that are going to benefit the Nation or its people and is only going to benefit himself, offhand I don't see why he ought to have any tax advantage, do you?

Senator HART. Senator Long, in the so-called expenditure or consumption tax, both phrases that I don't like, you are dealing with true supply-side economics; instead of cutting people's taxes with the hope that they will invest it in a way that will increase productivity, this proposal says that you only get the tax break if you in fact invest it and invest it productively.

Now, the definition of what is "a productive investment" would in my judgment be one of the few possibly lengthy or complicated provision in the reformed tax code, because clearly you would have to have some technical definition of what was productive investment. Racehorses, Persian rugs, diamonds, and Kruggerands, probably, wouldn't qualify. Investment in stock of a company that was going to automate itself, modernize itself or retrain its workforce so that it could compete in the international marketplace clearly would be.

But this would be the job for experts. I understand there are definitions of productive investments in the Tax Code already; we could build on those. But you couldn't just say "savings or investments in anything" because, as you indicated, there are some investments that don't increase productivity at all.

Senator LONG. To a large extent we already have that. Senator Baucus made reference to the oil and gas industry. Well, you've got to make an investment. You've got to put some money into drilling. If you put money into drilling you get that intangible drilling expense. If you build machinery or if you build plants you get a tax advantage that you don't get if you just keep the money and buy land with it.

I would like to ask you, with regard to that part of it, I know it has been advocated by Lester Thoreau who I think is a very interesting and talented economist, do you favor that concept? A uniform deduction for types of investment that you think make good sense?

Senator HART. I favor it as far as I understand its implications now. I have not heard all the arguments on it, and that's why I think these hearings are so important. If we get some experts up here that show me the error of my ways or the errors of this concept, I certainly wouldn't support it; but right now, as a concept and as an idea, I would.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman. I have no questions except to thank you very much, Gary, for coming this morning and also bringing up the idea of a progressive expenditure tax. At the very least, at least that helps all of us look at all of this from a new perspective, and it hopefully keeps our thinking imaginative in that we are not locked into narrow alternatives and options but rather keep open many other options. I want to thank you for always keeping us on our toes, thinking of new ideas. I appreciate that very much.

Senator HART. If Senator Baucus or anyone else on the committee or anywhere else can think of a better title for this than "Expenditure or Consumption Tax" I would certainly welcome it.

Senator BAUCUS. Well, we have all been looking.

Thank you very much.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Mr. Chairman, let me compliment Senator Hart on his testimony. I think it raises a number of interesting points, and I'm pleased for his endorsement of the Bradley-Gephardt bill.

I would like to focus, if I could, on the progressive consumption tax, just to raise one question, to which I don't expect him to have the answer because I think we really have to go through committee deliberations, but I'd like to raise at least one red flag. That is: If you did go to the progressive consumption tax along the lines that Senator Long and Senator Baucus explored, which is essentially excluding from taxable income that portion of your income that you invest or save in whatever is finally defined as "productive investment," if you carried that through with very wealthy individual to the end of their life, with the present estate tax laws, wouldn't that result in an enormous transfer of wealth, and have you given some thought about that?

Senator HART. I certainly have, and in the longer statement which I would like to submit for the record I say that this system in my judgment would work only with modernization of the estate and gift taxes.

There has been a suggestion that this proposal, without what I think tax reformers would call a "strong estate and gift tax, would really contribute to concentrated wealth in this country. I would not support that; I think the only way the system would work is if you had a fairly strong estate and gift tax.

Senator BRADLEY. As I read your statement that you submitted to the record today, you seem to imply that, although you endorse the fair tax, you would like to see some more progressivity than exists, and you would like to exclude savings from the taxable base. I think if you do that, you head down the road where if you are excluding more and more from the taxable base, but you want the same amount of revenue, that inevitably you have to go to higher and higher rates, and pretty soon we are back where we are today with high rates that do discourage work, savings, and investments. So I think that is something that you ought to ponder a little bit. I wonder if you have any comments?

Senator HART. I think clearly you have identified a real problem, and it gets to fundamental tax philosophy.

First of all, the point that I was trying to make with regard to your proposal was that it seemed to me to ratify what I think we could call a post-Reagan degree of progressivity; that is, post-1981. The 1981 tax bill seemed to me to substantially reduce progressivity even further—it has been eroding over the years for a variety of reasons. It seemed to me that the formula that your proposal contained in effect went from there. And it seems to me one might think about taking the brackets or the rates back to a pre-1981 tax bill degree of progressivity at least.

On the question of exemption of savings, we all get different statistics here, and I think the committee could do a real service by getting a common data base so we can know whether or not there is a serious need of capital formation in this country. That was the hue and cry in the 1970's and I think contributed as much as anything else to the support that was garnered for the so-called supply-side tax cuts—we need a higher rate of savings; we need more capital formation—leave aside the fact that corporations are not using, by and large, those tax cuts for productivity increases or modernization but are using it for acquisition and mergers.

But regardless of what it was used for, the argument was made, and I think persuasively to many, that we needed higher rates of savings and we needed capital formation. I have heard it said by experts fairly recently that those are bogus numbers, that we still have very high rates of savings, that we have, if not plenty of capital, enough to modernize our industries. I don't know who has the correct answer there.

If in fact we are short of capital, if we need higher rates of savings, then I think we have to do something that more directly rewards people for saving than the so-called supply-side theory of hoping that tax cuts will lead to savings.

Senator BRADLEY. One last question.

In the concept of the consumption tax—in other words, not taxing that which is invested but taxing that which is consumed—how would you treat expenditures for education?

Senator HART. I mentioned in passing that I would count as productive investment money used for education or training.

Senator BRADLEY. Thank you.

Senator HART. But that gets to the point I was making earlier of how you define productivity.

The CHAIRMAN. Senator Hart, I certainly appreciate your coming before the committee. I haven't thoroughly reviewed your proposal,

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but I think one area that we might want to make certain of is that it doesn't create a problem or increase the tax burden relative to present law for those who might be unemployed or the elderly who have to use more of their income because they are at hard times. That may be taken care of in your bill, but certainly it is an area we want to explore.

Senator HART. Mr. Chairman, I don't have a bill, and I would not support a bill of any kind along these lines that did not have a very high standard deduction.

The CHAIRMAN. And I think, also, the flat-rate tax—the term "flat-rate" doesn't tell you very much. Some people may think there is a Senator Flat and a Congressman Rate. We had Roth-Kemp and now we have "Flat-Rate," and I am going to try to figure out who they are. [Laughter.]

So it leaves a lot to the imagination, and I think in the next several months we may be able to clarify some of the questions.

Thank you.

Senator HART. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nickles, you are the next victim.

STATEMENT OF HON. DON NICKLES, U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Thank you, Mr. Chairman.

I appreciate the opportunity to be here before you, and I wish my statement to be entered in the record in full.

Included in the back of my statement, Mr. Chairman, is a chart that was put together by an organization that shows the effective tax rates, and the history of the personal income tax rate since the tax rate began. It reminds me of a story my grandfather told me. He was born, incidentally, in 1887. He is 95 years old, is doing well, and has a lot of commonsense. He said, "Don, I remember quite well the days when we didn't have an income tax." He said, "Now, we don't have any income after tax." And I think he makes a very valid point.

When we talk about the tax rates today, we really have to look seriously at an overhaul, and I think an overhaul is overdue. I certainly congratulate you for holding this hearing today to take a look at this, and I can tell from the statements made by Senator Hart, now by myself, Senator Helms, and Senator Quayle, that there is a wide divergence of views on the subject—there may be a hundred different views in the Senate. But I think it is very timely and very expedient for you and the committee to be taking it up.

I hope that we would look at what the purpose of any tax should be. In my opinion, that should be to provide the basic fundamental services set out in the Constitution for a government to provide. If we look at our tax policy over the last several years, probably since the inception of the income tax, its purpose has really been the redistribution of income.

I wish Senator Long was still here, because I have a little disagreement with him over whether the tax system should be as progressive as it is.

I wholeheartedly endorse the flat-rate tax, but not a flat rate with as many bumps as some of the other so-called flat-rate proposals have. Senator Helms has a flat-rate tax proposal, which I think is the right direction we need to move forward.

A really true, equitable and fair flat-rate tax proposal could do a lot of things. All we have to do is look at the system that we have today. We have an extremely progressive system. I compliment the chairman and also this administration for taking some giant steps toward some very much needed reform in the tax bill of 1981—which did eliminate some of the progressive nature by rolling back the maximum rate to 50 percent. I have heard some people criticize that, but, to turn that around, I don't think the Government in any time, short of wartime, was ever entitled to take over half of anybody's income. That's not a right of government. If you go back to our Founding Fathers, they were looking at the tax system and saying, "Yes, government is supposed to protect our freedom and not redistribute income." When government redistributes income it takes away our freedoms—our personal freedom and economic freedom.

If you end up working for the Government half the time, or more than half the time, then you actually have become, to some degree, a slave of Government, and that's a policy that needs to be reversed. The steps last year, by this Congress, were a giant step in that direction and need to be followed up—I would hope—by a greater step. That greater step would be a flat-rate tax.

About the flat-rate tax, I have heard some people say, "Well, it would be detrimental to lower middle income." I come from the lower middle income. Actually, I come to to you today not as a U.S. Senator so much as a small businessman. I used to manage a small business, a janitor service, during my college days. We started with a few employees, then we added a few more employees. By the time we had about seven or eight employees, I went down to see the accountant. The accountant said, "Well, you are doing great. We are real proud of you." He said, "You are now in the 40-percent tax bracket; here is your estimated quarterly payment." And from that day on I didn't expand that work force. But who was penalized? Not so much Don Nickles the small businessman, but the people I would have hired. That progressive tax rate basically inhibited my desire to expand that business, by putting more people to work.

There is a great deal to be said for unleashing this economy of ours. If we get away from a very punitive, progressive tax rate we could be opening up, an outstanding economic growth potential.

The tax rate policies of the past several years have really inhibited our potential as a country to really get out and produce and survive.

The system that we have today is not simple. The business I was in before I came to the Senate has about 100 employees. I would have to turn over all of our tax forms to the accountant, and 3 or 4 months later he would come back and tell me what my net liability would be. And he would try to chase through all the various rules and regulations that have been passed and promulgated by Congress and come up and say, "Well, yes, Mr. Businessman, here is your final tax." I wasn't competent enough to figure it out. Even on an individual basis now you almost have to be a CPA.

Speaking of CPA's, I have a brother, who is a CPA. When I spoke out fairly strongly on the flat-rate tax, he said, "Well, Don, if I could, I would withdraw my support. You are going to put me out of a job."

The lawyers, the accountants, and the lobbyists, may like the system we have today, but the people of America don't, and the taxpayers of America don't. You can talk to the lower or middle income people, and I have heard their name mentioned—they are the people I work with, people on a machine, the people that make maybe $6 an hour or $7 an hour or $8 an hour—they are in favor of a flat-rate tax proposal. If you were to tell them, Senator Baucus, that your maximum tax rate would be no more than 12 percent, they don't want any deductions; they wouldn't need any deductions.

I would just encourage this committee, as you move forward, to start with no deductions, including those for interest, or charitable contributions. Because once you open up the floodgate, I don't really see how you can stop it.

I would encourage this committee to not only take a look at a flat-rate tax but hopefully move forward next year as soon as possible. I hope you will stay closer to a proposal that will actually be a flat-rate tax similar to that proposed by Senator Helms, one that will have few if any deductions or exemptions. Possibly, the deduction he proposed of $2,000 per person would be adequate to take care of lower income persons.

The system that we have today is not fair. The businessman who is in the 50-percent tax bracket spends half of his time figuring out how to use the legal deductions. I did that as a businessman, and I can tell you that most successful businessmen do. They are always considering ITC's, IDC's, and all of the other job tax credits, to see what their net is going to be. If we eliminate that mess, they can start spending more time trying to figure out how to make a profit, how to make a product, how to compete worldwide.

If we can move positively forward on this type of legislation it could be the greatest single thing that this Congress could do for an economic resurgence that we so desperately need.

Thank you, Mr. Chairman.

[The prepared statement of Senator Nickles follows:]

STATEMENT BY

SENATOR DON NICKLES

SENATE FINANCE COMMITTEE

HEARINGS ON THE FLAT-RATE TAX

I would like you to forget for the moment that I am addressing you today as a U.S. Senator. Rather, I am presenting my views as a taxpayer and also as a small businessman who wrestles with the complexity of our tax laws.

It is my view that the proper purpose of the Federal Income Tax is to provide funds for the proper functioning of federal government. The purposes should not be the redistribution of income or to promote economic or social policy of the government.

In recent months, considerable attention has focused on the Flat Tax Issue. Numerous articles and editorials have appeared in the Wall Street Journal, Newsweek, The New York Times, The Washington Post and others.

Additionally numerous studies on the issue have been developed including William E. Simon's "A Blue Print for Tax Reform" and a Stanford University Hoover Institution entitled "A Simple Income Tax With Low Marginal Rates."

Under ERTA, much was done to lessen the tax bite on the taxpayer, including lower the maximum rate from 70% to 50% beginning in 1982 and indexing beginning in 1985; this was a positive step in the right direction.

There is no doubt that the present tax system needs to be reformed. The complexity of returns and information required to be generated has put an increasing burden on the taxpaying citizens of this country. However, in spite of the fact that virtually universal agreement exists that our system is much too complex I sense that the excellent efforts made in regards to developing a flat rate tax may be given-up because of the entrenchment of our present system. I would encourage my colleagues on the Finance Committee to continue in their efforts to produce a major tax system reform bill.

As I have reviewed the proposals submitted thus far, including those of Senators Quayle and Bradley, I have developed an appreciation for difficulty of developing a simple yet equitable system.

Our present tax system is not fair, nor simple and attempts to dictate social and economic policy.

Currently, our progressive tax system creates disincentive to earn additional dollars due to the increasing marginal tax on each of those additional dollars. A Flat Tax System would, if properly structured, remove this disincentive to produce. Further, the new system should allow a sufficient zero-bracket amount and/or personal exemption as to not place an undue tax burden on lower incomes.

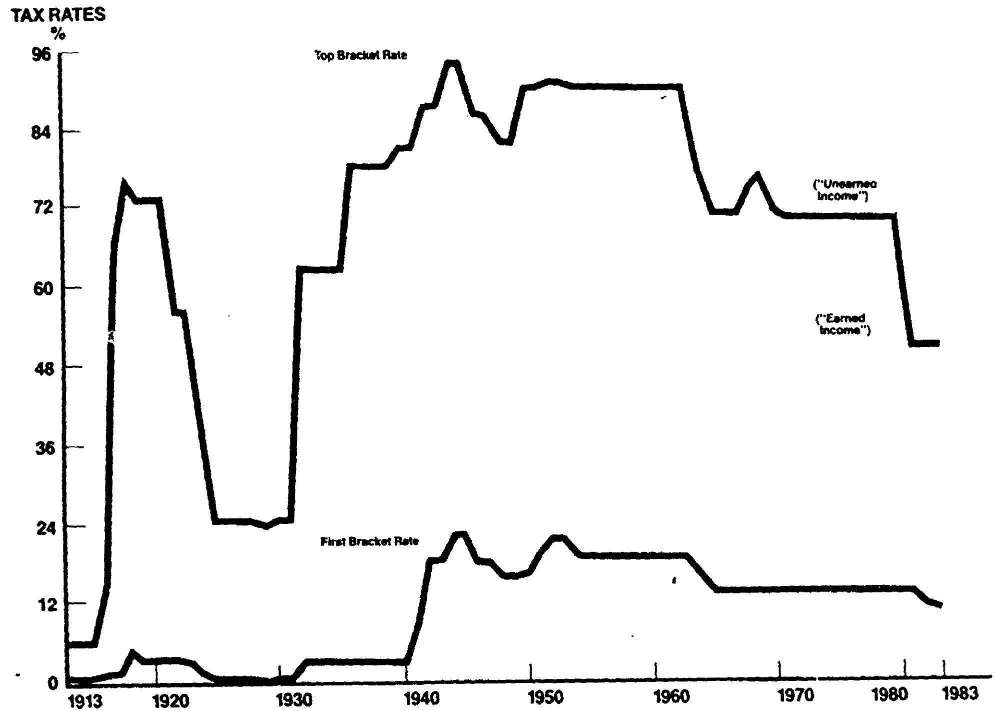
Simplicity is a key criteria in developing a new system. Under present law, extensive technical help is necessary to complete and submit a proper tax return. As has been stated before, in 1981, more than half of the persons using form 1040 use an outside preparer.

Present tax policy includes a myriad of provisions designed to deal with certain economic or social problems. While the intention behind these policy decisions are sincere and intended to help correct a given social or economic situation, they tend to distort the true economic picture by falslely stimulating the economy through tax policy.

It is a pleasure to appear befor you today. I hope to be of assistance during the formulation of any new system this committee may pursue.

Chart 5

PERSONAL INCOME TAX : FIRST AND TOP MARGINAL BRACKET RATES 1913-1983



The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Have you given any thought about how we get from where we are today to a simplified tax system such as flat-rate consumption tax or an expenditure tax?

Senator NICKLES. I have, Senator Grassley.

I appreciated your question to Senator Quayle, and I have read where some people say, "Yes, we would need to phase it in," and I read where somebody said we'd need to phase it in over 30 years. My opinion is, the sooner you would get to it, the faster you would be relying on the marketplace and not the Congress to be making these economic decisions.

I think one of the real fallacies of the entire Tax Code is that we have so much social and economic planning or steering by Congress. So, I think the more rapid it is possible, the better it would be.

Certainly there will be some changes, but I think all of those changes will ultimately be that we will be asking the marketplace to allocate the dollars instead of Washington, D.C.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. One question of Mr. Nickles.

Do you know how much Federal revenue a 10-percent or a 12-percent flat rate with no deductions would generate?

Senator NICKLES. I have understood that the personal income tax today raises about $300 billion.

Senator BAUCUS. Do you know what the defense budget is estimated to be about a year from now?

Senator NICKLES. Yes, 200 and——

Senator BAUCUS. Well, in about a year it would be beyond that, at least $300 billion—close to $300 billion. What are they going to do for the rest of the goods and services that people depend on—highways, for example.

Senator NICKLES. The Senator brings up a good question. Of course, you realize that we are just talking about one small percentage of the budget as a whole, anyway. Right now the personal income tax rate is $300 billion. I would say yes, we can raise the same amount of money with a much simpler, much easier, much fairer, more equitable system, through a flat-rate system than we are today, regardless of whether or not the goal is $300 or the goal would be $350 or whatever.

One concern I would have would be that the flat-rate proposal would be—well, it would be very easy, yes. A 12-percent rate with no deductions would raise $300 billion when an 11 percent will raise $330 billion.

I think there is something positive to that; but also, Congress would have to vote on that, and I think the constituents could tell very clearly, "Yes, they just raised my taxes 10 percent. They just went from 10 to 11 percent." So the people again could speak, and that would be a much easier vote for the people to understand than what they could from either the 1981 tax bill or the tax bill we had this year.

Senator BAUCUS. Thank you very much.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. I think I understood from your testimony, but I would like to just clarify it, that you would support eliminating interest on home mortage as a deductible item?

Senator NICKLES. I would. Senator Bradley, I think it is important. In the first place—and I know that you are aware of this—the larger the base that you have, the lower the tax rate can be. And if you do have a number of exemptions, as proposed in your bill and many of the other proposals, and those exemptions happen to be in most cases the ones that have the biggest bucks in them, then, correspondingly, the rate has to get higher and higher and higher.

Now, personally, I own two homes. I am paying interest on the homes; so I wrestled with that and said, Wait a minute—do we want to do that? I support charities by making contributions, and so on down the line, so it affects me as well as everybody else.

But I would much prefer for Congress to say yes, Mr. Individual, we are going to give you a lower rate; you are going to have more money in your own pockets, so you can use it anyway you want, whether it be to buy a house or whether it be to support a church or charitable organization on your own, and not have the Federal Government into those various areas.

Senator BRADLEY. Well, would you support elimination of the deductions for interest on home mortgages, charitable contributions, and property taxes?

Senator NICKLES. The tax question is a little bit different as a question. I think we would have to be careful. The only real distinction I would make between myself and Senator Helm's bill which includes inheritance tax as income, I wouldn't want to pay a receipt, to get into a situation where you are paying a tax on a tax. The Federal income tax would presumably be the first tax.

The only distinction I would make with Senator Helms' bill is that I would propose eliminating the inheritance tax. That is $7 billion worth of income. But, again, I perceive the primary role of tax policy, to be fair and equitable, is to collect money to pay for these goods and services, not the redistribution of income. And that's all an inheritance tax is, is redistribution of income.

Senator BRADLEY. Senator Byrd?

Senator BYRD. No questions, Mr. Chairman.

The CHAIRMAN. Senator Symms?

Senator SYMMS. No questions, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Senator Nickles. Again, I think our colleagues' appearances are very important, because it indicates the diverse views we have. I think if we started down the list and listed all of the different tax preferences and had you say you were for or against, I doubt that we would accomplish much. I think it indicates how difficult it is going to be to make major tax policy changes. That doesn't mean we should shrink from that obligation, and it is an obligation to try to simplify the code.

So we are not going to back away from it. I am not suggesting any date that we might accomplish what anybody wants to do, but we appreciate your willingness to testify because there are some who want to protect their special interest. I don't quarrel with that, but if every special interest is protected, then we end up with the same system we have today.

Senator NICKLES. I agree with you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Helms?

Welcome to the committee. You can proceed in any way you wish; your entire statement will be made a part of the record.

Senator HELMS. Well, we're glad. On the chairman's part, I won't take more than a minute.

STATEMENT OF HON. JESSE HELMS, U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator HELMS. I guess I ought to come here to apologize for raising this question, being among the first to raise the flat-rate tax. I certainly am not going to pontificate about the subject, nor am I going to pretend that I have all of the answers, or any of the answers, or the final answer. I think it is a little early to say that the flat-rate tax is no good; I want to have it proved to me by exhaustive hearings which I know the chairman is going to conduct to see what the possibilities are.

I don't have the details of it. I am a little bit like Will Rogers, who has been alluded to earlier today. During the submarine menace in the Atlantic some reporters went to him and said, "What would you do about it?" He said, "I would drain the Atlantic." They said, "Good Lord, how would you do that?" He said, "Well, wait a minute. I had the idea, man; you figure out the details." So that's the way some of us are who are talking about the flat-rate tax.

But let me tell you, Mr. Chairman and distinguished members of this committee, one of the staff members of the Finance Committee handed me these few cards—I understand that they are just a few of about 25,000 or 30,000 that have come into the committee—requesting these hearings.

The CHAIRMAN. Well, we have been putting them in sacks and boxes. We haven't answered all of them yet.

Senator HELMS. Well, I haven't counted them. I have been too busy trying to count heads in the Senate. I ran out of fingers last week before I could do that.

The CHAIRMAN. But you are right—there has been a great deal of interest.

Senator HELMS. I do thank you for the courtesy in allowing me to appear here this morning.

I suspect that there will be unanimous agreement from the outset that the existing Tax Code is a nightmare of complexity and frustration and inequity. It is in fact a bewildering sort of Rubik's Cube of Law for almost every American who tries to file an income tax return.

The convoluted nature of the tax laws has bordered on causing people to lose faith in their government. I hear more complaints, Mr. Chairman, about how difficult it is even to file a tax return let alone raise the money to pay the taxes. People are fed up, and most are convinced that the complexity of the law may be—may be—a disguise for what they perceive to be unfairness and inequity.

So, I compliment you again, Mr. Chairman, for calling these meetings, and no matter how it turns out I want to pledge to you that I will cooperate in any way. You may need me. I don't claim to have any particular expertise, but I do know that we are bordering on a tax rebellion, if the people of North Carolina are any indication. And I hear from people all over the country, just as the Chairman does and the Senator from Virginia.

So I am not going to claim that the bill that I have introduced is the last word; it's not. I didn't offer it for that purpose. I offered it as a starting point.

Again, I want to thank you for letting me come this morning and for holding these hearings.

The CHAIRMAN. Well, thank you, Senator Helms. I think you have indicated, properly, there is a great lack of confidence in the present system. We are told by the IRS people that some 5 million taxpayers who should have filed didn't file returns. Now, some may have done that purposely to avoid paying taxes. Others, I think, felt that the system wasn't fair; they saw somebody who could shelter their income down the street not paying any tax, at least they didn't think they were paying any tax; and they felt that they were being unfairly treated by the tax laws.

Again, I don't know of any proposal that has just been introduced that would pass the Congress; but at least we have 12 proposals—7 in the House, 5 in the Senate. There will be additional proposals. So at least we have started the process. It is going to be a long process, and we appreciate your contribution.

Senator HELMS. The Senator is absolutely correct. You know, you can have all the questions in the world—Do you favor eliminating this? Do you favor eliminating that?—well that depends on how high or how low you want the percentage to be, the flat-rate percentage. Now, if you add everything back in, obviously you are going to have a high percentage of taxpayers who are going to take them. So that's the reason I started at 10 percent.

Now, I wasn't born yesterday. I know that there will have to be compromises and political judgments and other kinds of judgments to be factored into the final judgment, assuming that there will be one.

Again, I want to thank you for letting me come today.

The CHAIRMAN. Senator Baucus, do you have questions?

Senator BAUCUS. No questions. Thank you very much, Jesse, for coming.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Just one question.

Senator Helms, I think that your flexibility here is admirable, because I do think we are going to have to go through a sorting out process.

I am concerned with starting at 10 percent, though; because I have been advised that that rate would raise about $100 billion less than present law, and that means the deficit would be $100 billion bigger. So before we start to consider any so-called loopholes, wouldn't you expect we would have to adjust that rate? Unless you want $100 billion more on the deficit.

Senator HELMS. That depends on whose figures are correct, Senator. It is part of the purpose of these hearings to analyze the various figures as to which percentage will do. I don't happen to agree with those figures; they may be right.

Senator BRADLEY. Well, I believe that figure is based on the Joint Tax Committee estimates.

Senator HELMS. I understand, but I have other figures. We won't debate about that.

Senator BRADLEY. Well, where are your figures from?

Senator HELMS. An accumulation of figures by various economists. What they did not factor in was increased production, therefore increased tax collection under the 10 percent. But this is illustrative of the kind of thing that has to be examined in detail.

Gee whiz, the income tax is what—69 years old this year, or 70? I think probably we ought to focus on the question of what we can do instead of what we can't do, in terms of rectifying what is obviously a bad situation.

Senator BRADLEY. Well, I'm for doing that; but if somebody is building a fire over on this side with unsubstantiated numbers, then it really creates unrealistic expectations. And if you can't explain and justify the numbers, then maybe we should just ask the Joint Tax Committee to come up with some "official" revenue estimates.

Senator HELMS. Mr. Chairman, I will submit in the statement that I am presenting the documentation for my figures. I was not anticipating a debate on this aspect, but I will present that.

The CHAIRMAN. They will be included.

Senator HELMS. I thank the Chair very much.

The CHAIRMAN. Senator Byrd, did you have questions?

Senator BYRD. No questions.

The CHAIRMAN. Senator Symms?

Senator SYMMS. I just want to thank you very much for your statement and would just say I think in your testimony you made it fairly clear that the lower the percentage rates, the less exemptions that you want to leave out; and the higher the percentage rate, then we will have to look at each one individually, whether it is churches or homes, whether there even would be a break; so it really wouldn't be a flat-rate tax—like the one that Senator Bradley has introduced, which is helpful to have before us also, where there is a break in it, there is a higher level of taxes after a certain amount of income, so it is progressive.

I do appreciate your willingness to work on this.

I was just going to ask the Senator from North Carolina, have you ever had the opportunity to take a look at the proposal by Jim Jones from Blanco, Tex., the GIT—Gross Income Tax? It is my understanding he will be testifying. He has a rate of 3½ or 4 percent, but he has a different tax base. And then there is the one from the Hoover Institute in Stanford that is 19 percent: but they have a different tax base and have a lot more of personal income and dividends, and so forth, that are not taxable, and people don't pay any taxes up till about $8,000, or something, to take care of that low income person. So there are many approaches and many angles as to how this thing can work.

I would agree with you on those numbers on where the rate would have to be. I don't suppose Congress would know until just after the first year it went on this just how much revenue would actually come in. I think you would have a great deal of the underground economy that would come above ground.

So we might actually have more revenue than we thought, because people will think it just isn't worthwhile trying to get around paying taxes and take the risk of a prison sentence or the embarrassment of civil penalties in the case of some tax-avoidance schemes, if the rate is only *x* amount, whether it is 19 percent or 10 percent. So I think the idea has a lot of merit. I am glad that we are moving this way, and I compliment the chairman and the committee for getting this thing started. And I appreciate your help.

The CHAIRMAN. Senator DeConcini?

STATEMENT OF HON. DENNIS DeCONCINI, U.S. SENATOR FROM THE STATE OF ARIZONA

Senator DECONCINI. Mr. Chairman, I want to thank the committee also, along with the remarks by Senator Symms, for holding hearings on this subject matter and giving me an opportunity to come before you and state my feelings on the issue of tax reform in general and the viability of a flat-rate system of taxation in particular.

Such an approach to a Federal tax policy has been advocated sporadically for many years. In recent months the dissatisfaction with the present Internal Revenue Code has seemed to reach a new high, and with it has come a piercing cry from the American public to reexamine the entire basis of our system of taxation. The most frequently suggested alternative is the so-called flat-rate approach.

As I said when I introduced the first flat-rate tax bill, S. 2147, in the Senate on March 1 of this year, "A complete overhaul of our tax system is long overdue. We must start over on a new patient." Events since that date have only served to reinforce my feeling that our present Tax Code has become so complicated and tortuous in its application, and so detrimental to spurring the economic recovery we are all anxiously awaiting to see happen, that a serious look must be given to an alternative tax system. Such a system should embody the principles of equity, simplicity, and efficiency, and contain within it provisions that enhance rather than stifle our desire to be more productive.

What we are talking about when we say a flat-rate tax structure is a good question to submit for the discussion today. Simply put, it would subject the tax base to only one tax rate—although some amount of income would undoubtedly be excluded from the tax to provide for the lowest income, I believe, in almost every system—and broaden the tax base for repealing many of the tax benefits that subsidize various types of economic activities or provide relief from circumstances that Congress has deemed worthy of granting deductibility status to, such as medical expenses.

Although an element of progressivity is built into most flat-rate bills, my understanding is, today, the higher your income, the higher the tax rate. That would cease under my proposal. But, for example, if the zero bracket amount upon which no tax would be paid were set at $10,000, an individual earning $12,000 pays tax on only 16 percent, that is $2,000 of their income; while a person with $100,000 of income would pay tax on 90 percent of their income.

In rather summary fashion I will attempt to summarize the key benefits that I see can be derived from a flat-rate tax structure:

First, the elimination of the marriage penalty, whereby a couple with separate incomes could pay higher income taxes if married than single.

Second, elimination of bracket creep, whereby taxpayers are put into increasingly high tax brackets without having an increase in real income. Indexing will address this issue, but why do indirectly what is possible to do by simply applying one rate to all income? No longer will the Government be able to make up for its deficit financing by allowing ever greater amounts of income to flow into its coffers without having passed a tax increase.

Third, the integrity of the system will be increased. We will pick up billions of dollars owed in taxes that go uncollected because of false deductions and income that goes unreported.

Fourth, great savings in time and compliance costs would accompany a flat-rate system. It is estimated that $60 billion was spent on tax compliance last year, and an undetermined amount of hand-wringing and headaches have accompanied the monetary expense.

Fifth, accountability of Government would increase. The primary purpose of the income tax is to raise revenue; but today's law has become a major and hidden way to effect social policy. Many of these policies are quite worthy of support, but wouldn't we be more honest with the taxpayer if we eliminated the tax expenditure and replaced it with direct payments that directly demonstrate the policy choices we are making? The public would certainly be more aware of how their tax dollars are being spent.

Sixth, this would add productivity. By reducing the deterioration built into the economy by the varied impact of present tax laws, business decisions can be made in an environment that will reward efficiency and profitability.

Seventh, incentive increases would be another benefit. Clearly, if a person can keep 80 cents of the last dollar they earn, rather than 50 cents as in the case today with a 50-percent tax bracket, a person is more likely to make the extra effort and produce more because they will be able to keep more of what they earn.

I have always believed that a person has a right to keep the income they earn. Since the strength of that argument does not diminish in my point of view as a person's income rises, a flat-rate tax may even lay claim to being morally superior to the present system.

Eighth, loopholes would disappear. Any attempt to eliminate loopholes is generally met with fierce opposition by the affected group, and understandably. However, under a flat-rate system this problem largely solves itself, because tax shelters will not be nearly as attractive if only 15 or 20 cents of every dollar is exposed to the IRS.

Ninth, horizontal equity will increase. Because the definition of income will be broadened significantly, it is much more likely that individuals in similar income categories will also be taxed equally.

Tenth, diminish the incentive to extend tax benefits to those in high income brackets.

Mr. Chairman, I realize the time is speeding along here, and I appreciate an opportunity to even testify before this distinguished committee. I would ask that the balance of my statement, which goes into my particular bill with some detail, be inserted in the record as if read.

The CHAIRMAN. Thank you, Senator. We appreciate your testimony and appreciate having you here this morning.

I don't know if you actually got to the point in your testimony to tell us exacly what is in your bill. Did you care to mention a quick summary of the purpose and direction of the legislation you have introduced?

Senator DECONCINI. Yes, I would, Mr. Chairman. I thought the clock had gone off there, indicating the time was up, and I know how busy you all are.

My bill, Mr. Chairman, really sets forth direction to the Treasury Department to draw up a new tax system to replace the present system, and it sets some guidelines for them to achieve this. Those guidelines are that all income should only be taxed once, and it should be taxed as close as possible to the source of the income.

Second, all forms of income should be taxed at the same rates, and such rates should be less than 20 percent. The poorest households would not pay any income tax. My suggestion is very similar to the Hoover Institute's, somewhere in the neighborhood of $8,000, and of course that would be applicable to every taxpayer.

The tax returns should be simple. The Hoover Institute has come up with the form of a simple card that I am sure you will see when Dr. Hall, or whoever, is testifying for Rebushka tomorrow or today.

There should only be two taxpaying entities—the individual and business.

With regard to business taxes, it is important that something be provided for the legitimate cost of business, and it is set out in the Hoover Institute study and scenario that will be submitted to you.

To me, this is going to restore credibility to our present tax system. Even though there are arguments and mathematical formulas that will demonstrate some will pay more and some will pay less, I am convinced that if the public really felt that everyone was paying a certain share of their income, that they would be far more accepting of such a tax system than what they have today.

The CHAIRMAN. Thank you very much for a very excellent statement.

Senator Byrd?

Senator BYRD. No questions.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. No questions. Thank you.

Senator DECONCINI. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. I appreciate your being here.

[The prepared statement of Senator DeConcini follows:]

STATEMENT OF SENATOR DENNIS DECONCINI BEFORE THE COMMITTEE ON FINANCE, SEPTEMBER 28, 1982

Mr. Chairman, other members of this Committee, thank you for the opportunity you have given me to come before you and state my feelings on the issue of tax reform in general and the viability of a flat-rate system of taxation in particular.

Such an approach to a Federal tax policy has been advocated sporadically for many years but in recent months the dissatisfaction with the present Internal Revenue Code has seemed to reach a new high and with it has come piercing cry from the American public to reexamine the entire basis of our system of taxation. The most frequently suggested alternative is the so-called "flat-rate" approach. As I said when I introduced the first flat-rate tax bill, S. 2147, in the Senate on March 1st of this year, "A complete overhaul of our tax system is long overdue. * * * We must start over on a new patient." Events since that date have only served to reinforce my feeling that our present tax code has become so complicated and tortuous in its application, and so detrimental to spurring the economic recovery we are all anxiously awaiting, that a serious look must be given to an alternative tax system. Such a system should embody the principles of equity, simplicity and efficiency, and contain within it provisions that enhance rather than stifle our desire to be more productive.

What are we talking about when we say a "flat-rate" tax structure? Simply put, we would subject the tax base to only one tax rate (although some amount of income would doubtless be excluded from tax to provide "low income relief"), and broaden the tax base by repealing many of the tax benefits that subsidize various types of economic activity or provide relief from circumstances that Congress has deemed worthy of granting deductibility status to, such as medical expenses. Although an element of progressivity is built into most flat-rate bills, progressivity as we understand it today—the higher your income the higher the tax rate—would cease. But, for example, if the zero-bracket amount upon which no tax would be paid were set at $10,000, an individual earning $12,000 pays taxes on only 16 percent, that is $2,000, of their income; while a person with a $100,000 income would pay taxes on 90 percent of their income.

In rather summary fashion, I will attempt to summarize the key benefits that I see can be derived from a flat-rate tax structure:

1. *Elimination of the marriage penalty* (whereby a couple with separate incomes could pay higher income taxes if married than single);

2. *Elimination of "bracket creep"* whereby taxpayers are hurtled into increasingly high tax brackets without having any increase in real income. Indexation will address this issue, but why do indirectly wht is possible to do by simply applying one rate to all income. No longer will the government be able to make up for its deficit financing by allowing ever greater amounts of income to flow into its coffers without having passed a tax increase.

3. *The integrity of the system will increase.* We'll pick up billions of dollars owned in taxes that go uncollected because of false deductions and income that goes unreported. A flat-rate system should be easy for the IRS to administer and for the taxpayer to honestly try to comply with.

4. *A great savings in time and compliance costs* would accompany a flat-rate system. It is estimated that $60 billion was spent on tax compliance last year and an inestimable amount of hand wringing and headaches must have accompanied the monetary expense.

5. *Accountability of government would increase.* The primary purpose of the income tax is to raise revenue, but today's law has become a major, and hidden, way to affect social policy. Many of these policies are quite worthy of support, but wouldn't we be more honest with the taxpayer if we eliminated the "tax expenditure" and replaced it with direct payments that clearly demonstrated the policy choices we were making? The public would certainly be more aware of how their tax dollars were being spent.

6. *Added productivity.* By reducing the distortion built into the economy by the varied impact of present tax laws, business decisions can be made in an environment that will reward efficiency and profitability.

7. *Incentives increase.* Clearly if a person can keep 80 cents of the last dollar they earn rather than 50 cents as is the case today with a 50 percent tax bracket, a person is more likely to make the extra effort and produce more because they will be able to keep more of what they earned. I have always believed that a person has a right to keep the income they earn. Since the strength of that argument does not diminish in my point of view as a person's income rises, a flat-rate tax may even lay claim to being morally superior to a progressive one.

8. *Loopholes disappear.* Any attempt to eliminate "loopholes" is generally met with fierce opposition by the effected group. However, under a flat-rate structure this problem largely solves itself because tax shelters will not be nearly as attractive if only 15–20 cents of every dollar is exposed to the IRS.

9. *Horizontal equity will increase.* Because the definition of income will be broadened significantly, it is much more likely that individuals in similar income catego-

ries will also be taxed equally. No more bellyaching that the guy next door isn't paying his fair share.

10. *Diminish the incentive to extend tax benefits to those in high income brackets.* The final key question that has to be answered before talk of a flat-rate tax can be more than that is "What will I pay?" The American taxpayer does not want to see an increase in his tax burden and that is particularly clear to politicians. Where the tax burden will fall has been the subject of numerous studies and numerous results. Under my bill, which presupposes a zero-bracket amount of about $10,000, it is probably safe to say that the poorest households would pay either no tax or significantly less than what they pay today. The middle income brackets may suffer a slight increase in taxes, although I feel that many of the factors inherent in a flat-rate structure would more than offset any slight tax increase. For example, is it worth it to a taxpayer to pay 3 percent higher taxes if in return the taxpayer: (1) need not keep detailed records necessarily kept today to justify the taking of tax preferences; (2) need not solicit professional tax preparation assistance with its attendant costs; (3) saves substantial amounts of time that otherwise would have been devoted to tax preparation; (4) achieves a peace of mind concerning the accuracy (read lack of audit probability) of his return; (5) believes other taxpayers are now also paying their fair share and opportunities for cheating have been cut back dramatically; and (6) the taxpayer may have found himself with more money on which to pay tax as a result of a financial and tax environment conducive to rewarding economic activity designed to reward efficiency and production. Answers to such a hypothetical question may vary, but on the whole I don't believe that any income class will ultimately suffer from imposition of a flat-rate tax. Higher income earners will probably on the whole have a reduced tax burden but if a person is presently sheltering extensive amounts of income they may well end up paying more to Uncle Sam in taxes.

The people of this country want tax reform. I believe a flat-rate tax is fair and that it would make the system immeasurably more easy to understand and to comply with. I further believe that with a flat rate of 19 percent beginning in fiscal year 1983, we could raise sufficient revenues to bring about a balanced budget within 3 years thereafter assuming spending levels are kept reasonable. Additionally, it would be my hope that through increased productivity and the additional revenues that could be expected to be derived from the taxation of economic activities that are now a part of a $200 billion underground economy, that the tax rate could be driven down much further by 1990.

The essence of what a good tax system must contain was outlined by former Secretary of the Treasury Mellon with these words: "The problem of Government is to fix rates which will bring in a maximum amount of revenue to the taxpayer or on business enterprises. A sound tax policy must take into consideration three factors: It must produce sufficient revenue for the Government; it must lessen so far as possible, the burden of taxation on those least able to bear it; and it must also remove those influences which might retard the continued steady development of business and industry on which, in the last analysis, so much of our prosperity depends."

I believe a flat-rate structure meets these criteria and deserves a chance to prove itself.

Thank you.

Senator SYMMS. The next witness will be the Honorable John E. Chapoton, Assistant Secretary for Tax Policy, Department of the Treasury.

Welcome to the committee again, Buck. You must feel like you live down here in this committee room.

Mr. CHAPOTON. Sometimes, Mr. Chairman.

Senator SYMMS. We are delighted to have you here and are looking forward to your input on this important subject.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

Mr. CHAPOTON. Thank you, Mr. Chairman. I have a very lengthy statement, and I will summarize it, although the summary itself may be a little longer than I would have preferred. If we are taking too much time, please feel free to tell me to speed it up.

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We are pleased to be here today to discuss some frames of reference for evaluating flat-tax approaches to reforming our income tax system.

As I think has been clear from the discussion that you have already heard this morning, the Federal Income Tax is widely perceived to be complicated and unfair. Although many provisions in the current law were enacted to promote worthwhile social and economic goals, one result has been that individuals or families of equal means pay quite different amounts of tax, depending on how they earn or use their incomes. This complex and uneven tax system leads to excessive planning and rearranging of business affairs, primarily to reduce taxation, and to a great deal of taxpayer uncertainty, anxiety, and disrespect for the tax law. I think it is obvious that taxpayers want a less complicated Tax Code, along with more uniform tax treatment and lower tax rates.

The income tax has been a serious impediment to private capital formation and to individual efforts to work and save. Throughout the 1970's, high inflation caused systematic overstatement of business taxable income and pushed more and more individual taxpayers into higher marginal tax brackets. The result has been a reduction of the reward for savings and investment and a raising of the cost of business investment.

In 1981 the Congress and the administration united to enact ERTA, which provided a much needed reduction in marginal tax rates and a vital acceleration of cost recovery allowances. The administration continues to be committed to the elimination of the tax barriers to capital formation, and we think that any discussion of major tax reform must continue to concentrate on reducing marginal rates and removing the barriers to savings and investment.

Even with the dramatic marginal rate reductions enacted by ERTA, the marginal rate under the personal income tax will range from 11 to 50 percent in 1984. Taking into account the corporate tax, marginal rates on some income can range from 11 percent to 73 percent. Moreover, the man in the street continues to have the conviction that his neighbor who is just as well off as he is pays less tax, and that a wealthier person may pay even less tax than either he or his neighbor is paying.

It is important to keep in mind the two elements that give rise to the current interest in a flat tax. One is sharply progressive tax rates that we have, and the other is the lack of uniform treatment of income in the base. These are distinct but interrelated characteristics of our income tax—the tax base and the schedule of rates.

A single rate could, for example, be applied to our current tax base, leaving intact all of the exclusions, deductions, and credits. A single rate of about 19 percent on the current individual tax base would raise the same amount of revenue raised by a progressive rate structure applied to the individual income tax in 1984, after the ERTA changes are fully in effect.

Under current law there is, of course, a separate levy on corporations. If the top individual rate were substantially reduced, a 46-percent rate on corporations would be too great a disparity between individuals and corporations. Thus, it is interesting to see what the revenues would be if you dropped both rates. A single corporate rate of about 20 percent and a single individual rate of about 20 percent would be required to produce the same total revenue as we have today with no expansion of the tax bases.

Most flat-rate proposals would of course substantially broaden the tax base, along with changes in the tax rates. A tax system designed to treat taxpayers consistently according to a well-defined tax base, with no narrow exceptions, is referred to as a "uniform" tax throughout my statement. Term "uniform" is used to connote broad-based taxation—no exclusions, credits, or deductions, except those necessary to measure income.

Assume, for example, a uniform tax system with integration of the corporate and individual taxes. With a taxpayer exemption of $3,000 per joint return and $1,000 for each dependent for a total of $5,000 in exemptions for a family of four, a single flat rate of about 16 percent would be sufficient to produce the current levels of revenue. Even with a single rate, the basic exemptions would cause average tax rates to be somewhat progressive across income classes, as shown in table 1 attached to my statement.

Table 1 also shows that a substantial redistribution of the tax burden would occur, despite base broadening and a basic exemption, as a result of replacing graduated tax rates by a single tax rate.

If the exemption levels were doubled to $10,000 for a family of four, a 20-percent flat rate would be needed to produce current levels of revenue and would produce the distribution shown in table 2 of my statement. The increased exemption would result in less tax than present law for those in the zero to $5,000 income class, and significantly less redistribution of tax burden from high income groups to the lower and middle-income classes. Still, about $22 billion of tax reduction would go to those above $50,000 of income, while $27 billion of additional taxes would be paid by those in the $5,000 to $50,000 income range.

A pure flat tax that has a broad uniform tax base and a single rate, but allows no exemptions for the taxpayer or dependents, would permit the rate to be lowered to about 13 percent on the uniform income tax base. This would be a strictly proportional tax, not a progressive tax. As shown in table 3, this would of course cause a significant redistribution of the tax burden—a tax reduction of about $40 billion for taxpayers above $50,000, matched by a similar tax increase for those below $30,000, and the $30,000 to $50,000 class would stay about even.

The clear lesson from these tables, Mr. Chairman, is that any broad-based option with a single tax rate would involve a significant redistribution of tax liability. If a flat-rate tax is designed to raise the same revenue as present law, every dollar of tax reduction for one taxpayer must mean a dollar of increased tax for some other taxpayers.

Many discussions of broader based or flatter rate taxes leads one to conclude that tax burdens will fall for practically everyone. That simply is not the case. Tax burdens fall when a choice is also made to cut taxes in general, as in the Economic Recovery Tax Act of last year.

Instead of using a single rate, a uniform tax structure could be designed to contain a lower set of progressive tax rates that would apply to several broad brackets. In table 4 we show that you could achieve approximately the same degree of progressivity as present law with a three-rate structure, having a 10-percent rate on the first $19,500 of income, 25 percent from $19,500 to $75,000, and a 39-percent rate over $75,000.

The remainder of my statement goes through the points of evaluating tax systems, the criteria that we should use in evaluating tax systems, and then I discuss two uniform tax structures which might be used as a framework for flat tax reform. The first is a uniform income tax, and the second is a uniform tax on consumed income.

Discussing briefly the criteria for evaluating a tax system, any framework for future tax reform should carefully evaluate four criteria: Equity, the distribution of the tax burden, efficiency, and simplicity.

As the statement, I think, clearly points out, competing considerations are presented by different desirable proposals on any major change in the tax system that we look at.

Two equity considerations dominate the discussion of fundamental changes in the personal income tax. First, what is the appropriate tax base? Second, how does the tax system treat individuals who are considered to be in equal circumstances? For example, if you have two families who are identical in every respect except one spends more on housing and the other more on food, they pay different amounts of tax, and the tax system is said to violate the standard of horizontal equity.

The question of distribution of the tax burden is a separate issue. The extent of any increase or decrease in progressivity is essentially a value judgment and less subjective in nature than other criteria such as horizontal equity, efficiency, and simplicity. One can broaden the tax base, flatten tax rates, and still improve the efficiency of the economy without changing the existing distribution of tax burdens.

The standard of economic efficiency recognizes that a given amount of tax revenue can be raised in a number of ways and that the tax system should be designed to minimize its adverse effects on the economy. Businesses and households should be allowed to make the best use of resources at their disposal with the minimum intrusion of tax considerations. This would lead to an economy that operates more efficiently, thereby raising productivity, economic growth, and the standard of living for all Americans.

High marginal rates amplify the price distortions caused by the tax system, both those inherent in uniform taxes, like the disincentive to work, and those resulting from lack of uniformity in the tax treatment of similar activities.

The simplicity standard has been discussed in great detail in discussions of flat tax. Simplicity in the system is of course desirable in order to minimize the cost of complying with the tax laws—the costs of recordkeeping, calculating, reporting, and planning.

I think it is important to distinguish between three sources of complexity: The first is the computation on the tax form; second, the problems of measuring the tax base; and third, tax planning.

Computing taxes is what we usually think of when we talk about simplicity. Filling out the form 1040 makes many of us feel that we're back in school and April 15 is the date of the final exam in math.

But reducing the number of lines on the tax return without remedying the underlying lack of uniformity in determining the tax base would not substantially simplify the system. A simple tax return would not produce a simple tax if two volumes of Tax Code and three volumes of regulations were required to define the few lines.

Tax planning, or the rearranging of one's business affairs primarily to reduce taxes, is an important source of complexity that receives too little attention. Because of the uneven treatment of different but similar kinds of transactions, taxpayers often go to great lengths to qualify for the more favored tax treatment. With a uniform tax there would be little reason to search for tax-favored activities.

In summary, the flat tax would make the tax computation process somewhat easier, but the standard form still would not fit on a post card that could be read without a magnifying glass. But increases in efficiency, equity, simplicity, and arranging ones economic affairs, would all be obtained through an increase in uniformity in our tax system.

Now, Mr. Chairman, let me go through as quickly as I can some of the problems that will have to be faced in considering either a uniform income tax or the second system we discussed, the uniform tax on consumed income.

A truly uniform income tax would require accounting for every last dollar of income, net of necessary costs. It would not, however, imply the complete elimination of all deductions. Any necessary costs of earning income must be deductible. The basic principle of uniform income taxation is that deductions not be allowed to discriminate by source of income or according to consumption choices.

First, a major problem of full income measurement is that additions to net worth often do not coincide with cash receipts. This is the realization factor in present law, and that would be a factor in a uniform income tax system; but the realization concept also permits an opportunity for tax deferral.

Second, in a period of inflation, apparent appreciation of assets may provide no income at all. For example, if the $100 used to purchase a share of stock 10 years ago is equivalent today to $200, no real income has been obtained unless the sale of stock brings more than $200. Accurate income measurement requires an inflation adjustment for any ordinary income or cost that accrues over more than a year.

Third, accurate estimates of depreciation, also adjusted for inflation, would be necessary for a uniform tax.

Fourth, a uniform income tax would tax all corporate earnings according to the circumstances of each corporate shareholder, but only once. Thus, a uniform tax would require the integration of the corporation and individual income taxes.

Finally, under any practical income tax, some kinds of income that are difficult to measure would have to be excluded or approximated—for example, the value of employer contributions to group insurance or the net rental value of owner-occupied homes.

In addition, some family expenses that do not, strictly speaking, reduce income are nonetheless widely recognized as equitable adjustments to an income tax base.

Few would argue, for example, about the deduction for catastrophic medical expenses. I believe it is also recognized that some allowance must be made for family size, and that some minimal level of tax-free income should be allowed to every family of a given size.

Some recent proposals such as the one by Senator Bradley and Representative Gephardt attempt to move to a more uniform income tax base, but no proposals have really attempted to solve the fundamental problems of defining real business income during inflation. Indeed, the Bradley-Gephardt proposal would make the tax less uniform in a major way by taxing fully the nominal increase in value of capital assets, even though for any taxpayer the gains from an asset may be largely or entirely the result of inflation. In addition, some of the real gains are increases in corporate share values that reflect income already taxed to corporations. The Bradley-Gephardt proposal also does not address the other difficult problems of measuring business income or integrating the corporate tax, although the sponsors recognize this fact and plan to deal with this question in a later proposal.

A uniform income tax would be consistent with most people's conception of equity. Those with equal incomes, regardless of their sources or uses, would pay approximately the same tax.

Uniformity would reduce the expense and effort involved in tax planning and allow markets to choose the most productive uses of available capital. It would encourage employers to pay compensation in the form that is most valuable to their workers—cold cash to consume or save as they wish. It would be simpler in some respects than present law, but it cannot be really simple. While it would not end the complexity of measuring income, more uniform treatment would, however, simplify tax practices by reducing the number and importance of the fine distinctions needed to identify tax-favored activities.

Much has been said today about transition considerations. It is clear that immediate implementation of a uniform tax structure would cause significant changes in the values of individuals' assets and after-tax incomes. These changes in wealth and after-tax income can be moderated by transition rules, such as phasing in the provisions of a new law, grandfathering, and delaying effective dates; but designing adequate and acceptable transitional rules would be a major problem, perhaps the major problem, in an attempt to move to a uniform income tax.

The concept of a uniform tax on consumed income is an alternative model for tax reform. It differs from the uniform income tax in that the tax is on the amount of income consumed rather than the amount of income earned. The uniform tax on consumed income would differ from the uniform income tax basically by excluding net savings from the tax base.

Under the consumed income tax the taxpayer would include in his tax base all forms of current monetary income, the current consumption value of all fringe benefits supplied by employers, and the proceeds of all borrowings in excess of loan repayments. The taxpayer would be allowed to deduct from the tax base all purchases, in excess of sales, of income-earning assets, and all deposits in excess of withdrawals in interest-bearing accounts.

The tax on consumed income would be similar in many ways to the uniform income tax and would involve many of the same base-broadening steps as compared with current law.

The major differences between the two tax systems involve differences in the treatment of savings and borrowings. Under the consumed income tax, deductions would be allowed for all purchases of corporate shares, corporate and government bonds, mutual funds, and other financial instruments, assets used in a trade or business, and deposits in interest-bearing accounts. Any cash received from such assets, either in the form of distributed earnings, return of investment, or realized gains, would be subject to tax in full. Similarly, the proceeds of all borrowings would be included in the tax base, while both interest payments and repayment of loan principal would be deductible.

The inclusion of net loan proceeds in the tax base is particularly important. It must be realized that without such a rule taxpayers could reduce their tax by taking a deduction for the portion of assets acquired with borrowed funds, even though the combination of borrowing and purchase of assets does not add to a net increase in savings.

The question of equity is one of the most significant questions under a uniform consumed income tax. It would be equitable in the sense that two individuals with the same consumed income would pay the same tax regardless of the source of funds used for consumption or the types of consumer goods purchased, but it would tax two individuals with the same total income quite differently. To take an extreme example, a very frugal person who earns $100,000, who saves $90,000 and consumes only $10,000, would be taxed the same, under a consumed income tax, as a person who earns only $10,000 and consumes all of his earnings.

But before that makes you conclude that a uniform income tax is fairer than a uniform tax on consumed income, consider an alternative example, where the heir of a frugal person who earns only $10,000 but consumes $90,000 a year by selling part of his inheritance each year. Under an income tax, this wealthy person with a very high standard of living will pay only the same tax as a poorer person earning and spending $10,000 a year. The consumed income tax, however, places a heavier tax burden on the person spending $100,000 a year even though that person earned income of only $10,000.

The consumed income tax falls less heavily on the person who lives frugally and accumulates wealth and more heavily on the person who lives well by selling wealth. The income tax does exactly the opposite—it places a higher tax burden on the person who accumulates the wealth than on the person who spends the wealth.

A uniform tax on consumed income would allow personal exemptions for taxpayers and could tax the remaining consumed income, in excess of exemptions, at either a single rate or with a graduated rate structure involving several brackets. A tax on consumed income is not inherently more or less favorable to high-income households than a uniform income tax, even though low-income households generally consume a larger fraction of their income than high-income households. Under either uniform tax system, the distribution of the tax burden among taxpayers with different abilities to pay can be altered with the exemption and the rate structure.

Compared to the uniform income tax, a tax on consumed income would probably result in a higher savings rate leading to increased capital formation, a higher growth rate in the short run, and permanently higher levels of output in the long run.

The simplicity standard, though, is one that must direct particular attention to the consumed income tax. It would be much simpler than a uniform income tax, even though some new reporting requirements would be added. The main simplicity advantage is that it avoids many of the severe problems in measuring the tax base that are encountered under an income tax. Since income would be taxed only when consumed rather than when earned, there would be no need to account for changes in the value of assets between 2 different years. There would be no need for complex rules for depreciation accounting, no need to adjust the measurement of capital income for inflation, and no need for complex rules to allocate corporate retained earnings to the shareholders.

In the statement, Mr. Chairman, and in the discussion you have heard before you today, mention is made of other types of consumption taxes. One that deserves a good deal of review was mentioned by Senator DeConcini, the Hall-Rabushka proposal, which would propose a flat rate on both corporations and individuals in an attempt to impose what is, in effect, a proxy tax at the corporate level for earnings distributed to shareholders and debtholders of corporations.

Transition considerations in a consumption tax would be as important a consideration as they would be under a uniform income tax. Transition rules would be particularly important to insure that income does not escape taxation in the shift and is not subjected to tax twice. It would be quite difficult to design fair and equitable transition rules.

These are the two models that we would suggest should be used as the basis for evaluating proposals for a flat tax; that is, the uniform income tax and the uniform consumed income tax.

It is interesting to examine our present Tax Code and learn that it is a hybrid of these two structures. It contains a substantial number of provisions that are consistent with both and a substantial number of provisions that are inconsistent with both. I think it is impossible to say whether our present system is closer to an income tax or a consumption tax.

When you look at recent changes in the tax laws, they too have moved in different directions. The move in 1978, for example, to partially tax unemployment compensation is in line with the concept of a uniform income tax, but actions to encourage savings for special purposes such as the expansion of the availability of IRA's and Keogh's are a movement toward a uniform consumed income tax.

Provisions such as the expansion of the interest-income exclusion, the all savers certificate exclusion, credits for energy exploration, R&D, and earned income are all changes which would appear in neither of the two basic structures I have discussed.

Our point is that any future changes in the structure of our taxes should be based on a clear understanding of these uniform structures, and anyone addressing fundamental tax reform needs to have, we think, a uniform framework in mind.

We are continuing to study the issues I have mentioned and the ones that are covered in more detail in the full statement. We will be happy to share additional results from our studies with this committee as we go along.

Thank you, Mr. Chairman.

Senator SYMMS. Well, thank you very much for a very comprehensive statement. I can see that a lot of work has gone into this. Incidentally, in its entirety it will be a part of our record.

It will be very helpful for our committee, for a reference statement, Buck, and I appreciate it.

I note that both President Reagan and Secretary Regan have on different occasions spoken very favorably to the concept of the flat-rate income tax.

Do you find within Treasury, in your workings with the people who are actually doing the work and the tax collection and so forth in Treasury, the same enthusiasm for it? Is there going to be a lot of cooperation, do you feel, from Treasury with the Congress to try to come up with some kind of a reformed Tax Code?

Mr. CHAPOTON. There is qualified enthusiasm. When you look, as I think my statement makes clear, at the lack of uniformity in the present system, there is enthusiasm for a system that gets away from those problems.

As I tried to make clear, I think there are two different principles involved: One is the lack of uniformity in the present system, and then, quite another question, the rate structure. Certainly lowering the rates has the desirable effects—it removes a lot of the distortion caused by the higher marginal rates that we now have.

But we must keep in mind the problems of transition, the winners and losers created by another system, and the adjustment that would take place in our economy. If we were to move to a new system, those are the questions we would have to look at.

Senator SYMMS. Well, I think your points on equity are very interesting and I think very important for this committee to bear in mind as we progress forward with something in this direction.

The highest income tax rate in our present code as of last summer is what? Fifty percent?

Mr. CHAPOTON. Fifty percent.

Senator SYMMS. Is it 45 percent, now that the 10-percent tax rate reduction has gone into effect?

Mr. CHAPOTON. I'm sorry, I didn't understand the question.

Senator SYMMS. Didn't the American people get a 10-percent rate reduction on the first of July of this year?

Mr. CHAPOTON. That's right, but you remember last year, effective January 1 of 1982, the top rate was dropped immediately to 50 percent, so there is no further reduction in the top rate.

Senator SYMMS. How long will the top rate stay at 50, even after the cut next summer?

Mr. CHAPOTON. It will be permanently at 50, under the present law.

Senator SYMMS. Under the present law? Well, now, this might be something interesting to have the people at Treasury work on.

The last tax bill that passed this Congress here in the recent months largely was a taking-away tax preference for certain areas and so-called bringing about more tax equity. If the Congress realizes the complexity of the transitional problem that you mentioned in transition rules from the present Tax Code to a flat-rate tax code, whether it be a consumptive tax or a direct income tax, if we would just lower the income tax rates say, hypothetically, at a 5-percent rate on both corporations and personal income—5 percent a year for a 10-year program—and let the committee work on tax preferences, do you think we would eventually come up with something close to what we are talking about now?

Mr. CHAPOTON. You are suggesting just to put in a rate reduction and let that dictate base broadening?

Senator SYMMS. Well, yes. If the income isn't high enough, the committee would be in here trying to figure out how to broaden the base, but the rates are gradually coming down all the time.

Mr. CHAPOTON. If the revenues were needed? Well, that would be an interesting approach.

Senator SYMMS. It would lessen the problems of the transition. If the highest tax rate is 35 percent instead of 50, I would think that a lot of the incentive part of a flat-rate income tax would not be there.

Mr. CHAPOTON. Absolutely. As you reduce the rates some of the transition problems are lessened.

But the transition problems are usually caused not by rate changes, as you are suggesting, but by the——

Senator SYMMS. Now, when you talk about taxes on consumption, are you talking about a gross income tax, or a sales tax, or what?

Mr. CHAPOTON. No. The uniform tax on consumed income that we have outlined is one that we have looked at in some detail and are still studying. The starting point is a broad-based income with a deduction for net savings. So you would have the same concepts of income, and you would pay tax on income; you would simply get a deduction for your net increase in savings each year.

Senator SYMMS. So, in other words, the proposal that the Hall-Rabushka offered is a consumptive tax?

Mr. CHAPOTON. It is a consumption tax. It is a different type of consumption tax, but it is a consumption tax.

Senator SYMMS. And the bill that Senator Helms introduced is more of an income tax?

Mr. CHAPOTON. I believe that is correct; I haven't studied that as closely.

Senator SYMMS. Well, thank you very much. I appreciate your testimony.

Senator Bradley?

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Chapoton, let me thank you for your testimony. I think it is comprehensive and does survey the scene quite well, and I think you raised a number of interesting points.

I was interested in your response to Senator Symms' question about what priority the administration gives restructuring the tax system. I take it from your answer that there is some real interest in doing this on the administration's part. Is that correct?

Mr. CHAPOTON. Senator Bradley, there is concern. Let me start off by saying there is concern about the problems of the present tax structure, as I mention in the testimony. I want to be careful, though, about suggesting and sending a signal that we are about to come out with any proposals for change. Indeed, one thing that disturbs me is we have had significant changes in the tax laws in the last 2 years. For this reason, a strong case can be made for a moratorium on tax legislation for a year or two. A complete study of a uniform tax might well take that long.

Senator BRADLEY. So the administration is or is not now contemplating, within the next year or two, an initiative in this area?

Mr. CHAPOTON. Well, I think we will just have to wait and see the studies. We are not now planning an initiative in this area, but we are doing the groundwork that could precede such an initiative.

Senator GRASSLEY. Would you yield on that, Senator Bradley, please?

In June, we received two communications from the White House expressing the President's interest in a flat-rate tax without any detail. I don't know who the spokesman was, but presumably——

Senator BRADLEY. It was the President.

Senator GRASSLEY. Well, he was speaking for the President. Was it the President himself?

Senator BRADLEY. The President himself said it.

Senator GRASSLEY. Well, then, that lends even more weight to the point I want to make. [Laughter.]

Senator SYMMS. The fact is, I will just say to the Senator, Don Regan said it in front of the Budget Committee; because I asked him a question about it, and he said, "The longer I am down here at this office in this job, the better I like the idea."

Senator GRASSLEY. Well, my point is, are you sure, considering the statements of the President, that you aren't being a little cautious in how you are approaching this? Might there be something emanating from the administration in a formal program before 2 or 3 years have passed?

Mr. CHAPOTON. I didn't mean to state that there would not be; I meant to hold all options open, Senator Grassley.

The problems are severe, and we have done an awful lot of work not only in redesigning a system but in seeing the effects of moving to it. So I think one must be careful.

Senator GRASSLEY. Well, would you yield further?

Senator BRADLEY. Senator, certainly.

Senator GRASSLEY. You know, you folks started the study of alternate taxes about the time that we were talking in the Finance Committee about passing a resolution urging your study, and you assured us that we didn't really have to have a resolution because a study was going on.

Mr. CHAPOTON. Right.

Senator GRASSLEY. Now, obviously that is not in the abstract. Somebody higher up in the administration is interested in pushing an alternate income tax. Isn't that why the study was started in the first instance?

Mr. CHAPOTON. I think we are all interested in seeing what it looks like and the feasibility of it. I think that is really all one should say until one has studied it further.

I want to add the further caution that we really have changed the tax laws considerably in the last 2 years. That makes planning for businesses and individuals much more difficult. We have to get regulations out. We have caused a lot of changes in the system of tax in the last 2 years.

Senator BRADLEY. Well, let me come at Senator Grassley's question in just a little different way. Do you see a connection between economic recovery on the one hand and restoring efficiency and fairness to the Tax Code on the other hand?

Mr. CHAPOTON. I do not see a direct connection between those two. I do think that, if obtainable in a practical sense, a uniform system of taxation would be considerably more efficient than our present system.

Senator BRADLEY. So, what you are interested in is essentially the theoretical structure of the system? In other words, it is not something that you are going to propose in the next year, although you hold the option open, and you don't believe that it is important for economic recovery——

Mr. CHAPOTON. I meant to say I don't think it is essential. I think we will have economic recovery under this tax system as we have had economic recovery under similar tax systems in the past. But I don't think it is a cornerstone to economic recovery.

Senator BRADLEY. My point is that some of us believe that a tax system that didn't have us deciding what was the best place to put capital but had the investor deciding where he could get his best return in the real marketplace indeed would be a stimulant to economic recovery and economic growth. I guess my question to you is, are you really leaving the issue open, or does the administration already have an opinion on whether a simplified tax system that takes out a lot of the so-called loopholes that we have put in up here over the years in response to various political pressures or solicitations, is not the way to go?

When the income tax system came in, as you know, we had very low rates and a relatively simple system. Over the years we have financed wars, we have financed our way out of a depression, and rates went up. When rates got so high that they discouraged work, savings, and investment, people came to the political process and achieved selective relief. Now, some of those tax preferences are meritorious, some of them aren't; various Senators have differing opinions. But the question is: Is the general good best furthered by dropping the tax rates for all Americans, or by providing selective relief from high rates to some Americans through those loopholes?

The question is: Do you think that restructuring the system so as to simplify it, to lower the rates, and to eliminate special loopholes would be important for economic growth?

Mr. CHAPOTON. Senator, I would agree with you. I think it would be very helpful to economic growth, because it would be a more efficient system. Any taxes, as we state in my prepared statement, cause a distortion; but the less the rates, the less the distortion.

So I would answer your question definitely in the affirmative. But we would both have to recognize that getting there might be a very disruptive experience in itself, so we shouldn't just take as given that this is the way out of our current problems.

Senator BRADLEY. Let me say that I recognize that complexity, and I think you do, too. That brings us to the comments that you made about Bradley-Gephardt. In a sense what you said was— there were a couple of suggestions that you made. One was that you felt we failed to deal with the question of indexing the basis of capital assets. The second was that you said we failed to deal with the integration of corporate and individual income taxes.

Well, let me be quite clear that what we designed was not intended to be the purest of pure systems. It was a practical solution to high rates of income tax and erosion of the tax base. So I would urge you, and all of us really, not to let the best be the enemy of the good, or we are going to be stuck in our present system indefinitely.

I recognize the theoretical validity of addressing both of those questions—there are enormous practical difficulties that you have just pointed out, generally, with a move in this direction—and I would hope that we could conclude that the best way to deal both with double taxation and indexing of capital basis of assets is to get the rates as low as possible, rather than refraining from doing anything until we have solved every possible theoretical aspect of the tax system.

I take your remarks as, frankly, helpful; and I would hope that the committee might—and I'm sure we will if we get to this issue in a serious way—at least not make it all or nothing and insist on the purest, most theoretically perfect system, but rally support for one that is workable, that gets the tax rates down dramatically, simplifies the system, and makes it fairer by eliminating the bulk of the loopholes.

Mr. CHAPOTON. Senator, I agree with you. I think we both recognize that there are going to be some practical considerations and tradeoffs in any system that is adopted. I think it is helpful to have a standard out there and then to see where we fall short.

I would additionally stress the question of integration. In my review of this subject I, too, attempted to stay away from this issue; but I think one really cannot stay away from it, because it does represent a double tax.

The tax rates that we talk about will be 11 to 50 percent in 1984 when the ERTA cuts are fully in place. If you take into account the double tax on dividends, the top rate jumps to 73 percent on a certain type of income. Clearly, that distorts business planning dramatically.

Senator BRADLEY. That is under current law?

Mr. CHAPOTON. Under current law, right.

Senator BRADLEY. If those rates were lower, wouldn't things be better?

Mr. CHAPOTON. If those rates were lower it would be better; but still, as long as you have a double tax on that source of earnings, you have a distortion. The lower the rates, the less the distortion.

Senator SYMMS. Thank you very much, Senator Bradley. I happened to hear on the news, driving in this morning, where the

Commissioner of the IRS, Roscoe Egger, was talking that people should be forewarned not to go out and try to have tax shelters that may be questionable in the eyes of the IRS, because they will be screening them.

I would think, if I were a bureaucrat at the IRS or at the Treasury, that I would be enthusiastically pushing for this kind of a concept. I share what Senator Bradley had said: It may not be that we can get all or nothing in the thing, but certainly it would make it simpler for the general public to understand where they are; then if the Congress comes over here, if we had a simple, fair, equitable tax, and we don't have enough money to run the Government, then everybody can stand up over on the floor of the House and the Senate and vote for it, and they will know that they raised their rates by 2 percentage points or 1 percentage point, or whatever—you could see it on the front end of the tax thing. And it would be a lot simpler.

Now, I guess the downside of this would be that it would be awfully easy for Congress to raise taxes; but at least it will be above board. With this last tax bill that passed, I venture to say that there will be millions of taxpayers out there that will not realize that Congressmen pay taxes, other than the few days that it was in the news, because it doesn't directly affect them, and the old code—if you tax the other guy and not me, well, so what?—is kind of the way it has been for years.

So, I would think the IRS people at Treasury and Treasury officials themselves would be really enthused about this so they could do their jobs more equitably and more fairly. I would be surprised if the idea doesn't pick up a lot of momentum from that aspect.

When you start talking about being efficient, I get a little bit nervous, because I have always said, "Thank God the Government isn't efficient; if we got all we paid for, we'd all be out of business."

Mr. CHAPOTON. When I use "efficiency" in this term, I mean efficiency in causing less distortion in business decisions.

Senator SYMMS. Senator Grassley?

Senator GRASSLEY. In a slightly different vein if a drastic reform of the tax system is enacted, have you considered the international implications—not just international taxation but the flow of capital in and out of a country, in and out of this country—and how it might affect international trade?

Mr. CHAPOTON. Senator Grassley, that is a very good question, and there has been some but not nearly enough consideration of that.

Senator GRASSLEY. Well, is it anything to be scared of?

Mr. CHAPOTON. It is definitely something to look at very closely. It will change the tax system here, and therefore, since the tax system affects international trade and commerce very directly, there will be changes in that area. One must evaluate those changes very carefully.

Senator BRADLEY. Would the Senator yield there, just to kind of return the favor?

Senator GRASSLEY. Yes.

Senator BRADLEY. I frankly think that a simplified system with lower rates would be a real stimulus to our international competitiveness, for the following reasons: If you have a limited pool of capital and you are competing with countries around the world, you want that capital allocated in a way that is most efficient, that will lead to real growth in a real marketplace. You put your money with the company that is developing the new medicine because there is a demand, and you have made the assessment that there is a demand for that medicine, as opposed to putting it with avocado groves in northern California. I don't have anything against avocado groves, but you do that to lose money so you can pay less taxes.

So, if we cleared away the underbrush, the capital would flow to those industries and investments that actually would be the thing to maximize our comparative advantage internationally. And then the argument goes: It would help our international competitiveness.

Mr. CHAPOTON. I would agree with that general statement. The tax system would allow the market signals to work; therefore, capital would flow to its most efficient uses, and that should make us a more effective competitor in the world market.

But I want to emphasize that the changes must be looked at very closely. As a general statement, your point is certainly true.

Senator GRASSLEY. Well, you don't see anything on the horizon that is particularly negative concerning the questions I brought up?

Mr. CHAPOTON. Senator, not off the top of my head, but I, personally, haven't looked at that very closely.

Senator GRASSLEY. Is it possible we would have people come to us saying because we are reforming our tax system so drastically it would interfere with our capital investments that we have tried to encourage in underdeveloped nations, so that we aren't meeting our humanitarian responsibilities?

Mr. CHAPOTON. Well, you are immediately introducing a nontax or a social motive.

Senator GRASSLEY. Well, I'm sure that through our Tax Code there are some tax incentives to do that sort of thing.

Mr. CHAPOTON. Well, one example that comes to mind immediately is the section 911 benefit that excludes up to what will eventually be $100,000 worth of income earned abroad. It is designed to make our companies more competitive with companies of other nations whose workers often are not taxed at all in their own countries.

Under a uniform tax system you would, theoretically at least, do away with that exclusion. But that would be a trade-off. You would look at it at the time.

The CHAIRMAN. Mr. Chapoton, I don't have any questions, but I want to commend the Treasury Department. Obviously, a lot of people have done a great deal of work in preparing this testimony. Certainly, anyone who would try to summarize—certainly they would have right to comment on it—but it is another indication of what a massive undertaking we are about. That doesn't mean we shouldn't do it.

I think the contributions made by Treasury, and next will be CBO, and other agencies, plus all the individual efforts being made by members of this committee and other members not on the committee—there are probably 40 or 50 groups who aren't going to testify in these next couple of days, who will be testifying later—indicate what a massive undertaking it is.

Certainly as questions are raised—there was one raised by Senator Grassley—we need to go back and take a look. But in my view it really sets the stage for continuing what we may have started in a small way earlier this year, and that's at least in the interim continue the base broadening process and lowering the marginal rates, putting the pressure on preferences that probably ought to be looked at in the code.

We appreciate very much your appearance.

Mr. CHAPOTON. Thank you, Mr. Chairman.

[The prepared statement of John E. Chapoton follows:]

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STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE THE SENATE FINANCE COMMITTEE
September 28, 1982

Mr. Chairman and Members of this Committee:

I am pleased to be here today to discuss some frames of reference for evaluating flat-tax approaches to reforming the income tax system.

The Federal income tax is widely perceived to be complicated and unfair. Although many of the provisions in the current law were enacted to promote worthwhile social and economic goals, one result has been that individuals or families of equal means may pay quite different amounts of tax, depending on how they earn or use their incomes. Also, taxpayers in very unequal economic circumstances may pay the same amount of tax despite the apparent progressivity provided by a structure of marginal tax rates presently ranging from 12 to 50 percent. This complex and uneven tax system has led to excessive planning and rearranging of business affairs primarily for tax purposes. It also has led to a great deal of taxpayer uncertainty, anxiety and disrespect for the tax law. Taxpayers want less complicated tax provisions along with more uniform tax treatment and low tax rates.

The income tax has also been a serious impediment to private capital formation and to individual efforts to work and save. Throughout the 1970's, high inflation caused the systematic overstatement of investment income and pushed more and more taxpayers into high marginal tax brackets. The result was to reduce households' reward for saving and raise the cost of business investment.

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In 1981, Congress united with this Administration to enact the Economic Recovery Tax Act of 1981 (ERTA). This Act provided a much-needed reduction in marginal tax rates and a vital acceleration of cost recovery allowances. The Administration continues to be committed to the elimination of the tax barriers to capital formation, and any discussion of major tax reform must continue to concentrate on reducing marginal rates and removing barriers to saving and investment.

Even with the dramatic marginal rate reductions in ERTA, however, what continues to upset the man in the street is his conviction that his neighbor who is just as well-off pays less tax than he does. Furthermore, he is concerned that the fellow in the big house on the hill pays still less than either he or his neighbor is paying.

This concern reflects the common perception that most taxpayers in the broad middle income classes have few opportunities to take advantage of special tax concessions because they receive their incomes in the form of fully taxed wages. They are not poor enough to receive income in the form of untaxed government services and untaxed transfer payments. Yet, neither are they affluent enough to gamble on high-risk, low-taxed investments or to elect to receive significant amounts of compensation in the form of noncash or deferred benefits.

In part, the complaint that the middle class has no tax preferences is overstated. The middle-class worker does enjoy special tax concessions associated with home ownership and employer-paid benefits. These concessions are often overlooked, possibly because they are widely available and are not usually the result of sophisticated tax planning. It is also true, however, that our complex tax rules enable some high-income taxpayers more than others to make use of special exclusions, deductions, and credits, or to take advantage of lower rates of tax that apply to certain sources or certain uses of income.

Whatever income group benefits, there are many cases in which income is treated in different ways for tax purposes. For example:

> Compensation is fully taxed if it is in the form of cash wages, but left untaxed if it is in the form of fringe benefits such as employer contributions to health plans or the personal consumption elements of employee business expenses.
>
> Capital income may be taxed at high rates if it is in the form of dividends from corporate stock because both the corporation income tax and the individual income tax applies, or it may be taxed at a zero rate if it is in the form of tax-exempt bond interest, or it may even be taxed at negative rates on certain sheltered invest-

ments. The tax may apply only to a fraction of the real income from capital gains or, when inflation is greater than the gain, a tax will be assessed on what is really a loss.

Income spent on most goods and services is highly taxed while income spent on selected goods and services such as home energy saving devices, owner-occupied housing in general, and some medical expenses is sheltered from tax.

Current interest in a flat rate tax reflects a growing concern about the complexity of the tax law and the related inequality of treatment under the law as in the examples just given. There is also a concern over our sharply progressive rate structure. Marginal rates under the personal income tax will range from 11 percent to 50 percent in 1984. Taking into account the corporate tax, marginal rates on some income can range from 11 percent to 73 percent.

The two elements, our sharply progressive tax rates and the lack of uniform treatment of income in the tax base, are distinct but interrelated characteristics of our income tax. A single tax rate might, for example, be applied to our current tax base, leaving intact all of the exclusions, deductions and credits, along with the current exemption for taxpayer and dependents. A single rate of about 19 percent on the current individual tax base would raise the same amount of revenue that would be raised by the present individual income tax at the rates scheduled for 1984.

In addition, there is a separate levy on corporations. If the top individual tax rate were substantially reduced, a 46 percent rate on corporations would create too great a disparity between individuals and corporations. A single corporate rate of about 20 percent, together with a single individual rate of 20 percent, would produce the same total revenue with no expansion of the bases.

Collapsing the tax rates without broadening the base to make it more uniform would simplify the tax somewhat and eliminate the disincentive of high marginal rates. At the same time, however, any single-rate tax would inevitably result in a major redistribution of tax burden from high-income to low- and middle-income families.

Most flat tax proposals would substantially broaden the tax base. A tax system designed to treat taxpayers consistently according to a well-defined tax base, with no narrow exceptions, will be referred to as a "uniform" tax throughout the testimony. The term "uniform" will be used to connote broad-based taxation regardless of the structure of rates. For example, a "uniform income tax" could be defined with no exclusions, credits, or deductions, except those necessary to measure income; with integration of the corporate and individual taxes; and with a single marginal rate. Under such a uniform income tax, with a taxpayer exemption of $3,000 per joint return ($2,000 for single returns)and $1,000 exemption per dependent (i.e. $5,000 for a family of four), a single flat rate of about 16 percent would be sufficient to produce the current levels of revenues. A uniform tax on consumed income, i.e., a uniform income tax with deductions for all savings, would require a slightly higher single rate of about 17 percent.

Even with a single rate, the basic exemptions would cause average tax rates to be somewhat progressive across income classes. As shown in Table 1 attached to this statement, average tax rates would vary from 5 percent for taxpayers below $5,000 of income to nearly 16 percent at the highest income levels. Table 1 also shows that a substantial redistribution of the tax burden would occur, despite base broadening and the basic exemption, as a result of replacing graduated tax rates by a single rate. Those with over $50,000 of income would pay about $32 billion less, to be made up by those with less than $50,000 of income.

More progressivity and less redistribution of the tax burden across income classes would occur if larger basic exemptions were allowed. For example, a uniform income tax with basic exemption levels that are double those of the previous example, i.e. $10,000 instead of $5,000 for a family of four, would require a tax rate of about 20 percent and would produce the distribution shown in Table 2. The increased exemption would result in less tax than present law for those in the $0-$5,000 income class, and significantly less redistribution of tax burden from high-income groups to the lower- and middle-income classes. Still, about $22 billion of tax reduction would go to those above $50,000 of income, while $27 billion of additional tax would be paid by those in the $5,000-$50,000 income range.

Some have suggested a "pure" flat-rate tax that has a broad uniform tax base and a single tax rate, but permits no exemptions for the taxpayer or dependents. In the absence of personal exemptions, the single rate for a uniform income tax would be lowered to about 13 percent on the uniform income tax base and to about 14 percent on the uniform consumed income base. The elimination of the basic exemptions would result in a strictly proportional tax, not a progressive tax, further increasing the tax burden for low-income taxpayers. As shown in Table 3, a single-rate uniform income tax with no exemption would result in a tax reduction of about $40 billion for taxpayers above $50,000 of income, matched by a similar tax increase for those below $30,000 of income. (Those in the $30-50,000 class would roughly break even, on the average.) Even though the total tax revenue would be the same, about 77 percent of taxpayers would experience a tax increase under this type of flat tax.

Any broad-based option with a single rate would involve a significant redistribution of income. If a flat-rate tax is designed to raise the same revenue as present law, every dollar of tax reduction for one taxpayer must mean a dollar of increase for some other taxpayers. Many discussions of broader base or flatter tax rates lead one to conclude that tax burdens will fall for practically everyone. That simply is not the case. Tax burdens fall when a choice is also made to cut taxes in general, as in the Economic Recovery Tax Act of 1981.

Instead of using a single tax rate, a uniform tax structure could be designed to contain a lower set of progressive tax rates that would apply to several broad brackets. For example, approximately the same degree of progressivity as in current law could be retained by a tax on the uniform income base with three rates--10 percent on the first $19,500; 25 percent from $19,500 to $75,000; and 39 percent over $75,000. These income brackets are for joint returns and for income in excess of a $3,000 exemption per return plus a $1,000 exemption for each dependent. (See Table 4.) Although the tax burden within each class would be roughly the same as under present law, much redistribution of burdens within classes would still occur because of base-broadening. Even a uniform tax structure with progressive rates, if it is to raise the same revenues as our current system, must cause some persons to have a tax increase if others have a tax decrease. About 55 percent of taxpayers would experience a tax increase in this example.

In the following sections of this testimony, the criteria by which a tax system should be judged are presented and, then, two uniform tax structures which might be frameworks for flat tax reform are described. The first of these two is a uniform income tax.

The uniform income tax not only provides for uniform tax treatment of wages, salaries, and interest income and eliminates many special deductions, credits, and exemptions, but it also provides for uniform treatment of personal income earned through businesses. One cannot discuss eliminating personal deductions or taxing certain fringe benefits for wage earners without also examining tax shelters and business expense deductions. In addition, there remain severe cases of overtaxation of business income, such as the tax on purely inflationary gains and the double taxation of dividends. A true uniform income tax must deal with all of these issues. Flat tax proposals that do not deal with income from businesses do not provide uniform tax treatment of all income.

The second general tax structure described is a uniform tax on consumed income. That tax is identical to the uniform income tax except that a deduction is allowed for all net savings. The tax on consumed income has many advantages, especially its greater simplicity and encouragement of saving.

Our current tax structure contains elements of an income tax concept and a consumed-income tax concept. Indeed, many changes enacted in our tax laws over the past decades have moved us closer to one concept or the other, while some have been consistent with a common path to both. Still other changes, primarily those put into the Tax Code to affect social policy and to influence behavior, have been clear movements away from both concepts of taxation. Before we can evaluate further changes to the system, however, we need to examine some fundamental tax principles.

CRITERIA FOR EVALUATING TAX SYSTEMS

Any framework for future tax reform should be chosen only after careful evaluation of four criteria: equity, distribution of tax burdens, efficiency, and simplicity. Some changes, it will be seen, can be consistent with all these criteria. Many changes, however, require a balancing of these goals. For instance we may need to approximate uniformity, at some sacrifice of fairness or efficiency, by adopting simple rules when exact accounting rules are difficult to design or use.

The Equity Standard

Two equity considerations dominate the discussion of fundamental changes in the personal income tax. First, what is the appropriate tax base? Second, how does the tax system treat individuals who are considered to be in equal circumstances? Do they bear the same burden of tax, or do they have different tax burdens due to other considerations? Suppose two families are identical in every respect except that one spends more on housing and the other more on food. If they pay different amounts of tax, and if market prices do not fully adjust to equalize their tax burdens, then the tax system is said to violate the standard of horizontal equity.

Although most discussions of fairness have made comparisons based on income, many observers since the times of Thomas Hobbes (1588-1679) and John Stuart Mill (1806-1873) have also considered consumed income to be a proper base for taxation. A tax on consumed income would tax individuals according to what they take from society rather than what they earn and make available to it. On the other hand, an income tax is favored by those who believe that income, whether for saving or consumption, is the better measure of ability to pay. Tax equity therefore implies that those who consume equal amounts bear equal tax burdens under a tax on consumed income, or that those with equal incomes bear equal tax burdens under an income tax.

Distribution of Tax Burdens

Uniform treatment of all income or consumption would result in substantial base broadening from current law. Base broadening, however, does not dictate the answer to the separate and distinct question of how taxes might be allowed to vary by income or consumption class. If the tax base were broadened, marginal rates could be lowered in every bracket without affecting the overall distribution of the tax burden by income class. The net result would be a flatter rate schedule, but no effect on the existing progressivity of the tax system, i.e., the extent to which average tax rates increase with income.

Some persons also believe that the distribution of tax burdens should be different than that provided by our current tax system. The extent of any increase or decrease in progressivity is, however, essentially a value judgment and less objective in nature than other criteria such as horizontal equity, efficiency and simplicity. One can broaden the tax base, flatten tax rates and still improve the efficiency of the economy without changing the existing distribution of tax burdens.

The Standard of Economic Efficiency

Since a given amount of tax revenue can be raised in any number of ways, the tax system should be designed to minimize its adverse effects on the economy. Businesses and households should be allowed to make the best use of the resources at their disposal with the minimum of intrusion of tax considerations. This would lead to an economy that operates more efficiently; thereby raising productivity, economic growth, and the standard of living for all Americans.

Efficiency in taxation is based on the notion of efficiency in the marketplace. In most circumstances, market prices reflect the relative values of products to buyers and the costs and alternative opportunities of sellers. Our market system based on such prices allocates labor, capital and material resources to their highest-valued (most efficient) uses.

Taxes reduce the efficiency of the private sector because they interfere with the price signals of the market. The price paid by a buyer (a consumer, employer, or investor) will exceed the price received by a seller. As a result, some transactions will not take place, producing losses in efficiency for the economy. Because of the tax, the resources that would have been traded either will not be put to a productive use or will be shifted to a lower taxed but less productive use.

Any realistic tax system unavoidably distorts some market signals and thereby distorts decisions on how much to work, when and what to consume, when and how to save, how much to invest and in what types of capital. Even a completely uniform income tax will affect individual choices between work and leisure, and between consuming now or saving for future consumption. A tax on all consumed income does not discourage saving, as does an income tax, but both types of taxes will encourage leisure at the expense of work.

While a distortion of the choice between work and leisure is inherent in both a tax on all income and a tax on all consumed income, it remains important to minimize distortions that result from differential taxation among goods or particular activities. Many of these differentials can be eliminated in either type of tax or even in a hybrid tax such as we have today. A lack of uniformity of the tax burden among alternative uses of capital, such as we have in our current system, so distorts the allocation of resources that it can make financial successes out of projects that are less productive, and losers out of undertakings that would otherwise be winners. Choices among investment projects, financial arrangements, and production methods are biased toward those that are tax-favored. The result is a waste of resources.

High marginal tax rates amplify the price distortions caused by the tax system, both those inherent even in uniform taxes, like the disincentive to work, and those resulting from lack of uniformity in the tax treatment of similar activities. The higher the rates, the greater the penalty on fully-taxed activities and the greater the value of tax preferences. In addition, legal tax avoidance and illegal tax evasion are more rewarding with high than with low rates.

Sharply graduated rates introduce further distortions by encouraging individuals to change the timing of transactions from year to year or to arrange for taxable income and deductions to be traded between higher- and lower-taxed individuals. The cost to the economy comes, again, from exaggerating the relative worth of certain activities that the taxpayer would otherwise find unprofitable.

For the most part, both equity and efficiency considerations favor uniformity of tax treatment, whichever tax base is chosen. Tax provisions that penalize or favor a particular product or production method will rarely improve either the efficiency or fairness of the system. Uniformity of tax treatment may not always be consistent with simplicity, however.

<u>The Simplicity Standard</u>

Simplicity in the tax system is desirable in order to minimize the costs of complying with the tax laws--the costs of record-keeping, calculating, reporting, and planning. Unnecessary complexity erodes taxpayer respect for, and voluntary compliance with, the law. The complexity of the present law and accompanying regulations result in much time and talent being devoted to understanding the Tax Code in an attempt to minimize tax payments.

Simplifying the tax structure cannot be the sole or even the dominant goal of tax policy, however. Rather the desire for a less complicated system must be balanced against the often-conflicting desires for a fairer tax system and for one that interferes less with the workings of the economy. An extremely simple tax system would also be extremely unfair and extremely wasteful.

Discussions of tax complexity often center on the tax return, the most visible manifestation of the problem. It is important, however, to consider the issue more broadly and to distinguish among three sources of complexity: (1) computations on the tax form; (2) the problems of measuring the tax base; and (3) tax planning.

Computing taxes is what many think of as the primary source of complexity. Filling out the form 1040 makes many of us feel that we're back in school and that April 15th is the date of the final exam in math. Much of the information on the form is necessary for full reporting of receipts from various sources, for making appropriate distinctions between "receipts" and "income," and for enforcement of the law. Other lines that contribute to the complexity result from special tax rules that provide a variety of exclusions, adjustments, deductions, and credits. Still another set of lines is devoted to alternative procedures for determining the tax bill.

Reducing the number of lines on the tax return without remedying the underlying lack of uniformity in determining the tax base would not substantially simplify the system. A simple return would not produce a simple tax if two volumes of Tax Code and three volumes of regulations were still required to define the few lines.

Measuring the tax base can require complicated rules, if it is to be done accurately and consistently. Since an accurate definition of the tax base is fundamental to a uniform tax on either income or consumed income, the rules to define the base for either uniform tax would not be simple. Employees would still need to keep records of income receipts and necessary costs; employers and financial institutions would still be required to report information about employees and clients; and businesses still would have to keep and report complete accounts. Wherever possible, however, the costs and uncertainties of compliance with these rules should be kept to a minimum.

Tax planning or the rearranging of one's business affairs primarily to reduce taxes is an important source of complexity that receives too little attention. Because of the uneven treatment of different but similar kinds of transactions, taxpayers often go to great lengths to qualify for the more favored tax treatment, such as when partnerships of professionals have incorporated to take advantage of favorable pension provisions. Investors will seek "tax shelters," devoting more attention to the intricacies of the Tax Code than to the merits of the projects. These activities have high costs in professional fees, tax administration, and inefficiency in the use of scarce capital. With a uniform tax, there would be little reason to search for tax-favored activities.

The advantages of uniformity for efficiency and fairness do not always carry over to simplicity. The tax computation process may be somewhat easier but the standard tax form still would not fit on a postcard that could be read without a magnifying glass. Measuring the tax base would be simpler in some respects, especially under a consumed income tax, but not in all. The major simplification would probably come from reducing the efforts needed to rearrange business affairs to minimize taxation.

UNIFORM TAX STRUCTURES

Uniformity in tax treatment would require consistent measurement of a clearly defined tax base. As we learned long ago, it is not enough to declare "income," or "consumed income," or "payrolls" to be the base for a tax. Accounting rules must be specified; records must be kept; and reports will be required. The kinds of rules and records needed for measuring income will be somewhat different than those required for measuring consumed income, even though there are many common elements. The differences are important enough to justify describing separately the requirements for a uniform tax on total income and those for a uniform tax on consumed income.

The Uniform Income Tax

The Concept of Income. Like many commonplace words, a precise definition of "income" is more complicated than everyday usage suggests. The most correct definition when discussing taxes is "the total amount that contributes to a family's consumption in a year or adds to its net worth." Dividends and wages are clearly income, for example, because these receipts can be spent for consumption or used to acquire assets. Increases in vested pension rights or increases in the value of a portfolio are less obvious cases. But these are also income if they add to real net worth. By contrast, borrowing is a receipt of cash that is not income. If the proceeds are used to buy assets, there is no increase in net worth; if they are consumed, net worth is reduced by the amount borrowed.

There are difficult gray areas in applying the definition of income that are a constant source of dispute in tax legislation and administration. For example, a business lunch is partly a business expense and partly an ordinary consumption expenditure. In a uniform income tax, the consumption part should be included in the income of the employee (or the self-employed), not excluded from income. The remaining portion should not be taxed. Determining the right proportions in various situations is extremely difficult.

A truly uniform income tax would require accounting for every last dollar of income, net of necessary costs. The full measurement of income would include at least the following items:

- Wage and salary receipts, net of necessary employee expenses.
- Employer contributions to pension, profit-sharing, and other retirement plans.
- Employer contributions for health, life, or other insurance.
- Earnings on all reserve funds (such as pension reserves) held for future payment of employees' benefits.
- Receipts of proprietorships, net of business expenses.
- A partner's allocable share of partnership income.
- Rent and royalty income, net of expenses.
- All dividend and interest receipts.
- Transfer payments, including:
  - -- Social security and railroad retirement benefits;
  - -- Unemployment compensation payments;
  - -- Veterans' benefits;
  - -- Workers' compensation and other disability income;
  - -- AFDC, SSI, and other general relief payments.
- Total capital gains, net of capital losses, adjusted for inflation.
- Retained corporate earnings, allocated to shareholders.
- Annual rental value of owner-occupied homes, net of housing-related costs.

Taxation of all income does not imply the complete elimination of deductions. Any necessary costs of earning income must be deductible. This includes deduction of interest as a cost associated with debt-financed assets. Deductions for extraordinary medical costs, casualty losses, state/local taxes, and charitable contributions all may be defended on grounds that they do not represent personal consumption expenditures. The basic principle of uniform income taxation is that deductions not be allowed to discriminate by source of income or according to consumption choices.

Careful consideration of the list of items in a uniform income base will explain how that base differs from the present income tax. Some quantitative differences are indicated in Table 5. This table compares the distribution of taxpayers by Adjusted Gross Income (AGI) class, a customary measure of taxpayers' incomes, with the distribution by the broader, uniform income definition. For each uniform income class, Table 5 shows the percentage of taxpayers in each AGI class. For example, for those with $15,000-$20,000 of uniformly measured income, slightly more than half (51.21 percent) also have $15,000-$20,000 of AGI. For most of the remaining taxpayers, AGI understates income. Of those with $15,000-$20,000 of uniform income, about 29 percent are in the $10,000-$15,000 class, as measured by AGI; and another 12 percent have less than $10,000 of AGI. The tendency for AGI to understate uniformly measured income appears at every income level, and this tendency to understate generally increases as income increases.

Uniform income is a useful standard for measuring the distribution of tax burdens and for evaluating an income tax system. Full measurement of income does, however, present a number of formidable practical problems that must be considered if a tax on uniform income is to be considered as a model for tax reform.

Income Accruals. A major problem of full income measurement is that "additions to net worth" often do not coincide with cash receipts. In legal jargon, they are not "realized." When shares appreciate or pension rights increase, income has accrued, but full current measurement would require annual estimates of their values without a market transaction to confirm them. The practical alternative that has generally been followed is to wait for a "recognition event"--a sale, exchange, or distribution--before counting the income, but this provides the familiar opportunity for tax deferral. A postponement of tax is, in effect, an income tax preference.

Inflation Adjustment. In a period of inflation, apparent appreciation of assets may provide no income at all. This is true where the appreciation in value is just enough to maintain a family's real wealth. Any smaller appreciation is really a loss. Thus, if the $100 used to purchase a share of stock 10 years ago is equivalent to $200 at today's prices, no real income has been obtained unless sale of the stock brings more than $200. Accurate income measurement requires inflation adjustment for any return, or cost, that accrues over more than a year. This would mean indexing the basis for all capital assets and the face amounts of all long-term debt, a formidable task.

Depreciation. An element of income measurement that has been most troublesome over the years is depreciation accounting. It is required because the loss in real value of assets is a necessary business expense--a loss of net worth. Conceptually, each physical asset should be valued in each year, and an inflation adjustment should be provided for basis. As a practical matter, historic practice is to use the familiar formulas with an estimated useful life for each broad class of assets. Inflation adjustment, while widely recognized as necessary, is not universally or consistently practiced even for purposes of business decisionmaking. Nevertheless, accurate estimates of depreciation, adjusted for inflation, would be necessary for a uniform income tax.

Integration. One implication of the income definition is that business income ultimately belongs to families (and single individuals), not to the business entities. Increases in corporate net worth, for example, belong to the shareholders and are part of their incomes. Similarly, distributed earnings are income only to the shareholder, not also to the corporation. A uniform income tax would tax all corporate earnings according to the circumstances of each corporate shareholder, but only once. Thus, a uniform income tax would require the integration of the corporation and individual taxes.

Other practical considerations in taxing income. Many features of the present income tax, including some that are derided as loopholes, are reactions to the inherent difficulties of income measurement. The partial exclusion of capital gains, ACRS, and LIFO inventory accounting are, at least in part, responses to the otherwise intolerable overstatement of income during periods of inflation.

Under any practical income tax, some kinds of income that are difficult to measure would have to be excluded or approximated. These include the value of employer contributions to group insurance; the value of certain services, such as checking accounts, that would be taxable if paid out in cash; and especially, the net rental value of owner-occupied homes. Indeed, most taxpayers will refuse to believe that they derive income from their own homes. The national income accounts recognize this source of income by estimating (or imputing) the amount that homeowners earn, and automatically spend, by renting to themselves. No serious proposals for taxing income have included this item directly, although some other countries have tried to do so. Some serious base-broadening proposals would disallow the deduction for mortgage interest, however, as a way of including a portion of the gross return from owner-occupied housing.

Some family expenses that do not, strictly speaking, reduce income are nonetheless widely recognized as equitable adjustments to an income tax base. Few would argue, for example, about the deduction of catastrophic medical expenses. It is also widely recognized that some allowance should be made for family size and that some minimal level of tax-free income should be allowed alike to every family of a given size.

In summary, a practical uniform income tax with no real compromises, but with minimal recognition of measurement problems, would necessarily involve considerable complexity, along with some approximations and some exclusions. It would also retain some of the present personal deductions--at least those for certain interest expenses, employee business expenses, investment expenses and extraordinary medical costs. Thus, some lack of uniformity is inevitable.

Some recent proposals, such as the one by Senator Bradley and Representative Gephardt, attempt to move toward a more uniform income tax base. But no proposals have really attempted to solve the fundamental problems of defining real investment income during inflation. Indeed, the Bradley-Gephardt proposal would make the tax less uniform in a major way by taxing fully the nominal increase in the value of capital assets, even though for any taxpayer, the gains from an asset may be largely, or entirely, the result of inflation. In addition, some of the real gains are increases in corporate share values that reflect income already taxed to corporations. The Bradley-Gephardt proposal also has not addressed the other difficult problems of measuring business income or integrating the corporate tax. Another area of controversy is personal deductions. The Bradley-Gephardt bill would continue to allow certain of these deductions; but they would not allow them uniformly for all taxpayers. For taxpayers above $40,000 of taxable income on a joint return, a portion of the deduction is effectively denied. If these deductions are necessary to assure that those of equal means are treated equally, one must ask why they should not be fully allowed at every income level.

Equity Issues. A uniform income tax would be consistent with most people's conception of equity. Those with equal incomes, regardless of the sources or uses, would pay approximately the same tax. No one could escape tax by choosing particular employers or occupations and by making particular investments.

After base broadening has been achieved, and tax rates have been lowered in all classes, it would also be possible to adjust the tax rate schedules to make them more progressive or less. I want to reiterate, however, that the degree of progressivity is not a consequence of the base broadening. Instead, it should be viewed as an independent decision to change the existing distribution of tax burdens. Unlike present law, however, whatever rate structure is chosen under a uniform tax would accurately portray the distribution of tax.

Efficiency Considerations. Uniform taxation of income would remove many tax distortions from the marketplace. For example, under current law:

> The exclusion of many fringe benefits from taxable compensation encourages workers to choose more fringe benefits than they would if all forms of compensation were taxed equally. The tax exclusion for employer-paid medical insurance is a major contributor to the over-consumption of health services and to the continuing rapid rise in health care costs.
>
> Preferential tax treatment among industries distorts investment decisions. For example, the capital gains treatment for livestock or the expensing of mining costs allow those industries to attract investors in projects that yield lower pre-tax returns than those in other higher-taxed industries.
>
> The separate corporate income tax distorts economic decisions. By imposing a double tax on dividends, the corporate income tax encourages firms to issue debt rather than equity, and to retain earnings rather than to pay out dividends. It also favors the unincorporated business over the corporation, and it favors industries typically characterized by non-corporate enterprises (principally agriculture, housing, and services) relative to industries dominated by corporations.
>
> Accelerated cost récovery and the investment tax credit have reduced the excessive tax burden on investment in equipment and machines, but the income tax continues to fall heavily on investments in structures and inventories. This differential distorts choices of production methods and raises the relative tax burden on activities and industries that naturally require more of the heavily-taxed capital.

Uniformity would reduce the expense and effort involved in tax planning and allow markets to choose the most productive uses of available capital. It would encourage employers to pay compensation in the form that is valuable to their workers--cold cash to consume or save as they wish. All of these represent gains in economic efficiency.

A great disadvantage of the income tax is its built-in bias against saving. The income tax discourages saving by reducing the rate of return to the saver below the market return derived from investing in capital. A taxpayer who would be willing to postpone consumption to obtain a 10 percent return, thereby making resources available for capital formation, may not be willing to make the same sacrifice for a 6 percent return, after-tax. This is not a double tax on savings as some have asserted; it is a single tax on capital income. But this single tax has the inevitable consequence of reducing the reward for deferring consumption and, thus, by making less saving available for investment impairs the future growth and productivity of the economy.

Simplicity. A uniform income tax would be simpler in some respects than present law, but it cannot be really simple. For example, businesses with capital expenditures must account for depreciation. More accurate depreciation rules are likely to be more complicated and contentious. This is especially true in a period of inflation, which also complicates the valuing of inventories and the proper calculation of capital gains and losses.

Another illustration is fringe benefits of employees. These are often close substitutes for cash wages. When they are excluded from the tax base, they provide a convenient means for avoiding tax and, thus, contribute to the perception of unfairness. But many fringe benefits, like the personal use of company cars, are difficult to distinguish from properly excludable business expenses, and many others, like employer-paid group insurance, are not easily valued for each employee.

Deductions and adjustments to the income of employees also complicate the measurement of the tax base but many of these are necessary to reflect differences in ability to pay. Moving costs, employee business expenses, interest expenses, and extraordinary medical expenses may be examples. A tax system that allows too few adjustments of this type can be just as unfair (though perhaps simpler) as one with too many exclusions.

Neither a uniform tax on all income nor on consumed income would end the complexity of measuring income. More uniform treatment would, however, simplify tax practice by reducing the number and importance of the fine distinctions needed to identify tax-favored activities.

The computation of tax liability can be complicated under present law by income averaging, the alternative minimum tax, and options of filing status, and by various tax credits, some of which have complicated limitations. A more uniform definition of the tax base and a flatter rate schedule would reduce many of these complexities. In general, a more uniform income tax presents difficult policy tradeoffs in the area of simplification. The more we attempt to make the income tax uniform in every particular, the more complicated the rules must become. The more rough-and-ready rules, the more opportunities are created for otherwise unproductive tax avoidance and the more inequities are created.

Transition Considerations. Immediate implementation of a uniform tax structure would cause significant changes in the value of individuals' assets and after-tax incomes. Such changes would create windfall gains for some individuals and unfair losses for others. These changes in wealth and after-tax income can be moderated by transition rules, such as phasing-in provisions of a new law, grandfathering, and delaying effective dates.

Transition rules for a uniform income tax should insure that income is not subject to tax twice, once under the prior system and a second time under the new tax law. Conversely, a tax change should not result in some income never being subject to tax. For instance, the exclusion of social security benefits and the 60 percent exclusion of long-term capital gains could still apply to accrued, but unrealized, income prior to the effective date of the new law. Benefits or real gains accrued after the effective date, however, should be fully subject to tax.

Transition rules can also reduce the income and wealth redistribution resulting from changes in relative tax rates. The value of assets that currently receive favorable tax treatment, such as state and local government bonds, would fall as demand for those assets declined under a uniform tax structure. Individuals who had made specific investments because of favorable tax treatment would suffer losses. Grandfathering existing tax treatment for the life of the asset or as long as the owner retained control, or delaying the effective date, would reduce the present value of the loss on tax-favored assets.

The design of transition rules should weigh the advantages of increased efficiency and simplicity of a uniform tax structure against the wealth and income effects caused by the change in tax laws. Transition rules can reduce the amount of windfall gains and losses, but only by delaying implementation and increasing the complexity associated with the new tax system. Grandfathering assets purchased under prior law could involve delays in implementation of the new law for up to 30 years on long-lived assets. Alternatively, delaying the effective date of the new law could shorten the transition period while reducing the present value of the windfall gain or loss. During the transition period, the income tax base would be lower than the ultimate base, which would necessitate higher temporary tax rates for a given level of revenue.

Uniform Tax on Consumed Income

Concept of Consumed Income. An alternative model for tax reform is a uniform tax on the amount of income consumed, rather than on the amount of income earned. The uniform tax on consumed income would differ from the uniform income tax by excluding net saving from the tax base.

This alternative model for tax reform does not represent as radical a departure from current law as it might seem. In many ways, the current rules applying to saving are much closer to those required under a tax on consumed income than to rules necessary under a uniform income tax. In particular, two important sources of saving for many families--homeownership and retirement saving--are taxed almost the same way under current law as they would be taxed under a consumed income tax with a deduction for saving. Similarly, the adoption of the Accelerated Cost Recovery System in ERTA moved the tax treatment of business investments in machinery and equipment much closer to the treatment required under a consumed income tax. Provisions in the tax law that allow expensing of certain capital investments, such as mining exploration and development expenses, and rules that permit most costs of research and development to be expensed rather than capitalized are also consistent with a consumed income base.

The issue of whether income consumed or income earned is the appropriate base for a tax system has been debated for many years by tax theorists and social philosophers. Some prominent twentieth century economists, including Professor Irving Fisher of Yale University and Professor Nicholas Kaldor of Cambridge University, have advocated some form of tax on personal consumption as a substitute for the personal income tax. The idea of taxing personal consumption rather than income has gained increasing favor and was given favorable consideration in the Treasury Department study, Blueprints for Basic Tax Reform, released in January, 1977, and in the Report of the Meade Commission in the United Kingdom in 1978.

Under the consumed income tax, the taxpayer would include in his tax base all forms of current monetary income, the current consumption value of all fringe benefits supplied by employers, and the proceeds of all borrowing, in excess of loan repayments. The taxpayer would be allowed to deduct from the tax base all purchases, in excess of sales, of income-earning assets, and all deposits, in excess of withdrawals in interest-bearing accounts. Accrued interest, earnings from ownership of corporate shares, increases in the value of pension and life insurance reserves, and other increases in the value of asset holdings would not be subject to tax until paid out or withdrawn for consumption.

As a simple example, a family with $20,000 of wages out of which $4,000 is saved would be taxed on $16,000, not on $20,000 as under a uniform income tax. On the other hand, if the family spent more than it earned--say $25,000--by borrowing or dipping into its savings account for the extra $5,000, it would be taxed on the $25,000 of consumption. Since total consumption in the economy is less than income, tax rates would need to be higher to generate the same amount of revenue.

The tax on consumed income would be similar in many ways to the uniform income tax and would involve many of the same base-broadening steps, as compared with current law. Each taxpayer would continue to file an annual tax return that would be similar to the current Form 1040, though somewhat simpler. All forms of employee compensation (except for employer contributions to pension plans) and all personal deductions (except for interest deductions) would be treated the same as under the uniform income tax. Wages and salaries (net of necessary employee expenses), the value of employer-provided fringe benefits, and transfer payments would be included in the tax base. Personal deductions other than interest deductions and deductions necessary to measure ability to pay, such as a deduction for catastrophic medical expenses, would be eliminated. There would be no tax credits, except for the foreign tax credit. The $100 dividend exclusion, the provisions exempting from tax certain forms of interest income, such as income from All Savers certificates, and the exclusion from tax of 60 percent of recognized capital gains would all be eliminated under both the uniform income tax and the uniform tax on consumed income.

Because only individuals consume, there would be no separate corporate tax nor any need to integrate personal and corporate earnings. Taxable income of an individual would include distributions from corporations and individuals' sales of corporate shares. In effect, corporate income would be taxed when it found its way into individual consumption. Retained earnings would receive no tax advantage over dividends, so attributing retentions to stockholders would be unnecessary. A tax on consumed income would, however, encourage corporations, particularly closely-held corporations, to buy consumption for their employees, permitting the workers to evade taxes unless fringe benefit rules were tightly drawn and applied.

The major differences between the two tax systems involve differences in the treatment of saving and borrowing. Under the tax on consumed income, deductions would be allowed for all purchases of corporate shares, corporate and government bonds, shares of mutual funds and other financial instruments, assets used in a trade or business, and deposits in interest-bearing accounts. Any cash receipts from such assets, either in the form of distributed earnings, return of investment, or realized gains, would be subject to tax. Similarly, the proceeds of all borrowing would be included in the tax base, while both interest payments and repayment of loan principal would be deductible.

The inclusion of net loan proceeds in the tax base is particularly important. Otherwise, taxpayers could reduce their tax by taking a deduction for the portion of assets acquired from borrowed funds, even though the combination of borrowing and purchase of assets does not add to net saving.

The purchase price of consumer assets, such as owner-occupied homes, automobiles, and furniture would not be deductible in the same way as business investments. While business assets yield income in the form of interest, dividends, or capital gains, consumer assets produce income in the form of services--the use of the house or car. For investment in business and consumer assets to be treated the same would require an estimate of the annual value of the services that the house or the car or the furniture provides--an estimate of their rental value. Since this would be extremely difficult to accomplish and for the taxpayer to understand, a method that is approximately equivalent, in present value terms, would be used instead. Under this method, individuals would neither include loan proceeds for these purchases in income, nor would they be able to deduct loan repayments. In addition, the tax liability for withdrawals from savings accounts used to finance purchases of housing and automobiles might be spread out over a period of years. These special provisions would allow the tax liability arising from consumption of the services of houses, automobiles, and other major consumer durables to be spread more evenly over the useful life of the asset, rather than being assessed all at once at the time of acquisition.

The tax on consumed income would require some different, but not more complicated, reporting and record-keeping information than the uniform income tax. Taxpayers would need to report both purchases and sales of all capital assets, but there would be no need to maintain records for assets purchased in previous years, because the entire sales proceeds, not just the gain, would be subject to tax upon sale. The Form 1099 sent by banks and other depository institutions to report taxable interest to individuals would be altered slightly. Instead of reporting annual interest from accounts, Form 1099 would report net withdrawals. Net withdrawals would be computed by adding together the beginning of year balance and interest received and then subtracting the end of year balance. For example, if additions to savings accounts exceeded interest earnings withdrawn from the accounts, the individual would be able to claim a deduction. There would also need to be an accounting for all loans received, but there would be no need to divide loan repayments between principal and interest, since all loan repayments would be deductible.

Equity. A uniform tax on consumed income would have some of the same equity benefits, compared to current law, as would a uniform tax on all income. Two individuals with the same consumed income would pay the same tax, regardless of the source of funds used for consumption or the types of consumer goods purchased. In contrast, current law allows tax advantages for individuals who receive income in certain forms, such as transfer payments and tax-exempt fringe benefits, or who spend income on certain goods and services, such as home insulation expenditures qualifying for residential energy credits.

However, under the uniform tax on consumed income, two individuals with the same total income might pay very different amounts of tax, depending on how much each individual saved. To take an extreme example, consider a very frugal person earning $100,000 a year who saves $90,000 and consumes only $10,000. Under a consumed income tax, such a person would pay the same taxes as a person who earned only $10,000, but consumed all of his earnings. A uniform income tax would tax the person earning $100,000 more than the person earning only $10,000.

This example might lead many persons to conclude that a uniform income tax is fairer than a uniform tax on consumed income because the person earning more should pay more taxes. An alternative example, however, often leads to the opposite conclusion. Consider the heir of the frugal person who earns only $10,000 but consumes $90,000 a year by selling part of his inheritance each year. Under a uniform income tax, this wealthy person with a very high standard of living will pay the same tax as a poorer person earning and spending $10,000 a year. The consumed income tax, however, places a heavier tax burden on the person spending $100,000 a year even though that person earns only $10,000.

Thus, compared to a uniform income tax, the consumed income tax falls less heavily on the person who lives frugally and accumulates wealth and more heavily on the person who lives well by selling wealth. The uniform income tax has the opposite effect in that it places a higher tax burden on the person who accumulates wealth than on the person who spends it.

The above examples do not clearly demonstrate whether or not a consumed income tax is less equitable than a uniform tax on all income. There is, however, a further issue. In many cases wealth is not spent by later generations but, indeed, is increased from generation to generation. Under the consumed income tax, such permanently growing estates would never be subject to income taxation. If this is a matter of concern, an estate tax can be designed as a complement to the consumed income tax to limit the tax-free accumulation of wealth over many generations.

Under a uniform income tax, or even under our current tax system, an estate tax imposes a true double tax on wealth, because accumulations of wealth are taxed as income is saved. One's attitude toward an estate tax might be much different under a consumed income tax as there would be no double tax on wealth. In that case, some might be more willing to use an estate tax to provide a single tax on the transfer of very large estates.

Distribution of tax burdens. A uniform tax on consumed income would allow personal exemptions for taxpayers and could tax the remaining consumed income, in excess of exemptions, at either a single rate or with a graduated structure involving several rate brackets. A tax on consumed income is not inherently more or less favorable to high-income households than a uniform income tax, even though low-income households generally consume a larger fraction of their income than high-income households. Under either uniform tax system, the distribution of the tax burden among taxpayers with different abilities to pay could be altered by changing the basic exemption level and the rate structure.

<u>Efficiency</u>. A uniform tax on consumed income would also have many of the same benefits in improved economic efficiency as would a uniform tax on all income. Under either form of uniform taxation, the tax system would no longer bias choices among investment projects, methods of finance, and different consumption goods. Both tax systems would be neutral among different types of capital investments, neutral between debt and equity finance, neutral between corporate and non-corporate forms of enterprise, and neutral between consumer goods and services generally and certain goods and services, such as medical insurance, that receive tax benefits under current law.

A further advantage of a tax on consumed income is that, unlike the uniform income tax, it would not cause a disincentive for saving and capital formation. Since saving is exempted from the tax base, all consumption would be taxed when it occurs, whether financed from the proceeds of current earnings or from the proceeds of accumulated savings. In contrast, under a uniform income tax, consumption made possible by past saving is taxed <u>before</u> it occurs, when the income is earned. The present value of taxes can be lowered by moving the timing of consumption forward, either by reducing saving or by increasing borrowing.

Compared to a uniform income tax, a tax on consumed income would probably result in a higher saving rate, leading to increased capital formation, a higher growth rate in the short run, and a permanently higher level of output in the long run.

However, the exclusion of savings from the tax base also means that a tax on consumed income would require slightly higher tax rates to raise the same revenue as a uniform tax on all income. Higher tax rates would increase the disincentive to work to obtain current consumption goods and would worsen the distortions from any preferences that might remain in the tax system. Treasury's estimates indicate that the rate differential would not be large, so that the impact of the differential would also be small.

<u>Simplicity</u>. A tax on consumed income would be much simpler than a uniform income tax, even though some new reporting requirements would be added. The main simplicity advantage of the tax on consumed income is that it avoids many of the severe problems in measuring the tax base that are encountered under a uniform tax on all income. The main simplification benefit from taxing income only when consumed, rather than when earned, is that there would be no need to account for changes in the value of assets between two different tax years. Thus, there would be no need for complex rules for depreciation accounting, no need to adjust the measurement of capital income for inflation, and no need for complex rules to allocate corporate retained earnings among shareholders and to allocate accumulations of pension fund and life insurance reserves among policyholders. All purchases

of productive assets would be immediately deductible in the year purchased. There would be no separate tax on the income of corporations, only a tax on distributions from corporations to individuals and on sales of corporate shares. Since all assets would be purchased with pre-tax dollars, the entire sales proceeds, not only the gain, would be subject to tax.

Other Consumption Taxes. One version of a flat tax that approximates a uniform tax on consumed income is S. 2147, introduced by Senator DeConcini. S. 2147 is based on the flat tax proposal developed by Robert Hall and Alvin Rabushka of the Hoover Institution. Under S. 2147, there would be a single-rate tax on employee compensation and on business cash flow. Corporations and non-corporate business entities would be taxed on total revenues less purchases of assets, wages, and purchases of goods and services from other firms. Dividends and interest payments would not be deductible in computing the business tax, nor would they be includible in the income of the recipient. S. 2147 would, in effect, tax most of the consumed income of individuals, other than consumption from wages, at the enterprise level. The single tax rate makes it possible to use cash flow of business enterprises as a proxy for the cash flow of owners and creditors of business firms. Such a simplifying device could not be used in any system with graduated rates or individual exemptions that apply to consumption out of past savings as well as to current wage income.

Another way of taxing consumption is to collect the entire tax from business firms, either in the form of a retail sales tax or as a tax on value added at each stage of production. A retail sales tax or a value-added tax, if sufficiently general, could be designed to have the same total tax base as the uniform tax on consumed income. However, any tax on business sales could not adequately take account of variations in individuals' ability to pay. By its very nature, such a tax could not maintain the overall progressivity of the current income tax and could not provide basic personal exemptions for low-income households. In constrast, the uniform tax on consumed income would achieve the major benefits of a sales tax--simplicity and improved savings incentives--without necessarily redistributing the tax burden from high-income to low-income families.

Transition Considerations. As in the case of the uniform income tax, movement toward a uniform tax on consumed income would involve significant changes in the distribution of wealth and income that could be limited by transition rules. Transition rules for a uniform tax on consumed income are especially important to ensure that income does not escape taxation or is not subject to tax twice. Older persons could be subject to tax twice if their consumption during retirement depends on wealth accumulated out of after-tax income. Treating all existing wealth as if it were tax-paid, however, would result in income from certain assets escaping taxation completely since many existing assets have been purchased with pre-tax dollars. This is true, for example, of individual retirement and Keogh accounts, benefits received under qualified pension or profit-sharing plans, and untaxed accumulations, such as unrealized capital gains or accrual of life insurance reserves.

Transition rules to a uniform consumed-income tax would require the same tradeoffs between equity, efficiency, and simplicity as transition rules to a uniform income tax. For instance, designation of existing wealth as tax-paid assets would not require measuring existing wealth, but it would allow some consumption to escape taxation completely. Identifying and measuring assets according to whether they were established out of pre-tax or after-tax income would be administratively difficult. Delaying the implementation of the consumed income tax would require higher taxes on consumption during the transition period and would reduce the present value of efficiency gains from the imposed tax system.

Summary. By-and-large, a uniform tax based on consumed income has considerable appeal as a model for tax reform. It would allow for important simplifications in the taxation of the return to savings and would remove the disincentive to saving present under both current law and a uniform income tax. However, a tax on consumed income would be considered inequitable by some because it would allow wealth to be accumulated tax-free. It would also require higher tax rates to raise the same revenue than would a uniform income tax, although elimination of many deductions, exclusions, and credits could enable the tax rates to be lower than current law tax rates.

CONCLUSION

There are, then, two models for evaluating flat-tax proposals, the income tax and the consumed-income tax. The current Tax Code is a hybrid of the two structures that also contains a substantial number of provisions inconsistent with both. In fact, it is impossible to say whether current law is closer to a uniform income tax or to a uniform tax on consumed income.

Many recent changes in the tax laws and many proposed reforms have been consistent with one or both of the uniform structures. There have been recent actions partially to further expand the tax base. The move in 1978 to tax a portion of unemployment compensation is a good example. Any such change is in line with both concepts of uniformity.

There have also been actions to encourage saving for special purposes, such as the expansion of the availability and uses of IRAs and Keoghs. These move the tax law closer to a consumed-income tax and further away from a uniform income tax. The important accelerated cost recovery provisions enacted in the Economic Recovery Tax Act of 1981 again moved our tax structure towards a tax on consumed income.

There have been other changes in the law to require better matching of income and related deductions. Such reforms are consistent only with an income tax. Recent tax law changes dealing with completed contract accounting, capitalization of construction period interest and taxes related to real property, and the cut back of deductions for mineral exploration costs and intangible drilling and development costs all represent shifts toward a uniform income tax.

Not all the recent revisions in the tax laws have been consistent with the two models, however. Provisions such as expansion of the general interest exclusion, the exclusion of interest on All Savers certificates, credits for energy exploration, research and development, and earned income all would appear in neither of the two structures.

Any future changes in the structure of our taxes should be based on a clear understanding of uniform structures. Anyone addressing fundamental tax reform needs to have a uniform framework in mind. Most proposals touted as basic tax reform are incomplete and contain features moving in exactly the wrong direction. This misdirection is not for lack of lofty objectives. Rather, it appears to result from lack of a uniform framework that will require making very tough, unpopular decisions along with the easy ones.

The Treasury Department is continuing its study of these issues and will be happy to share additional results with the Congress as they become available.

Table 1

Total Liability and Average Tax Rates Under a Uniform Income Tax with a $3,000 Deduction Per Return for Joint Returns ($2,000 Single Returns) and a $1,000 Exemption Per Dependent and Under Present Law

(1981 Levels)

Uniform income class	Tax under 1984 law 1/		Tax under a uniform tax with a 16.27 percent tax rate		Change in tax	
	Amount	Percent of uniform income	Amount	Percent of uniform income	Amount	Percentage change from present law
($000)	($ millions)	(percent)	($ millions)	(percent)	($ millions)	(percent)
Less than 0	$3,507	n.a.	--	0.0%	$-3,507	-100.0%
0 - 5	1,775	2.9%	$3,080	5.0	1,305	73.5
5 - 10	8,200	5.0	15,402	9.4	7,202	87.8
10 - 15	14,611	7.2	22,563	11.2	7,952	54.4
15 - 20	19,754	9.4	25,792	12.2	6,038	30.6
20 - 30	48,208	10.9	57,444	13.0	9,236	19.2
30 - 50	76,339	13.0	80,574	13.7	4,235	5.5
50 - 100	47,068	18.1	37,557	14.5	-9,511	-20.2
100 - 200	23,874	25.5	14,282	15.3	-9,592	-40.2
200 and over	25,223	33.6	11,908	15.8	-13,315	-52.8
Total	$268,558	13.0%	$268,602	13.0%	$44	0.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 24, 1982

1/ Includes the attributable share of the corporation income tax.

Table 2

Total Liability and Average Tax Rates under a Uniform Income Tax
with a $6,000 Deduction Per Return for Joint Returns ($4,000 Single Returns)
and a $2,000 Exemption Per Dependent and under Present Law

(1981 Levels)

Uniform income class	Tax under 1984 law 1/		Tax under a uniform tax with a 20.00 percent tax rate		Change in tax	
	Amount	Percent of uniform income	Amount	Percent of uniform income	Amount	Percentage change from present law
($000)	($ millions)	(percent)	($ millions)	(percent)	($ millions)	(percent)
Less than 0	$3,507	n.a.	--	0.0%	$-3,507	-100.0%
0 - 5	1,775	2.9%	352	0.6	-1,423	-80.2
5 - 10	8,200	5.0	9,258	5.6	1,058	12.9
10 - 15	14,611	7.2	18,281	9.1	3,670	25.1
15 - 20	19,754	9.4	23,598	11.2	3,844	19.5
20 - 30	48,208	10.9	57,104	13.0	8,896	18.5
30 - 50	76,339	13.0	85,801	14.6	9,463	12.4
50 - 100	47,068	18.1	42,668	16.4	-4,400	-9.3
100 - 200	23,874	25.5	16,930	18.1	-6,944	-29.1
200 and over	25,223	33.6	14,481	19.3	-10,742	-42.6
Total	$268,558	13.0%	$258,473	13.0%	$ -86	0.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 27, 1982

1/ Includes the attributable share of the corporation income tax.

Table 3

Total Liability and Average Tax Rates Under a Uniform Income Tax and Under Present Law

(1981 Levels)

Uniform income class	Tax under 1984 law 1/		Tax under a uniform tax with a 13.48 percent tax rate		Change in tax	
	Amount	Percent of uniform income	Amount	Percent of uniform income	Amount	Percentage change from present law
($000)	($ millions)	(percent)	($ millions)	(percent)	($ millions)	(percent)
Less than 0	$3,507	n.a.	--	0.0%	$-3,507	-100.0%
0 - 5	1,775	2.9%	$7,853	12.9	6,078	342.4
5 - 10	8,200	5.0	20,382	12.4	12,171	148.5
10 - 15	14,611	7.2	25,283	12.5	10,672	73.0
15 - 20	19,754	9.4	26,863	12.7	7,109	36.0
20 - 30	48,208	10.9	56,705	12.9	8,497	17.6
30 - 50	76,339	13.0	75,684	12.9	-655	-0.9
50 - 100	47,068	18.1	33,475	12.9	-13,593	-28.9
100 - 200	23,874	25.5	12,255	13.1	-11,619	-48.7
200 and over	25,223	33.6	9,972	13.3	-15,251	-60.5
Total	$268,558	13.0%	$268,473	13.0%	$-86	0.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 24, 1982

1/ Includes the attributable share of the corporation income tax.

Table 4

Total Liability and Average Tax Rates Under a Uniform Income Tax with a $3,000 Deduction Per Return for Joint Returns ($2,000 Single Returns) and a $1,000 Exemption Per Dependent and Under Present Law

(1981 Levels)

Uniform income class	Tax under 1984 law 1/		Tax under a uniform tax with a progressive tax rate schedule 2/		Change in tax	
	Amount	Percent of uniform income	Amount	Percent of uniform income	Amount	Percentage change from present law
($000)	($ millions)	(percent)	($ millions)	(percent)	($ millions)	(percent)
Less than 0	$3,507	n.a.	—	0.0%	$-3,507	-100.0%
0 - 5	1,775	2.9%	$1,893	3.1	118	6.6
5 - 10	8,200	5.0	9,467	5.8	1,266	15.4
10 - 15	14,611	7.2	14,568	7.2	-43	-0.3
15 - 20	19,754	9.4	18,904	9.0	-850	-4.3
20 - 30	48,208	10.9	45,091	10.2	-3,117	-6.6
30 - 50	76,339	13.0	80,169	13.7	3,830	5.0
50 - 100	47,068	18.1	47,568	18.3	500	1.1
100 - 200	23,874	25.5	25,069	26.8	1,195	5.0
200 and over	25,223	33.6	26,156	33.5	934	3.7
Total	$268,558	13.0%	$268,885	13.0%	$326	0.0%

Office of the Secretary of the Treasury
Office of Tax Analysis

September 24, 1982

1/ Includes the attributable share of the corporation income tax.

2/ For joint returns the marginal tax rates are 10 percent on the first $19,500, 25 percent from $19,500 to $75,000 and 39 percent on income over $75,000. For single returns, the bracket widths are half the joint schedule.

Table 5

Percentage Distribution of Returns in Uniform Income Classes, by Present Law Adjusted Gross Income Class

Adjusted gross income class ($000)	Uniform Income Class ($000): Less than 0	0-5	5-10	10-15	15-20	20-30	30-50	50-100	100-200	200-500	500 and over	Total
Less than 0	27.95	0.30	0.15	0.11	0.04	*	0.01	0.02	0.04	0.16	0.09	0.46
0 - 5	48.34	95.31	49.58	16.77	4.44	1.01	0.15	0.14	0.24	*	*	33.46
5 - 10	4.89	3.09	45.13	28.52	7.91	1.15	0.04	0.24	*	*	0.01	14.54
10 - 15	3.74	0.85	3.54	48.29	29.09	5.67	0.48	0.40	*	0.01	*	11.81
15 - 20	2.56	0.18	0.83	4.33	51.21	20.75	1.21	0.13	0.01	0.02	0.01	9.64
20 - 30	4.53	0.19	0.56	1.56	6.22	66.56	26.71	0.96	0.02	0.07	*	15.05
30 - 50	4.14	0.05	0.17	0.36	0.99	4.58	69.80	32.30	0.46	0.11	0.03	11.59
50 - 100	3.00	0.04	0.04	0.05	0.10	0.27	1.57	64.74	40.96	0.99	0.07	2.86
100 - 200	0.67	*	*	*	*	0.01	0.03	1.05	57.41	49.49	2.07	0.47
200 - 500	0.12	*	*	*	*	*	*	0.02	0.82	48.61	43.46	0.09
500 and over	0.05	*	*	*	*	*	*	*	0.02	0.54	54.26	0.01
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Office of the Secretary of the Treasury
Office of Tax Analysis

September 23, 1982

*Less than 0.005 percent.

The CHAIRMAN. Ms. Rivlin?

I might say that tomorrow morning we will lead off with Senator Domenici and Lou Harris, who will tell us about the latest poll results—not on political poll results but on taxes.

Dr. Rivlin?

STATEMENT OF DR. ALICE RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE, WASHINGTON, D.C.

Dr. RIVLIN. Good morning, Mr. Chairman.

My statement is a good deal shorter than the very excellent statement of the Treasury, but I thought, in the interests of time, I might just read the first part and submit the rest for the record.

Federal budget projections indicate that large deficits are in store for at least the next several years. To reduce these deficits, tax increases as well as spending cuts must be considered. Raising income or payroll tax rates would narrow the deficit, but at the same time would slow the economy and decrease economic incentives. What is needed, therefore, is a tax alternative that would encourage—or at least not inhibit—work, savings, and investments; that would increase capital formation, economic growth, and productivity; and that would reduce tax-induced misallocations of resources.

Two alternative courses to explore are: Broadening the base of the income tax to allow lower rates—perhaps only a single lower rate; and replacing the income tax with a broad-based expenditure tax.

A BROAD-BASED LOW-RATE INCOME TAX

The individual income tax is widely believed to be unfair, a drag on efficiency, and overly complex. Many Americans perceive that the wealthy have access to hidden and arcane legal provisions that permit them to pay little tax or none at all. Economists argue that this same tangle of legal provisions hinders economic efficiency by diverting resources from the activities with the greatest pretax yields into less profitable but tax-favored enterprises. And almost every taxpayer feels overwhelmed by the mass of forms and instructions he confronts every April.

Broadening the tax base is a widely discussed policy option because it would not only raise badly needed revenue but also make the tax system simpler, fairer, and more efficient. Many of the preferential provisions in the tax law require more and longer tax forms, and add pages to the instructions that every taxpayer must wade through, whether he uses the preferences or not. Most taxpayers are left with a sense of favoritism and unfairness. And with so many preferences in the law, it is not surprising that some taxpayers use them, either individually or in combination, to reduce their tax liability. Repealing some or all of those preferences would cut back on this complexity and perceived unfairness.

Perhaps the greatest advantage of broadening the tax base, though, is that it would make it possible to raise additional tax revenue with less cost in inefficiently allocated resources. Many tax preferences in the law today induce taxpayers to invest differently from how they would in an entirely free market. For example, the tax system favors mineral extraction through depletion allowances, selective capital gains preferences, and expensing of intangible costs of even successful long-term development operations. It favors foreign operations and export activities through deferral of tax, and it exempts part of foreign salaries. It allows deductions to be accelerated and income to be postponed for certain projects. These examples are indicative of the efficiency price the economy pays for such tax subsidies, and the $273 billion total estimated for tax expenditures in fiscal year 1983 suggests that the influence of the tax system on resource allocation is by no means small.

Scaling back some tax expenditures, as this committee did in the Tax Equity and Fiscal Responsibility Act of 1982, pushes the tax system toward greater neutrality and a more market-responsive allocation of resources. Further base broadening could allow general tax rate reductions without loss of revenue. These general rate reductions can partly compensate those taxpayers whose preferences have been repealed, whereas a more limited base broadening would not provide the revenue for any compensating rate cuts. Further, lower rates yield their own efficiency benefits.

Lower tax rates increase the incentive to work, save, and invest, and they decrease the incentive to borrow. They therefore push in the right direction relative to the economy's need for greater productivity and capital formation, though the improvement that can be attained in these areas through the tax system alone should not be overestimated. At the same time, lower tax rates have numerous technical benefits. Distortions caused by the tax treatment of interest and debt during inflation, the double taxation of corporate-source income, the incentive to make use of tax shelter schemes, the marriage penalty, and the incentive to conceal income in the so-called underground economy would all be at least partly corrected if tax rates were lower and the rate schedule correspondingly flatter. The misallocation and waste of resources from attempts to profit from the Tax Code would likewise be cut back. Thus, the payoff from reduced tax rates can be far reaching.

The question, of course, is: How much broader should the tax base be? The theoretical efficiency benefits of having the broadest possible tax base must be weighed against some of the practical difficulties. First and foremost is that taxpayers have been making tax-preferred investments for years in anticipation of the continuation of these preferences. Millions of middle-income families have contractural mortgage obligations built into their household budgets; repeal of their mortgage interest and property tax deductions might squeeze many of those budgets to the breaking point. Homeowners' long-term contracts greatly reduce their flexibility to respond to a sudden and comprehensive broadening of the tax base. Further, repeal of the tax preferences might shrink the market value of homes so far as to eliminate the sales of homes as a potential solution to the family budget squeeze.

The charitable contributions deduction is another question to consider in the context of base broadening. Repeal of this deduction would eliminate the tax incentive for giving to finance many socially beneficial activities. Adjustment could be extremely difficult for the many educational, medical, artistic, and religious institutions now dependent on charitable giving.

Another potential limitation to base broadening is complication in the Tax Code itself. Though many tax preferences complicate the Tax Code, some types of income are excused from the tax because taxing them would be so complicated. Nonwage employee benefits are an example. Costs of group life and health insurance coverage would have to be assigned to individual employees, which would be quite complex, particularly in instances when the employers self-insure. If pension contributions were also added to the tax base, even more difficult valuation problems would arise in the equal treatment of defined contributions and defined benefit plans. Many other base broadening steps would entail such difficulties.

How flat should the tax rates be? Either lower graduated rates or a single flat rate could be used with a broader tax base. A flat rate tax would have some limited simplicity advantages over a tax with the same base and low graduated rates. The single rate would eliminate the incentive artificially to move taxable income from high bracket to low bracket taxpayers, or to postpone receipt of income to years when the taxpayer is in an unusually low tax bracket. Bracket creep could be eliminated—if the zero-rate bracket were indexed—and the marriage penalty could be reduced. Of course, simply lowering the graduated rates would at least reduce all of these problems.

But the most important effect of the flat-rate tax would be a significant shift of the tax burden from upper- to middle-income taxpayers, and possibly even lower-income taxpayers, if larger personal exemptions and zero bracket amounts were not provided. The attached table demonstrates this redistribution for four alternative flat-rate tax systems. The largest group of losers would be the same middle income families who might lose their homeowner deductions under a comprehensive broadening of the tax base. (For table, see p. 211.)

Conclusions: To sum up, the broad-base, low-rate income tax has the potential to provide badly needed tax revenue with a minimum loss or, perhaps, even a gain of economic efficiency. It therefore clearly deserves a very serious examination. Equally clear is the fact that a blanket broadening of the tax base or a complete flattening of the tax rates would involve significant transition costs and a shift of the tax burden from upper- to middle-income taxpayers.

Tax incentives such as the mortgage interest and charitable contributions are widely used and deeply imbedded in our economy, and they could be eliminated only at substantial costs in dislocation. Selectively maintaining all or some portion of such tax incentives could make the transition easier. Similarly, a flat tax would impose a larger tax burden on middle-income groups. Low but graduated tax rates could prevent such a redistribution.

The statement continues, Mr. Chairman, to discuss the problem of indexing the tax base, which we regard as a very complicated one, and moves on to discuss the corporate tax and, more briefly, a more major move from the income tax to an expenditure tax. But we will leave those for later discussion or the record.

[The prepared statement of Alice M. Rivlin follows:]

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PREPARED STATEMENT OF ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Federal budget projections indicate that large deficits are in store for at least the next several years. To reduce these deficits, tax increases as well as spending cuts must be considered. Raising income or payroll tax rates would narrow the deficit, but at the same time would slow the economy and decrease economic incentives. What is needed, therefore, is a tax alternative that would encourage -- or at least not inhibit -- work, saving, and investment; that would increase capital formation, economic growth, and productivity; and that would reduce tax-induced misallocations of resources.

Two alternatives courses to explore are:

- o Broadening the base of the income tax to allow lower rates (or perhaps only a single low rate); and
- o Replacing the income tax with a broad-based expenditure tax.

A BROAD-BASED LOW-RATE INCOME TAX

The individual income tax is widely believed to be unfair, a drag on efficiency, and overly complex. Many Americans perceive that the wealthy have access to hidden and arcane legal provisions that permit them to pay little tax or none at all. Economists argue that this same tangle of legal provisions hinders economic efficiency by diverting resources from the activities with the greatest pre-tax yields into less profitable but tax-favored enterprises. And almost every taxpayer feels overwhelmed by the mass of forms and instructions he confronts every April.

Broadening the tax base is a widely discussed policy option because it would not only raise badly needed revenue, but also make the tax system simpler, fairer, and more efficient. Many of the preferential provisions in the tax law require more and longer tax forms, and add pages to the instructions that every taxpayer must wade through, whether he uses the preferences or not. Most taxpayers are left with a sense of favoritism and unfairness. And with so many preferences in the law, it is not surprising that some taxpayers use them, either individually or in combination, to reduce their tax liability. Repealing some or all of these preferences would cut back on this complexity and perceived unfairness.

Perhaps the greatest advantage of broadening the tax base, though, is that it would make it possible to raise additional tax revenue with less cost in inefficiently allocated resources. Many tax preferences in the law today induce taxpayers to invest differently from how they would in an entirely free market. For example, the tax system favors mineral extraction through depletion allowances, selective capital gains preferences, and expensing of intangible costs of even successful long-term development operations. It favors foreign operations and export activities through deferral of tax, and it exempts part of foreign salaries. It allows deductions to be accelerated and income to be postponed for certain projects. These examples are indicative of the efficiency price the economy pays for such tax subsidies, and the $273 billion total of tax expenditures in fiscal 1983 suggests that the influence of the tax system on resource allocation is by no means small.

Scaling back some tax expenditures, as this committee did in the Tax Equity and Fiscal Responsibility Act of 1982, pushes the tax system toward greater neutrality and a more market-responsive allocation of resources. Further base broadening could allow general tax rate reductions without loss of revenue. These general rate reductions can partly compensate those taxpayers whose preferences have been repealed, whereas a more limited base broadening would not provide the revenue for any compensating rate cuts. Further, lower tax rates yield their own efficiency benefits.

Lower tax rates increase the incentive to work, save, and invest, and they decrease the incentive to borrow. They therefore push in the right direction relative to the economy's need for greater productivity and capital formation, though the improvement that can be attained in these areas through the tax system alone should not be overestimated. At the same time, lower tax rates have numerous technical benefits. Distortions caused by the tax treatment of interest and debt during inflation, the double taxation of corporate-source income, the incentive to make use of tax shelter schemes, the marriage penalty, and the incentive to conceal income in the so-called "underground economy" would all be at least partly corrected if tax rates were lower and the rate schedule correspondingly flatter. The misallocation and waste of resources from attempts to profit from the tax code would likewise be cut back. Thus, the payoff from reduced tax rates can be far reaching.

<u>How Much Broader Should the Tax Base Be</u>? The theoretical efficiency benefits of having the broadest possible tax base must be weighed against some practical difficulties. First and foremost is that taxpayers have been making tax-preferred investments for years in anticipation of the continuation of those preferences. Millions of middle-income families have contractual mortgage obligations built into their household budgets; repeal of their mortgage interest and property tax deductions might squeeze many of those budgets to the breaking point. Homeowners' long-term contracts greatly reduce their flexibility to respond to a sudden and comprehensive broadening of the tax base. Further, repeal of the tax preferences

might shrink the market values of homes so far as to eliminate the sales of homes as a potential solution to the family budget squeeze.

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But the most important effect of the flat rate tax would be a significant shift of the tax burden from upper- to middle-income taxpayers (and possibly even lower-income taxpayers, if larger personal exemptions and zero-bracket amounts were not provided). The attached table demonstrates this redistribution for four alternative flat rate tax systems. The largest group of losers would be the same middle-income families who might lose their homeowner deductions under a comprehensive broadening of the tax base.

To sum up, the broad-base, low-rate income tax has the potential to provide badly needed tax revenue with a minimum loss -- or perhaps even a gain -- of economic efficiency. It therefore clearly deserves a very serious examination. Equally clear is the fact that a blanket broadening of the tax base or a complete flattening of the tax rates would involve significant transition costs and a shift of the tax burden from upper- to middle-income taxpayers. Tax incentives such as the mortgage interest and charitable contributions deductions are widely used and deeply embedded in our economy, and they could be eliminated only at substantial costs in dislocation. Selectively maintaining all or some portion of such tax incentives could make the transition easier. Similarly, a flat tax rate would impose a larger tax burden on middle-income groups. Low but graduated tax rates could prevent such a redistribution.

Indexing the Tax Base. Some provisions now in the tax law, such as the exclusions of certain forms of retirement savings and part of long-term capital gains, are justified in part as compensation for inflation. If such provisions were repealed

TABLE 1. DISTRIBUTION OF TAX LIABILITIES UNDER ALTERNATIVE FLAT RATE TAX SYSTEMS COMPARED TO 1984 TAX LAW[a] AT 1981 INCOME LEVELS

Expanded Income (thousands)	Number of Taxable Returns (thousands)	Tax Liability 1984 Law (millions)	System 1 (11.8 percent tax on adjusted gross income with long-term capital gains included in full): Tax Liability (millions)	System 1: Change (Percent)	System 1: Change (Dollars Per Return)	System 2 (19.5 percent tax on 1984 law taxable income less zero bracket amount): Liability (millions)	System 2: Change (Percent)	System 2: Per Return)	System 3 (15.7 percent tax on 1984 law taxable income less zero bracket amount, with long-term capital gains included in full, and no itemized deductions): Tax Liability (millions)	System 3: Change (Percent)	System 3: Change (Dollars Per Return)	System 4 (18.7 percent tax on taxable income as in System 3 with $1,500 personal exemption and $3,000 ($6,000) zero bracket amount for single (joint) returns): Tax Liability (millions)	System 4: Change (Percent)	System 4: Change (Dollars Per Return)
< 5	6,482	403	5,479	1,259.5	783.07	1,574	290.7	180.71	2,232	453.7	282.10	1,996	395.2	245.71
5- 10	15,057	5,772	14,280	147.4	565.04	8,752	51.6	197.91	7,854	36.1	138.26	5,345	-7.4	-28.33
10- 15	13,092	12,526	19,700	57.3	547.99	17,610	40.6	388.31	15,720	25.5	243.97	12,698	1.4	13.11
15- 20	10,737	17,462	22,496	28.8	468.88	22,665	30.0	484.54	20,778	19.0	308.88	18,802	7.7	124.76
20- 30	16,800	44,080	49,701	12.8	334.58	52,871	19.9	523.28	49,978	13.4	351.06	48,170	9.3	243.45
30- 50	13,568	63,833	60,579	-5.1	-239.82	66,419	4.1	190.61	66,466	4.1	194.08	68,804	7.8	366.41
50-100	3,580	38,687	27,389	-29.2	-3,155.74	30,486	-21.2	-2,290.90	32,658	-15.6	-1,684.20	36,104	-6.7	-721.60
100-200	631	18,656	9,872	-47.1	-13,920.58	10,743	-42.4	-12,540.20	12,459	-33.2	-9,821.59	14,344	-23.1	-6,833.56
200 <	164	16,385	7,675	-53.2	-53,107.15	7,129	-56.5	-56,438.05	10,050	-38.7	-38,630.67	11,843	-27.7	-27,692.33
Total	80,110	217,803	217,172	-0.3	-7.87	218,249	0.2	5.57	218,194	0.2	4.88	218,106	0.1	3.78

SOURCE: Joint Committee on Taxation.

a. To facilitate comparison, 1984 law does not include the earned income credit, the two-earner couple deduction, or the IRA or Keogh provisions. The flat rate tax systems similarly do not include those provisions.

b. Outcomes under the flat-rate tax for tax returns of under $5,000 of income would be highly uncertain. Some taxpayers at that income level currently make use of tax preferences that would be terminated under the flat-rate tax, and those taxpayers would thus face substantial tax increases. A particular problem would arise under System 1, in which all income would be subject to tax without exemption or deduction; many households with very low incomes who are excused from filing tax returns under the 1984 law are therefore not represented in the table, but would have to file returns and pay taxes under System 1. The impact of this factor on the table would likely be small, though it would significantly change administrative burdens under the tax system.

as a part of broadening the tax base, greater interest in explicit inflation indexing might follow. An example of recent interest is the number of proposals for indexing capital gains to reflect the inflation that occurred since assets were purchased. But tax experts have long argued against indexing only part of the tax code. (Taxpayers could easily profit from a partly indexed tax code. For example, if interest income were indexed but interest receipts were not, a taxpayer who borrowed and lent identical amounts at the same interest rate would have his interest income reduced for tax purposes because of the inflation indexing, but could take his interest expense deduction in full.) Therefore, indexing would be necessary for all assets and debts. This would mean, for example, that the extra income debtors implicitly receive when inflation erodes the real value of their debt would be subject to tax.

Such indexing of the tax base would require some extraordinarily complex changes in the tax code and in taxpayer and business planning. (For example: What would be the correct inflation adjustment on the sale of a home that had been financed with a mortgage loan? Only the seller's equity in the home should be indexed, but that equity changed continuously as the mortgage loan was amortized.) Until the inflation statistics were compiled, taxpayers would be uncertain of the tax liabilities on the income from their investments. Debtors would have to pay tax on the depreciation of their liabilities without a corresponding cash receipt from which to pay the tax. Indexing the tax code might lead to further indexation of a broad range of financial transactions, causing a rapid transmission of inflationary shocks throughout the economy and making inflation even harder to stop than it already is. The government's finances would be less predictable, because they would be more dependent on inflation than they are now.

Indexing the tax base would greatly complicate the tax code, and it would mark a significant step away from the use of the dollar as our unit of account. It is thus not a step to be taken lightly.

The Corporate Income Tax. Just as broadening the individual income tax base would be an efficient way to raise needed revenue, so would broadening the corporate tax base. The efficiency and simplicity benefits would be analogous. For example, corporate tax preferences such as the Domestic International Sales Corporation (DISC) or subsidies for mineral exploration and development could be repealed or reduced, and the general corporate tax rates could be cut as partial compensation. The result would be a greater incentive to corporate enterprise generally in addition to a pickup of additional revenue.

One additional option is the elimination of the double taxation of corporate source income. Separate taxation of corporate enterprise places an extra burden on business activities that cannot be undertaken in non-corporate ways. (The existence of a corporate tax, however, discourages manipulation of the corporate form to avoid individual income taxes.) One approach to the elimination of double taxation is "integration," whereby all income of corporations would be attributed to shareholders, to be taxed only to them. The corporation would pay a withholding tax at the highest individual income tax rate; individual shareholders who pay less than the maximum tax rate would receive a refund of the excess corporate withholding.

While integration may be desirable to improve economic efficiency, it would hardly be a move toward simplification. The meshing of millions of corporate and individual tax returns on different tax years would be an enormous task, especially considering that corporate returns are typically not closed for years after the tax year ends. Shareholders would have to adjust the basis of their shares for retained corporate earnings, which would involve a great deal of paperwork. The handling of foreign taxes and the pass-through of foreign tax credits to individuals would be exceedingly complex. The treatment of shares held by tax-exempt organizations would be complex and could result in a large revenue drain. Finally, there would be a tremendous incentive just before the date of record for temporary trades of shares of corporations with tax losses from low- to high-bracket taxpayers.

In sum, the tax-writing committees would have their hands full with corporate tax integration if it were considered in isolation. Combining it with a comprehensive revision of the individual income tax might prove an impossible task.

AN EXPENDITURE TAX

A totally different approach would be an expenditure, or consumption, tax. Many recent income tax initiatives that have exempted various forms of saving from tax have moved in the direction of an expenditure tax; such piecemeal approaches, however, have left the tax code much more complicated and ripe for abuse than would a true expenditure tax.

An expenditure tax is essentially an income tax with a deduction for saving. Taxpayers would compute their liabilities by adding up all their income, and then deducting from that all saving. Exemptions would include purchases of stocks and bonds, deposits in bank accounts, business investments, and so on. Their tax would be computed on the income that they did not save, that is, their expenditure. (For corporations, the equivalent of the deduction of saving would be immediate expensing rather than depreciation of investment.)

The major argument for the expenditure tax is that it would increase the incentive to save through its deduction for saving. The deduction would also eliminate the income tax's "double tax" on saving--that is, taxing the money saved when it is earned, and then also taxing the interest that the savings earn. Economists differ on just how much additional saving would be forthcoming under an expenditure tax, but the amount is likely to be small. Also, the expenditure tax base would be smaller by the amount of saving than that of an equivalent income tax. That means that the expenditure tax would need higher tax rates than the income tax, and those higher tax rates would discourage work by a small amount.

An expenditure tax would in some respects be considerably simpler than an income tax. Because saving would be immediately tax deductible, there would be no need for depreciation accounting or tax base indexing. On the other hand, the expenditure tax would require a complicated transition to treat appropriately any previously accumulated wealth that may or may not have borne income tax (for example, money in savings accounts, as opposed to accrued but unrealized capital gains). Taxpayers would have to report their saving, as well as their income as they do now. Further, borrowed money, like income, would have to be taxed as consumption. Many problems of taxpayer compliance and administration could arise, but there is little experience to help solve them, inasmuch as the expenditure tax has been tried only very briefly in India and Sri Lanka, and is not now in use anywhere in the world.

An expenditure tax is sometimes envisioned as simpler than the income tax because it has no need for the many tax preferences now part of the U.S. income tax. But there is no guarantee that an expenditure tax would pass through the legislative process without alteration of the tax base. Many socially desi able forms of expenditure--housing, education, medical care, charitable giving, even domestically produced fuel-efficient automobiles--are likely candidates for preferential treatment under an expenditure tax. We could easily exchange a leaky and inefficiency-inducing income tax base for a leaky and inefficiency-inducing expenditure tax base.

People differ on the inevitably subjective value judgments regarding the fairness of the expenditure tax versus the income tax. While some argue that the expenditure tax would be fair because savings should not be taxed twice, others counter that the expenditure tax would be unfair because savings should not be exempt from tax when made. From this latter point of view, income is the appropriate tax base, because it measures the power to consume; people who already have considerable wealth have the greatest ability to save, and therefore can take the greatest advantage of the savings deduction. Finally, because the expenditure tax would allow saving without tax, some would argue for additional taxation of wealth to prevent almost unlimited tax-free accumulation, and might fear that such wealth taxation would not be forthcoming.

To sum up, the expenditure tax has a distinct advantage in its greater incentive to save, but the income tax provides a greater incentive to work. The expenditure tax is seen by some as more fair, because it taxes what people consume, while others call the income tax more fair because it taxes the power to consume. With no real practical experience in the administration of an expenditure tax anywhere in the world, and with the many imponderable factors regarding such a fundamental and complex transition, the expenditure tax is probably not a realistic option for dealing with our budgetary problems in the short term.

CONCLUSION

Unless major additional steps are taken to reduce spending and increase revenues, large budget deficits are likely to persist. In light of the importance of restoring economic growth, any sources for increased revenues must be carefully chosen to maximize incentives for work and capital formation.

Moving toward a broader based lower rate income tax appears to be a promising approach. Additional revenues could be gained by cutting back on individual and corporate tax preferences that distort the allocation of resources, while partly compensating general rate cuts would increase overall incentives for work, saving, and investment. Variations could be considered to minimize the impact on vulnerable sectors of the economy, such as homeowners and not-for-profit institutions, and to prevent any substantial redistribution of the tax burden to middle-income taxpayers.

Other revisions to the tax system, such as tax base indexing and corporate tax integration, offer some potential benefits but also considerable complexity. They would probably take some time to be developed fully. Similarly, an expenditure tax could replace the current income tax and increase the incentive for saving, though the debate on its fairness continues. Further, with no practical experience in its implementation and many complexities in store, it should probably be considered an option for the longer term.

The CHAIRMAN. Well, thank you very much, Dr. Rivlin. This may be your last official visit before this committee, and I wanted to thank you for all your fine cooperation over the years. It has been a pleasure working with you, and we wish you well in your new responsibilities.

Dr. RIVLIN. Thank you, Mr. Chairman.

Senator BRADLEY. Thank you, Mr. Chairman.

I would like to echo the chairman's words. Your advice has always been extremely valuable, and I guess from my perspective, your testimony today has never been more valuable, because, as I understand it, you have basically said that indeed, lowering the tax rates would be a very important stimulus to work, savings, and investments. At the same time, you agree that there are certain deductions that are critical for middle-income people and I think you mentioned interest on home mortgages and charitable contributions.

You also, I think, took a little different viewpoint than the Treasury did on the indexing of the capital basis of assets. While they said that this was an important thing, you point out that it is also extremely complex. I think if you have backup material that will be in the record, and we probably won't have to go over it today.

But generally you think that this is a proper direction for us to head in, and that there is a very real trade-off in that the amount of rate reduction is directly related to what you give up in the way of loopholes. Is that not correct?

Dr. RIVLIN. Oh, that's clearly right. And you are, unfortunately, in a very difficult situation for the future. It would be nice to cut rates and not worry about broadening the base, perhaps, as Senator Grassley suggested earlier. But, as we look down the road, it is not going to be possible to reduce revenue without making the deficit larger. So I think you are faced with the trade-off: if you want to lower rates, you do have to broaden the base, which does have the advantage of making the tax seem fairer, as well.

Senator BRADLEY. As I have said earlier, it seems to me that is an important recognition; because we have always tried to close loopholes before from a kind of position of self-righteousness or moral superiority, when what we are really doing here is closing loopholes with a carrot, and that carrot is "lower tax rates."

As you point out, it will not be easy given the present budgetary circumstance over the next couple of years.

Thank you very much, Dr. Rivlin, for your testimony and for your advice, since I have been here, at least.

Dr. RIVLIN. Thank you, Senator.

The CHAIRMAN. Dr. Rivlin, I confess I haven't studied your testimony, and I intend to do that, but I think you have highlighted some of the potential problems we will have in trying to define some of the options. I listed some of the preferences that would have to go by the wayside, and they become very, very sensitive—whether or not you include social security payments and railroad retirement, and different payments as income for income tax purposes.

You don't touch any of those in your bill, do you, Senator?

Senator BRADLEY. No, we don't touch social security benefits or veterans' benefits.

The CHAIRMAN. Again that points up that we need a lot of very careful study before we try to put together any final package. I would assume the CBO has a lot of material available that we might be able to use in the coming months, certainly in preparation of your testimony plus just the store of knowledge and resources they have that we might be able to call upon.

Dr. RIVLIN. We do, Mr. Chairman, and we would be eager to help.

The CHAIRMAN. Is CBO looking ahead in 1983, 1984, and 1985 on the revenue side? Has CBO looked at any revenue possibilities in the next 3 years? I don't suggest you are advocating any, but have you looked at any?

Dr. RIVLIN. In terms of other than tax alternatives?

The CHAIRMAN. What we might do in the base-broadening area or the loophole-closing area, if in fact we were directed by the Budget Committee to raise revenues.

Dr. RIVLIN. Well, for the last budget round, we offered a menu of possibilities, and we expect to do that again for the fiscal year 1984 budget rounds. For the Congress use, we have put together a whole list of possible ways of raising additional revenue, which would certainly include base-broadening alternatives.

The CHAIRMAN. That list is not yet available or it is in the process?

Dr. RIVLIN. It is in process. Of course, the number of possibilities is limited. I don't want to suggest that this coming list will differ very much from the last version; but the analytical numbers will be updated. The basic large items will of course be the same.

The CHAIRMAN. And I understand you are not making any recommendations?

Dr. RIVLIN. No.

The CHAIRMAN. You merely list those possibilities and leave that judgment up to the House, Senate, Congress, whatever?

Dr. RIVLIN. That's right.

The CHAIRMAN. Again, I thank you very much.

Senator Bradley, any other questions?

Senator BRADLEY. Mr. Chairman, I don't have anything else to say.

I think, Dr. Rivlin, what this exchange highlights is whether we approach this problem in a kind of comprehensive way with a bold move, or whether we do it gradually with loophole closings and some rate reductions, my position is clear: I would support the bold movement. At the same time, I think that there is a real validity if you can't go the bold, at least getting something.

The CHAIRMAN. I don't quarrel with that observation, but I do believe we are probably some time away from that particular move. But we certainly intend to pursue it.

Again, Dr. Rivlin, we thank you for your cooperation over the years and appreciate your appearance here today.

We will stand in recess until 10 tomorrow morning.

[Whereupon, at 12:10 p.m., the hearing was recessed.]

FLAT-RATE TAX

WEDNESDAY, SEPTEMBER 29, 1982

U.S. SENATE,
SENATE COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:12 a.m., in room 2221, Dirksen Senate Office Building, the Honorable Robert J. Dole (chairman) presiding.

Present: Senators Dole, Heinz, Grassley, Long, Bradley, and Mitchell.

Also present: Senator Domenici.

[The prepared statement of Senator Grassley follows:]

STATEMENT BY SENATOR CHARLES GRASSLEY

Mr. Chairman, I think we have heard some rather interesting and enlightening testimony thus far in these hearings. But I am somewhat concerned that we haven't heard many specifics yet about the serious transitional problems that are likely to result when reforming the tax code. Also not talked about is how we might expect asset values to change as tax preferences are eliminated. I hope that these questions can be addressed in more depth.

I also hope, Mr. Chairman, that we will hear some discussion about what we consider to be the primary economic goals of our tax reform efforts. We must ask ourselves what kind of economy we want to create through tax reform. As yet, we still don't have a clear sense of where we are right now, let alone where we are going, in terms of the type of economy we want to build. On Tuesday, Buck Chapoton of the Treasury Department told us that our tax code is somewhat of a hybrid of both an income tax and a consumption tax. Well, if we want to make fundamental changes in the tax code, Mr. Chairman, it seems to me we must first determine which is the better way to go, and why. Otherwise, proceeding with tax reform becomes pointless. So I hope there can be a meaningful discussion, here, on economic goals.

Earlier in these hearings I stated what I consider to be the chief economic goals of tax reform. I outlined them as: efficiency of production, the creation of capital, and a steady increase in real per capita income for everyone. These goals cannot be achieved under the present tax system because the code is weighted toward the exact opposite sort of economic activity—namely, debt, consumption, and nonproduction.

The question becomes how to best attain these economic goals. I believe we can attain them through erasing the bias in the code toward debt and consumption. I hope we can get further input on this from our experts who are testifying. After all, that is why we're here—to draw upon the expertise of these witnesses, and to synthesize their wisdom and implement it into policy.

In particular, Mr. Chairman, I would hope to get an idea from each witness as to how, specifically, we on the Finance Committee can take the first steps toward tax reform, as early as next year. Now I know there are some who feel that we need a break from tax revision after 2 consecutive years of major reform. Let me just say, Mr. Chairman, that this is one Senator who feels we cannot waste any time in eliminating the debt-and-consumption bias in the tax code.

We need to create capital right now. We need to maximize efficiency of production right now. And we need to increase real per capita income right now.

If we continue to delay tax reform, our competitive edge in world markets will further be eroded. We are also in danger of losing our edge in the high-technology

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field, which is the key to the future of this economy. All this might happen because we will not have acted swiftly to repair or replace an inefficient tax code.

I would like to address a point pertaining to the goal of economic efficiency that was brought up in yesterday's session, in an exchange between Senators Long and Domenici. And that is the relative efficiency of the tax code in allocating resources.

I agree with Senator Long that the tax code is a more efficient allocator of resources than the appropriations process. But even our attempts to allocate resources through the tax code have led to biases and distortions—the very distortions that have led us to consider an alternative code in the first place.

What we need, as Jim Jones told us yesterday, is a "tax code for the space age"—a slim, trim tax code that adheres to the principles of neutrality and allows the free market to do its will.

Finally, Mr. Chairman, I would hope that we could put together a tax force to continue these studies on tax reform, with a report to be issued sometime early next year, prior to congressional consideration of tax legislation. I would be pleased to participate in such a task force, and it would be encouraging if we could get some bipartisan support.

Thank you, Mr. Chairman.

The CHAIRMAN. We have a number of distinguished witnesses today, and we are very pleased to start the second day of the hearings on these flat-rate, or low-rate or proportional tax discussions. I wouldn't suggest we are even yet maybe in the hearing stage; we are attempting to obtain information.

We do have a number of matters on the Senate floor, so I am not going to cut any witness off but we will probably try to move quickly, because a number of those amendments on the floor involve this committee and at least I will have to be gone part of that time.

We are very pleased to have our leader and chairman of the Senate Budget Committee, Senator Domenici from New Mexico, as our leadoff witness this morning.

Senator DOMENICI. Thank you very much, Mr. Chairman.

The CHAIRMAN. Can you put one of those mikes in front of you there, so we can record this for posterity?

Senator DOMENICI. I am not used to the Finance Committee with its fancy equipment.

The CHAIRMAN. We are well organized.

STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. First, Mr. Chairman, I want to say on behalf of myself and the Budget Committee that it really is a pleasure to work with your committee.

The CHAIRMAN. Well, we enjoy being a subcommittee of the Budget Committee.

Senator DOMENICI. And I gather that you enjoy being instructed to get your work done on time and on the money.

The CHAIRMAN. Right.

Senator DOMENICI. Leaving all that aside, I do commend you for the discussions and hearings you are having. It is obvious that the people of this country, by very, very large proportions, are interested in simplifying the existing Tax Code. I don't think there is any doubt about that; all recent surveys and poll data clearly reflect the perception that the present tax system is too complex and that these complexities work to the advantage of those with the highest incomes.

Now, I am not an expert, but I stress that that is the perception. I assume it is real, but at least that is the firm perception of the American people.

This frustration has a devastating impact on voluntary compliance, as recent IRS studies show. Voluntary compliance with the tax laws is the bedrock for funding our national Government. If we allow an unfair and complicated Federal income tax system to undermine voluntary compliance, an important foundation of our democratic way of life will have been eroded.

However, Mr. Chairman, the frustration of the average taxpayer should not, in my view, be construed as absolute support for a specific tax proposal such as the flat-rate tax system. A flat-rate system, in and of itself, raises serious equity problems not only between high- and low-income taxpayers but also between those with significant medical expenses and those without, between those with homes and other long-lived assets which would decline in value under a flat tax rate and those without, and between those who can defer income until the adoption of the flat-rate tax and those who cannot.

An abrupt move to the flat rate would fundamentally change long-standing institutional understandings about tax policy, some of which have evolved over a half century and are now embodied in our economic structure. Some asset values would decline; reducing the capital gain in homes, for example, would be one rather natural effect. Charitable giving would probably decline with adverse effects on churches, hospitals, and universities—I am not sure of that, but everyone I talk to that knows says it would. State and local governments would likely find their interest expense on bond issues rising. This would have the consequence, I think, of slowing construction of roads and other public works. While we can't burden this committee with all of these things, it is obvious that the infrastructure of the country, in terms of its physical assets, is on the wane, and we certainly would not want to add to that national problem.

I cite these examples not to defer consideration of the flat rate, or even deter it, but to caution against being too exuberant in approaching a solution to the problems of our tax system. We need some sure, steady, and permanent progress toward a simpler and fairer tax system, not a sudden wild lunge which ultimately proves destabilizing and unsuccessful. It is my opinion that a discussion of possible reform of the individual tax system should begin with the principles and the purposes to which we believe that system should be put.

It has long been a key principle of the Federal tax system in the United States that those with high incomes should pay a larger share of their income to taxes than those with lower incomes. A flat rate would apply the same rate to all taxpayers. Moreover, the present tax system is increasingly used to achieve desirable economic and social objectives—in part, because it appears to be a more efficient vehicle than direct Federal spending programs. The pure flat rate would eliminate all the deductions and special preferences that now attempt to achieve such objectives.

If a flat tax rate can be developed which preserves the principle that the tax burden is distributed according to the ability to pay, then I'm sure I can support it. If a flat tax system can be developed that provides genuine simplification and not just a cosmetic realinement of deductions, then I think we will have made real progress. However, I think we have to answer some fundamental questions before we plunge into some dramatic change, especially something as deeply rooted in the economy of our country as this code.

For example, do we want to abrogate the principle of the progressive tax system, that those with higher incomes should pay relatively more to support the goals and objectives and activities of Government than those with lower incomes? Do we believe that the Federal tax system should be used as an instrument of social and economic change? Do we want to eliminate all incentives for special purchases, like housing, or for personal needs like medical expenses? Do we believe that income maintenance in the society can be better accomplished through the active Federal spending programs or through the tax system? What is the effect of a flat tax rate on the revenue base of this country today and in the future years? Obviously that is important to all of us.

These are the questions that I would urge the committee to consider as it undertakes serious consideration of these proposals.

I will talk about budget implications of a flat tax rate, and then I will ask that my statement be made a part of the record.

A flat tax rate would significantly change the relationship between growth in revenues and growth in the economy. Under the current progressive system, Federal revenues increase about 1.6 times the growth in personal income—about 1.6 times the growth in personal income. This means that when personal income grows by 10 percent, in nominal terms, personal income taxes grow by 16 percent. Under indexing, which is scheduled to begin in 1985, Federal revenues will grow more slowly. They will grow at 12 percent, assuming 3 percent real income growth.

Under a pure flat tax rate, personal tax revenues would grow only as rapidly as personal income. That extra bonus of either six-tenths, or once indexing begins the two-tenths, would be gone from the budget process in terms of revenue expectations. So to the extent that certain elements of the progressive tax system are built into the flat tax rate, revenue growth would be somewhat higher.

As you can see, the effect of a move from the progressive tax system toward a flat one could have the effect of reducing revenue growth in future years. This is also true to a lesser extent under indexing, as I indicated. The budgetary impact of the change to a flat tax rate may not be large in the first year, but after several years it would substantially reduce Federal revenues if compared to projected revenue under our present tax system.

Certainly lower revenue growth than under current law would put even greater pressure on Federal spending. Given our past experiences with Federal spending and Federal revenues, the unavoidable conclusion is that we are substantially overcommitted on the budget's spending side relative to the revenues we can hope to collect. I merely ask the question: Would a flat tax rate on personal taxes exacerbate that imbalance? Looking at it purely objectively, it seems that it would.

I have some additional concerns: What is going to happen to low-income taxpayers? Is it sufficient or desirable to just eliminate taxes for them? I have a concern about shifting the significant burden to the middle-income taxpayers. Under most flat tax rates that is the inevitable conclusion. If you eliminate taxes on the low side and if the flat rate on the very high income group is reduced there is only one group left to make up the difference. It means higher taxes for middle-income America.

Mr. Chairman and members of the committee, I would like to make the remainder of this statement and a detailed analysis a part of the record, with your permission.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Domenici and the analysis follow:]

TESTIMONY OF SENATOR PETE V. DOMENICI
ON THE FLAT RATE INCOME TAX
BEFORE THE
SENATE FINANCE COMMITTEE
SEPTEMBER 29, 1982

Mr. Chairman, thank you for the opportunity to testify before your Committee on the issue of the Flat Rate Tax. As you are well aware, there is substantial support among the people of this country for simplifying the tax code. To be more blunt, Mr. Chairman, the American people have developed a serious dislike of the federal individual income tax system, not just because they dislike taxes, but also because of the increasing complexity of the tax law.

THE BURDEN OF COMPLIANCE

Each year the IRS publishes hundreds of forms. The long form has 66 lines, and if that taxpayer itemizes as most long form taxpayers do, another 41 lines are required. The amount of record keeping and time spent filling out returns is enormous. No one knows exactly how much time and effort that is, but some indication can be gleaned from the fact that 61 percent of all long form taxpayers resort to professional tax return preparers. Obviously, most Americans feel that special expertise is required to avail themselves of all the deductions and credits to which they are legally entitled. This is a shocking indictment for a system which purports to be fair.

Another indication of the burden of complying with our complicated tax laws is the error rate. Eight percent of all the tax returns filed last spring for the 1981 tax year had an error. Tax return preparers had a 5.1 percent error rate and those who prepared their own returns erred 10.6 percent of the time. Even though there is no data to prove it, I suspect that low income taxpayers suffer a higher error rate than high income taxpayers. These rates have been growing steadily over the past decade as major tax law changes have been made nearly every year. The public, including tax lawyers and accountants, have been unable to keep up with the torrent of tax legislation. Many taxpayers plead not for wide-ranging reform, but merely for Congress to stop changing the law so often.

A final measure of public dissatisfaction and confusion with the tax system is the degree of non-compliance. Preliminary data from the IRS estimates show that noncompliance will cost the Treasury $77 billion in lost individual income tax revenue this year. Even after the much needed reforms of the Tax Equity and Fiscal Responsibility Act of 1982, individuals are expected to underpay their federal income taxes by $93 billion in FY 1985. Only 80 percent of nonwage income is reported, and in some cases, such as capital gains and tips, those percentages are much lower.

Voluntary compliance with the tax laws is the bedrock of the federal income tax system. If we allow the unfairness and complexity of the system to undermine voluntary compliance, an important foundation of our democratic way of life will have been eroded.

THE FLAT RATE

Our system is complicated beyond the comprehension of most taxpayers, and our high marginal tax rates on a narrow tax base has shifted capital investment away from productive uses into wasteful tax shelters. From this kind of frustration, naturally arises the public demand for a simpler system.

A poll by the Advisory Commission on Intergovernmental Relations shows that the income tax has just moved ahead of property taxes as our most "unfair tax" in the opinion of the taxpayers. This frustration on the part of the average taxpayer should not, in my view, be construed as absolute support for any specific tax proposal such as the flat tax rate system. The promise of increased simplicity and fairness is very enticing when the proposals lack detail, but as the details are added, I see great risk that the poor will be unnecessarily disadvantaged, that special exemptions will be retained for the strongest political constituencies, that simplification will occur in name only, and that instead of a better tax system, we would only end up with a different one.

There are very real problems which deserve the Committee's consideration. First, at every income level there is wide variation in effective tax rates. Second, inflation has pushed the average taxpayer into marginal rate brackets which were never contemplated when they were enacted. In 1961, 90 percent of all taxpayers fell into either the 20 or 22 percent brackets. Today, just over half of our taxpayers fall into higher brackets than that. Third, the regressivity of our tax system has grown because of the increasing fiscal pressures upon our state and local governments. They have recently adopted the largest tax increases in decades. The Tax

Foundation reports that last year, 31 states raised their taxes by $3.8 billion. This year, another 26 states have a whopping $6.8 billion of further tax increases under consideration. Most of these tax increases are quite regressive. Increases in employee payroll taxes, a major source of revenue growth in recent years, are also regressive -- which adds to the tax burden of low income wage earners.

These are the challenges that must be met if this undertaking to improve our tax system and to revive our economy is to be successful. In general, taxpayers with the same income should pay the same tax. The tax base should be broadened and marginal tax rates should be reduced. Special provisions should be made to offset the increasing regressivity of state and local taxes and payroll taxes. Our tax system should be much more neutral in its impact on investment decisions.

The frustration of the average taxpayer should not, in my view, be construed as absolute support for a specific tax proposal such as a flat rate tax system. A flat rate tax, in and of itself, raises serious equity problems not only between high and low income taxpayers, but also between those with significant medical expenses and those without, between those with homes and other long lived assets which would decline in value under a flat rate tax and those without, and between those who can defer income until adoption of the flat rate tax and those who cannot.

An abrupt move to a flat rate tax would fundamentally change long standing institutional understandings about tax policy, some of which have evolved over half a century and are now well embedded in our economic structure. Some asset values would decline, reducing the capital gain in homes, for example. Charitable giving would probably decline with adverse effects upon churches, hospitals, and universities. State and local governments would likely find their interest expense on bond issues rising. This would slow construction of roads and other public works.

I cite these examples not to deter consideration of the flat rate tax, but to caution against being too exuberant in approaching a solution to the problems of our tax system. We need sure, steady and permanent progress toward a simpler and fairer tax system, not a sudden wild lunge which ultimately proves destabilizing and unsuccessful.

If a flat rate tax can be developed which preserves the principle that the tax burden is distributed according to the ability to pay -- then I will support it. If a flat tax system can be developed that provides genuine simplification, and not just a cosmetic realignment of deductions, then, I think that we will have made real progress. It is the opinion of this Senator that reform of our individual tax must closely adhere to these principles.

For example, do we really want to eliminate progressive taxation? Should those with higher incomes pay a larger share of their income to support government activity than those with lower incomes? Do we believe that the federal tax system should never be used as an instrument of social and economic change? Do we want to eliminate incentives for housing, charitable contributions, and medical care? Do we believe that certain objectives, like basic income maintenance in the society, can be better accomplished through federal spending programs or through the tax system? Will reduced outyear revenues effectively constrain spending growth or will it just increase deficits?

These are the questions that I would urge this Committee to consider as it undertakes serious consideration of a specific flat rate tax proposal.

BUDGET IMPLICATIONS

Let's look for a moment at the effect of a flat rate tax on the budget. A flat rate tax would significantly change the relationship between the growth in revenues and the growth in the economy. Under the current progressive system, federal revenues increase about 1.6 times the growth in personal incomes. This means that when the personal income grows by 10 percent, in nominal terms, personal income taxes grow by 16 percent. Under indexing, which is scheduled to begin in 1985, federal revenues will grow more slowly, at 12 percent assuming 3 percent real income growth.

Under a pure flat rate tax, personal tax revenues would grow only as rapidly as personal income. So, if personal income grows by 10 percent, revenues will grow by 10 percent as well. To the extent that certain elements of a progressive system are built into the flat rate tax, revenue growth will be somewhat higher.

As you can see, the effect of a move away from a progressive tax system toward a flat rate tax will reduce revenue growth in future years. This is also true to a lesser extent under indexing which eliminates taxes on the portion of personal income growth associated with inflation. The budgetary impact of the change to a flat rate tax may not be large in the first year, but after several years, the effect would be substantial.

Clearly, lower growth in revenues than already in current law will put still greater pressure on federal spending. Given our past experiences with federal spending and federal revenues, it is hard to avoid the conclusion that we are substantially overcommitted on the spending side of the budget given the revenues we can expect to collect. A flat tax rate on personal taxes could worsen this imbalance.

This is particularly true when we look at the structure of federal spending compared to the revenues from a flat tax rate. Over a third of the federal budget is directly indexed to the rate of inflation, which means that, given the natural growth in case loads, these programs will likely grow more rapidly than the economy and far more rapidly than the real growth in the economy. Most of these costs are for federal pension programs. Other programs are indirectly indexed for inflation -- such as Medicare and Medicaid. In addition, the present Congressional budget implies a substantial increase in this nation's commitment to defense, which means that defense spending, too, is likely to grow faster than the growth in the economy. Finally, interest costs, too, may grow more rapidly than the economy.

You can easily see the problem. If upwards of 75 percent of Federal outlays are growing at 12 percent, while revenues grow at only say 9 percent, under a flat rate tax, the present structual imbalance between spending and revenues will get worse <u>not</u> better.

The federal government is already commandeering 54 percent of the nation's credit resources through direct borrowing and federal credit activities. We certainly want to reduce the government's intrusion into capital markets, not increase it.

Therefore, I say to the Committee, a decision to adopt a fairer, simpler tax, which I support, in the form of a flat rate system is also a decision to make sizeable outyear spending reductions beyond those already contemplated by the current budget, and, I emphasize, beyond additional reductions that will almost certainly be required to bring large federal deficits down further.

LOW INCOME TAXPAYERS

Mr. Chairman, let me turn to the effect of a flat rate tax on low income taxpayers. A flat rate tax will transfer disposable income from low income taxpayers to high income taxpayers unless the personal exemption and/or the zero bracket amount are increased. Table 1 shows this shift under a purely revenue neutral flat rate tax with the present law exemption and zero bracket amount. Those with incomes below $30,000 experience a $30 billion tax increase. This becomes a tax reduction for those with incomes in excess of $30,000.

Most current proposals for a flat tax rate would increase the personal exemption or the zero bracket amount or both to cope with this problem. The difficulty arises in that the closer one comes to eliminating any tax increase for those with low incomes, the higher the flat rate has to be in order to avoid revenue loss.

This increases the relative share of the tax burden for the middle and upper middle income taxpayer. You cannot reduce taxes for both upper and lower income taxpayers without increasing taxes for the majority of taxpayers with the middle incomes. Simply put, someone has to pay.

Clearly, a pure flat rate tax has to be adjusted both to modify the tax reduction for the upper income taxpayer and to make judicious use of the increased revenue from base broadening to offset tax increases for the lower and middle incomes. Part of this adjustment will probably have to take the form of a surcharge for the very highest income taxpayers. This would alleviate the potential burden upon the middle and lower income taxpayers. High income taxpayers would still receive the benefits of substantially lower marginal tax rates even though their average tax rate would be unchanged. This is the approach taken in the Bradley-Gephardt proposal. It is important to note that even with such a surcharge, three quarters of the taxpayers would still be taxed at one rate.

Then the question is: Is it enough to avoid a tax increase for the poor? I do not believe that it is. It seems to me that we should reemphasize the principle enunciated by President Nixon and implemented in the 1969 and 1971 revenue acts, that no citizen below the poverty level should pay federal income tax.

There are 6.9 million families in the United States below the poverty level. Just over half of them have at least one wage earner, and a substantial minority pay some federal income tax.

Back in 1979 when the tax thresholds were last changed they were closely aligned with the poverty levels as shown in Table 2. With inflation and no change in the zero bracket amount of the personal exemption, the gap between the poverty level and the tax threshold has widened. I believe there is an obligation on our part to reduce this gap especially during such difficult economic times.

Even if we succeed in removing the poor from the federal tax rolls they are still subject to considerable state and local taxation. Forty-six states have a sales tax, and all states have local property taxes. Four states have increased their sales taxes already and another 13 are considering doing so this year. State tax increases in 1981 amounted to $3.8 billion, and another $6.8 billion of tax increase proposals are before state legislatures this year. These increases will compound the impact on the poor of the stringent fiscal policies that all levels of government have been forced to adopt to reduce inflation.

Another feature of our tax system affecting the poor is the overlap with our welfare systems which contain potent work disincentives. These disincentives operate through a combination of rules regarding the effect of new wage income on benefit payments and program eligibility, much like a marginal tax rate. The Congressional Research Service has computed the combined effect of these programs and has found that a welfare mother with two children will only get a 15 percent increase in income if she takes a full time job at the minimum wage. That represents an 85 percent marginal tax on her earnings, not including the possible Medicaid cut-off or additional work related expenses such as transportation and clothing. Is it any wonder that this woman decides she is better off staying home with her children and living at public expense?

The Congress and my own state of New Mexico have already taken action to address these problems. In 1975, at the urging of Senator Long, this Committee adopted the earned income credit as an attempt to reduce the powerful disincentives which affect the working poor. This refundable tax credit, equal to 10 percent of the first $5,000 of earned income, helps over 6 million working low income taxpayers to be part of the workforce.

In 1972, my state of New Mexico confronted a similar question of how to insulate the poor from a broad-based state sales tax. Sales taxes are regressive and most states exempt food and medical care from sales tax as a way of reducing the regressivity. Unfortunately, exempting basic purchases like food and medical care does not actually reduce the regressivity of sales taxes because the tax rate on other types of purchases must be increased to offset the revenue loss from the exempted items. New Mexico's solution to this problem was to adopt a refundable tax credit in order to to insure that no low income New Mexican paid a greater portion of income to state taxes than the share paid by a taxpayer at the poverty level.

In 1972, the New Mexico State Legislature adopted a scaled down version of the original refundable credit proposal to stay within the state's revenue constraints. The initial experience under the program was hampered by the same income disregard questions you have faced with the federal earned income credit. There was also a period of hard work by the revenue department to publicize the availability of the credit.

But, these problems were solved and the program has proven quite successful. In 1981, 101,343 New Mexicans claimed the "low income comprehensive tax rebate" as we will call it. This represents over 80 percent of those eligible to receive it. The remainder do not bother to claim a small credit, because it phases out near the poverty level.

This high level of participation on the part of New Mexico taxpayers shows that a well conceived and faithfully administered tax credit can be quite successful in offsetting regressive taxation. Therefore, I urge the Committee, in its consideration of a flat rate tax, to follow through on the initiative it showed in 1975 by including in a flat rate tax system an expanded version of the present law earned income tax credit to insure fair treatment of our low income citizens.

CONCLUSION

In conclusion, Mr. Chairman, it is clear, given not only my testimony, but the statements of those who have preceded me, that reform of the existing personal income tax system is one of the most important issues facing the Congress today. Various attempts over the years at reforming the individual income tax with minimum taxes and limitations on deductions have nibbled at the edge of the real issues. The difficulty of defining the appropriate tax rate structure and the tax base have simply overwhelmed whatever consensus there was for change in the system as a whole. My sense is that the balance has now shifted strongly in favor of change.

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Your remarks to the Committee yesterday, described more clearly and more thoroughly than I can the real choices we face in effecting this change. These are: first, the extent of progressivity to include in the federal system, particularly after taking the effects of other types of taxation like state and local taxes and payroll taxes into account, and second, the definition and comprehensiveness of the tax base.

I agree with your view completely that we should move with caution, and, in all probability, in stages, to implement careful reform that will be enduring and which will not impose unfair hardships on those taxpayers who have made substantial long term economic decisions on the expectation that the tax laws would not change.

Table 1

REDISTRIBUTION OF TAX UNDER
A 12.3 PERCENT FLAT RATE TAX
UNDER 1984 LAW AT 1981 INCOME LEVELS

Expanded Income (thousands)	Expanded Income (billions)	1984 Tax Liability (billions)	Change In 1984 Liability With Flat Rate Tax (billions)
Below $5	$ 17.5	-$ .3	+$ 2.4
$5 - $10	98.7	4.7	+ 7.4
$10 - $15	162.8	12.5	+ 7.4
$15 - $20	188.2	17.5	+ 5.6
$20 - $30	416.7	44.3	+ 6.9
$30 - $50	509.7	64.3	- 1.8
$50 - $100	230.7	39.1	- 10.8
$100 - $200	83.9	18.9	- 8.6
$200 + Above	67.5	16.7	- 8.5
Total	1775.7	217.9	0.0

Table 2

POVERTY LEVELS COMPARED TO
TAX THRESHOLDS UNDER PRESENT LAW

	Single	Family of Four
1981 Poverty Level	$4,620	$9,287
Tax Threshold	3,300	7,400
1979 Proverty Level	$3,689	$7,412
Tax Threshold	3,300	7,400

The CHAIRMAN. Again, I want to express my appreciation because I know the Budget Committee and the staff have done a great deal of work in this area, and we will be working with the Budget Committee as we further develop if not what one might perceive to be a flat-rate tax maybe some variation thereof, or continue to broaden the base and to lower the rates, and to continue to scrutinize the Tax Code for provisions that should be modified. Let's face it, there are still a lot of provisions that have been asleep in the Tax Code for years and that may or may not serve a useful purpose today. I think that is a responsibility we have, and certainly the Budget Committee has been most helpful in working with this committee and other committees.

So I think you have fairly stated not only the problem but some of the limits on what we refer to as a flat-rate tax.

My own view is that we must be very careful. We must do our best to try to inform the American people of just what a flat-rate tax is, because the term "flat rate" doesn't really tell you much at all. We will find out maybe from the next witness, Mr. Harris, how little or how much it does tell. He will give us an insight into what the polls may reflect—what people may be thinking a flat-rate tax is, whether they want to give up deductions. The answer is generally no, but——

Senator DOMENICI. But they want a flat rate.

The CHAIRMAN [continuing]. But they want a flat rate. We have variations of flat rates: Senator Bradley has proposals, there are seven House bills, five Senate bills. Some are pure flat-rate proposals.

I think the value here is not only of airing the ideas—and I commend those who have bills introduced—but hopefully these hearings will continue to stress the need for fairness and simplicity, base broadening, equity, however you may want to describe it. We will be working with the Budget Committee, and we appreciate your being here this morning.

Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman. I appreciate the testimony of Chairman Domenici. I think that his opinion on matters that relate to the budget and economics generally has always been respected, but in the last year or two it has become an even more respected opinion.

I am particularly glad that he—and, frankly, Mr. Chairman, along with virtually every other witness who has testified before the committee to date—has raised serious questions about a pure flat-rate tax. I think if there is one service that these hearings will provide for the Congress and the public at large, it is to lay aside the notion that a flat-rate tax is as simple as it appears or as income-neutral as it appears. I hope that what will flow from these hearings—and I think the Senator's testimony is just another nail in the coffin of the flat flat-rate tax, the pure flat-rate tax—is that there is another alternative that keeps income distribution at its present levels as under current law, and that is the fair tax. I think that Senator Domenici's voice will be another voice along that road to the realization that we can have a fairer and simpler system without going to a pure flat rate and that there is a median course.

I was struck by one thing that he said, though, which was that we don't want to make an abrupt change in tax policy. Now, let's lay aside the flat rate as such, meaning a rate of x percent with no deductions. Could you talk a little bit about what you mean by abrupt? Some people think, for example, that what happened in the 1981 Tax Act was abrupt. People who look at the deficits say that the 1981 act is in part responsible for the size of the deficit that we are grappling with today and was one of the reasons why we had to come back with the Tax Act of 1982, to try to make up that deficit.

So I would like for you, if you could, to describe what you mean by abrupt.

Senator DOMENICI. Well, the abruptness that I was addressing did not have to do with raising or lowering, dramatically or otherwise, the revenue base. I had two distinct propositions. I cautioned against taking a path where we will get a lot less revenue as the economy grows. This is a hidden danger in eliminating the progressivity in our present system. I just wanted to make sure we understood the problem in terms of our budget commitments.

The abruptness I was speaking of has to do with the social and economic impact of the specific provisions within the tax law of the country. You have been faced with that when you wanted to eliminate the business deduction for business lunches, just for a small example. What does the restaurant industry say? "An abrupt change will break us."

Now if you have all of the deductions, credits, and exclusions in front of you and you are going to do away with all of them, do we really know enough to do something that abruptly? What businesses are going to be wiped out? What plans for growth are going to be disrupted or abandoned? What habits of the American people that then affect the business life and the commercial life are going to be dramatically changed? It is in that context that I say that we surely can't do something abrupt.

Senator BRADLEY. I think that is a valid point. The question is, if you think that there are little loopholes that dot the Tax Code that you want to look at, and you know that each group that has that loophole is going to come in and say, "To eliminate that loophole means we are in a depression," the question is: How are you going to go about it?

I have argued that the way you have to go about it is, you can close loopholes with a carrot or with a stick. With a stick you just close them because you get the deficit down, but with a carrot you close them because you have lower tax rates. I think we can do that in a systematic way and in a way that allows taxpayers and the marketplace ample time to adjust.

As I get the drift of the 1981 act, lower tax rates are what we are all after because that means more incentives for work, savings, and investment.

A second question, if I could, and I think that we really need to focus on this: What would a flat-rate tax rate have to be? What would the rate of a flat-rate tax have to be if we were not going to increase the deficit dramatically? Have you looked at that, given the present deficit?

Senator DOMENICI. I don't have it with me, Senator Bradley.

Senator BRADLEY. I don't mean to put you on the spot. As I understand it, you would have to have a 14-, 15-, 16-percent rate.

Now, I think the illusion that is being perpetrated on the American public is that somehow or other you can have a flat rate of 12 percent or 10 percent, and have the same amount of revenue. If you don't look at this thing carefully what you are going to have is a deficit time bomb out there.

For example, yesterday Senator Helms said with a 10-percent tax rate—maybe not 10 percent, maybe 11—we would not have a bigger deficit. Well, the fact is we could end up with a much greater deficit.

I think that brings us back to the fair tax, where under the proposal that Congressman Gephardt and I have made, for 75 percent of the taxpayers the maximum rate is 14 percent. So there is no reasonable flat-rate system that could give a taxpayer a lower rate than Bradley-Gephardt. In addition, taxpayers wouldn't get to keep the deductions that are in Bradley-Gephardt, such as for interest on a home mortgage or property taxes or charitable giving or the various others that we have kept.

I think these hearings should result in people focusing on these distinctions. I thank you for your testimony because I think you have indeed focused on a lot of the major problems with the pure flat rate.

Senator DOMENICI. Senator, you didn't put me on the spot; we have the numbers, I just didn't bring them with me. But it is certainly more than 10 or 11; it is somewhere near 14, 15, 16. You have them as well as we do; if not we certainly would give them to you.

I would say there is an additional problem. Unless you expect some significant new growth because of the structural changes that might occur under a flat rate, you don't want to forget that under the current progressive system Federal revenues increased about 1.6 times the growth in personal income. So it is very important when you look at this flat tax proposal that you don't take that first or first and second year and stop there. You must look at your economic projections. If you expect 5 percent real growth for 4 or 5 years, you had better know that this 1.6 times the growth in personal income tax revenue won't be realized. You will have to build a compensating factor into the flat rate. I am not saying you shouldn't or you can't, but you might have to add one-half point to the flat rate.

Senator BRADLEY. Well, again, if it didn't go into effect until 1985 you would only want to make up 1.2 percent—12 percent instead of 16 percent. Because as you correctly pointed out, that is when we have introduced the indexing.

Senator DOMENICI. Well, we haven't arrived at 1985 yet.

The CHAIRMAN. No; it's coming.

Senator BRADLEY. That's an interesting point. That's the news today, maybe.

The CHAIRMAN. What, 1985?

Senator DOMENICI. 1985 is the news?

Senator BRADLEY. No, no—that indexing might not make it to 1985.

The CHAIRMAN. Oh, no; it's in good shape. [Laughter.]

I wonder, Senator Bradley, if you might run over and vote? I have Senator Grassley voting, and we will just have sort of a revolving group here.

Senator BRADLEY. Yes, sure.

The CHAIRMAN. We will wait a few minutes.

I hope I can explain to the witnesses. We are going to have a series of votes, and you will have new Senators coming and others leaving.

Senator Long?

Senator LONG. Thank you, Mr. Chairman.

I see in your statement at the bottom of page 3, "It has long been a key principle of the Federal tax system that those with high incomes should pay a larger share of their income in taxes than those with lower incomes." Do you subscribe to that principle, Senator Domenici?

Senator DOMENICI. Senator Long, I stated in this text that I do.

Senator LONG. I do, too. I am not saying that we shouldn't have a flatter tax, flatter than it is now, but I do think that the flat tax, particularly on income, goes contrary to that, especially when you take into account the fact that the social security tax is a flat tax—it is a regressive tax; it is a tax on consumption, and it does not apply to income above a certain level. The very rich don't pay near as much directly. Indirectly, as consumers, they do pay a great deal more than that. But when you couple it with the other revenues that flow into the Government, and where the final impact rests on those other revenues, the very rich are not paying as much as they would have us believe.

I am not advocating that they pay more; I am just saying that it is only fair that those who make a great deal should pay more, even a higher rate, than those who make a very little bit. Even they would buy the principle. They would exclude a personal exemption at the bottom; but I think it works at the middle-income level as well, and I am glad to see that you do, too.

Now, you say also, "The tax system is increasingly used to achieve desirable economic and social objectives." I would make this point, and I think if you agree with this I would sort of like you to say it: We spend all of our money in ways that we think would achieve the most desirable results for our country, both in terms of social results and in terms of defense.

Now, if we are going to try to encourage productivity and to encourage conduct that is good for this society with our spending laws, should not the same principle apply with our taxing laws? In other words, if we want to bring about a certain type of human conduct, and we do it with our spending, why shouldn't we also seek to achieve the same purpose in the way we raise $700 billion a year?

Senator DOMENICI. Well, Senator, obviously it is relative. The answer is yes, I support that. The purpose for the hearings is to identify whether there is a better way to accomplish the same goal within the tax laws of the country. I don't think the purpose is to abandon the use of the tax laws for the results that you have just stated.

If you go look in the budget, you will find that you spend a certain amount of money for medical care that you put out and spend, but if you go over and look in the Tax Code you will also find that we encourage health care by the way we treat medical deductions, both business and personal, and particularly business.

We have not done a study as to which method is more efficient that I know of—there probably are some. My present conclusion would be that probably the Tax Code is a more efficient way of doing many of these things than the direct spending programs that are on the books that purport to do the same things.

Senator LONG. Thank you very much.

The CHAIRMAN. Thank you very much, Senator Domenici.

I would like to now have Mr. Harris get ready to testify while I run over and vote. Senator Grassley will come right back, and Senator Bradley.

Lou Harris, chairman and chief executive officer of Louis Harris & Associates, from New York, we are very pleased to have you before the committee this morning.

We only have about 4 minutes left on this vote, so I will depart. Senator Grassley will be here in a minute or so, then you can start your testimony.

Your entire statement will be made a part of the record, and you can proceed in any way you wish. I have already read it; it is interesting, and I think it will be very interesting to the committee.

So, I will be right back.

Mr. HARRIS. Mr. Chairman, do you want me to begin now or wait for Senator Grassley?

The CHAIRMAN. If you would, wait until Senator Grassley comes back. Thank you.

[Whereupon, the hearings went off the record and were resumed on the record shortly thereafter.]

Senator BRADLEY. The committee will come to order.

Chairman Dole mentioned to me that I should start the hearings. This is a rare privilege for someone who is on the minority. Senator Grassley, and I think Senator Roth, have been detained on the floor, so I think that we ought to start. They will be joining us in the course of your testimony, Mr. Harris. Welcome to the committee, and please go ahead.

Mr. HARRIS. Thank you.

STATEMENT OF LOUIS HARRIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LOUIS HARRIS & ASSOCIATES, NEW YORK, N.Y.

Mr. HARRIS. Mr. Chairman, it is a pleasure and a privilege to be here.

I must begin by saying that in the public's mind, by any measure, we are living through the bleakest economic environment since the 1930's. Indeed, startling to me is that 57 percent of the people of this country now think we are in a depression, nor does the public see any signs of recovery for at least another 12 months, if indeed it will take place then.

One significant result of the very hard times our people have been living through is that sizable majorities of the public believe we live in highly inequitous times. Put bluntly, by 63 to 32 percent, a big majority of the public is convinced that as a result of President Reagan's economic program, the elderly, the poor, and the handicapped are being especially hard hit. By contrast, by a 65 to 27 percentage, the majority say the rich and big business are much better off.

In turn, this perceived inequity has now permeated deeply into people's thinking about the tax system and how it ought to be changed. When asked directly in a recent Business Week Harris poll—I call this shocking—by 86 to 7 percent, a majority, nationwide feels that "while most lower- and middle-income people now pay their Federal tax by taking standard deductions, most higher income people get out of paying much of their taxes by hiring clever tax accountants and high-priced lawyers who show them how to use loopholes in the tax law for tax shelters and other devices."

Put bluntly again, it means that the prevailing view in this country is that if you are well enough off you can afford the expertise to avoid paying taxes. Those who can't afford such help end up paying through the nose.

The sad consequence of this state of cynicism about the way the tax system works is that support for the progressive tax system principle has dropped precipitously just in the last year. A year ago a substantial and clearcut 58 to 38 percent majority of the public felt that the progressive tax principle—and the way we defined it was that higher income people not only have to pay more in taxes, but because of their ability to pay they must pay a higher percentage of their income in taxes—people then thought this was all fair and equitable.

This year, by only 47 to 45 percent, which statistically is an insignificant margin, a narrow plurality of the public still believes that the progressive income tax principle is right—but that's just surviving by the skin of its teeth.

Significantly, the cynics and opponents of the progressive tax notion are to be found among those who are having a harder time making ends meet, among those with the least education, among women, blacks, Hispanics, low-income families, blue-collar people, and union members. They are joined in a kind of unholy alliance, Mr. Chairman, by those in the highest income brackets who feel the same way but for obviously different reasons.

More Democrats are fed up with the progressive tax system than Republicans, for indeed a 50 to 42 plurality of Republicans say they believe in it.

Thus, by a thumping 62 to 25 percent, the majority of the American people today would favor changing the basic Federal income tax system by going to a single across-the-board rate of 14 percent taxation for everyone, but—and this is a critical "but"—at the same time eliminating nearly all of the current deductions and exclusions that people take now, so that more people's income is taxable. This last closing of loopholes, I might emphasize, is really the critical point. However, when we asked about getting rid of these deductions, a large number were deemed as "sacred cows" by a vast majority of the American people. Let me tick off a few:

By 80 to 18 percent, a big majority wants to keep all medical deductions above the 3-percent level of total income.

By 71 to 24 percent, a sizable majority wants to maintain deductions for house mortgage interest.

By 66 to 30 percent, another big majority wants to preserve deductions for charitable contributions.

By 64 to 29 percent, a decisive majority wants to keep deductions for State and local income and property taxes.

By 63 to 29 percent, an almost identical majority wants to keep deductions for casualty and theft losses.

By 53 to 37 percent, another majority wants to keep deductions for State and local taxes other than State and local income and property taxes—that means they want all State taxes deductible.

A plurality of 48 to 43 percent wants to keep deductions for employee business expenses.

Deductions for interest paid on installment and credit card bills is a standoff—47 to 47.

And out of 10 major deductions we asked about, only two yielded up candidates for getting rid of: By 57 to 38 percent the majority would give up deductions of political contributions up to $100, and by 51 to 34 percent a majority would also give up being able to deduct investment in drilling costs in oil and natural gas. [Laughter.]

In the area of exclusions, the list grows longer:

By 86 to 11 percent, a majority nationwide wants to keep all social security and veterans benefits payments tax free.

By 71 to 25 percent, a solid majority wants no taxes paid on unemployment compensation.

By 66 to 29 percent, a big majority wants to spare interest on life insurance savings which are not now taxable.

By a narrower 49 to 42 percent, a plurality wants to keep tax free all interest from State and local bonds that are used to finance State and local government.

The only exception among all those tested in the exclusion area was, by 69 to 24 percent, a majority favors taxing part of the income U.S. citizens earn abroad that is now tax free.

I might add, Mr. Chairman, that we did not include Americans living overseas in the sample. I'm sure we would have gotten a very different answer from them.

Finally, we tested a compromise version of the flat-tax idea, the so-called fair tax, put forth by Senator Bradley and Representative Gephardt, which calls for everyone making up to $25,000 a year to pay a flat tax of $14,000 of their total income, with deductions allowed only for employee business expenses, home mortgage payments, charitable contributions, and State and local income and property taxes. In addition, all interest from State and local government bonds used to finance State and local governments would remain tax-free, as would all social security and veterans benefit income. Finally, for those making over $25,000, there would be an additional basic tax that would increase up to a total of 28 percent for married people with joint incomes of over $65,000.

Mr. Chairman, you will be particularly interested to know the Bradley-Gephardt tax bill meets with 58 to 32 percent support.

But the pattern of support for such a measure is somewhat different. It is favored by low-income people and not by higher income people; it is favored a bit more by Democrats than Republicans; it is favored more by those having the hardest time making ends meet, and supported by higher majorities of blue-collar and union people.

What we are obviously getting here are the fruits of deep-seated cynicism over the way the progressive income tax has been working out over the past few years. People want some progressive features in a tax system, but at the same time would like most of the loopholes used by the rich and corporations, or at least as they perceive these, are eliminated. Yet when asked about the roster of consumer deductions and exclusions, why, they are notably unwilling to give up very much themselves.

Clearly, there is a sense of desperation reflected in these results that I might suggest: The American people want equity restored to the tax system, and they want that with a vengeance. They think that the people for whom the system is designed to pay the highest taxes have found ways, and many ways, to avoid paying their taxes. The idea of cutting the basic rate but also eliminating the most flagrant loopholes has real appeal.

The Bradley-Gephardt or some other version like it would have a public mandate today. But it is not the idea, significantly, of paying a lower basic rate or just simplifying the tax system that is the real appeal; to the contrary, its real backing emanates from a sense that most middle- and low-income families are being had today by an inequitous economic program put forth by this administration and a well-meaning progressive tax principle that has been undermined by precisely those most in a position to pay the highest rate of taxes.

How long this window will be open, I cannot say; but it is clear, just as clear as can be, that the broad majority of the American people have had it with inequity, as they see it, in both the economic system and especially the tax structure that exists at the Federal level.

[The prepared statement of Louis Harris follows:]

TESTIMONY OF LOUIS HARRIS
CHAIRMAN, LOUIS HARRIS AND ASSOCIATES, INC.
BEFORE SENATE FINANCE COMMITTEE
WASHINGTON, D.C.
SEPTEMBER 29, 1982

MR. CHAIRMAN, MY NAME IS LOUIS HARRIS. I AM A RESIDENT OF NEW YORK CITY, BUT I OPERATE A SURVEY RESEARCH COMPANY IN OVER 60 COUNTRIES, WITH OFFICES IN NEW YORK, WASHINGTON, LONDON, AND PARIS. IT IS A PRIVILEGE TO BE CALLED BEFORE YOUR COMMITTEE TODAY.

OUR FIRM RECENTLY COMPLETED A SURVEY FOR BUSINESS WEEK AMONG 1249 ADULTS NATIONWIDE ON THE SUBJECT OF FEDERAL TAXATION. I WOULD LIKE TO REPORT SOME OF THOSE STARTLING RESULTS HERE TODAY.

THE RESULTS ARE STARTLING, FOR THEY INDICATE THAT THE PUBLIC NOW HAS DEEP AND ABIDING RESERVATIONS ABOUT THE FAIRNESS AND EQUITY OF THE CURRENT FEDERAL TAX SYSTEM AND THAT CHANGE, EVEN RADICAL CHANGE, MIGHT WELL BE THE AMELIORATIVE MOST PEOPLE NOW SEEK.

IT MIGHT BE WELL TO BEGIN BY REPORTING ON WHAT HAS BEEN THE PUBLIC'S REACTION TO MANY OF THE ECONOMIC PROGRAMS, APPROACHES, AND DEVELOPMENTS THAT HAVE TAKEN PLACE OVER THESE PAST FEW YEARS. FOR, IN MY JUDGMENT, THEY HAVE MUCH TO DO WITH THE CURRENT PUBLIC ATTITUDES TOWARD TAXATION.

THE SHOCK WAVES WHICH THE AMERICAN PEOPLE HAVE EXPERIENCED OVER THE PAST FEW YEARS HAVE BEEN OF MAJOR MAGNITUDE AND NOT AT ALL WHAT EITHER THE PUBLIC OR THOSE RUNNING THE PUBLIC AND PRIVATE ESTABLISHMENT IN THIS COUNTRY MIGHT HAVE EXPECTED.

BACK IN 1980, AT THE TIME OF THE PRESIDENTIAL ELECTION, MOST AMERICANS FELT THAT THERE WAS SOMETHING DRASTICALLY WRONG IN THE WAY THE ECONOMIC SYSTEM WAS WORKING. SIZABLE MAJORITIES WERE DEEPLY CONCERNED THAT OUR NATIONAL PRODUCTIVITY HAD SLIPPED AND WAS CONTINUING TO SLIP, THAT WE WERE FALLING BEHIND THE JAPANESE IN OUR TECHNOLOGICAL CAPABILITIES, THAT INFLATION WAS ROBBING US OF OUR STANDARD OF LIVING, THAT REAL INCOME HAD FALLEN BEHIND WITH EACH PASSING YEAR, THAT INFLATION HAD SAPPED OUR VITAL ENERGIES, AND THAT QUITE SEVERE RECESSIONS OF RATHER SHORT DURATION FOLLOWED BY RECOVERIES MARKED BY STILL HIGHER INFLATION SEEMED TO BE THE ORDER OF THE DAY. PRESIDENT CARTER APPEARED TO BE TOTALLY INEPT TO 8 IN 10 AMERICANS, ESPECIALLY IN HIS ABILITIES TO COPE WITH DOMESTIC ECONOMIC PROBLEMS.

PART OF THE PROMISE THAT RONALD REAGAN BROUGHT TO THE ELECTORATE WAS THAT HE WOULD BE TRYING QUITE A DIFFERENT APPROACH, AND GIVEN THE UTTER LACK OF CONFIDENCE IN JIMMY CARTER TO HELP SOLVE OUR ECONOMIC TROUBLES, PRESIDENT REAGAN WAS ELECTED. THE PUBLIC THOUGHT THEN THAT THE APPROACH OF THE FEDERAL RESERVE BOARD UNDER CHAIRMAN PAUL VOLCKER OF PURSUING A RELATIVELY TIGHT CONTROL OF MONEY SUPPLY, IN ORDER TO WRING OUT INFLATION MADE SENSE. THAT WAS THE ONE CONTINUITY OF CARTER POLICY THAT PEOPLE WERE WILLING TO ABIDE.

A HIGH 81 PERCENT OF THE PUBLIC FELT THAT FEDERAL SPENDING HAD GOTTEN OUT OF CONTROL AND WAS A MAJOR ENGINE DRIVING THE INFLATION. BUT THE BASIC PROPOSITION THAT PEOPLE BOUGHT WAS THAT WAYS HAD TO BE FOUND TO GET PRIVATE CAPITAL TO BE GENERATED TO INFUSE A NEW HIGH TECHNOLOGY MODE INTO OUR INDUSTRY SO THAT IN TURN NATIONAL PRODUCTIVITY COULD BE TURNED AROUND. PEOPLE WERE WILLING TO PROVIDE BUSINESS AND THE CAPITAL MARKETS WITH A WHOLE SPATE OF INCENTIVES TO GET THIS JOB DONE: FASTER WRITE-OFF ON PLANT AND EQUIPMENT, A REDUCTION OF THE MAXIMUM TAX ON UNEARNED INCOME FROM 70 TO 50%, A REDUCTION OF THE MAXIMUM CAPITAL GAINS TAX FROM WHAT WAS 50% ONLY A FEW YEARS EARLIER DOWN TO 15 OR 20%. MAJORITIES AS HIGH AS 75-20% FAVORED JUST SUCH AN APPROACH.

HOWEVER, DURING ALL OF THIS PERIOD, WE WERE NEVER ONCE ABLE TO FIND MAJORITIES OF THE PUBLIC WHO WERE WILLING TO GO ALONG WITH THE CENTERPIECE OF THE REAGAN PROGRAM: TO HAVE A 10% CUT IN THE RATE OF FEDERAL INCOME TAXES FOR THREE YEARS RUNNING. FROM THE BEGINNING OF THAT 10-10-10 ACROSS-THE-BOARDS TAX CUT IDEA, KNOWN AS THE KEMP-ROTH MEASURE, PEOPLE EXPRESSED A REAL RESERVATION THAT IT COULD PROVE TO BE INFLATIONARY IN A TIME OF RISING PRICES, AND WOULD NOT BE EQUITABLE AND FAIR IN A TIME OF DEEP RECESSION. HOWEVER, WHEN ASKED ABOUT THE REAGAN PACKAGE AS A WHOLE BACK IN THE FIRST MONTHS OF THIS ADMINISTRATION, A 71-19% MAJORITY OPTED FOR GIVING THE NEW PRESIDENT WHAT HE DESIRED.

IT IS WELL TO RECALL THAT BACK IN THOSE FIRST SEVEN MONTHS OF 1981, THE HOPES OF THE AMERICAN PEOPLE WERE QUICKENED ENORMOUSLY BY THE PROMISE, REITERATED BY A PRESIDENT WHO OBVIOUSLY WAS AN EFFECTIVE COMMUNICATOR, THAT IF HE COULD JUST GET HIS ECONOMIC PACKAGE PASSED BY CONGRESS, MAINLY HUGE CUTS IN FEDERAL SPENDING, WITH THE EXCEPTION OF DEFENSE SPENDING WHICH HAD TO BE SHARPLY INCREASED IN REAL TERMS BY OVER 10%, AND IF HE COULD GET HIS TAX CUT--THE BIGGEST IN THE HISTORY OF THE COUNTRY--THEN THE VERY ACT OF PASSING SUCH A PROGRAM WOULD STIMULATE AND EXCITE THOSE IN A POSITION TO INVEST SO THAT CAPITAL INVESTMENT WOULD SURGE, A NEW MODE OF HIGH TECHNOLOGY WOULD TAKE OVER, AND PRODUCTIVITY COULD BE TURNED AROUND IN RAPID ORDER.

BUT SOMETHING HAPPENED IN THE FALL OF 1981. INSTEAD OF EXPERIENCING A RECOVERY AND EXPANSION OF THE ECONOMY THAT HAD BEEN PROMISED, INSTEAD HARD TIMES SEEMED TO BE UPON US ONCE MORE. EVERYONE, INCLUDING THE REAGAN ADMINISTRATION RECOGNIZED THAT WE HAD FALLEN INTO A RECESSION--AN EVENT THAT ALMOST NO ONE HAD PREDICTED OR FORESEEN. STILL, BACK IN THE FALL OF 1981, PEOPLE WERE ESSENTIALLY PATIENT AND FELT WE WOULD GET OUT OF THIS RECESSION AS WE HAD THE ONE THAT TOOK PLACE IN 1980.

BUT THEN, AS THE MONTHS PASSED AND THE ECONOMIC FUNK GREW WORSE, AT LEAST IN THE EYES OF THE PUBLIC, OPTIMISM EVAPORATED, AND A MOOD OF DESPERATION TOOK OVER THE AMERICAN PEOPLE. TWO SETS OF ECONOMIC WORRIES NOW BESET THE PUBLIC. ONE DEALT WITH THE DIMENSIONS THAT HAD BEEN RAISED BY THE PRESIDENT.

HIS PROMISE THAT BY CUTTING SPENDING HE COULD BETTER BALANCE THE BUDGET OBVIOUSLY CAME ACROPPER IN THE MINDS OF THE PEOPLE TO THE POINT WHERE BY 69-25% A BIG MAJORITY GAVE THE PRESIDENT LOW MARKS ON HIS EFFORTS TO BALANCE THE BUDGET. INDEED, JUST IN THE PAST MONTH, A 60-33% MAJORITY FEELS THAT PRESIDENT REAGAN HAS GONE BACK ON HIS CAMPAIGN PROMISE TO BALANCE THE BUDGET, WHICH IS NOT SURPRISING IN LIGHT OF THE ESTIMATES OF HIS OWN OMB THAT RECORD FEDERAL DEFICITS COULD BE COMTEMPLATED OVER THE NEXT THREE YEARS. BY 61-32%, A MAJORITY FELT THAT THE ECONOMY WELL INTO 1983 WOULD NOT BE EXPANDING AT A HEALTY RATE. A SOLID 62-29% MAJORITY NOW DOUBTED THAT INTEREST RATES WOULD REALLY COME DOWN BELOW THE DOUBLE DIGIT LEVELS ANY TIME SOON INTO THE FUTURE. EVEN AFTER INFLATION OBVIOUSLY HAD COME DOWN TO BELOW THE 10% MARK, PLURALITIES DOUBTED AND DO TO THIS DAY THAT BY 1983, THE RATE OF INFLATION REALLY WILL BE SLOWED LONG TERM. BY 57-36%, A MAJORITY FELT THE TAX CUTS, ESPECIALLY THE 5-10-10, AS THEY TURNED OUT TO BE, ACROSS-THE-BOARDS CUT MADE SENSE.

BUT A WHOLE HOST OF OTHER FAR MORE DRACONIAN EXPECTATIONS BEGAN TO OVERTAKE THE AMERICAN PEOPLE IN THE SPRING OF THIS YEAR. BY 63-34%, A BIG MAJORITY NOW DID NOT SIMPLY EXPECT MORE LAY-OFFS, BUT MORE PLANTS SHUTTING DOWN. A 66-31% MAJORITY EXPECTED THAT AN ACCELERATED RATE OF FORECLOSURES OF MORTGAGES ON FARMS AND ON INDIVIDUAL HOMES WAS NOW IN THE OFFING. A POIGNANT 54-42% MAJORITY FEARED NOW THAT MORE PEOPLE WOULD BE GOING HUNGRY ACROSS THE UNITED STATES.

THIS IS NOT SIMPLY RECESSION TALK, BUT IS DEPRESSION TALK. INDEED, WE HAVE FOUND NOW THAT WHEREAS ONLY 34% OF THE AMERICAN PEOPLE THOUGHT WE WERE IN A DEPRESSION LAST APRIL, A MUCH HIGHER 58% THOUGHT WE WERE IN JULY AND 57% FELT THAT WAY IN AUGUST. A YEAR AGO, WHEN ASKED TO NAME THE TOP PROBLEMS FACING THE COUNTRY, 51% SINGLED OUT INFLATION AND 22% SAID IT WAS UNEMPLOYMENT. NOW, UNEMPLOYMENT IS UP AT THE TOP OF THE LIST VOLUNTEERED BY 54% AND NO MORE THAN 27% SAY INFLATION IS THE BIGGEST PROBLEM.

ONE MAJOR RESULT OF THIS BASICALLY DOUR MOOD ABOUT THE ECONOMY IS THAT CONSUMER PESSIMISM IS RIFE. IN TURN, THIS MEANS THAT THE DAY WHEN CONSUMER DEMAND WILL LEAD THE WAY BACK TO ECONOMIC RECOVERY LOOKS TO BE MORE DISTANT THAN MANY HAVE BEEN FORECASTING. FOR MAKE NO MISTAKE ABOUT IT, RESEARCH FROM THE PAST 8 YEARS HAS CONSISTENTLY SHOWN THAT WHEN PEOPLE ARE PESSIMISTIC ABOUT THE ECONOMIC OUTLOOK, THEY ARE NOT BIG SPENDERS FOR MAJOR CONSUMER GOODS.

ANOTHER SIGNIFICANT RESULT OF THE VERY HARD TIMES OUR PEOPLE HAVE BEEN LIVING THROUGH IS THAT SIZABLE MAJORITIES OF THE PUBLIC BELIEVE THAT WE LIVE IN HIGHLY INEQUITOUS TIMES. PUT BLUNTLY, BY 63-32%, A BIG MAJORITY OF THE PUBLIC IS CONVINCED THAT AS A RESULT OF PRESIDENT REAGAN'S ECONOMIC PROGRAM, "THE ELDERLY, THE POOR AND THE HANDICAPPED ARE BEING ESPECIALLY HARD HIT," AND, BY 65-27%, THAT "THE RICH AND BIG BUSINESS ARE MUCH BETTER OFF."

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IN TURN, THIS PERCIEVED INEQUITY HAS NOW PERMEATED DEEPLY INTO PEOPLE'S THINKING ABOUT THE TAX SYSTEM AND HOW IT OUGHT TO BE CHANGED. ON A SIMPLE BASIS, A STARTLING 55-41% MAJORITY NOW FEELS THAT "IT IS IMPOSSILBE TO MAKE ENDS MEET ANYMORE BY FOLLOWING ALL THE RULES AND REGULATIONS." IN OTHER WORDS, TO MAKE OUT THESE DAYS, YOU HAVE TO SHAVE CORNERS AND TRIM WHEN IT COMES TO PAYING TAXES OR IN REPORTING INCOME.

WHEN ASKED DIRECTLY, A SHOCKING 86-7% MAJORITY NATIONWIDE FEELS THAT "WHILE MOST LOWER AND MIDDLE INCOME PEOPLE NOW PAY THEIR FEDERAL TAX BY TAKING STANDARD DEDUCTIONS, MOST HIGHER INCOME PEOPLE GET OUT OF PAYING MUCH OF THEIR TAXES BY HIRING CLEVER TAX ACCOUNTANTS AND LAWYERS WHO SHOW THEM HOW TO USE LOOPHOLES IN THE TAX LAW FOR TAX SHELTERS AND OTHER DEVICES." PUT BLUNTLY AGAIN, IT MEANS THAT IF YOU ARE WELL ENOUGH OFF, YOU CAN AFFORD THE EXPERTISE TO AVOID PAYING TAXES. THOSE WHO CANNOT AFFORD SUCH HELP END UP PAYING THROUGH THE NOSE.

THE SAD CONSEQUENCE OF THIS STATE OF CYNICISM ABOUT THE WAY THE TAX SYSTEM WORKS IS THAT SUPPORT FOR THE PROGRESSIVE TAX SYSTEM HAS DROPPED PRECIPITOUSLY JUST IN THE PAST YEAR. A YEAR AGO, A SUBSTANTIAL AND CLEAR-CUT 58-38% MAJORITY OF THE PUBLIC THOUGHT THE PROGRESSIVE TAX PRINCIPLE--THAT HIGHER INCOME PEOPLE NOT ONLY HAVE TO PAY MORE IN TAXES BUT BECAUSE OF THEIR ABILITY TO PAY THEY MUST PAY A GREATER PERCENTAGE OF THEIR INCOME IN TAXES--WAS FAIR AND EQUITABLE. HOWEVER, THIS YEAR, BY ONLY A RAZOR-THIN 47-45%, A NARROW PLURALITY OF THE PUBLIC STILL BELIEVES IN THE PROGRESSIVE INCOME TAX PRINCIPLE.

SIGNIFICANTLY, THE CYNICS AND OPPONENTS OF THE PROGRESSIVE TAX NOTION ARE TO BE FOUND AMONG THOSE WHO ARE HAVING A HARDER TIME MAKING ENDS MEET, AMONG THOSE WITH THE LEAST EDUCATION, AMONG WOMEN, BLACKS, HISPANICS, LOW INCOME FAMILIES, BLUE COLLAR PEOPLE, AND UNION MEMBERS. THEY ARE JOINED BY THOSE IN THE HIGHEST INCOME BRACKETS WHO FEEL THE SAME WAY. MORE DEMOCRATS ARE FED UP WITH THE PROGRESSIVE TAX SYSTEM THAN REPUBLICANS.

THUS, BY A THUMPING 62-25%, A MAJORITY OF THE AMERICAN PEOPLE TODAY WOULD FAVOR CHANGING THE BASIC FEDERAL INCOME SYSTEM BY GOING TO A SINGLE ACROSS-THE-BOARD RATE OF 14% TAXATION FOR EVERYONE, BUT AT THE SAME TIME ELIMINATING NEARLY ALL THE CURRENT DEDUCTIONS PEOPLE TAKE SO THAT MORE OF PEOPLE'S INCOME IS TAXABLE. THIS LAST CLOSING OF LOOPHOLES IS CRITICALLY IMPORTANT.

HOWEVER, WHEN WE THEN ASKED ABOUT GETTING RID OF CERTAIN KEY DEDUCTIONS, A LARGE NUMBER ARE DEEMED SACRED COWS BY THE AMERICAN PEOPLE. FOR EXAMPLE, BY 80-18%, A BIG MAJORITY WANTS TO KEEP ALL MEDICAL DEDUCTIONS ABOVE THE 3% OF TOTAL INCOME LEVEL. BY 71-24%, A SIZABLE MAJORITY WANTS TO MAINTAIN DEDUCTIONS FOR HOUSE MORTGAGE INTEREST. BY 66-30%, ANOTHER BIG MAJORITY WANTS TO PRESERVE DEDUCTIONS FOR CHARITABLE CONTRIBUTIONS. ⟶

By 64-29%, a decisive majority wants to keep deductions for state and local income and property taxes. By 63-29%, an almost identical majority wants to keep deductions for casualty and theft losses. By 53-37%, another majority wants to keep deductions for state and local taxes, other than state and local income and property taxes. A plurality of 48-43% wants to keep deductions for employee business expenses. Deductions for interest paid on installment and credit card bills meet with a 47-47% standoff. Out of 10 major current deductions, only two yielded up candidates for getting rid of: by 57-38%, a majority would give up deduction of political contributions up to $100. And, by 51-34%, a majority would also give up being able to deduct investment in drilling costs for oil and natural gas.

In the area of exclusions, the list grows longer. By 86-11%, a majority nationwide wants to keep all Social Security and veterans' benefits tax-free. By 71-25%, a solid majority wants no taxes paid on unemployment compensation. By 66-29%, a big majority wants to spare interest on life insurance savings, which now are not taxable. By a narrower 49-42%, a plurality wants to keep tax-free all interest from state and local bonds that are used to finance state and local government. The only exception among those tested: a 69-24% majority favors taxing part of the income U.S. citizens earn abroad that is now tax-free.

FINALLY, WE TESTED A COMPROMISE VERSION OF THE FLAT TAX IDEA, THE SO-CALLED "FAIR TAX," PUT FORTH BY SENATOR BRADLEY AND REPRESENTATIVE GEPHARDT, WHICH CALLS FOR EVERYONE MAKING UP TO $25,000 A YEAR PAY A FLAT TAX OF 14% OF THEIR TOTAL INCOME WITH DEDUCTIONS ALLOWED <u>ONLY</u> FOR EMPLOYEE BUSINESS EXPENSES, HOME MORTGAGE PAYMENTS, CHARITABLE CONTRIBUTIONS, AND STATE AND LOCAL INCOME AND PROPERTY TAXES. IN ADDITION, ALL INTEREST FROM STATE AND LOCAL GOVERNMENT BONDS USED TO FINANCE STATE AND LOCAL GOVERNMENTS WOULD REMAIN TAX-FREE, AS WOULD ALL SOCIAL SECURITY AND VETERANS' BENEFIT INCOME. FINALLY, FOR THOSE MAKING OVER $25,000, THERE WOULD BE AN ADDITIONAL BASIC TAX THAT WOULD INCREASE UP TO A TOTAL OF 28% FOR MARRIED PEOPLE WITH JOINT INCOMES OF OVER $65,000. THE BRADLEY-GEPHARDT TAX BILL MEETS WITH 58-32% SUPPORT.

BUT THE PATTERN OF SUPPORT FOR SUCH A MEASURE IS SOMEWHAT DIFFERENT. IT IS FAVORED BY LOWER INCOME PEOPLE AND NOT THE HIGHER INCOME GROUPS. IT IS FAVORED A BIT MORE BY DEMOCRATS THAN REPUBLICANS. IT IS FAVORED MORE BY THOSE HAVING THE HARDEST TIME MAKING ENDS MEET. IT IS SUPPORTED BY HIGHER MAJORITIES OF BLUE COLLAR AND UNION PEOPLE.

WHAT YOU ARE OBVIOUSLY GETTING HERE IS THE FRUITS OF DEEP-SEATED CYNICISM OVER THE WAY THE PROGRESSIVE INCOME TAX HAS BEEN WORKING OUT IN THE PAST FEW YEARS. PEOPLE WANT SOME PROGRESSIVE FEATURES IN A TAX SYSTEM, BUT AT THE SAME TIME WOULD LIKE MOST OF THE LOOPHOLES USED BY THE RICH AND CORPORATIONS ELIMINATED. YET, WHEN ASKED ABOUT THE ROSTER OF CONSUMER DEDUCTIONS AND EXCLUSIONS, THEY ARE NOTABLY UNWILLING TO GIVE UP MUCH THEMSELVES.

CLEARLY, THERE IS A SENSE OF DESPERATION REFLECTED IN THESE RESULTS. THE AMERICAN PEOPLE WANT EQUITY RESTORED TO THE TAX SYSTEM WITH A VENGEANCE. THEY THINK THE PEOPLE FOR WHOM THE SYSTEM IS DESIGNED TO PAY THE HIGHEST TAXES HAVE FOUND WAYS TO AVOID PAYING THEIR TAXES. THE IDEA OF CUTTING THE BASIC RATE BUT ALSO ELIMINATING THE MOST FLAGRANT LOOPHOLES HAS REAL APPEAL. THE BRADLEY-GEPHARDT BILL OR SOME OTHER VERSION LIKE IT WOULD HAVE A PUBLIC MANDATE TODAY. BUT IT IS NOT THE IDEA OF PAYING A LOWER BASIC RATE OR A SIMPLIFIED TAX SYSTEM THAT IS THE APPEAL. TO THE CONTRARY, ITS REAL BACKING EMANATES FROM A SENSE THAT MOST MIDDLE AND LOWER MIDDLE INCOME FAMILIES ARE BEING HAD TODAY BY AN INEQUITOUS ECONOMIC PROGRAM PUT FORTH BY THIS ADMINISTRATION AND BY A WELL-MEANING PROGRESSIVE TAX PRINCIPLE THAT HAS BEEN UNDERMINED BY PRECISELY THOSE MOST IN A POSITION TO PAY THE HIGHEST RATE OF TAXES.

HOW LONG THIS WINDOW WILL REMAIN OPEN, I CANNOT SAY. BUT IT IS CLEAR THAT THE BROAD MAJORITY OF THE AMERICAN PEOPLE HAVE HAD IT WITH INEQUITY, AS THEY SEE IT, IN THE ECONOMIC SYSTEM AND THE TAX STRUCTURE THAT EXISTS AT THE FEDERAL LEVEL.

THANK YOU.

ASK EVERYONE

2a. For the past 65 years, the federal income tax has been based on the principle that higher income people not only have to pay more in taxes but because of their ability to pay they must pay a greater percentage of their income in taxes. Do you feel that principle is fair and equitable, or not?

Fair and equitable.....(42(____-1
Not fair and equitable.....____-2
Not sure.....................____-3

2b. It has been argued that while most lower and middle income people now pay their federal tax by taking standard deductions, most higher income people get out of paying much of their taxes by hiring clever tax accountants and lawyers who show them how to use loopholes in the tax law for tax shelters and other devices. Do you feel that this tends to happen, or not?

Tends to happen..(43(____-1
Does not happen......____-2
Not sure.............____-3

2c. Now it is being proposed that instead of the system of higher income people paying a greater percentage in federal income taxes, everyone would pay the same percentage of their total income in taxes, such as 14% for everyone. Would you favor having everyone pay the same percentage of their total income in taxes, or would you favor keeping the present system, under which higher income people pay a greater percentage in taxes?

Favor everyone paying same percentage..(44(____-1
Favor keeping present system...............____-2
Not sure.....................................____-3

2d. It has been proposed that the federal income tax be simplified by going to a single, across-the-board rate of 14% taxation for everyone, but at the same time eliminating nearly all the current deductions people take so that more of people's income is taxable. Another provision would be to double the $1,000 exemption per person, which would keep the poor from paying higher taxes. In general, do you favor or oppose this approach to changing the tax system?

Favor....(45(____-1
Oppose.......____-2
Not sure.....____-3

2e. Would you favor keeping each of these deductions or would you favor getting rid of them to make it possible to lower the basi tax rate to 14%? [READ EACH ITEM]

[START AT "X"]		Keep	Get Rid Of	Not Sure
( ) 1.	Deductions for employee business expenses...........	(46(___-1	___-2	___-3
( ) 2.	Deductions for house mortgage interest..............	(47(___-1	___-2	___-3
( ) 3.	Deductions for charitable contributions.............	(48(___-1	___-2	___-3
( ) 4.	Deductions for state and local income and property taxes..	(49(___-1	___-2	___-3
( ) 5.	Being able to deduct investment in drilling costs for oil and natural gas...........................	(50(___-1	___-2	___-3
( ) 6.	Deduction of political contributions up to $100.....	(51(___-1	___-2	___-3
( ) 7.	Deductions for state and local taxes other than state and local income and property taxes.........	(52(___-1	___-2	___-3
( ) 8.	Deductions for casualty and theft losses............	(53(___-1	___-2	___-3
( ) 9.	Deductions for medical expenses.....................	(54(___-1	___-2	___-3
( ) 10.	Deductions for interest paid on installment and credit card bills...............................	(55(___-1	___-2	___-3

2f. Now I want to ask you about certain types of federal benefits or income on which people do not pay taxes today. Do you think (READ EACH ITEM) should remain tax-free, or should it be taxed in order to set the basic tax rate at 14%?

[START AT "X"]		Should Remain Tax-Free	Should Be Taxed	Not Sure
( ) 1.	Social Security and veterans' benefits.............	(56(___-1	___-2	___-3
( ) 2.	Interest from state and local bonds that are used to finance state and local government.......	(57(___-1	___-2	___-3
( ) 3.	Part of the income U.S. citizens earn abroad.......	(58(___-1	___-2	___-3
( ) 4.	Unemployment compensation..........................	(59(___-1	___-2	___-3
( ) 5.	Interest on life insurance savings.................	(60(___-1	___-2	___-3

2g. Another tax proposal is that everyone making up to $25,000 a year pay a flat 14% of their total income with deductions allowed only for employee business expenses, home mortgage payments, charitable contributions, and state and local income and property taxes. In addition, all those who receive Social Security and veterans' benefits would not pay taxes on that income. All interest from state and local government bonds used to finance state and local governments would be tax-free. For those making over $25,000, there would be an additional basic tax that would increase up to a total of 28% for married people with joint incomes of over $65,000. Would you favor or oppose this simplified federal income tax?

Favor..........(61(____-1
Oppose............ ____-2
Not sure.......... ____-3

[62-66Z]

Q.2A - FOR THE PAST 65 YEARS, THE FEDERAL INCOME TAX HAS BEEN BASED ON THE PRINCIPLE THAT HIGHER INCOME PEOPLE NOT ONLY HAVE TO PAY MORE IN TAXES BUT BECAUSE OF THEIR ABILITY TO PAY THEY MUST PAY A GREATER PERCENTAGE OF THEIR INCOME IN TAXES. DO YOU FEEL THAT PRINCIPLE IS FAIR AND EQUITABLE?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
TOTAL ANS	12525	3328	3316	3575	2307	3737	3818	1837	3333	3697	4088	2575	2067	911	5719	5827	8272	1463	2843
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAIR & EQUITABLE	5830	1610	1685	1514	1021	1725	1765	765	1575	2008	1832	1110	836	276	2636	2860	3743	783	1229
	47%	48%	50%	42%	44%	46%	49%	42%	47%	55%	45%	43%	40%	30%	46%	49%	45%	54%	48%
NOT FAIR & EQUITABLE	5682	1528	1315	1773	1066	1779	1622	889	1392	1532	2047	1195	879	437	2631	2604	3863	616	1159
	45%	46%	40%	50%	46%	48%	45%	48%	42%	41%	50%	47%	43%	48%	46%	45%	47%	42%	44%
NOT SURE	1012	188	316	289	220	234	231	182	366	159	207	270	352	198	452	363	665	64	255
	8%	6%	10%	8%	10%	6%	6%	10%	11%	4%	5%	10%	17%	22%	8%	6%	8%	4%	10%
BASE	1248	330	332	358	230	360	346	190	352	336	450	251	202	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

-822016- BUSINESS WEEK #7, LOUIS HARRIS & ASSOC., 8/16/82

TABLE 016B

Q.2A - FOR THE PAST 65 YEARS, THE FEDERAL INCOME TAX HAS BEEN BASED ON THE PRINCIPLE THAT HIGHER INCOME PEOPLE NOT ONLY HAVE TO PAY MORE IN TAXES BUT BECAUSE OF THEIR ABILITY TO PAY THEY MUST PAY A GREATER PERCENTAGE OF THEIR INCOME IN TAXES. DO YOU FEEL THAT PRINCIPLE IS FAIR AND EQUITABLE?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
TOTAL ANS	12525 100%	5948 100%	6577 100%	10547 100%	1334 100%	644 100%	1602 100%	1983 100%	2389 100%	2067 100%	1433 100%	1161 100%	519 100%	1853 100%	1270 100%	615 100%	1439 100%	2301 100%	2813 100%
FAIR & EQUITABLE	5830 47%	2982 50%	2848 43%	4940 47%	620 46%	270 42%	580 36%	1001 51%	1150 48%	906 44%	761 53%	651 56%	222 43%	929 50%	774 61%	276 45%	594 41%	1072 47%	1165 41%
NOT FAIR & EQUITABLE	5682 45%	2695 45%	2987 46%	4691 44%	681 52%	310 48%	732 46%	801 40%	1082 45%	1082 52%	649 45%	450 39%	259 50%	852 46%	409 32%	289 47%	765 53%	1110 48%	1490 53%
NOT SURE	1012 8%	271 5%	742 11%	916 9%	33 2%	64 10%	290 18%	181 9%	157 7%	79 4%	23 2%	60 5%	38 7%	72 4%	87 7%	50 8%	80 6%	120 5%	158 6%
BASE	1248	608	640	1078	95	75	142	225	346	228	124	38	40	173	117	59	153	225	298

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TABLE 018C

Q.2A - FOR THE PAST 65 YEARS, THE FEDERAL INCOME TAX HAS BEEN BASED ON THE PRINCIPLE THAT HIGHER INCOME PEOPLE NOT ONLY HAVE TO PAY MORE IN TAXES BUT BECAUSE OF THEIR ABILITY TO PAY THEY MUST PAY A GREATER PERCENTAGE OF THEIR INCOME IN TAXES. DO YOU FEEL THAT PRINCIPLE IS FAIR AND EQUITABLE?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REAGAN	CARTER	REPUBLICAN	DEMOCRAT	INDEPENDENT	CONSERVATIVE	MIDDLE OF ROAD	LIBERAL	YES	NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
TOTAL ANS	12525	4383	2970	3255	5158	3079	4288	5004	2082	8644	3803	1714	3972	382	2179	5882	5952	7680	7285
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAIR & EQUITABLE	5830	2051	1438	1615	2328	1473	1934	2504	990	4150	1651	846	2022	184	1044	-	2291	3534	3778
	47%	47%	48%	50%	45%	48%	45%	50%	48%	48%	43%	49%	51%	51%	48%	-	38%	46%	52%
NOT FAIR & EQUITABLE	5682	2078	1352	1379	2382	1472	2043	2213	991	3937	1696	772	1716	139	1008	5882	3311	3751	3057
	45%	47%	46%	42%	46%	48%	48%	44%	48%	46%	45%	45%	43%	38%	46%	100%	56%	49%	42%
NOT SURE	1012	258	182	261	448	134	311	287	100	557	456	96	234	39	129	-	350	395	450
	8%	6%	6%	8%	9%	4%	7%	6%	5%	6%	12%	6%	6%	11%	6%	-	6%	5%	6%
BASE	1248	448	286	317	508	324	434	493	214	866	374	184	403	33	223	587	608	775	743

TABLE 019A

Q.2B - IT HAS BEEN ARGUED THAT WHILE MOST LOWER AND MIDDLE INCOME PEOPLE NOW PAY THEIR FEDERAL TAX BY TAKING STANDARD DEDUCTIONS, MOST HIGHER INCOME PEOPLE GET OUT OF PAYING MUCH OF THEIR TAXES BY HIRING CLEVER TAX ACCOUNTANTS AND LAWYERS WHO SHOW THEM HOW TO USE LOOPHOLES IN THE TAX LAW FOR TAX SHELTERS AND OTHER DEVICES. DO YOU FEEL THAT THIS TENDS TO HAPPEN?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
TOTAL ANS	12525 100%	3326 100%	3316 100%	3575 100%	2307 100%	3737 100%	3818 100%	1837 100%	3333 100%	3697 100%	4086 100%	2575 100%	2087 100%	911 100%	5719 100%	5827 100%	8272 100%	1463 100%	2843 100%
TENDS TO HAPPEN	10803 86%	2923 88%	2902 88%	3022 85%	1958 85%	3184 85%	3189 88%	1680 91%	2750 83%	3415 92%	3598 88%	2222 87%	1479 72%	610 67%	4951 86%	5216 89%	7139 86%	1281 88%	2265 85%
DOES NOT HAPPEN	839 7%	191 6%	155 5%	298 8%	197 9%	357 10%	191 5%	65 4%	227 7%	141 4%	253 6%	190 7%	256 12%	127 14%	261 5%	441 8%	547 7%	140 10%	153 6%
NOT SURE	882 7%	213 6%	260 8%	256 7%	153 7%	196 5%	238 7%	92 5%	357 11%	141 4%	235 6%	163 6%	332 16%	174 19%	507 9%	170 3%	585 7%	43 3%	225 9%
BASE	1248	330	332	356	230	360	346	190	352	336	450	251	202	86	594	562	858	132	248

TABLE 019B

Q.28 - IT HAS BEEN ARGUED THAT WHILE MOST LOWER AND MIDDLE INCOME PEOPLE NOW PAY THEIR FEDERAL TAX BY TAKING STANDARD DEDUCTIONS, MOST HIGHER INCOME PEOPLE GET OUT OF PAYING MUCH OF THEIR TAXES BY HIRING CLEVER TAX ACCOUNTANTS AND LAWYERS WHO SHOW THEM HOW TO USE LOOPHOLES IN THE TAX LAW FOR TAX SHELTERS AND OTHER DEVICES. DO YOU FEEL THAT THIS TENDS TO HAPPEN?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7, 500 OR LESS	$7, 501 TO $15K	$15, 001 TO $25K	$25, 001 TO $35K	$35, 001 TO $50K	$50, 001 T[illegible] $[illegible]K	$65, 001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
TOTAL ANS	12525 100%	5948 100%	6577 100%	10547 100%	1334 100%	844 100%	1802 100%	1983 100%	2389 100%	2087 100%	1433 100%	1181 100%	519 100%	1853 100%	1270 100%	815 100%	1439 100%	2301 100%	2813 100%
TENDS TO HAPPEN	10803 86%	5304 89%	5499 84%	9143 87%	1108 83%	554 86%	1203 75%	1744 88%	2201 92%	1928 93%	1279 89%	1014 88%	447 86%	1629 87%	1194 94%	528 86%	1293 90%	2040 89%	2523 90%
DOES NOT HAPPEN	839 7%	373 6%	466 7%	621 6%	168 12%	52 8%	169 11%	117 6%	113 5%	80 4%	101 7%	87 7%	47 9%	139 8%	66 5%	25 4%	85 6%	122 5%	171 6%
NOT SURE	882 7%	271 5%	611 9%	782 7%	62 5%	38 6%	229 14%	122 6%	75 3%	59 3%	53 4%	60 5%	25 5%	85 5%	10 1%	63 10%	61 4%	140 6%	120 4%
BASE	1248	608	640	1078	95	75	142	225	348	228	124	38	40	173	117	59	153	225	298

TABLE 019C

Q.2B - IT HAS BEEN ARGUED THAT WHILE MOST LOWER AND MIDDLE INCOME PEOPLE NOW PAY THEIR FEDERAL TAX BY TAKING STANDARD DEDUCTIONS, MOST HIGHER INCOME PEOPLE GET OUT OF PAYING MUCH OF THEIR TAXES BY HIRING CLEVER TAX ACCOUNTANTS AND LAWYERS WHO SHOW THEM HOW TO USE LOOPHOLES IN THE TAX LAW FOR TAX SHELTERS AND OTHER DEVICES. DO YOU FEEL THAT THIS TENDS TO HAPPEN?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REA-GAN	CARTER	REPUB-LICAN	DEMO-CRAT	INDEP-ENDENT	CON-SER-VA-TIVE	MID-DLE OF ROAD	LIB-ERAL	YES	NO	SOME-ONE EARNS EX-TRA $	KNOW SOME-ONE EARNS EX-TRA $	DOES NOT RE-PORT EX-TRA $	IMP. TO FOL-LOW RULES	NOT FAIR AND EQUIT-ABLE	FA-VOR PAY-ING SAME PER.	FA-VOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
TOTAL ANS	12525 100%	4383 100%	2970 100%	3255 100%	5158 100%	3079 100%	4288 100%	5004 100%	2082 100%	8844 100%	3803 100%	1714 100%	3972 100%	362 100%	2179 100%	5682 100%	5952 100%	7680 100%	7285 100%
TENDS TO HAPPEN	10803 86%	3869 88%	2584 87%	2869 88%	4355 85%	2777 90%	3660 86%	4560 91%	1839 88%	7545 87%	3181 84%	1617 94%	3704 93%	324 90%	2057 94%	4788 85%	5281 88%	6916 90%	6575 90%
DOES NOT HAPPEN	839 7%	297 7%	172 6%	203 6%	418 8%	135 4%	320 7%	278 6%	146 7%	563 7%	276 7%	51 3%	112 3%	- -	53 2%	538 9%	340 6%	400 5%	341 5%
NOT SURE	882 7%	218 5%	213 7%	183 6%	385 7%	166 5%	308 7%	167 3%	97 5%	536 6%	346 9%	47 3%	156 4%	38 10%	70 3%	356 6%	331 6%	364 5%	369 5%
BASE	1248	446	286	317	508	324	434	493	214	866	374	184	403	33	223	567	608	775	743

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TABLE 020A

Q.2C - NOW IT IS BEING PROPOSED THAT INSTEAD OF THE SYSTEM OF HIGHER INCOME PEOPLE PAYING A GREATER PERCENTAGE IN FEDERAL INCOME TAXES, EVERYONE WOULD PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, SUCH AS 14% FOR EVERYONE. WOULD YOU FAVOR HAVING EVERYONE PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, OR WOULD YOU FAVOR KEEPING THE PRESENT SYSTEM, UNDER WHICH HIGHER INCOME PEOPLE PAY A GREATER PERCENTAGE IN TAXES?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
TOTAL ANS	12525 100%	3328 100%	3318 100%	3575 100%	2307 100%	3737 100%	3818 100%	1837 100%	3333 100%	3897 100%	4086 100%	2575 100%	2087 100%	911 100%	5719 100%	5827 100%	8272 100%	1483 100%	2643 100%
FAVOR EVERYONE PAYING SAME PERCENTAGE	5952 48%	1495 45%	1547 46%	1688 48%	1222 53%	1547 41%	1842 51%	1033 56%	1531 46%	1552 42%	2189 54%	1320 51%	862 42%	383 42%	2650 46%	2898 50%	3800 46%	761 52%	1340 50%
FAVOR KEEPING PRESENT SYSTEM	5284 42%	1503 45%	1381 42%	1483 41%	917 40%	1735 47%	1473 41%	675 37%	1401 42%	1866 50%	1489 36%	892 35%	974 47%	426 47%	2502 44%	2308 40%	3713 45%	470 32%	1023 39%
NOT SURE	1289 10%	328 10%	388 12%	404 11%	169 7%	455 12%	303 8%	129 7%	402 12%	278 8%	408 10%	363 14%	232 11%	102 11%	567 10%	620 11%	759 9%	233 16%	280 11%
BASE	1248	330	332	358	230	360	348	190	352	336	450	251	202	88	594	562	856	132	248

TABLE 0208

Q.2C - NOW IT IS BEING PROPOSED THAT INSTEAD OF THE SYSTEM OF HIGHER INCOME PEOPLE PAYING A GREATER PERCENTAGE IN FEDERAL INCOME TAXES, EVERYONE WOULD PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, SUCH AS 14% FOR EVERYONE. WOULD YOU FAVOR HAVING EVERYONE PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, OR WOULD YOU FAVOR KEEPING THE PRESENT SYSTEM, UNDER WHICH HIGHER INCOME PEOPLE PAY A GREATER PERCENTAGE IN TAXES?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $85K	$85,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
TOTAL ANS	12525 100%	5948 100%	6577 100%	10547 100%	1334 100%	644 100%	1602 100%	1983 100%	2389 100%	2067 100%	1433 100%	1161 100%	519 100%	1853 100%	1270 100%	615 100%	1439 100%	2301 100%	2813 100%
FAVOR EVERYONE PAYING SAME PERCENTAGE	5952 48%	3320 56%	2632 40%	5083 48%	576 43%	292 45%	667 42%	903 46%	1153 48%	1159 56%	792 55%	501 43%	258 49%	986 53%	582 46%	380 62%	774 54%	983 43%	1506 53%
FAVOR KEEPING PRESENT SYSTEM	5284 42%	2142 36%	3142 48%	4425 42%	554 42%	305 48%	757 47%	897 45%	1058 44%	734 36%	539 38%	468 40%	218 42%	622 34%	572 45%	160 26%	516 36%	1153 50%	1116 40%
NOT SURE	1289 10%	486 8%	803 12%	1038 10%	203 15%	47 7%	178 11%	183 9%	179 7%	175 8%	102 7%	192 17%	47 9%	245 13%	116 9%	75 12%	149 10%	166 7%	191 7%
BASE	1248	608	640	1078	95	75	142	225	348	228	124	38	40	173	117	59	153	225	298

TABLE 020C

Q.2C - NOW IT IS BEING PROPOSED THAT INSTEAD OF THE SYSTEM OF HIGHER INCOME PEOPLE PAYING A GREATER PERCENTAGE IN FEDERAL INCOME TAXES, EVERYONE WOULD PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, SUCH AS 14% FOR EVERYONE. WOULD YOU FAVOR HAVING EVERYONE PAY THE SAME PERCENTAGE OF THEIR TOTAL INCOME IN TAXES, OR WOULD YOU FAVOR KEEPING THE PRESENT SYSTEM, UNDER WHICH HIGHER INCOME PEOPLE PAY A GREATER PERCENTAGE IN TAXES?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REAGAN	CARTER	REPUBLICAN	DEMOCRAT	INDEPENDENT	CONSERVATIVE	MIDDLE OF ROAD	LIBERAL	YES	NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
TOTAL ANS	12525 100%	4383 100%	2970 100%	3255 100%	5158 100%	3079 100%	4288 100%	5004 100%	2082 100%	8644 100%	3803 100%	1714 100%	3972 100%	362 100%	2179 100%	5682 100%	5952 100%	7680 100%	7285 100%
FAVOR EVERYONE PAYING SAME PERCENTAGE	5952 48%	2422 55%	1332 45%	1662 51%	2219 43%	1682 54%	2291 54%	2295 46%	992 48%	4292 50%	1623 43%	847 49%	1677 48%	123 34%	1098 51%	3311 58%	5952 100%	4355 57%	3604 49%
FAVOR KEEPING PRESENT SYSTEM	5284 42%	1616 37%	1309 44%	1323 41%	2359 46%	1135 37%	1679 39%	2274 45%	837 40%	3532 41%	1712 45%	766 45%	1723 43%	197 54%	926 42%	1933 34%	- -	2619 34%	3157 43%
NOT SURE	1289 10%	346 8%	328 11%	270 8%	580 11%	262 9%	318 7%	435 9%	253 12%	821 9%	468 12%	102 6%	372 9%	42 12%	155 7%	438 8%	- -	706 9%	523 7%
BASE	1248	446	286	317	508	324	434	493	214	866	374	184	403	33	223	587	608	775	743

TABLE 021A

Q.2D - IT HAS BEEN PROPOSED THAT THE FEDERAL INCOME TAX BE SIMPLIFIED BY GOING TO A SINGLE, ACROSS-THE-BOARD RATE OF 14% TAXATION FOR EVERYONE, BUT AT THE SAME TIME ELIMINATION NEARLY ALL CURRENT DEDUCTIONS PEOPLE TAKE SO THAT MORE OF PEOPLE'S INCOME IS TAXABLE. ANOTHER PROVISION WOULD BE TO DOUBLE THE $1,000 EXEMPTION PER PERSON, WHICH WOULD KEEP THE POOR FROM PAYING HIGHER TAXES. IN GENERAL, DO YOU FAVOR OR OPPOSE THIS APPROACH TO CHANGING THE TAX SYSTEM?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
TOTAL ANS	12533	3328	3318	3575	2315	3745	3818	1837	3333	3697	4086	2583	2067	911	5727	5827	8280	1463	2643
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAVOR	7688	2160	1937	2137	1453	2314	2103	1260	2011	2298	2694	1677	978	451	3655	3536	5094	935	1566
	62%	65%	58%	60%	63%	62%	55%	69%	60%	62%	66%	65%	47%	50%	64%	61%	62%	64%	59%
OPPOSE	3184	859	897	898	532	999	962	369	855	1108	849	551	644	294	1366	1513	2128	361	675
	25%	26%	27%	25%	23%	27%	27%	20%	26%	30%	21%	21%	31%	32%	24%	26%	26%	25%	26%
NOT SURE	1661	307	482	542	330	433	553	209	467	292	544	355	446	167	706	778	1057	167	402
	13%	9%	15%	15%	14%	12%	15%	11%	14%	8%	13%	14%	22%	18%	12%	13%	13%	11%	15%
BASE	1249	330	332	356	231	361	346	190	352	336	450	262	202	86	595	562	857	132	248

-822018- BUSINESS WEEK #7, LOUIS HARRIS & ASSOC., 8/18/82

TABLE 021B

Q.2D - IT HAS BEEN PROPOSED THAT THE FEDERAL INCOME TAX BE SIMPLIFIED BY GOING TO A SINGLE, ACROSS-THE-BOARD RATE OF 14% TAXATION FOR EVERYONE, BUT AT THE SAME TIME ELIMINATION NEARLY ALL CURRENT DEDUCTIONS PEOPLE TAKE SO THAT MORE OF PEOPLE'S INCOME IS TAXABLE. ANOTHER PROVISION WOULD BE TO DOUBLE THE $1,000 EXEMPTION PER PERSON, WHICH WOULD KEEP THE POOR FROM PAYING HIGHER TAXES. IN GENERAL, DO YOU FAVOR OR OPPOSE THIS APPROACH TO CHANGING THE TAX SYSTEM?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
TOTAL ANS	12533 100%	5948 100%	6585 100%	10555 100%	1334 100%	644 100%	1602 100%	1991 100%	2389 100%	2067 100%	1433 100%	1161 100%	519 100%	1853 100%	1270 100%	615 100%	1439 100%	2301 100%	2813 100%
FAVOR	7688 62%	3859 64%	3828 58%	6503 62%	828 62%	356 56%	899 56%	1118 57%	1628 68%	1338 65%	883 61%	738 64%	343 66%	1217 65%	817 64%	413 67%	972 68%	1348 58%	1786 63%
OPPOSE	3184 25%	1583 27%	1601 24%	2580 24%	408 31%	196 30%	444 28%	585 29%	555 23%	517 25%	412 29%	279 24%	116 22%	419 23%	326 26%	127 21%	318 22%	587 26%	670 24%
NOT SURE	1661 13%	506 9%	1155 18%	1472 14%	97 7%	92 14%	253 16%	288 14%	207 9%	215 10%	138 10%	144 12%	60 12%	217 12%	128 10%	75 12%	148 10%	366 16%	356 13%
BASE	1249	608	641	1079	95	75	142	226	346	228	124	38	40	173	117	59	153	225	298

-822016- BUSINESS WEEK #7, LOUIS HARRIS & ASSOC., 8/16/82

TABLE 021C

Q.2D - IT HAS BEEN PROPOSED THAT THE FEDERAL INCOME TAX BE SIMPLIFIED BY GOING TO A SINGLE, ACROSS-THE-BOARD RATE OF 14% TAXATION FOR EVERYONE, BUT AT THE SAME TIME ELIMINATION NEARLY ALL CURRENT DEDUCTIONS PEOPLE TAKE SO THAT MORE OF PEOPLE'S INCOME IS TAXABLE. ANOTHER PROVISION WOULD BE TO DOUBLE THE $1,000 EXEMPTION PER PERSON, WHICH WOULD KEEP THE POOR FROM PAYING HIGHER TAXES. IN GENERAL, DO YOU FAVOR OR OPPOSE THIS APPROACH TO CHANGING THE TAX SYSTEM?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REA-GAN	CARTER	REPUB-LICAN	DEMO-CRAT	INDEP-ENDENT	CON-SER-VA-TIVE	MID-DLE OF ROAD	LIB-ERAL	YES	NO	SOME-ONE EARNS EX-TRA $	KNOW SOME-ONE EARNS EX-TRA $	DOES NOT RE-PORT EX-TRA $	IMP. TO FOL-LOW RULES	NOT FAIR AND EQUIT-ABLE	FA-VOR PAY-ING SAME PER.	FA-VOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
TOTAL ANS	12533	4383	2978	3255	5168	3079	4288	5012	2082	8652	3803	1714	3972	362	2179	5682	5952	7688	7285
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAVOR	7688	2965	1707	2110	3168	1984	2599	3228	1342	5360	2280	1080	2525	204	1407	3751	4355	7688	4934
	62%	68%	58%	65%	61%	64%	60%	64%	64%	62%	60%	63%	63%	57%	65%	66%	73%	100%	68%
OPPOSE	3184	919	871	807	1283	765	1181	1180	558	2180	974	484	1015	120	522	1365	1059	-	1674
	25%	21%	29%	25%	25%	25%	28%	24%	27%	25%	26%	28%	26%	33%	24%	24%	18%	-	23%
NOT SURE	1661	499	400	338	715	349	508	604	182	1113	548	151	432	38	250	567	538	-	676
	13%	11%	13%	10%	14%	11%	12%	12%	9%	13%	14%	9%	11%	10%	11%	10%	9%	-	9%
BASE	1249	446	287	317	509	324	434	494	214	867	374	184	403	33	223	567	608	776	743

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
DEDUCTIONS FOR EMPLOYEE BUSINESS EXPENSES	12504	3317	3297	3575	2315	3727	3618	1837	3323	3677	4086	2574	2067	911	5709	5818	8251	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5950	1598	1368	1883	1101	1830	1716	822	1581	1841	2055	1132	888	424	2719	2785	3996	751	1144
	47.6	48.2	41.5	52.7	47.6	49.1	47.4	44.7	47.6	50.1	50.3	44.0	43.0	46.5	47.6	47.9	48.4	51.3	43.3
GET RID OF	5334	1440	1575	1333	985	1619	1606	817	1292	1680	1765	1182	652	274	2472	2574	3552	528	1183
	42.7	43.4	47.8	37.3	42.5	43.4	44.4	44.5	38.9	45.7	43.2	45.9	31.5	30.1	43.3	44.2	43.0	36.1	44.8
NOT SURE	1221	279	354	359	229	278	295	198	450	156	266	260	526	213	518	458	703	185	315
	9.8	8.4	10.7	10.0	9.9	7.5	8.2	10.8	13.5	4.2	6.5	10.1	25.4	23.4	9.1	7.9	8.5	12.6	11.9
DEDUCTIONS FOR HOUSE MORTGAGE INTEREST	12526	3326	3318	3567	2315	3737	3618	1837	3333	3697	4078	2583	2067	911	5727	5819	8280	1463	2635
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8901	2423	2332	2435	1711	2669	2692	1176	2365	2793	2974	1663	1391	539	4006	4320	5904	1054	1839
	71.1	72.9	70.3	68.3	73.9	71.4	74.4	64.0	71.0	75.5	72.9	64.4	67.3	59.2	69.9	74.2	71.3	72.0	69.8
GET RID OF	2949	713	781	952	503	947	748	496	758	769	989	730	440	247	1334	1346	1955	377	608
	23.5	21.4	23.6	26.7	21.7	25.3	20.7	27.0	22.7	20.8	24.3	28.3	21.3	27.1	23.3	23.1	23.6	25.8	23.1
NOT SURE	675	191	203	180	101	122	178	166	210	135	115	189	236	125	387	153	420	32	188
	5.4	5.7	6.1	5.0	4.4	3.3	4.9	9.0	6.3	3.7	2.8	7.3	11.4	13.7	6.8	2.6	5.1	2.2	7.1

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
DEDUCTIONS FOR CHARITABLE CONTRIBUTIONS	12533	3326	3316	3575	'315	3745	3618	1837	3333	3697	4086	2583	2067	911	5727	5827	8280	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8232	2219	2077	2369	1568	2561	2343	1186	2142	2548	2524	1734	1346	601	3692	3872	5340	1061	1720
	65.7	66.7	62.6	66.3	67.7	68.4	64.8	64.6	64.3	68.9	61.8	67.1	65.1	66.0	64.5	66.4	64.5	72.5	65.1
GET RID OF	3730	989	1110	1035	597	1048	1156	593	934	1055	1428	746	481	171	1776	1783	2613	358	741
	29.8	29.7	33.5	29.0	25.8	28.0	32.0	32.3	28.0	28.5	34.9	28.9	23.3	18.8	31.0	30.6	31.6	24.5	28.0
NOT SURE	571	119	129	172	151	136	119	58	257	93	133	103	241	139	260	172	326	45	181
	4.6	3.6	3.9	4.8	6.5	3.6	3.3	3.2	7.7	2.5	3.3	4.0	11.7	15.3	4.5	3.0	3.9	3.1	6.8
DEDUCTIONS FOR STATE & LOCAL INCOME & PROPERTY	12533	3326	3316	3575	2315	3745	3618	1837	3333	3697	4086	2583	2067	911	5727	5827	8280	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7999	2201	2159	2163	1477	2309	2359	1153	2173	2484	2643	1648	1170	398	3608	3940	5307	1028	1582
	63.8	66.2	65.1	60.5	63.8	61.7	65.2	62.8	65.3	67.2	64.7	63.8	56.6	43.5	63.0	67.6	64.1	70.3	59.9
GET RID OF	3653	898	907	1173	675	1174	992	577	911	1015	1224	832	548	360	1711	1570	2408	376	842
	29.1	27.0	27.4	32.8	29.2	31.3	27.4	31.4	27.3	27.5	30.0	32.2	26.5	39.5	29.9	26.9	29.1	25.7	31.9
NOT SURE	880	227	250	240	164	263	267	107	244	198	219	102	349	155	409	317	564	59	219
	7.0	6.8	7.5	6.7	7.1	7.0	7.4	5.8	7.3	5.4	5.4	3.9	16.9	17.0	7.1	5.4	6.8	4.0	8.3
BASE	1249	330	332	358	231	361	346	190	352	336	450	252	202	88	595	582	857	132	248

TABLE 022B

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
DEDUCTIONS FOR EM-PLOYEE BUSINESS EXPENSES	12504	5920	6585	10526	1334	644	1602	1981	2389	2058	1423	1161	519	1844	1270	615	1429	2301	2794
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5950	2845	3105	5075	594	281	779	992	1174	907	695	558	269	674	743	304	679	1273	1213
	47.6	48.1	47.2	48.2	44.5	43.6	48.6	50.1	49.1	44.1	48.8	48.1	51.8	36.6	58.5	49.4	47.5	55.3	43.4
GET RID OF	5334	2657	2677	4468	549	317	559	808	1079	1064	660	531	143	952	470	285	688	894	1387
	42.7	44.9	40.7	42.4	41.2	49.2	34.9	40.8	45.2	51.7	46.4	45.7	27.6	51.6	37.0	46.3	48.1	38.9	49.6
NOT SURE	1221	418	803	984	191	47	264	181	137	87	68	72	107	218	58	26	63	135	195
	9.8	7.1	12.2	9.3	14.3	7.3	16.5	9.1	5.7	4.2	4.8	6.2	20.6	11.8	4.6	4.2	4.4	5.9	7.0
DEDUCTIONS FOR HOUSE MORTGAGE INTEREST	12525	5948	6577	10547	1334	644	1602	1991	2389	2059	1433	1161	519	1845	1270	615	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8901	4311	4590	7511	952	438	1024	1408	1733	1545	1063	882	329	1296	969	412	1062	1728	2015
	71.1	72.5	69.8	71.2	71.4	68.0	63.9	70.7	72.5	75.0	74.2	76.0	63.4	70.2	76.3	67.0	73.8	75.1	71.6
GET RID OF	2949	1501	1448	2436	333	179	416	479	549	479	329	279	178	433	291	164	319	531	704
	23.5	25.2	22.0	23.1	25.0	27.8	26.0	24.1	23.0	23.3	23.0	24.0	34.3	23.5	22.9	26.7	22.2	23.1	25.0
NOT SURE	675	136	539	599	48	28	162	104	107	35	41	-	12	116	10	40	57	42	94
	5.4	2.3	8.2	5.7	3.6	4.3	10.1	5.2	4.5	1.7	2.9	-	2.3	6.3	.8	6.5	4.0	1.8	3.3

TABLE 022B
CONTINUED -1

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
DEDUCTIONS FOR CHAR-ITABLE CONTRIBUTIONS	12533	5948	6585	10555	1334	644	1602	1991	2389	2067	1433	1161	519	1853	1270	615	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8232	4005	4227	6870	947	415	1086	1260	1492	1364	878	840	376	1205	828	371	990	1507	1778
	65.7	67.3	64.2	65.1	71.0	64.4	67.8	63.3	62.5	66.0	61.3	72.4	72.4	65.0	65.2	60.3	68.8	65.5	63.2
GET RID OF	3730	1778	1952	3212	342	177	426	608	830	694	498	291	114	614	400	232	369	692	924
	29.8	29.9	29.6	30.4	25.6	27.5	26.6	30.5	34.7	33.6	34.8	25.1	22.0	33.1	31.5	37.7	25.6	30.1	32.8
NOT SURE	571	165	405	473	45	52	90	123	68	9	56	30	29	35	42	12	81	103	111
	4.6	2.8	6.2	4.5	3.4	8.1	5.6	6.2	2.8	.4	3.9	2.6	5.6	1.9	3.3	2.0	5.6	4.5	3.9
DEDUCTIONS FOR STATE & LOCAL INCOME & PROPERTY	12533	5948	6585	10555	1334	644	1602	1991	2389	2067	1433	1161	519	1853	1270	615	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7999	3897	4102	6812	779	409	899	1235	1632	1332	997	813	315	1180	854	328	892	1669	1715
	63.8	65.5	62.3	64.5	58.4	63.5	56.1	62.0	68.3	64.4	69.6	70.0	60.7	63.7	67.2	53.3	62.0	72.5	61.0
GET RID OF	3653	1892	1761	2987	457	209	527	597	637	654	379	348	152	528	393	248	475	525	939
	29.1	31.8	26.7	28.3	34.3	32.5	32.9	30.0	26.7	31.6	26.4	30.0	29.3	28.5	30.9	40.3	33.0	22.8	33.4
NOT SURE	880	159	722	756	98	27	176	159	120	81	56	-	52	145	24	39	72	107	159
	7.0	2.7	11.0	7.2	7.3	4.2	11.0	8.0	5.0	3.9	3.9	-	10.0	7.8	1.9	6.3	5.0	4.7	5.7
BASE	1249	608	641	1079	95	75	142	226	348	228	124	38	40	173	117	59	153	225	298

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

	TOTAL	VOTED '80 REAGAN	VOTED '80 CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
DEDUCTIONS FOR EMPLOYEE BUSINESS EXPENSES	12504	4373	2989	3255	5137	3079	4288	5003	2082	8834	3793	1714	3982	352	2189	5872	5933	7859	7266
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5950	1988	1487	1419	2560	1475	1831	2534	1079	3902	2001	889	1856	158	978	2804	2552	3495	3465
	47.6	45.5	50.1	43.6	49.8	47.9	42.9	50.6	51.8	45.2	52.8	51.9	46.8	44.9	45.1	49.4	43.0	45.6	47.7
GET RID OF	5334	2002	1185	1552	2037	1405	2026	2114	884	3858	1444	735	1941	184	1110	2448	3006	3687	3362
	42.7	45.8	39.9	47.7	39.7	45.6	47.5	42.3	42.5	44.7	38.1	42.9	49.0	52.3	51.2	43.2	50.7	48.1	46.3
NOT SURE	1221	384	297	284	541	199	411	355	119	873	348	90	185	10	81	420	375	477	439
	9.8	8.8	10.0	8.7	10.5	6.5	9.6	7.1	5.7	10.1	9.2	5.3	4.2	2.8	3.7	7.4	6.3	6.2	6.0
DEDUCTIONS FOR HOUSE MORTGAGE INTEREST	12525	4383	2989	3255	5158	3079	4288	5004	2082	8644	3803	1714	3984	362	2171	5674	5952	7680	7277
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8901	3046	2278	2216	3704	2194	2791	3824	1589	6231	2602	1315	2939	277	1600	3807	3814	5196	5482
	71.1	69.5	76.7	68.1	71.8	71.3	65.1	76.4	76.3	72.1	68.4	76.7	74.1	76.5	73.7	67.1	64.1	67.7	75.3
GET RID OF	2949	1175	554	913	1134	767	1327	1009	391	2041	898	328	947	85	515	1592	1841	2186	1551
	23.5	26.8	18.7	28.0	22.0	24.9	30.9	20.2	18.8	23.6	23.6	19.1	23.9	23.5	23.7	28.1	30.9	28.5	21.3
NOT SURE	675	162	138	125	320	117	170	170	102	372	303	72	78	-	56	276	298	298	244
	5.4	3.7	4.6	3.8	6.2	3.8	4.0	3.4	4.9	4.3	8.0	4.2	2.0	-	2.6	4.9	5.0	3.9	3.4

TABLE 022C
CONTINUED -1

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

	TOTAL	VOTED '80' REAGAN	VOTED '80' CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
DEDUCTIONS FOR CHARITABLE CONTRIBUTIONS	12533	4383	2978	3255	5166	3079	4288	5012	2082	8652	3803	1714	3972	362	2179	5682	5952	7688	7285
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	8232	2730	2161	2091	3530	1957	2740	3342	1428	5600	2582	1123	2555	214	1314	3615	3366	4792	4786
	65.7	62.3	72.6	64.2	68.3	63.6	63.9	66.7	68.6	64.7	67.9	65.5	64.3	59.1	60.3	63.6	56.6	62.3	65.7
GET RID OF	3730	1479	728	979	1422	1041	1356	1537	576	2705	998	568	1339	148	806	1852	2378	2666	2284
	29.8	33.7	24.4	30.1	27.5	33.8	31.6	30.7	27.7	31.3	26.2	33.1	33.7	40.9	37.0	32.6	40.0	34.7	31.4
NOT SURE	571	175	88	184	214	80	191	132	78	348	223	23	78	-	59	216	206	230	215
	4.6	4.0	3.0	5.7	4.1	2.6	4.5	2.6	3.7	4.0	5.9	1.3	2.0	-	2.7	3.8	3.5	3.0	3.0
DEDUCTIONS FOR STATE & LOCAL INCOME & PROPERTY	12533	4383	2978	3255	5166	3079	4288	5012	2082	8652	3803	1714	3972	362	2179	5682	5952	7688	7285
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7999	2893	2011	2098	3315	1966	2764	3470	1201	5780	2152	1157	2589	283	1422	3311	3465	4758	4937
	63.8	66.0	67.5	64.5	64.2	63.9	64.5	69.2	57.7	66.8	56.6	67.5	65.2	78.2	65.3	58.3	58.2	61.9	67.8
GET RID OF	3653	1287	770	954	1458	950	1296	1347	689	2374	1269	481	1196	74	634	2064	2112	2532	1967
	29.1	29.4	25.9	29.3	28.2	30.9	30.2	26.9	33.1	27.4	33.4	28.1	30.1	20.4	29.1	36.3	35.5	32.9	27.0
NOT SURE	880	204	197	202	393	163	228	196	192	498	382	77	187	5	124	306	375	398	381
	7.0	4.7	6.6	6.2	7.6	5.3	5.3	3.9	9.2	5.8	10.0	4.5	4.7	1.4	5.7	5.4	6.3	5.2	5.2
BASE	1249	446	287	317	509	324	434	494	214	867	374	184	403	33	223	567	606	776	743

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
BEING ABLE TO DEDUCT INVESTMENT IN DRILLING COSTS FOR OIL & NATURAL GAS	12488	3307	3296	3569	2315	3745	3588	1837	3318	3697	4079	2545	2067	911	5682	5827	8234	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4216	861	1122	1381	852	1447	1046	674	1049	1467	1321	645	729	315	2111	1754	2810	419	943
	33.8	26.0	34.0	38.7	36.8	38.6	29.2	36.7	31.6	39.7	32.4	25.3	35.3	34.6	37.2	30.1	34.1	28.6	35.7
GET RID OF	6393	1927	1700	1653	1114	1841	1912	954	1686	1963	2293	1351	766	347	2776	3270	4270	827	1217
	51.2	58.3	51.6	46.3	48.1	49.2	53.3	51.9	50.8	53.1	56.2	53.1	37.1	38.1	48.9	56.1	51.9	56.5	46.0
NOT SURE	1878	519	475	535	349	457	630	209	583	266	465	549	572	249	795	803	1154	217	483
	15.0	15.7	14.4	15.0	15.1	12.2	17.6	11.4	17.6	7.2	11.4	21.6	27.7	27.3	14.0	13.8	14.0	14.8	18.3
DEDUCTION OF POLITICAL CONTRIBUTIONS UP TO $100	12472	3326	3277	3553	2315	3706	3618	1837	3311	3674	4047	2583	2067	911	5705	5788	8248	1433	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4698	1272	1206	1221	998	1456	1593	586	1063	1337	1400	1066	873	329	2019	2304	3176	613	876
	37.7	38.2	36.8	34.4	43.1	39.3	44.0	31.9	32.1	36.4	34.6	41.3	42.2	36.1	35.4	39.8	38.5	42.8	33.1
GET RID OF	7080	1908	1886	2080	1206	2061	1925	1139	1954	2264	2391	1389	955	437	3332	3299	4632	783	1568
	56.8	57.4	57.6	58.5	52.1	55.6	53.2	62.0	59.0	61.6	59.1	53.8	46.2	48.0	58.4	57.0	56.2	54.6	59.3
NOT SURE	694	147	185	252	111	189	100	112	294	74	256	128	239	145	354	186	440	38	198
	5.6	4.4	5.6	7.1	4.8	5.1	2.8	6.1	8.9	2.0	6.3	4.9	11.6	15.9	6.2	3.2	5.3	2.7	7.5

TABLE 023A
CONTINUED -1

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
DEDUCTIONS FOR STATE & LOCAL TAXES OTHER THAN STATE & LOCAL INCOME & PROPERTY TAXES	12511	3305	3316	3575	2315	3745	3603	1831	3333	3697	4073	2583	2059	903	5714	5827	8264	1463	2636
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	6652	1874	1784	1810	1184	1893	2032	935	1793	2269	2055	1365	922	310	2959	3337	4476	785	1327
	53.2	56.7	53.8	50.6	51.1	50.5	56.4	51.1	53.8	61.4	50.5	52.8	44.8	34.3	51.8	57.3	54.2	53.7	50.3
GET RID OF	4575	1171	1199	1332	873	1537	1246	751	1041	1226	1695	967	640	354	2193	2027	2962	570	969
	36.6	35.4	36.2	37.3	37.7	41.0	34.6	41.0	31.2	33.2	41.6	37.4	31.1	39.2	38.4	34.8	35.8	39.0	36.8
NOT SURE	1284	260	333	433	258	316	324	145	500	201	323	251	497	239	562	462	826	109	340
	10.3	7.9	10.0	12.1	11.1	8.4	9.0	7.9	15.0	5.4	7.9	9.7	24.1	26.5	9.8	7.9	10.0	7.5	12.9
DEDUCTIONS FOR CASUALTY & THEFT LOSES	12483	3294	3316	3558	2315	3724	3607	1829	3323	3697	4078	2554	2067	911	5689	5816	8230	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7905	2191	2094	2162	1458	2450	2374	1052	2029	2828	2296	1402	1312	568	3744	3548	5414	909	1464
	63.3	66.5	63.1	60.8	63.0	65.8	65.8	57.5	61.1	76.5	56.3	54.9	63.5	62.3	65.5	61.0	65.8	62.1	55.4
GET RID OF	3617	913	964	1065	674	1059	1083	634	840	731	1608	916	341	120	1457	2039	2178	483	956
	29.0	27.7	29.1	29.9	29.1	28.4	30.0	34.7	25.3	19.8	39.4	35.9	16.5	13.2	25.6	35.1	26.5	33.0	36.2
NOT SURE	961	190	258	330	183	215	149	143	454	138	174	236	414	223	488	229	638	72	223
	7.7	5.8	7.8	9.3	7.9	5.8	4.1	7.8	13.7	3.7	4.3	9.2	20.0	24.5	8.6	3.9	7.8	4.9	8.4
BASE	1249	330	332	356	231	361	346	190	352	336	450	252	202	86	595	562	857	132	248

TABLE 023B

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,601 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
BEING ABLE TO DEDUCT INVESTMENT IN DRILL-ING COSTS FOR OIL & NATURAL GAS	12488	5927	6561	10510	1334	644	1602	1982	2376	2067	1410	1161	519	1853	1270	615	1439	2289	2777
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4216	2067	2149	3475	482	260	575	835	805	596	487	291	187	550	431	240	492	833	821
	33.8	34.9	32.8	33.1	36.1	40.4	35.9	42.1	33.9	28.8	34.5	25.1	36.0	29.7	33.9	39.0	34.2	36.4	29.6
GET RID OF	6393	3213	3181	5391	704	299	669	798	1356	1305	778	648	256	959	717	278	802	1191	1632
	51.2	54.2	48.5	51.3	52.8	46.4	41.8	40.3	57.1	63.1	55.2	55.8	49.3	51.8	56.5	45.2	55.7	52.0	58.8
NOT SURE	1878	647	1231	1644	148	86	358	348	215	167	145	222	75	344	122	98	144	265	323
	15.0	10.9	18.8	15.6	11.1	13.4	22.3	17.6	9.C	8.1	10.3	19.1	14.5	18.6	9.6	15.9	10.0	11.6	11.6
DEDUCTION OF POLI-TICAL CONTRIBUTIONS UP TO $100	12472	5899	6572	10493	1334	644	1593	1988	2389	2087	1433	1131	519	1853	1240	605	1430	2289	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4698	2359	2339	3864	578	255	601	771	798	743	535	600	282	757	459	222	520	884	1073
	37.7	40.0	35.6	36.8	43.3	39.6	37.7	39.2	33.4	35.9	37.3	53.1	54.3	40.9	37.0	36.7	36.4	38.6	38.1
GET RID OF	7080	3383	3697	6078	672	332	860	1110	1483	1266	841	501	225	1062	759	370	841	1280	1636
	56.8	57.3	56.3	57.9	50.4	51.6	54.0	56.4	62.1	61.2	58.7	44.3	43.4	57.3	61.2	61.2	58.8	55.9	58.2
NOT SURE	694	158	537	553	84	57	132	87	108	59	56	30	12	35	22	13	70	125	104
	5.6	2.7	8.2	5.3	6.3	8.9	8.3	4.4	4.5	2.9	3.9	2.7	2.3	1.9	1.8	2.1	4.9	5.5	3.7

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
DEDUCTIONS FOR STATE & LOCAL TAXES OTHER THAN STATE & LOCAL INCOME & PROPERTY TAXES	12511	5935	6577	10533	1334	644	1602	1983	2382	2081	1433	1161	519	1853	1284	615	1432	2301	2808
	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	6652	3427	3226	5520	764	368	795	1016	1395	1183	779	555	308	1008	745	335	731	1318	1522
	53.2	57.7	49.0	52.4	57.3	57.1	49.6	51.2	58.6	57.4	54.4	47.8	59.3	54.4	58.9	54.5	51.0	57.3	54.2
GET RID OF	4575	2215	2360	3818	529	229	523	747	807	750	595	489	176	623	485	251	599	804	1105
	36.6	37.3	35.9	36.2	39.7	35.6	32.6	37.7	33.9	36.4	41.5	42.1	33.9	33.6	38.4	40.8	41.8	34.9	39.4
NOT SURE	1284	293	991	1196	41	47	284	220	180	129	59	117	35	222	34	29	101	179	179
	10.3	4.9	15.1	11.4	3.1	7.3	17.7	11.1	7.6	6.3	4.1	10.1	6.7	12.0	2.7	4.7	7.1	7.8	6.4
DEDUCTIONS FOR CASU-ALTY & THEFT LOSES	12483	5937	6546	10513	1334	637	1573	1983	2389	2087	1433	1161	519	1853	1270	615	1431	2291	2792
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7905	3765	4141	6527	975	404	1042	1292	1596	1284	856	648	334	1127	837	377	782	1627	1670
	63.3	63.4	63.3	62.1	73.1	63.4	66.2	65.2	66.8	62.1	59.7	55.8	64.4	60.8	65.9	61.3	54.6	71.0	59.8
GET RID OF	3617	1938	1678	3188	279	150	304	509	688	723	504	513	160	643	392	238	563	561	919
	29.0	32.6	25.6	30.3	20.9	23.5	19.3	25.7	28.8	35.0	35.2	44.2	30.8	34.7	30.9	38.7	39.3	24.5	32.9
NOT SURE	961	234	727	798	80	83	228	182	105	80	73	-	25	83	41	-	86	104	203
	7.7	3.9	11.1	7.6	6.0	13.0	14.5	9.2	4.4	2.9	5.1	-	4.8	4.5	3.2	-	6.0	4.5	7.3
BASE	1249	608	641	1079	95	75	142	228	346	228	124	38	40	173	117	59	153	225	:98

11-384 O - 83 -- 19

TABLE 023C

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

	TOTAL	VOTED '80 REAGAN	VOTED '80 CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
BEING ABLE TO DEDUCT INVESTMENT IN DRILLING COSTS FOR OIL & NATURAL GAS	12488	4351	2978	3255	5144	3056	4272	4989	2075	8614	3798	1714	3972	362	2179	5683	5925	7659	7257
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4216	1303	1083	999	1722	1059	1408	1803	728	2735	1434	714	1289	131	719	1898	1736	2332	2616
	33.8	29.9	36.4	30.7	33.5	34.7	33.0	38.1	35.1	31.8	37.8	41.7	32.5	36.2	33.0	33.5	29.3	30.4	36.0
GET RID OF	6393	2331	1445	1635	2700	1879	2333	2506	1163	4502	1860	838	2215	173	1191	3105	3598	4485	3840
	51.2	53.6	48.5	50.2	52.5	54.9	54.6	50.2	56.0	52.3	49.0	48.9	55.8	47.8	54.7	54.8	60.7	58.6	52.9
NOT SURE	1878	717	450	621	721	318	531	680	184	1377	502	163	468	57	268	662	593	841	802
	15.0	16.5	15.1	19.1	14.0	10.4	12.4	13.6	8.9	16.0	13.2	9.5	11.8	15.7	12.3	11.7	10.0	11.0	11.1
DEDUCTION OF POLITICAL CONTRIBUTIONS UP TO $100	12472	4383	2939	3255	5105	3079	4288	4981	2082	8614	3780	1704	3953	352	2160	5680	5933	7839	7263
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	4698	1587	1350	1205	2101	979	1600	1956	852	3379	1298	638	1334	156	662	1914	1817	2655	2904
	37.7	36.2	45.9	37.0	41.2	31.8	37.3	39.3	40.9	39.2	34.3	37.4	33.7	44.3	30.6	33.8	30.6	34.8	40.0
GET RID OF	7080	2554	1482	1824	2724	1951	2495	2882	1105	4833	2191	1003	2499	189	1449	3490	3841	4682	4128
	56.8	58.3	50.4	56.0	53.4	63.4	58.2	57.9	53.1	56.1	58.0	58.9	63.2	53.7	67.1	61.7	64.7	61.3	56.8
NOT SURE	694	242	107	226	279	149	193	143	124	401	293	64	120	7	49	256	276	302	231
	5.6	5.5	3.6	6.9	5.5	4.8	4.5	2.9	6.0	4.7	7.8	3.8	3.0	2.0	2.3	4.5	4.7	4.0	3.2

TABLE 023C
CONTINUED -1

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

	TOTAL	VOTED '80' REAGAN	VOTED '80' CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
DEDUCTIONS FOR STATE & LOCAL TAXES OTHER THAN STATE & LOCAL INCOME & PROPERTY TAXES	12511	4383	2964	3255	5153	3079	4281	5005	2082	8639	3794	1714	3972	362	2179	5667	5952	7681	7263
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	6652	2355	1640	1709	2644	1714	2137	2942	1103	4640	1964	1011	2159	247	1223	2767	2958	3808	4173
	53.2	53.7	55.3	52.5	51.3	55.7	49.9	58.8	53.0	53.7	51.8	59.0	54.4	68.2	56.1	48.8	49.7	49.6	57.5
GET RID OF	4575	1667	1061	1187	1961	1133	1763	1701	728	3119	1437	551	1511	95	794	2426	2553	3300	2564
	36.6	38.0	35.8	36.5	38.1	36.8	41.2	34.0	35.0	36.1	37.9	32.1	38.0	26.2	36.4	42.8	42.9	43.0	35.3
NOT SURE	1284	361	263	359	547	231	381	362	251	881	394	152	302	20	162	474	441	575	526
	10.3	8.2	8.9	11.0	10.6	7.5	8.9	7.2	12.1	10.2	10.4	8.9	7.6	5.5	7.4	8.4	7.4	7.5	7.2
DEDUCTIONS FOR CASUALTY & THEFT LOSES	12483	4375	2959	3255	5129	3079	4288	4981	2074	8603	3803	1714	3954	362	2161	5674	5944	7661	7248
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	7905	2398	1973	1910	3477	1902	2599	3278	1471	5129	2704	1247	2525	264	1402	3539	3301	4535	4814
	63.3	54.8	66.7	58.7	67.8	61.8	60.6	65.8	70.9	59.6	71.1	72.8	63.9	72.9	64.9	62.4	55.5	59.2	66.4
GET RID OF	3617	1686	792	1128	1261	1002	1424	1463	519	2883	728	433	1310	86	709	1802	2339	2770	2088
	29.0	38.5	26.8	34.7	24.6	32.5	33.2	29.4	25.0	33.5	19.1	25.3	33.1	23.8	32.8	31.8	39.4	36.2	28.8
NOT SURE	961	291	193	217	392	175	265	240	84	591	370	34	120	12	50	333	304	356	346
	7.7	6.7	6.5	6.7	7.6	5.7	6.2	4.8	4.1	6.9	9.7	2.0	3.0	3.3	2.3	5.9	5.1	4.6	4.8
BASE	1249	446	287	317	509	324	434	494	214	867	374	184	403	33	223	567	608	776	743

TABLE 024A

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
DEDUCTIONS FOR MEDI-CAL EXPENSES	12516	3326	3318	3566	2307	3728	3618	1837	3333	3697	4077	2575	2067	911	5719	5818	8262	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	9958	2733	2623	2779	1823	2967	2838	1419	2735	3166	3186	1933	1606	697	4657	4549	6808	1123	1897
	79.6	82.2	79.1	77.9	79.0	79.6	78.4	77.2	82.1	85.6	78.1	75.1	77.7	76.5	81.4	78.2	82.4	76.8	71.8
GET RID OF	2227	500	605	712	410	645	711	383	487	498	858	533	316	145	934	1136	1263	308	639
	17.8	15.0	18.2	20.0	17.8	17.3	19.7	20.8	14.6	13.5	21.0	20.7	15.3	15.9	16.3	19.5	15.3	21.1	24.2
NOT SURE	331	94	88	75	74	116	69	35	111	32	33	108	144	69	129	133	191	33	107
	2.6	2.8	2.7	2.1	3.2	3.1	1.9	1.9	3.3	.9	.8	4.2	7.0	7.6	2.3	2.3	2.3	2.3	4.0
DEDUCTIONS FOR INTE-REST PAID ON INSTALL-MENT & CREDIT CARD BILLS	12518	3326	3316	3566	2307	3730	3618	1837	3333	3689	4086	2575	2067	904	5719	5827	8264	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5885	1466	1546	1773	1099	1761	1798	820	1508	159[illegible]	2116	1228	917	385	2682	2794	3990	727	1076
	47.0	44.1	46.6	49.7	47.6	47.2	49.6	44.6	45.2	43.2	51.8	47.7	44.4	42.6	46.9	47.9	48.3	49.7	40.7
GET RID OF	5860	1663	1546	1559	1092	1728	1675	934	1523	1953	1878	1200	770	364	2666	2816	3750	704	1350
	46.8	50.0	46.6	43.7	47.3	46.3	46.3	50.8	45.7	52.9	46.0	46.6	37.3	40.3	46.7	48.3	45.4	48.1	51.1
NOT SURE	773	196	224	236	116	241	146	83	303	142	92	146	380	155	370	218	524	33	216
	6.2	5.9	6.8	6.6	5.0	6.5	4.0	4.5	9.1	3.8	2.3	5.7	18.4	17.1	6.5	3.7	6.3	2.3	8.2
BASE	1248	330	332	356	230	360	346	190	352	336	450	251	202	86	594	582	856	132	248

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TABLE 0248

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
DEDUCTIONS FOR MEDI-CAL EXPENSES	12516	5948	6568	10538	1334	644	1602	1974	2389	2067	1433	1161	519	1853	1270	615	1439	2292	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	9958	4625	5333	8269	1163	527	1342	1633	1985	1661	1046	840	322	1352	945	458	1211	1851	2159
	79.6	77.8	81.2	78.5	87.2	81.8	83.8	82.7	83.1	80.4	73.0	72.4	62.0	73.0	74.4	74.5	84.2	80.8	76.8
GET RID OF	2227	1268	959	1964	171	91	168	269	374	381	374	321	183	442	315	157	215	423	598
	17.8	21.3	14.6	18.6	12.8	14.1	10.5	13.6	15.7	18.4	26.1	27.6	35.3	23.9	24.8	25.5	14.9	18.5	21.3
NOT SURE	331	55	276	304	-	26	91	72	30	25	12	-	13	59	10	-	13	18	55
	2.6	.9	4.2	2.9	-	4.0	5.7	3.6	1.3	1.2	.8	-	2.5	3.2	.8	-	.9	.8	2.0
DEDUCTIONS FOR INTE-REST PAID ON INSTALL-MENT & CREDIT CARD BILLS	12518	5941	6577	10539	1334	644	1602	1976	2389	2067	1433	1161	519	1853	1270	608	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5885	2624	3261	4926	682	277	633	1061	1187	963	658	582	237	803	612	269	694	1198	1343
	47.0	44.2	49.6	46.7	51.1	43.0	39.5	53.7	49.7	46.6	45.9	50.1	45.7	43.3	48.2	44.2	48.2	52.1	47.7
GET RID OF	5860	3124	2735	4994	546	320	787	777	1118	1069	748	579	270	933	637	327	725	1066	1368
	46.8	52.6	41.6	47.4	40.9	49.7	49.1	39.3	46.8	51.7	52.2	49.9	52.0	50.4	50.2	53.8	50.4	46.3	48.6
NOT SURE	773	193	580	620	106	47	183	138	85	35	28	-	12	117	22	12	21	38	102
	6.2	3.2	8.8	5.9	7.9	7.3	11.4	7.0	3.6	1.7	2.0	-	2.3	6.3	1.7	2.0	1.5	1.7	3.6
BASE	1248	608	640	1078	95	75	142	225	346	228	124	38	40	173	1,7	59	153	225	298

Q.2E - WOULD YOU FAVOR KEEPING EACH OF THESE DEDUCTIONS OR WOULD YOU FAVOR GETTING RID OF THEM TO MAKE IT POSSIBLE TO LOWER THE BASIC TAX RATE TO 14%?

	TOTAL	VOTED '80' REAGAN	VOTED '80' CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
DEDUCTIONS FOR MEDICAL EXPENSES	12516	4374	2989	3248	5158	3079	4288	4995	2082	8835	3803	1714	3963	362	2179	5673	5952	7680	7276
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	9958	3243	2491	2409	4297	2416	3276	4132	1740	6683	3197	1455	3171	301	1768	4357	4365	5941	6046
	79.6	74.1	83.9	74.2	83.3	78.5	76.4	82.7	83.6	77.4	84.1	84.9	80.0	83.1	81.1	76.8	73.3	77.4	83.1
GET RID OF	2227	1005	440	728	711	614	918	775	307	1711	515	233	755	61	383	1181	1476	1608	1073
	17.8	23.0	14.8	22.4	13.8	19.9	21.4	15.5	14.7	19.8	13.5	13.6	19.1	16.9	17.6	20.8	24.8	20.9	14.7
NOT SURE	331	126	39	109	150	49	94	88	34	241	90	26	36	-	28	135	110	131	155
	2.6	2.9	1.3	3.4	2.9	1.6	2.2	1.8	1.6	2.8	2.4	1.5	.9	-	1.3	2.4	1.8	1.7	2.1
DEDUCTIONS FOR INTEREST PAID ON INSTALL-MENT & CREDIT CARD BILLS	12518	4383	2969	3255	5158	3079	4288	5004	2074	8644	3795	1714	3965	362	2172	5682	5952	7672	7277
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
KEEP	5885	2089	1636	1438	2542	1351	1951	2517	977	4235	1607	834	1910	177	1135	2389	2316	3246	3670
	47.0	47.7	55.1	44.2	49.3	43.9	45.5	50.3	47.1	49.0	42.3	48.7	48.2	48.8	52.3	42.0	38.9	42.3	50.4
GET RID OF	5860	2085	1153	1598	2255	1646	2169	2295	952	3942	1896	816	1916	171	984	3007	3413	4083	3346
	46.8	47.6	38.8	49.1	43.7	53.5	50.6	45.9	45.9	45.6	50.0	47.6	48.3	47.2	45.3	52.9	57.3	53.2	46.0
NOT SURE	773	209	181	218	360	82	167	192	146	467	292	64	139	14	53	287	224	344	261
	6.2	4.8	6.1	6.7	7.0	2.7	3.9	3.8	7.0	5.4	7.7	3.7	3.5	3.9	2.4	5.1	3.8	4.5	3.6
BASE	1248	446	286	317	508	324	434	493	214	866	374	184	403	33	223	567	608	775	743

TABLE 025A

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
SOCIAL SECURITY & VETERANS' BENEFITS	12513	3326	3304	3575	2307	3725	3618	1837	3333	3697	4086	2575	2055	911	5719	5815	8271	1451	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	10797	2913	2832	2945	2107	3125	3180	1599	2893	3220	3530	2189	1779	757	5103	4881	7234	1237	2200
	86.3	87.6	85.7	82.4	91.3	83.9	87.9	87.0	86.8	87.1	86.4	85.0	86.6	83.1	89.2	83.9	87.5	85.3	83.2
SHOULD BE TAXED	1322	372	344	451	155	473	379	192	279	396	433	302	182	79	511	733	746	195	361
	10.6	11.2	10.4	12.6	6.7	12.7	10.5	10.5	8.4	10.7	10.6	11.7	8.9	8.7	8.9	12.6	9.0	13.4	13.7
NOT SURE	394	42	128	180	44	128	59	46	161	80	123	84	94	75	105	201	292	20	82
	3.1	1.3	3.9	5.0	1.9	3.4	1.6	2.5	4.8	2.2	3.0	3.3	4.6	8.2	1.9	3.5	3.5	1.4	3.1
INTEREST FROM STATE & LOCAL BONDS THAT ARE USED TO FINANCE STATE & LOCAL GOVERNMENT	12517	3326	3316	3568	2307	3737	3618	1837	3325	3689	4086	2575	2067	903	5719	5827	8264	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	6111	1856	1560	1471	1224	1945	1924	830	1412	1980	2036	1103	958	353	2800	2922	4089	803	1107
	48.8	55.8	47.0	41.2	53.1	52.0	53.2	45.2	42.5	53.7	49.8	42.8	46.3	39.1	49.0	50.1	49.5	54.9	41.9
SHOULD BE TAXED	5290	1269	1398	1755	869	1522	1454	851	1462	1538	1753	1178	776	379	2432	2466	3456	566	1239
	42.3	38.2	42.2	49.2	37.7	40.7	40.2	46.3	44.0	41.7	42.9	45.7	37.5	42.0	42.5	42.3	41.8	38.7	46.9
NOT SURE	1117	202	358	342	214	270	239	156	451	171	297	294	334	171	488	439	719	94	298
	8.9	6.1	10.8	9.6	9.3	7.2	6.6	8.5	13.6	4.6	7.3	11.4	16.2	18.9	8.5	7.5	8.7	6.4	11.2

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
PART OF THE INCOME U.S. CITIZENS EARN ABROAD	12395	3228	3307	3582	2299	3701	3578	1820	3298	3653	4043	2540	2067	911	5824	5792	8158	1447	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	2914	757	788	834	536	912	732	474	796	1218	860	462	350	273	1237	1368	1979	400	490
	23.5	23.5	23.8	23.4	23.3	24.6	20.5	26.0	24.2	33.3	21.3	18.2	16.9	30.0	22.0	23.6	24.3	27.6	18.5
SHOULD BE TAXED	8526	2249	2298	2373	1607	2434	2618	1282	2192	2299	2916	1876	1390	464	3986	4055	5649	939	1856
	68.8	69.7	69.5	66.6	69.9	65.8	73.2	70.4	66.5	62.9	72.2	73.9	67.2	50.9	70.9	70.0	69.2	64.9	70.2
NOT SURE	955	221	222	356	156	355	228	63	308	136	266	201	328	174	401	370	531	109	297
	7.7	6.9	6.7	10.0	6.8	9.6	6.4	3.5	9.3	3.7	6.6	7.9	15.9	19.1	7.1	6.4	6.5	7.5	11.2
UNEMPLOYMENT COMPENSATION	12482	3326	3300	3550	2306	3719	3611	1837	3316	3697	4052	2583	2050	911	5727	5776	8246	1454	2635
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8915	2460	2259	2465	1731	2834	2474	1325	2282	2451	2903	1976	1484	665	4282	3936	6191	1029	1612
	71.4	74.0	68.5	69.4	75.1	76.2	68.5	72.1	68.8	66.3	71.6	76.5	72.4	73.0	74.8	68.1	75.1	70.8	61.2
SHOULD BE TAXED	3144	768	929	915	533	793	1054	422	875	1176	1055	526	387	185	1218	1726	1803	385	901
	25.2	23.1	28.2	25.8	23.1	21.3	29.2	23.0	26.4	31.8	26.0	20.4	18.9	20.3	21.3	29.9	21.9	26.5	34.2
NOT SURE	423	98	113	170	42	91	83	89	160	69	95	81	179	60	227	114	252	40	123
	3.4	2.9	3.4	4.8	1.8	2.4	2.3	4.8	4.8	1.9	2.3	3.1	8.7	6.6	4.0	2.0	3.1	2.8	4.7

TABLE 025A
CONTINUED -2

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
INTEREST ON LIFE INSURANCE SAVINGS	12533	3326	3316	3575	2315	3745	3618	1837	3333	3697	4086	2583	2087	911	5727	5827	8280	1463	2643
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8207	2257	2147	2308	1495	2529	2238	1227	2213	2411	2540	1801	1390	647	4150	3355	5625	892	1595
	65.5	67.9	64.7	64.6	64.6	67.5	61.9	66.8	66.4	65.2	62.2	69.7	67.2	71.0	72.5	57.6	67.9	61.0	60.3
SHOULD BE TAXED	3695	901	1035	1050	709	965	1272	550	908	1125	1386	701	461	180	1319	2185	2282	472	910
	29.5	27.1	31.2	29.4	30.6	25.8	35.2	29.9	27.2	30.4	33.9	27.1	22.3	19.8	23.0	37.5	27.6	32.3	34.4
NOT SURE	631	168	134	217	112	251	108	61	212	161	160	82	216	85	259	288	373	100	138
	5.0	5.1	4.0	6.1	4.8	6.7	3.0	3.3	6.4	4.4	3.9	3.2	10.4	9.3	4.5	4.9	4.5	6.8	5.2
BASE	1249	330	332	356	231	381	346	190	352	336	450	252	202	88	595	562	857	132	248

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
SOCIAL SECURITY & VETERANS' BENEFITS	12513	5936	6577	10535	1334	644	1602	1983	2389	2067	1421	1161	519	1841	1270	615	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	10797	4981	5816	9039	1201	557	1428	1790	2148	1812	1153	969	348	1465	1089	519	1203	2008	2505
	86.3	83.9	88.4	85.8	90.0	86.5	89.0	90.3	89.9	87.7	81.1	83.5	67.1	79.6	85.7	84.4	83.6	87.3	89.1
SHOULD BE TAXED	1322	791	531	1156	92	72	138	111	176	217	218	162	147	319	146	88	154	209	251
	10.6	13.3	8.1	11.0	6.9	11.2	8.6	5.6	7.4	10.5	15.3	14.0	28.3	17.3	11.5	14.3	10.7	9.1	8.9
NOT SURE	394	164	230	338	40	15	39	82	64	39	49	30	23	57	35	8	82	84	57
	3.1	2.8	3.5	3.2	3.0	2.3	2.4	4.1	2.7	1.9	3.4	2.6	4.4	3.1	2.8	1.3	5.7	3.7	2.0
INTEREST FROM STATE & LOCAL BONDS THAT ARE USED TO FINANCE STATE & LOCAL GOVERNMENT	12517	5948	6569	10539	1334	644	1602	1993	2381	2067	1433	1161	519	1853	1270	615	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	6111	2852	3259	5075	724	312	714	950	1168	1019	679	615	228	921	661	305	554	1221	1327
	48.8	47.9	49.6	48.2	54.3	48.4	44.6	47.9	49.1	49.3	47.4	53.0	43.9	49.7	52.0	49.6	38.5	53.1	47.2
SHOULD BE TAXED	5290	2807	2483	4507	526	257	616	809	1087	926	667	516	222	810	540	278	738	953	1303
	42.3	47.2	37.8	42.8	39.4	39.9	38.5	40.8	45.7	44.8	46.5	44.4	42.8	43.7	42.5	45.2	51.3	41.4	46.3
NOT SURE	1117	290	827	958	83	76	272	223	127	122	88	30	69	123	69	32	148	127	183
	8.9	4.9	12.6	9.1	6.2	11.8	17.0	11.2	5.3	5.9	6.0	2.6	13.3	6.6	5.4	5.2	10.3	5.5	6.5

TABLE 025B
CONTINUED -1

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

	TOTAL	SEX		RACE			INCOME							OCCUPATION					
		MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
PART OF THE INCOME U.S. CITIZENS EARN ABROAD	12395	5908	6487	10417	1334	644	1568	1948	2389	2059	1424	1161	519	1853	1262	615	1429	2257	2805
	100,0	100,0	100.0	100,0	100,0	100.0	100,0	100,0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	2914	1427	1488	2261	450	203	450	496	505	448	257	372	139	510	233	128	299	563	636
	23.5	24.2	22.9	21.7	33.7	31.5	28.7	25.5	21.1	21.8	18.0	32.0	26.8	27.5	18.5	20.8	20.9	24.9	22.7
SHOULD BE TAXED	8526	4182	4344	7388	762	375	895	1354	1796	1519	1114	702	334	1241	1012	471	978	1600	2024
	68.8	70.8	67.0	70.9	57.1	58.2	57.1	69.5	75.2	73.8	78.2	60.5	64.4	67.0	80.2	76.6	68.4	70.9	72.2
NOT SURE	955	299	655	767	121	66	222	98	88	92	54	87	46	102	18	17	153	94	145
	7.7	5.1	10.1	7.4	9.1	10.2	14.2	5.0	3.7	4.5	3.8	7.5	8.9	5.5	1.4	2.8	10.7	4.2	5.2
UNEMPLOYMENT COMPENSATION	12482	5922	6561	10522	1316	644	1584	1974	2382	2058	1433	1161	519	1827	1261	615	1432	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8915	4216	4700	7409	1013	494	1194	1568	1754	1412	983	717	342	1146	802	365	1077	1697	2177
	71.4	71.2	71.6	70.4	77.0	76.7	75.4	79.4	73.6	68.6	68.6	61.8	65.9	62.7	63.6	59.3	75.2	73.8	77.4
SHOULD BE TAXED	3144	1605	1539	2769	254	121	300	334	571	609	438	444	163	640	442	250	328	569	574
	25.2	27.1	23.5	26.3	19.3	18.8	18.9	16.9	24.0	29.6	30.6	38.2	31.4	35.0	35.1	40.7	22.9	24.7	20.4
NOT SURE	423	101	322	344	49	30	90	72	57	37	12	-	14	41	17	-	26	35	62
	3.4	1.7	4.9	3.3	3.7	4.7	5.7	3.6	2.4	1.8	.8	-	2.7	2.2	1.3	-	1.8	1.5	2.2

TABLE 025B
CONTINUED -2

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $85K	$85,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
INTEREST ON LIFE INSURANCE SAVINGS	12533	5948	6585	10555	1334	844	1602	1991	2389	2087	1433	1181	519	1853	1270	815	1439	2301	2813
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8207	3518	4690	6873	954	379	1164	1479	1650	1163	878	651	277	1024	709	354	940	1597	1786
	65.5	59.1	71.2	65.1	71.5	58.9	72.7	74.3	69.1	56.3	61.1	56.1	53.4	55.3	55.8	57.6	65.3	69.4	63.5
SHOULD BE TAXED	3695	2132	1563	3164	310	221	323	431	627	788	536	456	213	749	504	241	412	632	846
	29.5	35.8	23.7	30.0	23.2	34.3	20.2	21.6	26.2	38.1	37.4	39.3	41.0	40.4	39.7	39.2	28.6	27.5	30.1
NOT SURE	631	300	332	518	70	44	114	81	113	118	20	54	29	80	57	19	87	72	182
	5.0	5.0	5.0	4.9	5.2	6.8	7.1	4.1	4.7	5.6	1.4	4.7	5.6	4.3	4.5	3.1	6.0	3.1	6.5
BASE	1249	608	641	1079	95	75	142	226	346	228	124	38	40	173	117	59	153	225	298

TABLE 025C

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REAGAN	CARTER	REPUBLICAN	DEMOCRAT	INDEPENDENT	CONSERVATIVE	MIDDLE OF ROAD	LIBERAL	YES	NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
SOCIAL SECURITY & VETERANS' BENEFITS	12513 100.0	4371 100.0	2969 100.0	3255 100.0	5158 100.0	3067 100.0	4288 100.0	4992 100.0	2082 100.0	8632 100.0	3803 100.0	1714 100.0	3972 100.0	362 100.0	2179 100.0	5870 100.0	5940 100.0	7888 100.0	7285 100.0
SHOULD REMAIN TAX-FREE	10797 86.3	3617 82.7	2666 89.8	2744 84.3	4586 88.9	2610 85.1	3681 85.8	4374 87.6	1791 86.0	7428 86.1	3291 86.5	1525 89.0	3376 85.0	329 90.9	1896 87.0	4856 85.6	5048 85.0	6817 86.3	6409 88.0
SHOULD BE TAXED	1322 10.6	631 14.4	234 7.9	439 13.5	403 7.8	384 12.5	498 11.6	519 10.4	219 10.5	986 11.4	336 8.8	161 9.4	460 11.6	32 8.8	211 9.7	686 12.1	773 13.0	879 11.5	699 9.6
NOT SURE	394 3.1	124 2.8	70 2.4	71 2.2	168 3.3	73 2.4	109 2.5	98 2.0	72 3.5	218 2.5	175 4.6	28 1.6	136 3.4	- -	71 3.3	129 2.3	119 2.0	172 2.2	177 2.4
INTEREST FROM STATE & LOCAL BONDS THAT ARE USED TO FINANCE STATE & LOCAL GOVERNMENT	12517 100.0	4383 100.0	2969 100.0	3247 100.0	5158 100.0	3079 100.0	4288 100.0	5004 100.0	2082 100.0	8644 100.0	3795 100.0	1714 100.0	3972 100.0	362 100.0	2179 100.0	5682 100.0	5952 100.0	7872 100.0	7277 100.0
SHOULD REMAIN TAX-FREE	6111 48.8	2150 49.1	1403 47.3	1653 50.9	2492 48.3	1494 48.5	2116 49.3	2475 49.5	1082 52.0	4173 48.3	1903 50.1	836 48.8	1975 49.7	170 47.0	1080 49.6	2751 48.4	2661 44.7	3549 46.3	3596 49.4
SHOULD BE TAXED	5290 42.3	1926 43.9	1253 42.2	1370 42.2	2120 41.1	1377 44.7	1808 42.2	2206 44.1	858 41.2	3731 43.2	1516 39.9	778 45.4	1786 45.0	164 45.3	1001 45.9	2547 44.8	2911 48.9	3617 47.1	3178 43.7
NOT SURE	1117 8.9	307 7.0	313 10.5	224 6.9	546 10.6	208 6.8	364 8.5	323 6.5	142 6.8	741 8.6	378 9.9	99 5.8	212 5.3	27 7.5	98 4.5	385 6.8	380 6.4	506 6.6	503 6.9

TABLE 025C
CONTINUED -1

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		VOTED '80'		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REAGAN	CARTER	REPUBLICAN	DEMOCRAT	INDEPENDENT	CONSERVATIVE	MIDDLE OF ROAD	LIBERAL	YES	NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
PART OF THE INCOME U.S. CITIZENS EARN ABROAD	12395	4348	2953	3209	5095	3057	4251	4982	2047	8584	3733	1704	3948	382	2161	5835	5898	7586	7201
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	2914	756	549	785	1202	651	985	1087	550	1524	1353	287	773	64	442	1311	1265	1735	1740
	23.5	17.4	18.6	24.5	23.6	21.3	23.2	21.8	26.9	17.8	36.2	16.8	19.6	17.7	20.5	23.3	21.4	22.9	24.2
SHOULD BE TAXED	8526	3259	2201	2127	3495	2295	2938	3710	1356	6394	2092	1292	2953	298	1589	3925	4368	5444	5132
	68.8	75.0	74.5	66.3	68.6	75.1	69.1	74.5	66.2	74.5	56.0	75.8	74.8	82.3	73.5	69.7	74.0	71.8	71.3
NOT SURE	955	332	204	298	398	111	330	186	141	666	289	126	220	-	130	399	267	408	328
	7.7	7.6	6.9	9.3	7.8	3.6	7.8	3.7	6.9	7.8	7.7	7.4	5.6	-	6.0	7.1	4.5	5.4	4.6
UNEMPLOYMENT COMPENSATION	12482	4383	2942	3255	5139	3070	4280	4996	2055	8610	3794	1688	3945	353	2161	5640	5934	7654	7288
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8915	3056	2155	2136	3883	2204	2917	3588	1585	6089	2774	1101	2734	261	1520	3995	4051	5407	5331
	71.4	69.7	73.2	65.6	75.6	71.8	68.2	71.8	77.1	70.5	73.1	65.2	69.3	73.9	70.3	70.8	68.3	70.6	73.3
SHOULD BE TAXED	3144	1240	668	1022	1079	798	1221	1302	430	2286	852	552	1110	91	572	1565	1806	2090	1764
	25.2	28.3	22.7	31.4	21.0	25.9	28.5	26.1	20.9	26.6	22.5	32.7	28.1	25.8	26.5	27.7	30.4	27.3	24.3
NOT SURE	423	86	119	97	177	71	141	106	40	255	168	38	102	-	69	79	76	157	173
	3.4	2.0	4.0	3.0	3.4	2.3	3.3	2.1	1.9	3.0	4.4	2.1	2.6	-	3.2	1.4	1.3	2.1	2.4

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TABLE 025C
CONTINUED -2

Q.2F - DO YOU THINK THE FOLLOWING SHOULD REMAIN TAX-FREE, OR SHOULD IT BE TAXED IN ORDER TO SET THE BASIC TAX RATE AT 14%?

		VOTED '80		CONSIDER SELF			POL PHILOSOPHY			VOTED '80									
	TOTAL	REAGAN	CARTER	REPUBLICAN	DEMOCRAT	INDEPENDENT	CONSERVATIVE	MIDDLE OF ROAD	LIBERAL	YES	NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
INTEREST ON LIFE INSURANCE SAVINGS	12533	4383	2978	3255	5166	3079	4288	5012	2082	8652	3803	1714	3972	362	2179	5682	5952	7688	7285
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SHOULD REMAIN TAX-FREE	8207	2753	1911	2103	3496	1891	2495	3412	1501	5423	2720	1161	2471	237	1484	3729	3567	4874	4739
	65.5	62.8	64.2	64.6	67.7	61.4	58.2	68.1	72.1	62.7	71.5	67.7	62.2	65.5	68.1	65.6	59.9	63.4	65.1
SHOULD BE TAXED	3695	1486	855	1031	1375	1056	1635	1378	479	2770	918	523	1374	124	602	1663	2114	2529	2239
	29.5	33.9	28.7	31.7	26.6	34.3	38.1	27.5	23.0	32.0	24.1	30.5	34.6	34.3	27.6	29.3	35.5	32.9	30.7
NOT SURE	631	144	211	121	294	132	158	222	101	460	165	30	127	-	93	291	271	285	307
	5.0	3.3	7.1	3.7	5.7	4.3	3.7	4.4	4.9	5.3	4.3	1.8	3.2	-	4.3	5.1	4.6	3.7	4.2
BASE	1249	446	287	317	509	324	434	494	214	867	374	184	403	33	223	587	608	776	743

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TABLE 026A

Q.2G - WOULD YOU FAVOR OR OPPOSE THE PROPOSED SIMPLIFIED FEDERAL INCOME TAX?

		REGION				AREA				AGE				EDUCATION			MAKE ENDS MEET		
	TOTAL	EAST	MID-WEST	SOUTH	WEST	CIT-IES	SUB-URBS	TOWNS	RURAL	18-29	30-49	50-64	65 & OVER	8TH GRADE	HIGH SCH-OOL	COL-LEGE	HARD-ER	EAS-IER	ABOUT SAME
TOTAL ANS	12515	3326	3316	3557	2315	3745	3618	1837	3315	3697	4086	2571	2061	893	5727	5827	8262	1463	2643
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAVOR	7285	2126	1831	2001	1327	2114	2240	1015	1916	2375	2347	1513	1003	343	3435	3495	4958	847	1414
	58%	64%	56%	56%	58%	56%	62%	55%	57%	64%	58%	59%	48%	38%	60%	60%	60%	58%	54%
OPPOSE	3970	824	1177	1149	821	1231	1062	598	1078	1171	1314	823	654	357	1772	1817	2550	491	879
	32%	25%	35%	32%	35%	33%	29%	33%	33%	32%	32%	32%	32%	40%	31%	31%	31%	34%	33%
NOT SURE	1260	377	308	408	167	400	315	224	321	151	425	234	404	194	520	515	754	126	350
	10%	11%	9%	11%	7%	11%	9%	12%	10%	4%	10%	9%	20%	22%	9%	9%	9%	9%	13%
BASE	1247	330	332	354	231	381	348	190	350	336	450	251	201	84	585	562	855	132	248

TABLE 026B

Q.2G - WOULD YOU FAVOR OR OPPOSE THE PROPOSED SIMPLIFIED FEDERAL INCOME TAX?

		SEX		RACE			INCOME							OCCUPATION					
	TOTAL	MALE	FE-MALE	WHITE	BLACK	HISP-ANIC	$7,500 OR LESS	$7,501 TO $15K	$15,001 TO $25K	$25,001 TO $35K	$35,001 TO $50K	$50,001 TO $65K	$65,001 OR OVER	PRO-FES-SIONAL	EXEC-U-TIVE	PRO-PRI-ETOR	SKIL-LED LABOR	WHITE COLLAR	UNION FAM.
TOTAL ANS	12515	5948	6567	10537	1334	644	1602	1991	2383	2067	1433	1161	519	1853	1270	615	1439	2289	2813
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAVOR	7285	3719	3566	6142	738	405	880	1342	1494	1281	840	624	213	1064	752	444	906	1345	1699
	58%	62%	55%	59%	55%	63%	55%	68%	63%	62%	59%	54%	41%	57%	60%	72%	63%	59%	60%
OPPOSE	3970	1839	2131	3295	503	172	508	446	699	662	523	429	267	624	462	171	401	779	776
	32%	31%	32%	31%	38%	27%	32%	22%	29%	32%	36%	37%	51%	34%	36%	28%	28%	34%	28%
NOT SURE	1260	390	870	1100	93	67	213	203	190	125	70	108	39	166	56	-	133	169	338
	10%	7%	13%	10%	7%	10%	13%	10%	8%	6%	5%	9%	8%	9%	4%	-	9%	7%	12%
BASE	1247	608	639	1077	95	75	142	226	345	228	124	38	40	173	117	59	153	224	298

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TABLE 026C

Q.2G - WOULD YOU FAVOR OR OPPOSE THE PROPOSED SIMPLIFIED FEDERAL INCOME TAX?

	TOTAL	VOTED '80' REAGAN	VOTED '80' CARTER	CONSIDER SELF REPUBLICAN	CONSIDER SELF DEMOCRAT	CONSIDER SELF INDEPENDENT	POL PHILOSOPHY CONSERVATIVE	POL PHILOSOPHY MIDDLE OF ROAD	POL PHILOSOPHY LIBERAL	VOTED '80 YES	VOTED '80 NO	SOMEONE EARNS EXTRA $	KNOW SOMEONE EARNS EXTRA $	DOES NOT REPORT EXTRA $	IMP. TO FOLLOW RULES	NOT FAIR AND EQUITABLE	FAVOR PAYING SAME PER.	FAVOR FLAT TAX	FAVOR BRADLEY-GEPHARDT
TOTAL ANS	12515	4383	2972	3255	5154	3073	4288	5006	2082	8646	3781	1714	3972	362	2179	5682	5946	7688	7285
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
FAVOR	7285	2622	1738	1923	3007	1857	2409	3284	1169	5062	2163	946	2384	204	1320	3057	3604	4934	7285
	58%	59%	58%	58%	59%	60%	56%	66%	56%	58%	57%	55%	60%	57%	61%	53%	61%	64%	100%
OPPOSE	3970	1425	938	1063	1606	983	1527	1358	743	2733	1219	627	1329	135	748	2132	1917	2298	-
	32%	33%	32%	33%	31%	32%	36%	27%	36%	32%	32%	37%	33%	37%	34%	38%	32%	30%	-
NOT SURE	1260	336	295	269	541	232	352	363	170	851	409	141	258	23	111	493	424	455	-
	10%	8%	10%	8%	10%	8%	8%	7%	8%	10%	11%	8%	6%	8%	5%	9%	7%	6%	-
BASE	1247	446	286	317	506	323	434	493	214	868	373	184	403	33	223	567	607	776	743

Senator GRASSLEY. Senator Bradley, under the early-bird rule.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Harris, I find your testimony very interesting, particularly the sentence "The idea of cutting the basic rate and also eliminating the most flagrant loopholes has real appeal. The Bradley-Gephardt bill or some other version like it would have a public mandate today."

So, essentially, what you are saying is that it is an idea whose time has come?

Mr. HARRIS. It has come for the moment, Senator. I'm not sure that it will last for a long, long time; it might. I am not about to tell you that this is a great turning point from whence they won't go back.

The reason I say that is, people are boiling mad. They are saying, in addition to everything else, how hard it is to live and how difficult it is to make ends meet, and these genuine fears that people have about depression. On top of all that they feel here we have got a system that the rich and big companies are just exploiting. Therefore, they are wide open to an idea that has in it some of the better features of a progressive system, but also closes the loopholes. People go a long way toward that.

I must say, in the end they were not that happy about the recent tax increase that was passed by the Congress and signed by the President, but I'm not sure they understood or really felt that the loopholes were where the concentration was, as was claimed by the sponsors of it.

Senator BRADLEY. You stated that the support was broad based among low income, proprietors, skilled laborers, professionals, and executives, that support all over 60 percent.

Mr. HARRIS. Yes.

Senator BRADLEY. Tell me, do you think this feeling has any relationship to—I saw another poll by another firm that had a question that said, "If you abide by the rules in America, you no longer get ahead." Eighty-one percent of the people said that if they abide by the rules they didn't think they got ahead.

Mr. HARRIS. We asked that again in a different version in this week's Business Week survey. We asked, "Do you agree or disagree—It is impossible to make ends meet anymore by following all the rules and regulations." Fifty-five to forty-one percent—a little less than the 81 that you reported from this other poll—agreed with that.

Senator BRADLEY. And you would tie that to the tax system as such, in part?

Mr. HARRIS. Yes; I would say the tax system probably bears about half the brunt of blame for that.

Senator BRADLEY. Thank you very much.

Senator GRASSLEY. Senator Long?

Senator LONG. Thank you very much.

I came in in the middle of your statement. I enjoyed what you said about this, and I was carefully studying what you have said here. I am reading it right now. Thank you.

Senator GRASSLEY. Senator Mitchell?

Senator MITCHELL. Well, I didn't hear your statement either, but I did have some review of what you were going to say before you said it, because of the statements we have.

I guess the thing I was interested in was, in the support of progressivity, do people in your poll equate progressivity with fairness?

Mr. HARRIS. Yes. You see, you still get a 47- to 45-percent plurality who think that those with higher incomes not only should pay a higher gross amount, which obviously you would get under a Bradley-Gephardt flat tax as well, but that they should pay higher rates. There is a considerable body of opinion that backs this. A year ago we got a 58- to 38-percent majority; that is a 20-point difference that has shrunk to 2 just in the course of a year.

Senator GRASSLEY. In support of the concept of progressivity—the principle?

Mr. HARRIS. In support of the principle, yes.

Senator GRASSLEY. So, as the support for progressivity shrinks, does your data also show a movement toward a flat rate? Is that what you are saying?

Mr. HARRIS. Well, people are willing certainly to entertain the idea of a flat rate, but above all else they want an end to what they call the deductions and exclusions taken by the most privileged people in our society, at least as they perceive it. And that's not just a caveat, that is the body of their sentiment, while the flat tax advocacy is really a tail to it.

What people are saying, fundamentally, Senator Grassley, is that they would do almost anything to stop these inequities. They are roaring mad about it. Now, you might say they are very inconsistent because they are not willing to give up very much themselves, in terms of what they enjoy. And if they say that, why then shouldn't business or higher income people have their exclusions as well?

But, make no mistake about it, I couldn't leave here today without conveying one thought: People are just boiling mad and sore about what they feel as the advantage being taken of the system by the most privileged people in it.

Senator MITCHELL. Mr. Chairman, may I just follow up on that point?

Senator GRASSLEY. Yes. The Senator from Maine.

Senator MITCHELL. I think it is important to clarify for Mr. Harris the concept of simplifying the Tax Code, that is of eliminating the many deductions and preferences which you have described—and I think undoubtedly accurately—that people are mad about from the concept of a flat tax rate, they are really two seperate propositions. While they may be confused in the public dialog and in the public mind; they do not necessarily go together.

One can support simplification, which exposes a greater portion of the national income to taxation, without even commenting on the rate to be applied to the remaining income. Obviously it follows that if you have a greater portion of income subject to taxation the rates are likely to fall; but whether they fall in a continuing progressive manner or in a flat is too narrow.

Is there in the public mind, or do your surveys reveal, an understanding of the distinction? Or is it all lumped in together, that the only way to get simplification is to go to a flat rate?

Mr. HARRIS. No, there are three distinct parts to it. One is, people find tax forms, expecially if they don't use the simple form, full of gobbledygook and difficult to cope with. We have done other surveys which show that people do feel that way.

A second element in it, as I said a moment ago, is the deeply felt hostility about inequites in the system.

And the third would be, well, what kind of a tax alternative, therefore, do you want?

I think it is important, and I didn't say this in my testimony. I must say I am submitting here today the full printouts and the questionnaire we asked, and so on, but it is only by 49 to 42 percent that people nationwide say they would substitute some variation of a flat tax—or put it this way: A more simplified tax that has some flat tax features in it, provided it takes out a great number of the inequites—for the present tax system. It is not as though it is a runaway decision.

What's happened? The only way I can describe it is people have finally reached the point of saying, "Look, all of the rhetoric about progressive tax principles sounds great, but we know better," we know that people are just driving Mack trucks through the loopholes every time they file their income taxes, and those are precisely the people who can afford the lawyers, the accountants, the tax experts, and they are every bit as much in revolt against that as they are anything.

Senator MITCHELL. From whom I guess we are going to hear very shortly.

Senator GRASSLEY. Senator Long?

Senator LONG. You might be able to help some of us reach a decision with regard to the fact that the public perception seems to be somewhat behind the event.

For example, when I became chairman of this committee I discovered that a very considerable portion of millionaires in this country, persons receiving more than a million dollars a year of income, an alarming number of them were not paying us an income tax at all. The Treasury study made somewhere shortly after the end of World War II, back when the unlimited charitable deduction was on the books, concluded that about 30 percent of those who made over $5 million a year paid no income tax—none. And most of that was because of the unlimited charitable deduction.

Of course, when people found out how that was being used—in other words, in most cases they weren't saying goodby to all that wealth, they weren't parting company with it; they were just moving it over from their personal account into their private foundation. But they still maintained control of that money, enough to outrage people especially when they found that some of these foundations weren't doing any good for anybody—they simply proclaimed a charitable purpose and never did any charitable work.

Now, it took Congress a while to learn about that and say, "If you want to be in the charity business, you have got to give something to charity; you've got to do something for some poor soul, or a dog, or a cat, or something. You just can't claim a charitable purpose and deduct the money and keep it all in your own foundation, and even deal and trade with your own foundation, and all that." We stopped all that mischief, so the foundations are not blossoming as much as they were at one point.

But the good ones I think are still going ahead, those who really are doing what they said they were going to do.

We just got through raising this minimum tax, so to a large degree as far as these wealthy people are concerned that minimum tax is a flat tax. I think you understand how it works; generally we take the deductions that tend to keep you from paying a tax and tax you on that basis, so if you didn't pay any tax by the old rules we will tax you on a different basis, in which event you are likely to end up paying about 20 percent of what your income was.

Now, the public can't very well have caught up with that because they haven't been seeing much about it. Very few people have been explaining it to them on television, and things like that. What they have been seeing on television is just the opposite. You see some fellow who has made a lot of money and paid no tax.

Now, can you help enlighten me? As this thing goes along and we've got it so that people cannot legally avoid taxes and they go to the penitentiary when they do evade it, do you think that is going to reverse this trend that seems to be moving at the moment?

Mr. HARRIS. Senator, I think your point is extremely well taken in terms of public opinion. If you want to talk about seeds of potential revolution in this country, two of them that can provoke that are: First, that very wealthy people don't pay any taxes at all; and second the other is, which I have told a lot of corporate clients of mine, when the head of a big corporation gets paid $600,000 or $700,00 or $800,000 or $900,000 a year, people get outraged with that as well.

This gets particularly exacerbated in a period like we are living through today. People are just down to the hardest time, belt-tightening, missing meals, and all sorts of things. When they hear about such things, they just get blood in their eyes.

I think your point is that you can interpret some of the support for the flat tax as they are saying, "Well, at least we are going to make them pay 14 percent, or we are going to make them pay a certain amount."

Senator LONG. Well, it is 20 percent now, you know.

Mr. HARRIS. Yes. And that does have great appeal.

Senator LONG. The one thing I learned about tightening up on so-called loopholes is that when you get the tightening to where it reaches a lot of people, all of a sudden the pressure goes the other way.

Some time ago we were talking about the minimum tax in a conference, and I suggested that we ought to get that tax down to where Senators and Congressmen would pay the minimum tax, on the same type situation; basically just reduce the exemption so you would get it down where Members of Congress would have an opportunity to pay the minimum tax. Then, doing that, we got a lot of business people around the country. When we caught them, we caught a lot of people.

Now, at that point the minimum tax became so unpopular we had to back off with the minimum tax, because we were catching just a great number of people around the country with that minimum tax.

We are going to find with this one that there is going to be something of a big reaction to it, Mr. Harris. I don't know what the polls are going to show when the public finds out, but I am aware of just one situation that the staff computed for me:

Here was a dear old couple—papa in the nursing home, mama trying to stay in her little house and have somebody come in and help her a little bit, a "sitter" you might say, just to sit there and visit with papa in the nursing home. Now we find that because they had to rearrange some of their affairs to keep their income from eroding too badly, ~~they will be pay~~ing that minimum tax. All they are taking in is just enough to maintain their standard of living, which basically means that you have a sitter for papa in the nursing home and you've got somebody to come in and help mama do the household chores, because she can get around the house a little bit and is not required to be in the nursing home at this point.

Now, when people discover that that is being subject to a minimum tax for those kinds of families, all of a sudden you are going to see the same thing, I predict, Mr. Harris. People are going to say, "Hold on just a minute; those people are not millionaires, and they should not be taxed as though they are."

Mr. HARRIS. Well, Senator Long, aren't there a fair number of families who don't pay taxes? Are you saying the minimum tax would apply to all families?

Senator LONG. I said it would apply to the family I had in mind. Let's say $40,000 of income between the two of them—and not only paying income tax but paying a very heavy minimum tax under the new law we have passed.

Mr. HARRIS. I will make an unsolicited suggestion—this doesn't come out of our survey data at all. One way if you wanted to get a fast read on that is next year when the IRS sends out their income tax forms to people, if right at the head of that in big block printing was that under the new law people, I think you would have to say above a certain income level, must pay a minimum tax. That would be communicated awfully fast.

I don't know what the reaction would be, but we have tested it on corporations paying minimum tax. Under safe harbor leasing, there was quite a bit of public outrage on that. A 7-to-1 majority would like to see all corporations have to pay a minimum tax.

Senator LONG. That would help communicate it. Of course, if the media would pick it up and explain some of these things a little better, that would help speed the public notice, too.

Do you gain the impression that public perception tends to lag somewhat behind the fact?

Mr. HARRIS. Yes, on new legislation. I have maintained for a number of years, Senator Long, that Congress is so busy—both Houses—so busy arriving at its compromises internally that it doesn't take the trouble to explain to the American people what it is legislating. I believe that very firmly.

Senator LONG. In any case, though, it is not us doing it. We have to count on the media to do it.

Thank you very much, Mr. Harris.

Senator GRASSLEY. Any other questions?

[No response.]

Senator GRASSLEY. Mr. Harris, thank you very much for your testimony.

Senator BRADLEY. Mr. Chairman, did Mr. Harris submit his full survey to the record?

Senator GRASSLEY. Yes.

Mr. HARRIS. Yes, I am submitting all of that today along with my statement.

Senator GRASSLEY. Yes, and that will be included.

Thank you, Mr. Harris, for your testimony. Our next panel of witnesses will be Jerome Kurtz, Sheldon Cohen, and Bernard Aidinoff.

Would you come forward and proceed? If it is acceptable with you, please proceed in the order in which your names are on the list.

Your statement will be made a part of the record, and we would appreciate it very much if you would summarize.

Mr. KURTZ. Thank you; I will.

Senator GRASSLEY. Thank you.

STATEMENT OF MR. JEROME KURTZ, PARTNER, PAUL, WEISS, RIFKIN, WHARTON & GARRISON, WASHINGTON, D.C.

Mr. KURTZ. Mr. Chairman and members of the committee, my name is Jerome Kurtz and I am a lawyer in private practice in Washington, D.C. From 1977 to late 1980 I was Commissioner of Internal Revenue.

Our income tax has its problems. It is too complicated, it is widely regarded as unfair, the rates are too high, it is riddled with loopholes, and compliance is falling.

Many of these complaints about the income tax are well founded, but the problems have little to do with progressive rates. They rather have to do with the proliferation of exclusions, deductions, credits, and other tax benefits that have been grafted on to our income tax but are unnecessary in fact detrimental to the proper functioning of that tax.

"Simplified" and "flat rate" are clearly two separate and distinct issues. If we are seduced into believing that simplification requires a flat rate, we will unnecessarily sacrifice substantial equity for minimal gains in simplification.

Our tax laws now contain over 100 special provisions called, as you know, tax expenditures, which reduce taxes through exclusions, deductions, and credits, having little or nothing to do with taxpayers' real income and real ability to pay tax. These special provisions are called "tax expenditures" because they carry out, through tax relief, programs that more traditionally and more properly should be considered spending programs.

Using the tax system to further specific economic and social programs has, in the past, seemed attractive because tax expenditures appeared easier to administer than direct expenditure programs and provided an almost complete absence of redtape. Moreover, they don't appear on the budget.

We have, I hope, come to realize that ease of administration and absence of redtape has, for the most part, meant misdirected programs and waste. And I assume we all now realize that tax expenditures cost the same as comparable direct programs. This has become painfully apparent as we have seen our tax base shrink at the same time as the pressure for greater tax expenditures has increased. A cycle has ensued in which the erosion of the tax base, due to the granting of special tax relief, has required higher marginal rates, which rates, in turn, have only increased the demand for additional specific tax relief from those rates.

What perhaps has not been well recognized as the number and size of tax expenditures grew was the cumulative effect they were having on our tax system.

Individual income tax collections this year will amount to about $300 billion. According to official estimates, tax expenditures for individuals will be about $200 billion. That is an indication, not that the $200 billion can be raised by eliminating all tax expenditures, of the order of magnitude of rate reductions that could be put in place if all or most tax expenditures were eliminated. This would be true regardless of whether the rate structure were then to be progressive or flat.

The elimination or substantial reduction of tax expenditures would not only greatly simplify the income tax, improve equity, and lower rates, but it would greatly improve the economic efficiency of the income tax. Gross economic distortions are encouraged under our existing system because decisions, particularly investment decisions, are greatly influenced by the availability or lack of availability of various tax benefits.

The lower marginal rates which would be permitted by base broadening would most likely increase incentives and improve compliance. Lower marginal rates would also decrease the pressures for further tax expenditures. As the proliferation of tax expenditures narrows the base, requiring higher rates, those subject to such rates seek relief by pressing their own special tax relief provisions.

Again, whether the rates to be applied to a broadened base are progressive or whether a single rate should be applied to all income is a totally seperate question but a critically important one.

If a flat rate were applied, even to a greatly simplified and therefore expanded definition of income, the result would be substantial increases in the taxes of most lower- and middle-income taxpayers and corresponding reductions in the tax liabilities of those with the highest income.

Although it is sometimes asserted that a flat-rate tax would not reduce taxes on the rich because with tax shelters and special benefits they pay little taxes today, the assertion is untrue. While some wealthy people do pay little or no tax, many pay very substantial amounts of taxes. On average, our tax system is still progressive, although it has become less progressive since the enactment last year of the Economic Recovery Tax Act. Nevertheless, all proposals for flat-rate taxes would result in large tax reductions for the highest income taxpayers as a group at the expense of the less affluent. Others have submitted those figures, and I won't repeat them here.

I would like to make one further point: The debates about the fairness of progressive rates compared to a flat rate generally focus only on the individual income tax. But the individual income tax is only part of the total tax burden imposed on individuals. Most individual taxes other than the income tax are not only not progressive, they are not even proportionate. The individual income tax, as I say, will raise about $300 billion this year. Social security taxes, the second largest source of Federal revenue, will raise about $225 billion, and raise that enormous sum in a clearly regressive way. Under present law, wages are subject to social security taxes of 6.7 percent on each of the employer and the employee, and income from self-employment is taxed at the rate of 9.35 percent. The tax applies from the first dollar of income without exemptions or deductions and does not apply to wages or self-employment income over $32,400. Nor does it apply to interest or dividends, or any income other than that from wages and self-employment.

Taking social security taxes into account, the total Federal tax burden is roughly proportional today, not progressive. It takes progressive income tax rates to keep the overall system from being regressive. The question, therefore, should not be whether to have a flat rate or progressive income tax, but whether the income tax should be at least sufficiently progressive to make the overall system flat or proportionate.

While economists and social philosophers may debate whether a progressive tax system is fair, the fact is, I believe, that most people think it is. It seems reasonable to most people that the costs of government be borne in a manner having a relation to the rewards one receives from the system and that the most affluent can pay proportionately more than the less affluent.

We have a system which relies heavily on voluntary compliance, and that system can only succeed if it is perceived by most taxpayers as fair. And the perceived fairness of progressive rates applied to income are too much a part of our political and social structure to be abandoned. They are essential, given the rest of our structure, to prevent regressive burdens.

I might say a word about the Bradley-Gephardt bill. I believe it is clearly the most thoughtful entry in this debate so far. In the end, it essentially reproduces the existing distribution of the tax burden of our income tax system. One can well debate whether the rates applied to the broadened base as defined in that bill are sufficiently progressive, but certainly they represent the minimum degree of progressivity required to prevent the system from going into a regressive structure overall.

That concludes my prepared remarks, Mr. Chairman. I would be happy to answer any questions.

Senator GRASSLEY. Thank you. I think we will hear all of the witnesses on this panel first.

[The prepared statement of Jerome Kurtz follows:]

U.S. SENATE
COMMITTEE ON FINANCE
HEARING ON "FLAT RATE" TAX PROPOSALS
STATEMENT OF JEROME KURTZ
SEPTEMBER 29, 1982

Mr. Chairman and Members of the Committee:

My name is Jerome Kurtz. I am a lawyer in private practice in Washington, D.C. From 1977 to late 1980, I was Commissioner of Internal Revenue. I am pleased to appear today at your invitation to participate in this very important hearing.

Our income tax has its problems. It is too complicated. It is widely regarded as unfair. The rates are too high. It is riddled with loopholes and compliance is falling. A proposed solution is to adopt a "simplified flat rate income tax," a phrase which has become the current euphemism for tax reductions for the wealthy at the expense of middle income taxpayers.

Many of the complaints about the income tax are well founded. But the problems have little to do with progressive rates. They rather have to do with the proliferation of exclusions, deductions, credits and other tax benefits which have been engrafted on to our income tax, but are unnecessary and, in fact, detrimental to the proper function of that tax. "Simplified" and "flat rate" are clearly two separate and distinct issues. If we are seduced into believing that simplification requires a flat rate, we will unnecessarily sacrifice substantial equity for minimal gains in simplification.

It is understandable, given the present state of our income tax, that equity in taxation appears to many to be a concept lying primarily in the eyes of the beholder. But there is a benchmark against which to measure the performance of an income tax. The reason we have a tax based on income is because we think it is fair to allocate the tax burden according to financial well-being and that income is a fair measure of financial well-being.

That basic principle has too often been lost sight of as our tax system has been burdened with provisions that reduce the amount of income subject to tax but which have nothing to do with financial well-being and tax paying capacity. A taxpayer with income from oil wells or real estate has the same tax paying capacity as one with an equal amount of income from wages and yet, in most cases, the wage earner will pay substantially more taxes because taxable income from oil and real estate is reduced by tax allowances unrelated to real expenses. Over the years various special interest groups have succeeded in providing subsidies through the tax system for many types of business and investment activities.

Our tax system also encourages or rewards certain types of consumption. Homeowners and renters with the same incomes have the same tax paying capacities, yet because interest and taxes are deductible in computing the amount of income subject to tax and rent is not, the homeowner pays less income tax. Or compare two families with equal incomes, one of which has a more expensive home and therefore spends more for interest and taxes and less for food than the other. The one who has chosen to spend its income in one way -- more for housing -- will pay less income tax than the other who has chosen to live in a smaller house and go to restaurants more often. Their financial well-being and, therefore, tax paying capacity is the same but our tax system treats them differently.

Our tax laws now contain over 100 special provisions -- called tax expenditures -- which reduce taxes through exclusions, deductions and credits having little or nothing to do with a taxpayer's real income and ability to pay tax. These special provisions are called tax expenditures because they are carrying out, through tax relief, programs that more traditionally, and more properly, should be considered spending programs.

Using the tax system to further specific economic and social programs has seemed attractive because tax expenditures appear easier to administer than direct spending programs and provide an almost complete absence of red tape. Moreover, they do not appear in the budget.

We have, I hope, come to realize that ease of administration and absence of red tape has only meant misdirected programs and waste. And I assume we all now realize that tax expenditures cost the same as comparable direct programs. This has become painfully apparent as we have seen our tax base shrink at the same time as the pressure for greater tax expenditures has increased. A cycle has ensued in which the erosion of the tax base due to the granting of special tax relief has led to higher marginal rates which in turn has only increased the demand for more special relief.

What was not well recognized as the number and size of tax expenditures grew was the cumulative effect they were having on the tax system.

Individual income tax collections this year will amount to about $300 billion. According to official estimates, tax expenditures for individuals will be about $200 billion this year. That is an indication of the amount of additional tax that would be collected if there were no tax expenditures in our law. No one suggests that this additional revenue be collected. The relevance of the figure is that if there were no tax expenditures rates could be reduced by amounts approaching 40 percent and the same revenue would be collected. If this were done, not only would the tax law be far simpler, but the tax burden would be shared more equitably and rates would be much lower. There would be greater horizontal equity, i.e., those with similar amounts of income and thus similar tax paying capacity would pay similar taxes. And there would be greater vertical equity; those with greater real incomes would pay higher taxes. The situation of the oil baron paying less than the factory worker would be no more.

This would be true regardless of whether the rate structure were progressive or flat.

If most tax expenditures were to be eliminated -- and that is the underlying assumption of broad-based or simplified tax proposals -- there would be winners and losers in each income class. Those who now reduce their taxable incomes substantially by utilizing the various tax expenditures would face tax increases while those now paying tax on all or most of their real incomes would have tax decreases.

The elimination of tax expenditures would not only greatly simplify the income tax, improve equity and lower rates, it would greatly improve the economic efficiency of the income tax. Gross economic distortions are encouraged under our existing system because decisions -- particularly investment decisions -- are greatly influenced by the availability, or lack of availability of various tax benefits.

The lower marginal rates permitted by base broadening would most likely increase incentives and improve compliance. Lower marginal rates would also decrease the pressures for further tax expenditures. As the proliferation of tax expenditures narrows the tax base requiring higher rates, those subject to such rates seek relief by pressing their own special tax provisions.

Whether the rates to be applied to a broadened base are progressive, or whether a single rate should be applied to all income is a separate question -- and a critically important one.

If a flat rate were applied, even to a greatly simplified and therefore expanded definition of income, the result would be substantial increases in the taxes of most lower and middle income taxpayers and corresponding reductions in the tax liabilities of those with the highest incomes. Although it is sometimes asserted that a flat rate tax would not reduce taxes on the rich because with tax shelters and special benefits they pay little taxes today, the assertion is untrue. While some wealthy people do pay little or no tax, many pay very substantial amounts. On average, our income tax system is still progressive, although it has become less progressive since the enactment last year of the Economic Recovery Tax Act. Nevertheless, all proposals for flat rate taxes would result in large tax reductions for the highest income taxpayers as a group at the expense of the less affluent.

The tax reductions legislated under ERTA will be fully effective by 1984, and the following comparisions are with those rates,*/ remembering they are substantially less progressive than they were before 1981. If all itemized deductions were eliminated and long-term capital gains were taxed in full, but using present law exemptions and standard deduction ($1,000 per person and $3,200 standard deduction on a joint return), a flat rate of 15.7 percent would raise the same amount of revenue as the present system. But it would raise it quite differently. Those with incomes between $5,000 and $10,000 would have average tax increases of 36 percent; $10,000 to $15,000, 25.5 percent; $20,000 to $30,000 would have 13.4 percent increases. On the other hand, those with $100,000 to $200,000 income would have a 33.2 percent average reduction in taxes, almost $10,000 per return. Those with over $200,000 income would save an average of $38,000 each, a reduction of 38.7 percent.

The result would be somewhat improved if the personal exemption were increased from $1,000 to $1,500 and the standard deduction for a married couple were raised from $4,400 to $6,000. The first $12,000 of income for a family of four would therefore be exempt. The rate needed on all other income to raise the same amount of revenue as would be raised at 1984 rates would be 18.7 percent. Under this scheme, those at the very bottom of the scale would, of

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*/ Estimates are from those furnished in testimony of Joseph J. Manarik of the Congressional Budget Office before the Joint Economic Committee, July 27, 1982.

course, come out better. But middle income taxpayers would still have significant increases, and the top earners large reductions. Those with $15,000 to $20,000 income would have a 7.7 percent increase; those with $20,000 to $30,000 income, 9.3 percent; while those with $50,000 to $100,000 would have a 6.7 percent reduction. The reduction for those with over $200,000 income would average about $28,000 per return, 27.7 percent of total liabilities.

The debates about the fairness of progressive rates compared with a flat rate generally focus only on the individual income tax. But the income tax is only part of the total tax burden imposed on individuals.

Most individual taxes, other than the income tax are not only not progressive, they are not even proportionate. The individual income tax will raise about $305 billion this year. Social security taxes, the second largest source of federal revenue will raise about $225 billion, and raise that enormous sum in a clearly regressive way. Under present law, wages are subject to social security taxes of 6.7 percent on each of the employer and employee. Income from self-employment is subject to a rate of 9.35 percent. The tax applies from the first dollar of income without exemptions or deductions but it does not apply to wages or self-employment income over $32,400. Nor does it apply to interest or dividends or any income other than that from wages and self-employment.

Taking social security taxes into account, the total federal tax burden is roughly proportional -- not progressive. It takes progressive income tax rates to keep the system from being regressive. The question, therefore, should not be whether to have a flat rate or progressive income tax, but whether the income tax should be sufficiently progressive to make the total federal tax burden progressive.

While economists and social philosophers may debate whether a progressive tax system is fair, the fact is that most people think it is. It seems reasonable that the costs of government be borne in a manner having a relation to the rewards one receives from the system and that the most affluent can pay proportionately more than those less fortunate. While we are committed to a free enterprise system -- a system relying heavily on economic rewards to provide incentives -- it is widely recognized that this system requires constraints if it is to work effectively and fairly. We have child labor laws and antitrust laws to moderate the potential of uncontrolled free enterprise. While most believe deeply in rewards and incentives, most also believe there must be some limits. Reasonably progressive tax rates are a way to moderate the rewards our economic system might otherwise bestow and at the same time leave ample incentive to drive and reward the most able.

A tax system such as ours -- which relies heavily on taxpayer cooperation -- can only work if most taxpayers perceive the system as fair. The perceived fairness of progressive income tax rates are too much a part of our political and social structure to be abandoned. They are essential, given the rest of our structure, to prevent regressive burdens. Better yet, they should provide some overall progressivity.

Senator Bill Bradly and Representative Richard Gephardt have proposed a plan which would vastly simplify the income tax and at the same time leave the average tax burdens in each income class approximately the same as they will be in 1984. Under this plan, the personal exemptions would be raised from $1,000 to $1,500 per person and the standard deductions from $3,400 on a joint return to $4,600. Thus, a family of four would pay no income tax on the first $8,600 of income. Then a 14 percent rate would apply to all over that amount.

However, there would be an additional tax at rates ranging from 6 percent to 14 percent on income in excess of $40,000 for joint returns. Incomes over $65,000 would therefore be subject to income taxes at the top rate of 28 percent.

The Bradley-Gephardt bill retains mildly progressive rates. The aim of its proposed rate structure is to match closely the present distribution of the income tax burden by income class. One can well debate whether that is sufficiently progressive, but it demonstrates that these progressive rates are necessary to maintain the relative status quo. It does not move us into a regressive structure as all of the flat rate proposals would.

The Bradley-Gephardt bill would eliminate most tax expenditures -- percentage depletion, the investment credit, expensing of intangible drilling costs for oil and gas wells, fast amortization of pollution control facilities, general exclusion of interest and dividends, the deduction for long-term capital gains, the various energy credits, the exclusion of unemployment and disability payments, the exclusion of premiums on group term life insurance, the credit for political contributions, the deduction for casualty losses and many more.

On the other hand, it would retain as deductions, but only against the basic 14 percent rate home mortgage interest, charitable contributions, and state and local real estate and income taxes. This is a fair compromise.

Many people have made long-term commitments to buy homes based on the deductibility of mortgage interest and real estate taxes. And the marketplace has, in many cases, adjusted to the tax system so that prices frequently reflect tax provisions. What may be an ideal tax system if we were starting from scratch cannot, in some cases, be substituted for the existing structure without a transition period -- some time for people and the marketplace to adjust to the changes. This is only true, however, where there are long-term commitments. It is not true for provisions that would apply only to future conduct. I would, however, prefer to see the bill provide for the eventual phasing out of these deductions. The law would be simpler and fairer without them and existing commitments, expectations and market conditions need not be accommodated forever.

Some will point out that any progressivity in rates complicates the income tax system. However, with a broad base, low rates and wide brackets, the degree of complexity attributable to progressivity is not serious. Equity is usually more complex than simplicity. The proper question is how much complexity is worth how much equity. The relatively minor problems presented by progressive rates are well worth the fundamental equity they achieve. Most complexity would be eliminated with substantial base broadening and we should not retreat from important notions of fairness to achieve the last morsel of simplification.

Senator Bradley and Representative Gephardt have promised a corporate tax proposal along the same lines as the individual income tax proposal. It is needed. Our corporate tax was virtually legislated out of existence by the Economic Recovery Tax Act and this will inevitably put greater burdens on individuals. The corporate tax should be restored as a real contributor to our revenue needs.

A new tax structure will not come into being overnight. The debate is just beginning. But so far Bradley-Gephardt is the most thoughtful entry in the simplification debate.

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Senator GRASSLEY. Mr. Cohen, you were Commissioner of Internal Revenue in the Johnson administration.

Mr. COHEN. Yes, sir. I was Commissioner of Internal Revenue from January 1965 through January 20, 1969.

STATEMENT OF SHELDON COHEN, PARTNER, COHEN & URETZ, WASHINGTON, D.C.

Mr. COHEN. Thank you, Mr. Chairman, for the opportunity to be here.

I have been practicing tax law in Washington for 30 years this summer. I will not read my statement, since I associate my remarks with the chairman of the Budget Committee and with Mr. Kurtz; we are pretty much in agreement. I will try to give a quick summary of some other thoughts which may be helpful to the committee.

I have drafted legislation for the Treasury; I have been Chief Counsel for the Revenue Service; I have been Commissioner of the Internal Revenue; and I have practiced tax law as an outside private practitioner for some 20 of those 30 years.

We live in a very complex economy and a very complex society. It will be difficult, extremely difficult, in the system that we find ourself to have a simple tax system.

A philosopher once said that: "It is easier to expound an ideology than it is to carry forward a program." Mr. Kurtz and I have been in a position where we have for many years—7 years between us—to carry out the the program. That program, as has been discussed with you this morning, is explaining to the American people their duties and responsibilities, and the duties and responsibilities of other people. As I believe has been discussed with you this morning also, it is their perception which is important—not the reality.

In reality, about 75 percent of our population files a 1040A now. That is a very simple form with very few deductions, yet they perceive it to be complex, and indeed many of those 75 percent of our population go to get assistance to file that very simple form. They have that right, but it is because of the perception of complexity, not because of the reality that they do this.

We can do something about the deductions—that's what most of the discussion has concerned. I agree with the chairman of the Budget Committee and Mr. Kurtz that you have two separate issues. Flat tax is a two-issue concept. We keep confusing it. Rate structure is completely separate. Rate structure does not make a tax system complicated. Most people look at a chart. They don't even have to make the multiplication. In fact, on the 1040A you need not make a multiplication because the Government will compute the tax for you. So that isn't the complication; it is the deductions.

Now, one of the things that you cannot do under any system is get rid of the complications that deal with income. What is income is a very difficult concept for a tax lawyer to explain to anyone. I will use one example.

The one example I will use is an example where I had to draft the provisions dealing with fellowships and scholarships in 1954. The question was, Do you include fellowships and scholarships in income or do you treat them as an exclusion, and if so, do you give a dependency allowance for the parents?

Having gone through law school on a scholarship and having gone through undergraduate school on the GI bill, I believed scholarship income should be taxable, and I did not believe that my father should have been entitled to a dependency deduction, and I so recommended. The decisions were made otherwise, and now there is an exclusion now for fellowships and scholarships and the parent generally is entitled a deduction for the dependency allowance.

In a flat-rate tax system, how do we treat that income? I suppose the simplest way is to say all income is income. The scholarship is income, there is no doubt in the economist's mind that it is income. Now, if Sheldon Cohen's child—my boy happens to be at the Wharton School, and it costs about $12,000 to $13,000 a year—if he were to have a scholarship, I could reimburse him his income tax. I would just give him the difference. What about the janitor's child? What about the fellow who makes $8,000 to $10,000? He can't finance it. So you are going to have to look at the income side and say, "What do we do?"

That's one example in a very complex array. None of the approaches, yet, addresses this problem, except the attempt in the Bradley-Gephardt bill to explain to people that we are not going to go after social security and certain kinds of other excludable income. But there is a whole variety now of tax deductible, or tax excludable, or tax creditable income. Each one of those items must be examined and must be examined carefully if we are going to have simplification.

The other thing that I want to emphasize is the administerability of a tax. If there is anything that I know a little bit about, it's that. I lived at the IRS 9 years of my life—4 years drafting legislation, 1 year as Chief Counsel, and 4 years as Commissioner. I don't care what the tax is, it has to be administerable. And no one, in considering legislation yet, takes into account the administerability and, the cost. There is a cost. There is both a direct cost and an indirect cost.

The Revenue Service is efficient. It is efficient because it is relatively a single-purpose agency. Each time you add a new task, you make it less efficient, you make it less effective, you make it more onerous on the citizen—he has to answer more questions.

So if you are going to consider going to any new tax system—and one of the things in the notice of these hearings was our views on consumption taxes, value-added taxes—any of those new systems, which we don't talk about much and I hope we won't talk about much, because I have nothing much good to say for them, requires a whole new administrative complexity. The Service doesn't know how to administer them; it has to teach all of its people to do that. It has to teach all of the people of America to do it.

Indeed, I venture to say that you will have difficulty explaining to the average man on the street that when he withdraws moneys from his savings account, he will pay a consumption tax. One illustration.

So I would say to you, in any of these taxes, whether it be flat, broad-based progressive tax, a basic income tax—if we have enough discipline we could even make that work, by getting rid of some deductions and some simplification—in any of those things, please take into account not just the perceived complexity but the complexity that the Revenue Service has to deal with on a day-to-day basis and which taxpayers and their advisers must deal with on a day-to-day basis.

We tax lawyers deal only with the periphery of that. Most people don't understand that. The Internal Revenue Service would love to have a simple tax. It is the most forceful advocate of easily administered taxes because they have to deal with the people who are working with the system every day.

Please don't become infatuated with gross income taxes or broadly based alleged flat taxes. They are illusory. They have many complexities buried into them, and of course they are completely unfair. The gross income tax, for example, has been discussed in various versions.

Grocery stores, for example, in the United States, have somewhere between one-half of 1 percent and 1 percent net income. Now, what kind of a gross tax would you apply to that? If you applied gross tax on sales it won't work.

Believe me, as you get into any of those systems you will find that there are all sorts of gradations, of complexity that will eat into what would at first blush appear to be a simple system.

Thank you very much, Mr. Chairman.

[The prepared statement of Sheldon S. Cohen follows:]

Statement of
Sheldon S. Cohen
Before the
Committee on Finance
United States Senate
September 29, 1982

<u>Summary</u>

(1) The flat-rate income tax proposal consists of 2 parts: broadening the tax base and adjusting the rate structure. Base broadening is critical because it:

- creates virtually all of the simplification
- provides most of the economic efficiency
- permits rates to be lowered

(2) Attacking the problem of broadening the tax base head-on may be superior to a piecemeal approach:

- it becomes more difficult for defenders of tax breaks to focus their efforts
- it places the burden on supporters of tax breaks

(3) In order to facilitate a flat-rate type of revision,

- all tax breaks should start on an equal footing; the tax committees must then abstain from adding further tax breaks
- appropriate transition rules must be provided for those who fairly relied on existing tax breaks
- the resulting rate structure must be reasonably progressive

(4) In considering new taxes, such as value added taxes and consumption taxes, Congress must recognize the enormous hidden costs entailed in:

- creating a new administrative apparatus
- training and educating the IRS, taxpayers, and advisers
- a lengthy transition period of uncertainty

Statement

Mr. Chairman and Members of the Committee:

My name is Sheldon S. Cohen. I am a former commissioner of the Internal Revenue Service, and have been active as a tax lawyer for 30 years. I am a member of the law firm of Cohen and Uretz. The views I express here today are my own, and should not be attributed to my law firm or to any of its clients.

I appear before you to discuss various proposals for revitalizing the federal tax system. Currently, the most prominent of these proposals is the so-called "flat-rate" tax. The flat-tax proposal actually consists of two separate revisions. First, as the label suggests, the existing progressive tax-rate structure would be replaced by a much lower flat rate or, in a more preferable alternative, by modestly progressive tax rates. Second, the tax base would be greatly expanded by eliminating all or nearly all of the existing deductions, credits, exemptions, and exclusions. I will use the term "flat tax" to refer loosely to both parts of these various proposals.

The flat tax is advocated as a cure to the increasing complexity of the existing federal income tax. In addition, some proponents suggest that wholesale elimination of special tax provisions will promote economic efficiency by eliminating tax-induced distortions. Finally, it is argued that the proposed reduction in marginal and average tax rates will eliminate economic disincentives attributable to the existing progressive income tax rates. (I should also note that such a reduction will diminish incentives that many tax breaks were designed to provide.)

Each of these goals is worthy. Each would be achieved to some extent by one version or the other of the various flat-tax proposals.

In my judgment, the key element in making the flat tax work is broadening the tax base. A progressive tax-rate structure, by itself, does not create the complexity that has led to so much dissatisfaction. Virtually all of the promised simplification in the flat-tax proposal arises from eliminating the bulk of the deductions, credits, and so on, now found in the income tax.

The goal of enhancing economic efficiency also finds its primary realization in the base-broadening aspect of the flat tax. The mass of special tax deductions and credits has caused capital to be invested in what some would describe as a helter-skelter fashion, reflecting the political and economic circumstances of the day. Revisions of special tax provisions rarely keep pace with changing economic and political circumstances. Broadening the tax base hopefully would provide greater neutrality among competing investments, and thus promote economic efficiency.

Finally, providing economic stimulus by lowering or flattening the tax rates is made possible only by broadening the tax base. Assuming that the flat-tax proposal is intended only as a restructuring of the federal income tax, then total federal income tax revenue should remain the same. Since it is easier to vote for lower tax rates than it is for a broader tax base, the critical aspect, once again, is whether the tax base is broadened. _If_ the tax base can be broadened, then rates can be lowered while keeping revenues more or less constant.

Broadening the base of the federal income tax will not be easy. Attacking the problem wholesale, however, as flat-tax supporters advocate, may well be superior to the piecemeal approach taken in recent years. Declaring a handful of tax provisions to be under scrutiny allows supporters of those provisions to focus their efforts, and sharply reduces the chances of success. Even more important, under a piecemeal approach, the burden is initially on those proposing elimination of the tax provision to demonstrate why that provision should be removed. This may not be easy, especially when other, equally indefensible provisions are left untouched. Wholesale base broadening, on the other hand, makes it more difficult for any one group to focus their efforts. Moreover, it is easier to defend a proposal to eliminate all, or nearly all special tax breaks because the burden is on supporters of a special tax provision to demonstrate why it should be retained rather than on those making the case for repeal.

Let me now turn to some of the difficulties inherent in the various flat tax proposals. Disposing of long-standing tax breaks will not be easy. I would prefer, however, that all tax breaks start on an equal footing. I realize that a flat-tax proposal appears to be more realistic and practical if it already retains, for example, the home-mortgage interest deduction or the charitable-gift deduction. While political realities may necessitate retention of some tax breaks, it is essential that the proposal start out with no exceptions and with an attitude that few exceptions will ultimately be made. If it is perceived that many tax breaks will be retained, that would make it much easier for the next tax break to be accepted. Once the rush is on, the proposal will quickly collapse. This has happened in the past. Therefore, in order to avoid almost immediate failure, flat-tax deliberations should begin with the attitude that all tax breaks are to be excluded. If this plan is to work in the first place and to last any length of time, the tax writing committees will be required to maintain strict discipline. They will not be able to continue the practice of adopting tax breaks in response to each of our country's social and economic problems. There are other, more direct techniques for dealing with those problems.

Second, to the extent tax breaks are eliminated, Congress must be cognizant, as it has in the past, of those who fairly relied on those provisions. Much wealth is tied, and properly so, to the existence of certain tax provisions. The ultimate political success of broadening the income tax base depends on the ability to fashion rules that minimize disruption and unfairness, and yet still allow for the phasing out of tax breaks over a reasonable period of time. We should therefore be prepared to write detailed transition rules, and to recognize that the simplification inherent in base broadening is offset to some extent by such rules while they are outstanding.

Third, we should recognize that the flat-tax should not be, and cannot be, truly "flat." Some progressivity is necessary and inevitable. There is widespread political support for the proposition that tax burdens should increase with ability to pay. This consensus cannot be ignored. Indeed, popular acceptance of the capitalist system, with its risks and rewards, may well depend, in part, on some sort of accountability of the winners through the tax system. In addition, without a progressive federal income tax, it is likely that aggregate tax burdens, including federal employment taxes and local taxes, will become sharply regressive. I believe that such a result is unacceptable to most taxpayers. Finally, some adjustments to the ultimate rate structure will be necessary in order to mitigate the tax liability shifts that follow from broadening the tax base. Such adjustments cannot be made through a single tax rate. Thus, although broadening the tax base permits rates to be reduced and, to some extent, flattened, this should not be viewed as a signal to move immediately to a single, reduced tax rate.

In addition to the flat tax, the Committee may be considering tax proposals such as value-added taxes and consumption taxes. There is much that can and should be said on the substantive aspects of such proposals. At the outset, I should confirm that I oppose those proposals. In addition, as a former commissioner of the IRS, I would like to call the Committee's attention to one critical aspect of these proposals that is likely to receive insufficient attention.

Unlike the flat tax, these tax proposals have no counterparts in existing law. Whatever the merits, implementing a new federal tax entails enormous costs that are not readily apparent. A large federal apparatus must be created to administer the tax. Both the IRS and taxpayers must be trained and educated on how the tax works. Attorneys, accountants, and other advisers must become familiar with the tax. During the transition period, there will be great uncertainty over how the new tax works, who has to pay, when payments are due, and so on. All of this takes years, and imposes large financial burdens, only some of which are borne by the federal government. Therefore, in considering a brand new tax and deciding on the best course of action, please take into account the important fact that novelty itself has a substantial cost, much of which is hidden.

In conclusion, I believe that there is potentially much merit in considering base broadening and restructuring of the income tax. In addition, the Committee should be made aware of the enormous costs entailed in adopting a novel form of federal tax, such as a consumption tax. This Committee and its distinguished chairman are to be commended for undertaking a prompt and extensive inquiry into these subjects. I would be pleased to assist the Committee in the development of these proposals.

Thank you for the opportunity to be of service.

Senator GRASSLEY. Thank you.
Mr. Aidinoff?

STATEMENT OF M. BERNARD AIDINOFF, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION, WASHINGTON, D.C.

Mr. AIDINOFF. Mr. Chairman and members of the committee, I am a practicing lawyer from New York City. I am the current chairman of the Section of Taxation of the American Bar Association. I am pleased to be able to present some preliminary views of the Section of Taxation on the subject of flat-rate, broad-based income taxation.

All of the proposals that have been introduced under the guise of flat-rate taxation involve some simplification of the tax laws and a substantial reduction of tax rates. Some, but not all, tend to eliminate progressivity from the tax structure. Determining the appropriate amount of progressivity involves questions quite distinct from those involved in simplifying the tax system through base broadening and rate reduction. Base broadening and rate reduction are, on the other hand, related steps in tax reform because expansion of the tax base should generate the additional revenue needed to permit rate reduction. With a broader base and lower rates it would be possible to design a much simpler tax that could be either flat or graduated.

These related steps would allow simplification of the tax laws in two ways. First, much of the structural complexity of the existing tax law is due to special provisions that have been added to the Internal Revenue Code to avoid application of high marginal rates to particular transactions. These deviations from a comprehensive and consistent definition of income have introduced substantial complexity because they draw distinctions between favored and unfavored classes of taxpayers and transactions. Elimination of these special provisions would simplify much of our complex structure.

Base broadening and rate reduction would also permit simplification in a second and quite different sense. In addition to structural complexity, our tax system is noteworthy for what can be called transactional complexity. Taxpayers will naturally seek to obtain whatever preferential tax treatment is available by structuring transactions in ways that might not be sensible if only nontax factors were considered. The growth of the tax shelter industry is an example of this process. The tendency toward transactional complexity is accelerated if tax rates are high, or where there is opportunity for deferral, whatever the rate of graduation.

Transactional complexity is related to structural complexity in that the Service, the Treasury Department, and Congress must respond to aggressive tax-motivated transactions by issuing new rulings or regulations or by enacting new legislation.

Along with simplification of the code and its attendant regulations and rulings, base broadening and rate reduction would reduce tax complexity because tax-motivated transactions would no longer be as attractive to investors. Such rate reduction might also increase economic incentives which, in turn, would increase revenue sufficiently to allow for more meaningful rate reduction.

There are two principal routes to simplification through base broadening and rate reduction.

The first route is a familiar one. It involves elimination of special provisions of the personal income tax, coupled with substantial rate reduction. This basic strategy has been proposed many times in the last 30 years.

This strategy has not been successful in the past for political rather than technical reasons. It is not difficult to identify the provisions of the code that would have to be eliminated or changed to convert the system into a comprehensive tax on personal income. It has, however, been very difficult to achieve the necessary political consensus.

The second strategy for simplifying the tax structure involves the conversion of the personal income tax into a comprehensive tax on personal expenditures. Like a comprehensive income tax, a comprehensive personal expenditure tax provides a potential model for simplification of the tax system, coupled with substantial rate reduction. Because of the difference in treatment of savings, however, the two taxes are likely to have substantially different distributional and economic consequences.

Tax professionals have no particular expertise in choosing between comprehensive income and expenditure taxation. I can assure you, however, that either one could be implemented in a much simpler manner than the current code. Either approach requires a review of business taxation and transfer taxation.

I would like to just say a word about problems of transition. All tax legislation involves problems of transition, but enactment of a broad-based comprehensive income or expenditure tax would create unusually significant problems.

Consider enactment of the purest form of broad-based income tax, which might eliminate the deduction of interest on home mortgages. Would current homeowners be denied the deduction even though they had purchased and financed their homes in reliance on the longstanding deductibility of interest under our tax system? A decision to provide transitional relief for such homeowners might solve the problems of fairness; but it would quickly raise a question of tax complexity, because some method of identifying the category of transactions to be given special treatment would have to be devised and administered.

Or consider enactment of a comprehensive consumption tax, which would tax all expenditures for personal consumption. What would be the proper treatment of taxpayers who spend earnings saved under the present income tax? To deny such taxpayers special treatment would tax them twice on the same income.

I do not mean to suggest that these problems are not soluble, for they are; but I do suggest that the solutions are not likely to be simple.

There is no easy answer as to the best way of structuring a major reform of our tax system. If the committee is to engage in such an undertaking, it must make a number of major choices. You have a very, very difficult problem.

[The prepared statement of Mr. Bernard Aidinoff follows:]

UNITED STATES SENATE

COMMITTEE ON FINANCE

September 29, 1982

Statement of M. Bernard Aidinoff, Chairman
Section of Taxation
~~American~~ Bar Association

RE: Flat-Rate, Broad-Base Income Taxation

Mr. Chairman and Members of the Committee, my name is M. Bernard Aidinoff. I am the Chairman of the Section of Taxation of the American Bar Association. I am pleased to be able to present some preliminary views of the Section of Taxation on the subject of flat-rate broad-base income taxation. These views have not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and should not be construed as representing the position of the ABA.

Let me summarize my statement by making five points. First, it is essential to separate the issues involved in tax simplification through base broadening and rate reduction from the issue of how progressive tax rates should be. Complexity in the tax system is primarily the result of special provisions which sometimes accomplish nontax goals or close perceived tax loopholes. Graduation in the rate schedules alone does not contribute heavily to complexity.

Second, rate reduction and simplification of the individual income tax could be achieved by broadening the tax base and imposing either a comprehensive income tax or a comprehensive expenditure tax. Although either tax would result in substantial simplification and rate reduction for individuals, the two levies would have substantially different distributional consequences, with perhaps different social and economic consequences.

Third, any method chosen to accomplish simplification and rate reduction for individuals would have important implications for the taxation of corporations.

Fourth, fundamental changes in the nature of individual income taxation cannot be considered apart from the taxation of transfers in the form of gifts and bequests.

Fifth, any method chosen to accomplish simplification and rate reduction by broadening the income tax base is likely to involve considerable problems of fairness and complexity during the transition period.

Let me now briefly discuss each of these points.

1. Rate Reduction, Base Broadening, and Simplification

All of the proposals that have been introduced under the guise of flat-rate taxation involve some simplification of the tax laws and substantial reduction of tax rates. Some, but not all, tend to eliminate progressivity from the tax structure. Determining the appropriate amount of progressivity involves questions quite distinct from those involved in simplifying the tax system through base broadening and rate reduction. Base broadening and rate reduction are, on the other hand, related steps in tax reform because expansion of the tax base should generate the additional revenue needed to permit rate reduction. With a broader base and lower rates, it would then be possible to design a much simpler tax that could be either flat or graduated.

These related steps would allow simplification of the tax laws in two ways. First, much of the structural complexity of the tax laws is due to special provisions that have been added to the Internal Revenue Code to avoid application of high marginal rates to particular transactions. These deviations from a comprehensive and consistent definition of income have introduced substantial structural complexity into the tax system because they draw distinctions between favored and unfavored classes of taxpayers and transactions. By structural complexity I mean not only statutory complexity, but the whole panoply of regulations, rulings, and litigation that is needed to administer the statute. Elimination of these special provisions would simplify much of the complex structure of our tax system.

Base broadening and rate reduction would also permit simplification of the tax system in a second and quite different sense. In addition to structural complexity, our tax system is noteworthy for what can be called "transactional complexity." Taxpayers will naturally seek to obtain whatever preferential tax treatment is available by structuring transactions in ways that might not be sensible if only nontax factors were considered. The growth of the tax shelter industry is an example of this process. The tendency toward transactional complexity is accelerated when tax rates are high or where there is opportunity for deferral, whatever the rate of graduation.

Transactional complexity is related to structural complexity in that the Internal Revenue Service, the Treasury Department, and the Congress must respond to aggressive tax-motivated transactions by issuing new rulings or regulations or by enacting new legislation. These necessarily complicate the structure of the tax laws.

The interrelationship of the two kinds of tax complexity is often dynamic because taxpayers respond to changes in the structure of the tax laws by creating new forms of transactions, setting off another round of transactional and structural complexity.[1] Along with simplification of the Code and its attendant regulations and rulings, base broadening and rate reduction would thus reduce tax complexity because tax-motivated transactions would no longer be as attractive to investors. Such rate reduction might

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1. See Galper & Kaufman, Simplification and Comprehensive Tax Reform, O.T.A. Paper 34, U.S. Dep't of Treasury (Sept. 1978).

also increase economic incentives which, in turn would increase revenues sufficiently to allow for more meaningful rate reduction.

Elimination of special tax provisions might also require enactment of budgetary outlays to accomplish the goals of the repealed tax preferences. Of course, tax professionals have no special expertise with regard to whether any particular spending program is desirable once the tax laws have been simplified and tax rates reduced.

2. Comprehensive Personal Income and Expenditure Taxes

There are two principal routes to simplification through base broadening and rate reduction.

The first route is a familiar one; it involves elimination of special provisions of the personal income tax, coupled with substantial rate reduction. This basic strategy has been proposed many times in the last thirty years by leaders of both political parties and by various experts in the field of taxation.[2] The Ford and Carter administrations published tax studies and proposals that are consistent with this strategy, as are many of the provisions of the Tax Equity and Fiscal Responsibility Act of 1982 endorsed by the current Administration.

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2. The Committee on Simplification of the Section of Taxation of the American Bar Association analyzed this possibility in Evaluation of the Proposed Model Comprehensive Income Tax, 32 Tax Law. 563 (1979).

This strategy has not been successful in the past for political, rather than technical, reasons. It is not difficult to identify the provisions of the Internal Revenue Code that would have to be eliminated or changed to convert the present system into a comprehensive tax on personal income. It has, however, been exceedingly difficult to achieve the political consensus necessary to eliminate these provisions.

The second strategy for simplifying the tax structure through rate reduction and base broadening involves conversion of the personal income tax into a comprehensive tax on personal expenditures. Although less familiar than an income tax, such a levy, sometimes called a "personal consumption tax" or a "consumption-type income tax," has also been promoted as tax reform in the United States and in other countries by individuals with a variety of political perspectives.[3] Some recent proposals for a flat rate "income tax" are actually proposals for what has traditionally been called an expenditure tax.[4]

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3. See, e.g., U.S. Dep't of Treasury, Blueprints for Basic Tax Reform (1977), which considers comprehensive personal income and expenditure taxes as alternative models for basic tax reform.

4. See, e.g., Hall & Rabushka, A Simple Income Tax with Low Marginal Rates (1982), which excludes capital income from the individual tax base and permits business entities a current deduction for capital expenditures.

(Footnote continued on next page)

Basically, the expenditure tax differs from the income tax by excluding all savings from the tax base. Advocates of the tax assert that it is fairer and more conducive to capital formation than is the income tax.[5]

In addition, its proponents suggest that the current Internal Revenue Code may already be as much an expenditure tax as it is an income tax with respect to individuals. For example, deferral of tax on earnings set aside for a worker's pension, rollover of taxation on the sale of a principal residence, and nonrecognition of gain by shareholders in corporate reorganizations are more consistent with expenditure tax treatment than they are with income tax treatment.

Like a comprehensive income tax, a comprehensive personal expenditure tax provides a potential model for simplification of the tax system, coupled with substantial

(Footnote cont'd)

The resulting tax is similar to an expenditure tax because savings are effectively excluded, but the tax base is narrower than that of an expenditure tax because consumption out of borrowed funds would go untaxed. A comprehensive expenditure tax would include dissavings in the tax base, just as savings would be excluded.

5. Discussions of how a personal expenditure tax might be implemented are found in Andrews, A Consumption-Type or Cash Flow Personal Income Tax, 87 Harv. L. Rev. 1113 (1974); Graetz, Implementing a Progressive Consumption Tax, 92 Harv. L. Rev. 1575 (1979); Committee on Simplification, ABA Section of Taxation, Complexity and the Personal Consumption Tax, 35 Tax Law. 415 (1982).

rate reduction. Because of the difference in treatment of savings, however, the two taxes are likely to have substantially different distributional consequences. They would also have substantially different economic effects.

Tax professionals have no particular expertise in choosing between comprehensive income and expenditure taxation. I can, however, assure you that either a comprehensive income or a comprehensive expenditure tax for individuals could be implemented in a much simpler manner than the current Internal Revenue Code.

3. Corporate Taxation

Much of the discussion about flat-rate broad-based taxation has focused on individual taxes, but decisions made with respect to individual taxation will have a significant impact on the range of choices available with regard to corporate taxation. For example, adoption of a comprehensive personal income tax might suggest that corporate income should be taxed currently to shareholders rather than to the corporation, or alternatively, that the corporate income tax should become a withholding levy that would be credited against shareholder taxes imposed when corporate earnings are distributed in the form of dividends.

There are a variety of other possible relationships between individual and corporate taxation, and I do not mean to suggest that any particular relationship is superior. Rather, I simply want to caution that broadening of the personal tax base, reduction of individual tax rates, and even adoption of a flat-rate tax for individuals cannot be considered apart from the taxation of business entities.

4. Transfer Taxation

Fundamental changes in the individual income tax base also must be considered in conjunction with the federal estate and gift taxes. Some supporters of the personal expenditure tax would, for example, couple that levy with significant taxation of gifts and estates on the theory that accumulations of capital should enter the tax base when transferred to a new generation. Others, who support the expenditure tax because they believe the overall tax burden on capital is too great, would couple a comprehensive personal consumption tax with reduction or elimination of the transfer taxes. Whatever view one takes of these issues, the relationship between an income or expenditure tax and the transfer taxes is likely to be important enough so that the structure of the latter should be considered in conjunction with reform of the former.

5. Problems of Transition

All tax legislation involves problems of transition, but enactment of a broad-based comprehensive income or expenditure tax would create unusually significant problems.

Consider enactment of the purest form of broad-based income tax, which might eliminate the deduction for interest on home mortgages. Would current homeowners be denied the deduction even though they had purchased and financed their homes in reliance on the longstanding deductibility of interest under our tax system? A decision to provide transitional relief for such homeowners might solve the problem of fairness, but it would quickly raise a question of tax complexity because some method of identifying the category of transactions to be given special treatment would have to be devised and administered.

Or consider enactment of a comprehensive consumption tax, which would tax all expenditures for personal consumption. What would be the proper treatment of taxpayers who spend earnings saved under the present income tax? To deny such taxpayers special treatment would tax them twice on the same income -- once when it was earned under the income tax and again when it was spent under the expenditure tax. To provide special treatment, on the other hand, would likely involve considerable complexity for a significant period of transition.

I do not mean to suggest that these problems are not soluble, for they are, but I do suggest that the solutions are not likely to be simple. Accordingly, it is not enough to consider fundamental tax reform in the abstract. Rather, any far-reaching change in a tax system as complex as ours, on which taxpayers have relied in making decisions, will necessarily involve considerable complexities in the transition. Needless difficulties will be avoided if such transitional questions are considered from the beginning as part of the basic reform itself.

6. Conclusions

There is no easy answer as to the best way of structuring a major reform of our tax system. If this Committee is to engage in such an undertaking, it must make a number of major choices. The first choice is between a progressive rate structure and a flat rate.

Second, a choice must be made between the two major reform models -- a comprehensive personal income tax and a comprehensive personal expenditure tax. The choice between these models depends, in part, on fundamental issues of social and tax policy, such as the appropriate allocation of the burden of taxation between capital and labor income.

Third, either approach to reform of personal taxation will require choices as to the appropriate treatment of corporate income, transfers by gift or bequest, and the manner of transition from current law.

The existence of all these choices should not obscure the urgent need for reform. The tax code has grown increasingly and unduly complex. This complexity imposes tremendous compliance costs, particularly on small business. Both President Reagan and his predecessors have emphasized the importance of reducing the burden of Federal regulations. It will be very difficult to do this in the tax area unless the underlying law is simplified.

Differential tax treatment of analogous economic transactions under current law creates an incentive for individuals to modify their behavior in ways that may not at all be good for our economy. The advantages of structuring a transaction in a tax-favored way lead taxpayers to regard taxes as a charge to be avoided by creative financial transactions. There is an inevitable loss of respect for the system, particularly on the part of those not in a position to use tax-minimizing techniques.

In the course of the current Congress, virtually all categories of direct Federal expenditures have been subjected to stringent review, and this process promises to continue. By contrast, relatively little attention has been focused on sizeable back door spending in the form of tax expenditures. Whatever differences in the procedure of review may be appropriate, tax expenditures should be subject to a scrutiny comparable to that given direct spending. We must ask whether we want to continue subsidizing favored activities at existing levels, and whether the type of subsidy -- tax expenditure as opposed to direct expenditure -- makes sense. The major base-broadening proposals before this Committee can be seen as calling for a major reduction in Federal expenditures through the tax system, with the savings being distributed to all taxpayers in the form of lower rates.

The CHAIRMAN. Let's see. I have been necessarily absent.
Senator Bradley?
Senator BRADLEY. Thank you very much, Mr. Cohen.
Let me thank the panel for its testimony. I think there is probably more expertise at the table than we have heard from to date. I think they have made some very helpful suggestions.
I would like to ask each of them a couple of questions, and I would like to start with Mr. Cohen.
I think in your testimony, on page 6, you talk about the difficulty, the pitfalls, that are inherent in any kind of dramatic change in the tax system. You refer to expenditure taxes and to the pure flat-rate tax.
I think what the committee is going to look at is whether there is not some interim course here? Is there not some interim plan that is more evolutionary? I would like to have your thoughts about what the components of such a plan would be if it were evolutionary in nature as opposed to drastic and therefore subject to the pitfalls that you have enumerated.
Mr. COHEN. You could go either way. There are pitfalls in either direction, of course. The pitfalls in the direction of a slow, progressive move toward simplicity, if you will, or a broad-based tax is that the targets will unite. If you pick 5 items the first year or 10 items the first year to discuss and attack, eliminate certain deductions or exclusions, for example, they will unite as a group.
As I suggest in my paper, it probably is easier in terms of politics to take on the world, because each person has to then defend himself rather than unite in a group to defend the next bastion.
On the other hand—and this committee, of course, has to rely on the committee on the other side—if the two committees and the leadership of the Congress were to develop the discipline, a move toward a broadly based, more simple system can be had within the existing structure. It is hard in terms of the politics of the situation because you then have to resist that fair and equitable fact that somebody presents to you, because every little niche in the line creates another niche.
You can almost say—I think as a rule—that you can't have simplicity and equity, because simplicity requires a straight line. Everyone can understand a straight line; there are no exceptions to a straight line. Once you draw that line so that it goes around one little tree, there will be another one tomorrow who will have an equally equitable case. You can start that line, but it isn't simple to hold it.
Senator BRADLEY. Let me try to be a little more specific. Would not an evolutionary process entail a system that retains progressivity while reducing the complexity?
Mr. COHEN. Base broadening.
Senator BRADLEY. Base broadening, and essentially simplification by lower rates.
Mr. COHEN. I think that's right. The American public would understand that, because it is not a sharp departure from what they are used to.
Senator BRADLEY. Mr. Kurtz, do you want to comment on that?
Mr. KURTZ. Yes, I would like to comment on that, if I may, Senator Bradley.

I won't attempt to make a political comment, but I think it is very important in the normal course of tax legislation, year after year, that there be a goal in mind as to where the country ought to be heading.

Right now we don't have an income tax system in any real sense. We have a hybrid income-consumption tax system. And in my view, we have the worst of both.

In the last couple of years Congress has enacted—to mention a couple of provisions—all-savers certificates, increased IRA's, lower capital gains taxes, ACRS, the interest exclusion. All of these are elements of a consumption tax; that is, they are special tax benefits for saving. They don't have, however, the other side of what a pure consumption tax would have, and that is taxation when the savings are spent. So we now have a system which, for many people, results in their paying tax on the lower of income or consumption.

It seems to me important, in long-range planning, to decide at some point whether we are going to have an income tax or a consumption tax, and then move toward that goal.

I think it is fair to say that a number of the provisions that I have cited, which have been enacted in the last couple of years, were enacted because there was a feeling they were consistent with a consumption tax; but, at the same time, we don't have a consumption tax.

Senator BRADLEY. We have an income tax. Would both of you think that a direction that we might head toward is the proposal that Congressman Gephardt and I have offered, that maybe wouldn't happen overnight, but in the general direction of lowering the rates and broadening the base?

Mr. KURTZ. Broadening the base, lowering rates, and broadening brackets, it seems to me is the direction that the tax system ought to head. And it can be done gradually as well as overnight. The difference, of course, is that if you do it overnight the effect on rates is very dramatic; if you do it little by little there may not be a sufficiently noticeable rate reduction to build a constituency for it, but that's a political judgment.

Senator BRADLEY. So, the carrot of lower rates is the way you get the base broadened?

Mr. KURTZ. That's the trade-off. No one will want to lose their deductions unless they are getting something to trade off so that the total tax burden doesn't rise significantly.

The CHAIRMAN. Senator Long?

Senator LONG. We have a lot of provisions in the law that encourage investment—investment tax credits, perhaps depreciation, all the rest of it. I wonder how you gentlemen would feel about the suggestion to make it simply across-the-board that investments—defined rather broadly: that tend to provide jobs, create investments, develop the resources of the country—are deductible, just as though you are up-front expensing them. How would you react to that suggestion? In effect, the kind of thing that Lester Thoreau has been talking about, for example. I think you are familiar with that, Mr. Kurtz.

Mr. KURTZ. Well, there are a number of proposals for various kinds of consumption tax—the Hall-Rabushka, and Lester Thoreau's, David Bradford's proposal, et cetera.

First of all, all of the consumption tax proposals imply that, while there will be a tax based on consumption, that is, income less savings, that there will be a tax on dis-saving—that is, when the savings are spent—that that will enter into the tax base.

I believe the problem is that under virtually any rate structure that can be developed, based on consumption, there will be a significant lowering of the tax burden on the very highest-income people, because the very highest income people simply don't spend as significant a portion of their income as the lower income people.

You know, if one looks at the Forbes list of the 400 wealthiest people in the United States, I doubt that those in the over-a-billion class spend more than those in the over-200-million class. And you can carry that pretty far down the line. There is a limit to what one can spend. Therefore, you would have regressive rates as you get into the higher income.

Now, there is an argument for economic efficiency that some economists make. I am not an economist and I can't comment on those independently, but I think in those debates one shouldn't lose sight of the fact that our tax system can only work if most people have a sense that it's fair. And I don't think most people would have a sense that a tax which allowed our wealthiest people to pay less and less tax is fair. That's the concern that I have.

Senator LONG. Well now, if you couple that with a more tightly drawn gift and inheritance tax law or even with something that would tax them on their wealth as they go along, a very low capital levy, or something of that sort—I am not sure that they would like it, you understand; but I am not talking about what they would like, I am talking about a fair system.

Mr. KURTZ. Oh, unquestionably there are systems that could be constructed and a combination of taxes that would achieve what I think we would all agree would be an equitable result. But the simple substitution of a consumption tax for the income tax, I don't think that's fair. If we had effective and substantial inheritance and gift taxes, perhaps that would be a different story.

Senator LONG. But if we have some other tax device that solves that problem then I take it you would find appeal to it.

How do you feel, Mr. Cohen?

Mr. COHEN. There is one thing that is constantly bothering me, and that is that we have proceeded for the last 20-some years on the assumption that for every ill in America there is a tax cure. And that's why we have what we've got. You can't use the tax system for everything; it isn't that good. The Revenue Service is a very good administrative agency. It isn't that good. How in the world are we going to make the American public understand, as Jerry just said, that when you take money out of the bank and spend it you are going to pay a tax? That is a very difficult concept to understand, and I have stated it very simply, because it is much more complex than that.

I am sure that the Senator's staff, the committee's staff, the three of us, could design a combination consumption tax and estate and gift tax—which we have virtually repealed—that would work out to be not unfair. I doubt if it would be understandable to the American public.

Senator LONG. Well, to some extent, Mr. Cohen, you sound to me like a tax collector.

Mr. COHEN. I hope I don't sound that way to my clients. [Laughter.]

Senator LONG. Well, I know you do a good job for your clients, but it seems to me you are still looking at it from the point of view of a fellow who has had the burden of going out and getting all that money. I can understand your point of view.

Mr. COHEN. The ideal system in the world can't be drafted that is unadministrable. That's my problem; that is, it has to be administrable by human beings, by the Revenue Service, and by human beings that sit where we sit and, more so, accountants and tax practitioners out in the community. They have to understand it. They not only have to know how to fill out the forms but to understand it and be able to explain it to people. And that's the hard part.

Senator LONG. I hope you people understand that. All these people who come here talking about tax simplification, the moment they find out it is going to cost them more money that way they change their minds.

Mr. COHEN. I think that's right.

Senator LONG. Mr. Aidinoff.

Mr. AIDINOFF. But one thing we do know from our experience is that a reduction in tax rates does have the effect of reducing some of the incentives to engage in tax-motivated transactions.

There is no question, for example, that just the very introduction of the 50-percent rate on earned income in 1969 had the effect of causing many high-salaried people to look differently on traditional types of tax shelters.

There is no question that the reduction of 70 to 50 percent on all income has had the same effect. It doesn't mean that you destroy all incentives to reduce taxes, but you do reduce it marginally.

The straightening out of the original minimum tax and the elimination of capital gains as a tax preference reduced an awful lot of motivation.

I don't think there is any question that if you go in the direction that Senator Bradley is talking about, whether you ultimately get down to 14 percent or not, but as you go down the rate schedule, whether or not you are progressive, you make taxpayers a little less interested in special deductions.

Obviously the only way you can bring it down as much as most of us would like it to go down is by being pretty rough with respect to deductions and the definition of income.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Mr. Cohen, you raised the point about perception of complexity versus real complexity. I think you were making the point that people's dissatisfaction with the tax system today centers on its complexity. Obviously, because 75 percent of the people file the short form, this must be more perception than fact.

Aren't taxpayers more concerned with the perception of fairness that certain wealthy people—maybe not necessarily just wealthy people, but people of certain categories—have loopholes and benefits that other people don't have? They see the unfairness as the source of the complexity and they want to do away with that unfairness.

Mr. COHEN. Yes, sir, I think that's right. The cabdriver who was driving me over here today commented on all of the buildings that are going up in town, and he was wondering who was paying for them. I facetiously said, "The United States is paying for them, through a variety of deductions, credits, and otherwise."

Senator GRASSLEY. Then you are using the terms "complexity" and "fairness" interchangeably?

Mr. COHEN. No; I think that they are separable, but I think that one must deal with perception as reality; that is, if people think it is complex, then it is complex. It is what they believe.

Senator GRASSLEY. My point is that it isn't because people think it is complex but because they think it is unfair that they want an alternate tax system like a flat-rate tax.

Mr. COHEN. But in fact, sir, the present system is probably fair. One can pick out numerous examples of unfairness, but after all it is a broadly based system that applies to hundreds of millions of people. In its general application it is fair. There are enough examples of unfairness; yes, that it is fair.

Senator GRASSLEY. On the subject of administrability of any tax law, was your point that the present income Tax Code is more administrable than something that would be like a flat-rate tax?

Mr. COHEN. We have an investment in the present system is what I am saying.

Senator GRASSLEY. We have what?

Mr. COHEN. We have an investment in the concepts of the present system. We have an agency that understands it and can administer it, we have taught it to millions of high school children, and we have millions of people who have been applying it.

One of the things that disturbs people is change in the form they are used to. Any time you change the form, even to help them, they believe that is complex. So you have to take into account their understanding. And every time they have to read a new provision, even if it benefits them, it adds to their concern when they go to prepare that return next April.

Yes; if you were to put in a broadly based flat tax or even a broadly based progressive tax, you've got new definitions, new standards, new things for people to learn. As I say, on the income side, you still have to define income. There are a variety of items that just don't follow a natural law. There is no rule up there in the sky one can find as to what to do about a scholarship, for example.

The CHAIRMAN. Senator Mitchell.

Senator MITCHELL. I would like to follow up on a point that I believe Mr. Kurtz made during his presentation in which he argued against the pure flat rate. He suggested that the bill introduced by Senator Bradley and Congressman Gephardt contained a minimum level of progressivity.

I commend Senator Bradley, and have on many occasions, and Congressman Gephardt for their efforts, and I agree generally with the thrust of their bill; but I am concerned that it does not retain a sufficient level of progressivity, or a sufficient degree of progressivity in the Tax Code. Reducing the present spread from 14 to 28 percent, it seems to me, would be insufficient in that respect. I have suggested an alternative which would make the spread 12 to 36 percent, or something in that range. There already has been, as you know, a very significant decrease in the top marginal rate from 70 to 50 percent.

I wonder if each of the three of you could comment on your own personal views on that?

Mr. KURTZ. Senator Mitchell, from my point of view it depends very much on what the base is. While Senator Bradley still has the range from 14 to 28 percent, the remaining personal deductions are deductible only against the first 14 percent, so that the second 14 percent surtax is on adjusted gross income, which in most cases will be a substantially broader base.

I confess that I am not familiar with the base which you would apply.

Senator MITCHELL. It would be the same base.

Mr. KURTZ. But with deductions allowable to higher income, or not allowable?

Senator MITCHELL. Allowable.

Mr. KURTZ. Well, then I would have to see how it compares in particular cases. Obviously there would be different distributional effects within the group, but I don't know how it would come out overall.

My personal view is that I think the rates in the Bradley-Gephardt bill should be somewhat more progressive, because I think the 28 percent top rate is indeed modest, even on an expanded definition. I don't think they should be 50 percent, but with the definition of income in that bill there should be significant rate reduction at the top. But I think the rates could be maintained at something above 28 percent. Just what the whole scale would be, I don't know.

I am also very much taken by the fact that the rate, the basic 14-percent rate—and whether it should be 13, 14, or 15, I will put aside for a moment—applies to a very broad class. That eliminates a great many structural problems. That in itself eliminates some complexity; that is, it would eliminate, for the most part, problems of income averaging, and other minor timing differences where one decides to pay this year rather than next year, things of that kind; where the base covers all of the income that most taxpayers are likely to have in the foreseeable future timing becomes largely irrelevant—and therefore I like it for that reason. But I don't feel committed to those rates.

Senator MITCHELL. Thank you. Mr. Cohen?

Mr. COHEN. Senator Mitchell, I happen to agree; I would like to see it slightly more progressive. Maybe that's because my average effective rate is close to 30 or 35 percent. Each of us, of course, judges it by our own view. I am not an economist either, therefore I can't tell you what to do. Before I would want to light on a structure I would want to look at its distributional effects in a broader way than I have. I guess I have the same feeling Mr. Kurtz does: I would like to see it somewhat more progressive.

Mr. AIDINOFF. I suspect I differ with Mr. Kurtz and Mr. Cohen. My own feeling is that marginal rates over 28 percent probably are not very effective. My feeling is that perhaps the rate structure should come in at some point below 14 percent and have a little more progressivity in the bottom range. On the other hand, that really depends on the available deductions.

I have a fear, however, that when one gets to the practicality of setting a rate schedule, the pressures as to what is includable in income may very well demand more progressivity because the rate base just has not been expanded enough to justify 14 to 28, as opposed to 12 to 36. I think much of this is a function of what tax base you ultimately come up with.

Senator MITCHELL. Mr. Aidinoff, do you favor the pure flat rate? Or do you believe there should be an element of progressivity retained?

Mr. AIDINOFF. I personally don't believe that there should be a straight flat rate. I believe very strongly that we should have the type of structure where nearly everybody pays some income tax, even though it is a relatively small amount. But I do believe that people who do have more income should pay more than a proportional part of their increased income to the Government.

Senator MITCHELL. Thank you, gentlemen, and thank you, Mr. Chairman.

I just wanted to say in conclusion that I hope I made it clear I did not intend any criticism of Senator Bradley's provision, because I think he has done an outstanding job in putting it together. I am sure he is not locked in concrete on any specific provision; that was just one of the parts about it that did concern me.

The CHAIRMAN. Well, I missed some of the testimony but I do think, as Senator Bradley indicates, that we have an outstanding panel. We still have another panel to be heard from, so I will just ask a couple of questions. We are going to have a series of votes, I understand.

It is difficult to do much base broadening. We found that out this year. A lot of people talk about it, but they wouldn't vote for it. So I think we have to be very realistic when we have a lot of people espousing all these great ideas. Unless we can develop a political consensus it is going to be very difficult to make anything but incremental changes, and then maybe only then, when you are under the gun of a reconciliation process, a budget process.

I am certain this panel understands that. It is great to go out and make speeches about how unfair the tax system is, but when you try to take away some of those "generous provisions" or tighten them up, some of the best speakers can't be found. So I think we have to be realistic. That's one reason many people perceive the system to be unfair.

If I were the administration, I would be out talking about the tax reform bill this year instead of sort of hiding from it like it never happened. To me, that's equity, fairness, balance. I noticed a memo in the White House talking about a lot of charges made against the administration; it didn't even mention the tax reform bill, and others, maybe for different reasons.

Again, that isn't the end of reform, obviously, and maybe it wasn't a good beginning; but at least it was a start.

From the standpoint of the three practitioners, what is the biggest loophole that your people, upper-income taxpayers, use? Maybe we could get into specifics here.

Mr. COHEN. Depreciation and investment credit—which really go together—and capital gain. I guess we spend more of our time concerned with those issues.

The CHAIRMAN. They may not be loopholes.

Mr. COHEN. Well, if we are talking about either large corporations or wealthy individual taxpayers, those are the items from which they can get the maximum benefit; therefore they concentrate their efforts on obtaining the deductions, the credits, or getting the preferential rate.

The CHAIRMAN. What rate do they generally end up paying?

Mr. COHEN. You still have taxpayers who basically pay no more than a small percentage.

The CHAIRMAN. That's sort of the nub of it, isn't it?

Mr. COHEN. It's not the big pattern. For example, I represent a very wealthy entertainer. He pays a pretty good slug of his income. He has some investments in farm properties or depreciable properties, but he pays a pretty good slug of his income. I would suggest he pays a fair share of his tax. It is not 50 percent, but probably his average effective rate is about 25–30, something like that.

The CHAIRMAN. Somebody suggested we might take the Forbes magazine 400 and scan some of those returns to see if we can find a pattern of how people become so wealthy by not paying taxes.

Mr. AIDINOFF. Well, I would suspect, Senator, that if you did take those returns you would find really three elements: Substantial depreciation, with respect to real estate; intangible drilling; and businessmen who have been fortunate enough to build up their own corporations and then go public—they realize a very, very substantial capital gain—or the market value of their holdings rises to an astronomical figure.

Mr. KURTZ. It is interesting, in looking at that list, to see that a high percentage of those people are in oil and real estate.

The CHAIRMAN. I won't name any families, but I noticed there are a number of people in the shipping business and the mineral business. Again, I guess if you taxed all of their income at the highest rate that wouldn't solve our problem of fairness, or at least what is perceived as an unfair system.

Mr. Harris, the number is what? Eighty-one to seven?

Senator BRADLEY. It is 81 to 7 on the interest on home mortgage.

Mr. KURTZ. Those studies show over the years that everyone wants simplification but no one wants to lose a deduction.

Mr. COHEN. I'm in favor of losing that deduction. I have paid off my mortgage.

The CHAIRMAN. That's what? Forty billion? I don't quarrel with that; it just seems to me that we've barely made the small first step. But it is encouraging that there is so much interest in something. To say that it might finally pass this committee or the House Ways and Means Committee or the Congress, I wouldn't want to hold my breath waiting for that to happen.

Senator BRADLEY. Mr. Chairman, I take it you are not proposing, then, before the Congress is out that we eliminate the intangible drilling cost deduction, capital gains, and depreciation.

The CHAIRMAN. I think I would want to review that over the recess and take it up when we take up social security, maybe. [Laughter.]

Which is another thing we have been ducking.

I appreciate very much your testimony. We are searching for the answers, and I think everybody here is willing to face up to some hard choices. But I think one advantage of a bold move, as I think Senator Bradley referred to yesterday, is that you sort of catch people off balance. They don't have time to pick us off one at a time. You get a lot of momentum out there saying: Yes, we've got to do this, and you are able to overcome some of the opposition.

Mr. COHEN. That was the technique that was used this year, sir. By the constraints of the budget and your leadership, you managed to get a forceful bill that did a lot of good things. It wasn't simple, but it did a lot of good things for the fairness of the system.

The CHAIRMAN. Right. And no one was mortally wounded in the process. A lot of them bled a little. [Laughter.]

Mr. COHEN. Right.

The CHAIRMAN. But no one died that I know of.

Senator BRADLEY. Mr. Chairman, if I could, let me just follow up.

I think the bold move, as I think you experienced this year under the pressure of the budget, can either be with a stick, the pressure of the budget—or with a carrot, which is the lower rates. But I think there is a general consensus that the bolder you are, the better political chance you have in this process.

I appreciate all of those people who have invested in tax shelters, Mr. Aidinoff, and I appreciate the difficulty in administering a new tax, Mr. Cohen, but it seems to me that if that is the argument against it and that argument prevails, you will forever be stuck in the present system and it will become more and more difficult.

If not an equal number, there are certainly great numbers of the American people who made investments expecting inflation to be 10 or 15 percent. Now, when we get inflation down they are in trouble, but does that mean we shouldn't get inflation down? The answer is no. I think that that's because the general good is served by getting inflation down. If the general good is served by cleaning up the tax system and making it fairer, then I think that's the direction that we want to go.

The CHAIRMAN. Mr. Aidinoff?

Mr. AIDINOFF. Well, I personally feel that a little bit of bleeding in the transition can't be avoided. I think if we achieve a fairer system, with lower rates as a result of it, that is desirable. I think the two follow each other.

Senator BRADLEY. I think we do sometimes make political hay out of upper income people paying no tax. But as I understand it, and I think the question was asked if you know what percent they pay. At over $100,000 I think their effective rate is about 25 percent. So you do have some people who are not paying who abuse the system, but there are people who are making substantial payments.

Ultimately, if you get down to arguing whether it is a 28-percent or 30-percent or 27-percent or 34-percent rate, that depends. Do you get rid of capital gains? Do you index the basis of capital assets? How do you do that? They are all pretty tough questions, but they are all interrelated.

The CHAIRMAN. We thought we would get all the former Commissioners together and let them come up with a master plan. [Laughter.]

That's not a bad idea, come to think of it. Certainly if anybody understands both sides it would be those who have been in the private practice, active practitioners, not abusing the system but trying to do the best you can for your client and beyond the collecting side. As Senator Long said, "You sound like a collector." Well, I'm not certain that's so bad if you are talking about compliance, for example.

Senator Heinz, do you have questions?

Senator HEINZ. No, Mr. Chairman.

The CHAIRMAN. I appreciate it very much.

Mr. KURTZ. Thank you, sir.

Mr. COHEN. Thank you.

Mr. AIDINOFF. Thank you.

The CHAIRMAN. Our final panel this morning will be Bruce Hershensohn, KABC-TV in Hollywood, Calif.; Jim Jones, managing director, Government Research and Development Foundation, Blanco, Tex.; and Evelyn Davis, editor, Highlights and Lowlights, Washington, D.C.

Bruce, I guess you will lead off. I know there is a lot of interest in California in the flat-rate tax, and I think that's what you are about to tell us.

Mr. HERSCHENSOHN. There is, Senator. Thank you.

STATEMENT OF BRUCE HERSCHENSOHN, COMMENTATOR, KABC-TV, HOLLYWOOD, CALIF.

Mr. HERSCHENSOHN. In listening to the testimony of yesterday in this room, I was astonished to hear in some testimony the respectability given to prejudice—prejudice against the wealthy.

In this Nation I think too often we trade one prejudice for another rather than terminate prejudice altogether, and the cycle continues with a new palatable victim each time. And we have a new one—it's the wealthy. If we go about tax reform with a foundation of prejudice against any group, then tax reform defeats its very purpose of fairness.

I believe that it is always fun and it's always self-serving to talk about the economic contrast between the poor and the rich and tax progressivity, because it always sounds so terribly compassionate. But I find no virtue in being compassionate with other people's money—the taxpayers. And I find no compassion in the confiscation of funds for which others have worked.

A flat-rate tax should be flat, with no mountains, no hills, only a valley for people who can't make ends meet; in other words, a floor under which there will be no tax at all.

Second, we have heard many figures used here for that flat rate—3½, 9, 10, 12, 28 percent—but they are in essence arbitrary figures. Instead of an arbitrary figure we should make the law of logic be the law of the land. Our flat-rate tax should float; float with the budget of the U.S. Government. Fiscal year to fiscal year, that rate should be commensurate with expenditures. The budget and taxation will then become one subject rather than two. We will pay what we want to spend.

Right now income tax payments serve approximately 40 percent of our fiscal year 1983 budget, corporate taxes some 9 percent, social security some 29 percent, something like that. But no matter what is included in the flat-rate tax, the percentage should be its proportionate share of the budget; and by that, all at once, we can have a simplified tax system, guarantee no more deficit spending, have a balanced budget—without an amendment—and make every taxpayer part of the budget process as well as the taxation process, end Government-created inflation, ease interest rates, and in fact allow generations forward only the good fortune of birth in this country rather than combining it with the misfortune of being born into immense debt that we leave them as their negative inheritance.

Let me illustrate how this would work. Last February the President presented the Congress a budget of some $757,600 million. And there wasn't one person in the United States, including the President and including all of the Members of Congress, who could really imagine what that figure meant, because it is simply too immense; it is beyond comprehension.

In the future the President should be able to say, "I propose to the Congress a budget of 14½ cents." That everyone can understand. Never use the phrase "billions" again, except in the budget appendix. Fourteen and a half cents is the taxed amount from every earned dollar—period. The budget balanced, no deficit to leave behind to be paid by the hidden tax of inflation, and worse yet to be paid by the sleeping tax of the national debt which is going to awaken in generations forward if it doesn't in our own. And the President should be able to say, "It is 3½ cents for defense; it is 7 cents for Health and Human Services; it's 1½ cents for grants back to the States, cities, and localities," and so on, and so on, and then itemize further.

Right now does the average taxpayer have any idea what the budget is or should be for the Environmental Protection Agency? Should we have a budget of $128 million or $10 billion or $112 million? No one knows. But they would understand the dollars and cents of their own—that they will understand. And the point is that everyone will be able to understand what every figure means. The budget process will at last be naked to the public at large, and the mystery will be gone.

Now, in addition, a small percent should be added to the floating flat-rate tax to start paying off the national debt in increments through the years, at least its interest.

In short, what we buy let's pay for with a floating flat-rate tax that allows us to pay for what we buy, and not one more word about compassion. Instead, just the deed of compassion. Because those who sound the most compassionate are in fact the least, because they advocate thievery—theft from those from whom they have no permission to take money: From the wealthier among us, and most of all from the unborn.

If we are worthy of our country, and I hope that we are, and if we are worthy of our time on Earth, and I hope that we are, we should insure that those Americans who follow us aren't shackled to our greed—our greed that wears the ill-fitting disguise of compassion.

[The prepared statement of Bruce Herschensohn follows:]

PURPOSE: A Floating Flat-Rate Tax.

EXPLANATION: Current proposals for a flat-rate tax advocate a particular fixed percentage on each earned dollar. Proposals and bills have been submitted ranging all the way from five-percent to twenty-five percent. The percentages advocated have, for the most part, been based on nothing. A floating flat-rate tax would be based upon the projected expenditures of the United States Government. The percentage would change year-to-year dependent upon the budget of the forthcoming Fiscal Year.

REASONING: Automatically, every U.S. taxpayer is drawn into the budget process. Expenditures and taxation become one subject rather than two subjects. If blocks of citizens advocate further expenditures for one government program or another, the further taxation necessary becomes visible rather than hidden. Further, a budget of $757,600,000,000. such as proposed last February is beyond any persons comprehension, and well it should be. But a budget of 14¢ is not beyond anyones comprehension, and well it shouldn't be. Since the budget for FY '84 is yet unknown (thank God) I am using imaginary but not too far-off figures: The FY '84 Budget will be 14½¢...period. Forget the billions. They don't mean anything to anyone. The figure of 14½¢ means that the worth of every dollar earned by a taxpayer will be 85½¢. 14½¢ goes to Washington to pay for the federal budget of the forthcoming Fiscal Year. (Obviously the date of April the 15th will have to be changed or the Congress will have to determine the final budget figure much faster. September the 15th is a likely compromise.)

BENEFITS: The end of deficit spending. Any deficit incurred because of faulty estimations in the budget are immediately added to the next years flat-rate tax. There will be no excuse to add to the national debt or to cause government-created inflation.

FURTHER: An additional percent (perhaps one-half of one-percent) will be added to the floating flat-rate tax to pay off the national debt in increments through the years.

Bruce Herschensohn
KABC-TV and Radio
4151 Prospect Avenue
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The CHAIRMAN. Mrs. Davis.

STATEMENT OF EVELYN Y. DAVIS, EDITOR, HIGHLIGHTS AND LOWLIGHTS, WASHINGTON, D.C.

Mrs. DAVIS. Distinguished Senators.

As editor of a very successful business newsletter which is sold only to chairmen and presidents of corporations and which has put me solely through my own efforts for several years now into the top tax brackets, I think its about time that we do have some sort of a flat tax system, with everyone without exemptions or exceptions paying the same percentages of taxes on their incomes, instead of as is happening now being penalized for being a super-success.

For those who believe that such a system would benefit the rich, I would like to emphasize that, for instance, a 15-percent flat tax would have the 100,000-dollar-a-year person at $15,000 still pay 10 times as much as the 10,000-dollar-a-year earner, shelling out a mere $1,500, while everyone supposedly receives the same services from our Government.

If the current progressive system were to be eliminated it would bring in more for the Treasury by eliminating incentives for early retirement by super-successes in the top brackets. It would simplify the system, result in less complicated audit systems, eliminate more tax chiseling, and need less Government employees to administer this greatly simplified system which will result in fairness to all.

To make the system work, what is really needed is a thorough reeducation of the public and a readjustment in their thinking. They will have to learn that by the elimination of all deductions they will still have more left over. Only, and only by eliminating all deductions, all exemptions, and all exceptions will this work, and fairness will prevail. It is one thing for a top-bracket person to pay 10 times as much; but certainly 40 times as much, as happens in many instances, is grossly unfair to say the very least.

It is about time that our current tax system, where a very small percentage pays a top burden to support an overextended Government and receives the least amount of services to support a large percentage of the population who just do not want to work hard to achieve success, receive an amount of greater fairness and simplicity in a flat tax rate that will work for everyone.

In addition, flat taxes will result in greater amounts of investment and savings, creating in the long run more jobs, savings, and gross national income.

In addition, I would support a national sales tax, a consumption tax, or as the British say a VAT tax, which would encourage rather than penalize savings as our current system does.

I would like to finish by saying that personally, although I am in a top tax bracket, I don't engage any tax lawyers or use loopholes. I am not about to keep lawyers in limousines.

The CHAIRMAN. Well, some have them, anyway.

[The prepared statement of Evelyn Y. Davis follows:]

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STATEMENT BY EVELYN Y. DAVIS,
editor HIGHLIGHTS AND LOWLIGHTS
before the **SENATE FINANCE COMMITTEE**
September 29, 1982. SUBJECT: **FLAT TAXES**
DSOB: Room 2227

Distinguished Senators:

As editor of a VERY successful business newsletter which is sold only to chairmen and presidents of corporations and which has put me solely through my own efforts, for several years now into the TOP TAX BRACKETS, I think it is about time that we do have some sort of a flat tax-system, with EVERYONE, without exemptions or exceptions paying the SAME percentage of taxes on their incomes, instead of as is happening now being penalized for being a super-success!!!

For those who believe that such a system would benefit the "rich", I like to emphasize that for instance a 15% Flat Tax would have the $100,000 a year person at $15,000-still pay TEN TIMES as much as the $10,000 a year earner, shelling out a mere $1500-, while everyone supposedly receives the same "services" from our government!!

If the current progressive system were to be eliminated it would bring in more for the Treasury by eliminating incentives for early retirement by super-successes in the top brackets, it would simplify the system, result in less complicated audit systems, eliminate more tax-chiseling and need less government employees to administer this greatly simplified system which will result in fairness to all!!

To make this system work what is really needed is a thorough re-education of the public and a readjustment in their thinking. They will have to learn that by the elimination of all deductions they will still have left over more. Only and only by eliminating ALL deductions, ALL exemptions and ALL exceptions will this work and fairness will prevail. It is one thing for a top-bracket person to pay TEN times as much, but certainly FORTY times as much, as happens in many instances, is grossly unfair to say the very least!!!!!

It is about time that our current tax system, where a very small percentage pay a top burden to support an over-extended government and receive the least amount of services to support a large percentage of the population who just do not want to work hard to achieve success, receive an amount of greater fairness and simplicity in a flat tax rate that will work for everyone!!

In addition Flat Taxes will result in greater amounts of investment and savings, creating in the long run more jobs, savings and gross national income.

In addition I would support a national sales tax, consumption tax, or as the British say VAT tax., which would encourage rather than penalize savings as our current system does.

The CHAIRMAN. Mr. Jones, I guess you are the author of the gross income tax. We would like to hear from you.

Mr. JONES. Well, that's correct. Thank you, Mr. Chairman.

STATEMENT OF JIM JONES, MANAGING DIRECTOR, GOVERNMENT RESEARCH AND DEVELOPMENT FOUNDATION, BLANCO, TEX.

Mr. JONES. Thank you for this opportunity to testify.

I am Jim Jones of Blanco, Tex., the founder and semiretired owner of the J. Jones Co., which is a warehousing distributor of power transmission equipment with headquarters in Houston. I am also the founder and president of the Government Research and Development Corp., a nonprofit organization devoted exclusively to public policy research. The organization is staffed almost exclusively by volunteers. I provide its modest financial underwriting. I call it "An Agency of the Individual American Citizen."

These committee hearings on alternative tax systems, including a gross income tax, represent an important milestone for our society. For too many years the American wage earner and the American businessman have been trying to cope with the income tax reporting requirements that have become a crushing burden. This committee is in a position to do something to remove that burden.

For too many years the Nation has borne the cost of a massive and complex revenue-gathering system. This committee is in the position to do something to lower the cost of collecting the Federal taxes.

For too many years this Congress has struggled with an archaic net income tax system that is out of synchronization with the fiscal needs of the Government. This committee can do much to replace that outmoded system with a space-age tax collection system that will provide a steady cash flow for the Government on virtually a daily basis, if it is so desired.

The alternative tax system that will provide most of these answers is the gross income tax system, or as I have called it, simply, the GIT system. This system, which I explain in detail in my attached remarks, would apply a single tax rate, probably between 4½ to 7½ percent of the gross income of every business entity operating in the country.

GIT is a business-oriented tax system, because business generates the income, accumulates the capital, and employs the wage earners in our economy. GIT would require almost no elaborate or tax-induced special recordkeeping by wage earners or businesses. It would be vastly simpler and cheaper for the Internal Revenue Service to administer than the present system. And it would provide the Congress with a streamlined mechanism for revenue raising, one that could easily be adjusted to generate more or less revenue, as may be required.

GIT is equitable, for it applies the same rate—and this is important—to the same base for all taxpayers. It is simple, for it eliminates all above-the-line deductions and exclusions and applies the tax rate only to true gross income.

Gross income—the way it is defined in the IRC today—is "gross receipts of a business entity, less the cost of goods sold." This is the same way that we do it today in an ordinary business situation and as done in today's tax reporting.

GIT would do away with up to 90 percent of the recordkeeping and internal paperwork for employers, and 95 to 100 percent for employees.

GIT is neutral. Profitable companies would no longer have to shoulder the tax burden of unprofitable companies.

GIT is efficient, in that tax collection becomes a simple function of everyday business activity and administration.

I would also make these points about GIT:

First, GIT would have little distributional impact, because the burden of taxes would fall proportionately on low, middle, and upper income taxpayers.

Second, progressivity would not be an issue, because GIT taxes the rich at the same rate and on the same base as the poor. Wage earners below a certain minimum income would not be taxed at all under a limited GIT.

Third, transition from the net income tax system to GIT would not be easy, but it would not be easy to move to any truly alternative system. Transition to GIT would probably take about 5 years. Businesses probably would welcome GIT even if they had made long-term decisions based on the current tax system.

Fourth, GIT would greatly simplify taxation for proprietorships and corporations, enabling all businesses to pay their taxes quickly and easily—even daily. A business would always know its after-tax profit, which any business needs to know for operational predictability to achieve profitability.

Fifth, GIT would tax all businesses the same without regard to the form of business entity. Thus, it would eliminate the inequity that exists today on the basis of different tax rates for different business entities.

Let me say one more word about the problems of moving to an alternative tax system. Many individuals and businesses have planned their future on the basis of the current net income tax system. From time to time the Congress changes the ground rules for taxation; so does the IRS; so do the courts. An example of change came just a few weeks ago when the Congress enacted new tax legislation profoundly changing the rules for pensions, certain business deductions, safe-harbor leasing, et cetera. These things happen, and the Congress must retain the right and authority to change the tax laws. The public will not quarrel with that.

That does not mean that individuals and businesses should be treated arbitrarily, however. Any change, including GIT, should contain a built-in assurance that every member of the society will be treated fairly. Perhaps a special transition tax panel could be established to deal with those unusual situations in which an individual taxpayer was unfairly penalized because of a change to a new tax system.

But the committee might bear in mind that many decisions made in business today are made solely for tax purposes—indeed, for tax-avoidance purposes. Thus, professionals form professional corporations, partnerships, or other corporations. And major businesses establish satellite corporations for the sole purpose of minimizing income that would be subject to taxation. GIT would eliminate the tax relevance of such strategies, thus making taxable income uniformly subject to taxation. Importantly also, businesses would then be free to make their decisions on the basis of economic rather than tax considerations.

Under the current system unprofitable businesses—ones that are badly managed or should not be in the marketplace in the first place—are rewarded by not being taxed as heavily as their more profitable and well-run competitors. The profitable companies are required, in effect, to subsidize the unprofitable companies. Under GIT, this would not be the case. Well-managed companies would prosper under the GIT system, while poorly managed companies would not.

The time has come for profound changes in our tax system. The best approach for the Congress at this time is to investigate exhaustively the benefits of the business-oriented gross income tax system.

I have some extended remarks I would like to have in the record.

The CHAIRMAN. Thank you very much, Mr. Jones, and your entire statement will be made a part of the record.

[The prepared statement of Jim Jones follows:]

STATEMENT TO

TO

COMMITTEE ON FINANCE

SEPT. 29, 1982

HON. ROBERT J. DOLE, CHAIRMAN

97TH CONGRESS, SECOND SESSION

GOVERNMENT RESEARCH

AND

DEVELOPMENT FDN.

BLANCO, TX. 78606

THANK YOU FOR THE OPPORTUNITY TO TESTIFY. I AM JIM JONES, OF BLANCO, TEXAS, THE FOUNDER AND SEMI-RETIRED OWNER OF J. H. JONES CO., WHICH IS A WAREHOUSING DISTRIBUTOR OF POWER TRANSMISSION EQUIPMENT WITH HEADQUARTERS IN HOUSTON.

I AM ALSO THE FOUNDER AND PRESIDENT OF THE GOVERNMENT RESEARCH AND DEVELOPMENT CORPORATION, A NON-PROFIT ORGANIZATION DEVOTED EXCLUSIVELY TO PUBLIC POLICY RESEARCH. THE ORGANIZATION IS STAFFED ALMOST EXCLUSIVELY BY VOLUNTEERS. I PROVIDE ITS MODEST FINANCIAL UNDERWRITING. I CALL IT "AN AGENCY OF THE INDIVIDUAL AMERICAN CITIZEN."

THESE COMMITTEE HEARINGS ON ALTERNATIVE TAX SYSTEMS, INCLUDING A GROSS INCOME TAX, REPRESENT AN IMPORTANT MILESTONE FOR OUR SOCIETY. FOR TOO MANY YEARS, THE AMERICAN WAGE EARNER AND THE AMERICAN BUSINESSMAN HAVE BEEN TRYING TO COPE WITH INCOME TAX REPORTING REQUIREMENTS THAT HAVE BECOME A CRUSHING BURDEN. THIS

COMMITTE IS IN A POSITION TO DO SOMETHING TO REMOVE THAT BURDEN. FOR TOO MANY YEARS THE NATION HAS BORNE THE COST OF A MASSIVE AND COMPLEX REVENUE GATHERING SYSTEM. THIS COMMITTEE IS IN A POSITION TO DO SOMETHING TO LOWER THE COST OF COLLECTING FEDERAL TAXES. FOR TOO MANY YEARS, THIS CONGRESS HAS STRUGGLED WITH AN ARCHAIC NET INCOME TAX SYSTEM THAT IS OUT OF SYNCHRONIZATION WITH THE FISCAL NEEDS OF THE GOVERNMENT. THIS COMMITTEE CAN DO MUCH TO REPLACE THAT OUTMODED SYSTEM WITH A SPACE AGE TAX COLLECTION SYSTEM THAT WILL PROVIDE STEADY CASH FLOW TO THE GOVERNMENT, ON VIRTUALLY A DAILY BASIS.

THE ALTERNATIVE TAX SYSTEM THAT WILL PROVIDE ALL THESE ANSWERS IS THE "GROSS INCOME TAX" (GIT) SYSTEM. THIS SYSTEM, WHICH I EXPLAIN IN DETAIL IN MY ATTACHED REMARKS, WOULD APPLY A SINGLE TAX RATE (PROBABLY BETWEEN 4-1/2 % AND 7-1/2 %) TO THE GROSS INCOME OF EVERY BUSINESS ENTITY. GIT IS THE <u>BUSINESS ORIENTED</u> TAX SYSTEM, BECAUSE BUSINESS GENERATES THE INCOME, ACCUMULATES THE CAPITAL, AND EMPLOYS THE WAGE EARNERS IN OUR ECONOMY.

GIT WOULD REQUIRE ALMOST NO ELABORATE OR TAX INDUCED

SPECIAL RECORDKEEPING BY WAGE EARNERS OR BUSINESSES. IT WOULD BE VASTLY SIMPLER AND CHEAPER FOR THE INTERNAL REVENUE SERVICE TO ADMINISTER THAN THE PRESENT SYSTEM. AND IT WOULD PROVIDE THE CONGRESS WITH A STREAMLINED MECHANISM FOR REVENUE RAISING, ONE THAT COULD EASILY BE ADJUSTED TO GENERATE MORE OR LESS REVENUE, AS THE CASE MIGHT BE.

GIT IS EQUITABLE, FOR IT APPLIES THE SAME RATE TO THE SAME BASE FOR ALL TAXPAYERS. IT IS SIMPLE, FOR IT ELIMINATES ALL ABOVE THE LINE DEDUCTIONS AND EXCLUSIONS AND APPLIES THE TAX RATE ONLY TO TRUE GROSS INCOME. GROSS INCOME IS DEFINED AS GROSS RECEIPTS OF A BUSINESS ENTITY LESS COST OF GOODS SOLD. THIS IS THE SAME WAY AS DEFINED IN THE IRC TODAY. GIT WOULD DO AWAY WITH UP TO 90% OF RECORDKEEPING AND INTERNAL PAPERWORK FOR EMPLOYERS AND 95 TO 100% FOR EMPLOYEES. GIT IS NEUTRAL; PROFITABLE COMPANIES WOULD NO LONGER HAVE TO SHOULDER THE TAX BURDEN OF UNPROFITABLE COMPANIES. GIT IS EFFICIENT, IN THAT TAX COLLECTION BECOMES A SIMPLE FUNCTION OF EVERYDAY BUSINESS ACTIVITY AND ADMINISTRATION.

I WOULD ALSO MAKE THESE POINTS ABOUT GIT:

1. GIT WOULD HAVE LITTLE DISTRIBUTIONAL IMPACT, BECAUSE THE BURDEN OF TAXES WOULD FALL PROPORTIONATELY ON LOW, MIDDLE AND UPPER INCOME TAXPAYERS.
2. PROGRESSIVITY WOULD NOT BE AN ISSUE, BECAUSE GIT TAXES THE RICH AT THE SAME RATE AND ON THE SAME BASE AS THE POOR. (WAGE EARNERS BELOW A CERTAIN MINIMUM INCOME WOULD NOT BE TAXED AT ALL, UNDER A LIMITED GIT.)
3. TRANSITION FROM THE NET INCOME TAX SYSTEM TO GIT WOULD NOT BE EASY BUT IT WOULD NOT BE EASY TO MOVE TO ANY TRULY ALTERNATIVE SYSTEM. TRANSITION TO GIT PROBABLY WOULD TAKE ABOUT 5 YEARS. BUSINESSES PROBABLY WOULD WELCOME GIT, EVEN IF THEY HAD MADE LONG TERM DECISIONS BASED ON THE CURRENT TAX SYSTEM.
4. GIT WOULD GREATLY SIMPLIFY TAXATION FOR PROPRIETORSHIPS AND CORPORATIONS, ENABLING ALL BUSINESSES TO PAY THEIR TAXES QUICKLY AND EASILY - EVEN DAILY. A BUSINESS WOULD ALWAYS KNOW ITS AFTER TAX PROFIT WHICH ANY BUSINESS NEEDS FOR OPERATIONAL PREDICTABILITY TO ACHIEVE PROFITABILTIY.

5. GIT WOULD TAX ALL BUSINESSES THE SAME WITHOUT REGARD TO THE FORM OF BUSINESS ENTITY. THUS IT WOULD ELIMINATE THE INEQUITY THAT EXISTS TODAY ON THE BASIS OF DIFFERENT TAX RATES FOR DIFFERENT BUSINESS ENTITIES.

LET ME SAY ONE MORE WORD ABOUT THE PROBLEMS OF MOVING TO AN ALTERNATIVE TAX SYSTEM. MANY INDIVIDUALS AND BUSINESSES HAVE PLANNED THEIR FUTURE ON THE BASIS OF THE CURRENT NET INCOME TAX SYSTEM. FROM TIME TO TIME, THE CONGRESS CHANGES THE GROUND RULES FOR TAXATION; SO DOES THE IRS, AND SO DO THE COURTS. AN EXAMPLE OF CHANGE CAME JUST A FEW WEEKS AGO WHEN THE CONGRESS ENACTED NEW TAX LEGISLATION PROFOUNDLY CHANGING THE RULES FOR PENSIONS, CERTAIN BUSINESS DEDUCTIONS, SAFE-HARBOR LEASING, ETC. THESE THINGS HAPPEN, AND THE CONGRESS MUST RETAIN THE RIGHT AND AUTHORITY TO CHANGE THE TAX LAWS. THE PUBLIC WILL NOT QUARREL WITH THAT.

THAT DOES NOT MEAN THAT INDIVIDUALS AND BUSINESSES SHOULD BE TREATED ARBITRARILY, HOWEVER. ANY CHANGE - INCLUDING GIT - SHOULD CONTAIN A

BUILT-IN ASSURANCE THAT EVERY MEMBER OF THE SOCIETY WILL BE TREATED FAIRLY. PERHAPS A SPECIAL TRANSITION TAX PANEL COULD BE ESTABLISHED TO DEAL WITH THOSE UNUSUAL SITUATIONS IN WHICH AN INDIVIDUAL TAXPAYER WAS UNFAIRLY PENALIZED BECAUSE OF A CHANGE TO A NEW TAX SYSTEM.

BUT THE COMMITTEE MIGHT BEAR IN MIND THAT MANY DECISIONS MADE IN BUSINESS TODAY ARE MADE SOLELY FOR TAX PURPOSES - INDEED, FOR TAX AVOIDANCE PURPOSES. THUS, PROFESSIONALS FORM PROFESSIONAL CORPORATIONS, PARTNERSHIPS, OR CORPORATIONS. AND MAJOR BUSINESSES ESTABLISH SATELLITE CORPORATIONS FOR THE SOLE PURPOSE OF MINIMIZING INCOME THAT WOULD BE SUBJECT TO TAXATION. GIT WOULD ELIMINATE THE TAX RELEVANCE OF SUCH STRATEGIES, THUS MAKING TAXABLE INCOME UNIFORMLY SUBJECT TO TAXATION. INCIDENTALLY, BUSINESSES WOULD THEN BE FREE TO MAKE THEIR DECISIONS ON THE BASIS OF ECONOMIC RATHER THAN TAX CONSIDERATIONS.

UNDER THE CURRENT SYSTEM, UNPROFITABLE

BUSINESSES - ONES THAT ARE BADLY MANAGED, OR SHOULD NOT BE IN THE MARKETPLACE IN THE FIRST PLACE - ARE REWARDED BY NOT BEING TAXED AS HEAVILY AS THEIR MORE PROFITABLE AND WELL-RUN COMPETITORS. THE PROFITABLE COMPANIES ARE REQUIRED, IN EFFECT, TO SUBSIDIZE THE UNPROFITABLE COMPANIES. UNDER GIT, THIS WOULD NOT BE THE CASE. WELL MANAGED COMPANIES WOULD PROSPER UNDER THE GIT SYSTEM, WHILE POORLY MANAGED COMPANIES WOULD NOT.

THE TIME HAS COME FOR PROFOUND CHANGES IN OUR TAX SYSTEM. THE BEST APPROACH FOR THE CONGRESS AT THIS TIME IS TO INVESTIGATE EXHAUSTIVELY THE BENEFITS OF THE BUSINESS ORIENTED GROSS INCOME TAX SYSTEM.

THANK YOU.

END

EXTENDED REMARKS OF JIM JONES

THE UNITED STATES IS AT AN IMPORTANT CROSSROADS IN THE DEVELOPMENT OF THE METHOD BY WHICH THE NATION TAXES ITSELF. BEHIND US ARE 70 YEARS OF GROWTH OF AN INCOME TAX SYSTEM BASED ESSENTIALLY ON NET INCOME. THE RESULT IS AN ARCHAIC AND INEFFICIENT SYSTEM THAT BAFFLES AND ANGERS THE VERY PUBLIC THAT MUST HELP TO IMPLEMENT IT.

THE CHOICE BEFORE THE NATION IN THE 1980S IS THE CHOICE BETWEEN UNFAIRNESS OF THE PRESENT SYSTEM AND FAIRNESS OF A REFORMED SYSTEM. IT IS A CHOICE BETWEEN INEQUITY AND EQUITY, BETWEEN INEFFICIENCY AND EFFICIENCY.

THE PROBLEM IS NOT WITH THE AMOUNT OF TAXES THAT AMERICANS MUST PAY; CERTAINLY EVERY CITIZEN HAS A DUTY TO SUPPORT THE NATIONAL DEFENSE AND THE NATIONAL GOVERNMENT. THE PROBLEM IS WITH A SYSTEM THAT TAXES DIFFERENT KINDS OF INCOME AT DIFFERENT RATES, THUS FAVORING THOSE TAXPAYERS WITH THE RIGHT KINDS OF DEDUCTIONS AND EXEMPTIONS.

IN RECENT TESTIMONY BEFORE THE JOINT ECONOMIC COMMITTEE, FORMER COMMISSIONER OF INTERNAL REVENUE JEROME KURTZ SAID THAT THE CURRENT INCOME TAX HAD "SEEN A PROLIFERATION OF EXCLUSIONS, DEDUCTIONS, CREDITS AND OTHER TAX BENEFITS WHICH ARE UNNECESSARY, AND IN FACT HAVE PROVED DETRIMENTAL TO THE PROPER FUNCTION OF AN INCOME TAX. IT IS THESE PROVISIONS WHICH ACCOUNT FOR MOST OF THE COMPLICATIONS WITHIN OUR TAX SYSTEM."

A LONG-TIME CRITIC OF THE CURRENT INCOME TAX SYSTEM, MR. KURTZ WENT ON TO SAY: "OUR TAX SYSTEM HAS ITS PROBLEMS. IT IS TOO COMPLICATED, IT IS UNFAIR, RATES ARE TOO HIGH AND COMPLIANCE IS FALLING. THE ANSWER TO THESE PROBLEMS LIES IN VASTLY

SIMPLIFYING THE SYSTEM--RETURNING THE TAX LAW TO ITS ORIGINAL PURPOSE OF MEASURING ONE'S ABILITY TO PAY." (1)

WHILE MANY TAXPAYERS CRITICIZE THE USES TO WHICH THE GOVERNMENT PUTS ITS MONEY, THEIR REAL QUARREL IS WITH THE STAGGERING REQUIREMENTS OF THE TAX COLLECTION SYSTEM ITSELF. TO FILL OUT AN ENDLESS ARRAY OF TAX FORMS, TO MAINTAIN EVERGROWING STACKS OF RECEIPTS, AND OTHERWISE TO COMPLY WITH INTERNAL REVENUE SERVICE RULES AND REGULATIONS HAS BECOME A BACK-BREAKING TASK FOR INDIVIDUALS AND A HEAVY BURDEN FOR BUSINESSES.

THIS BURDEN IS NOT THE FAULT OF THE IRS. IT RESULTS FROM A LONG HISTORY OF CONGRESSIONAL TAX LEGISLATION, THE SUM OF WHICH SEEMS TO HAVE NO RHYME, NO REASON, NO RATIONAL BASIS TO IT AT ALL. THE TASK OF MAKING THIS "SYSTEM" WORK FALLS TO THE HAPLESS IRS, WHICH OFTEN FINDS ITSELF IN THE FRUSTRATING POSITION OF CLARIFYING AND SIMPLIFYING ITS TAX FORMS AND INSTRUCTIONS AT THE SAME TIME THAT CONGRESS IS DEVISING NEW AND EVEN MORE COMPLICATED TAX PROVISIONS.

IS ASPIRIN DEDUCTIBLE?

WHEN PRESIDENT WOODROW WILSON SIGNED THE FIRST FEDERAL INCOME TAX LEGISLATION INTO LAW IN 1913, HE SET IN MOTION A SYSTEM THAT TODAY HAS BECOME A CRAZYQUILT OF SHORT FORMS, LONG FORMS, SCHEDULES, DEDUCTIONS, PREFERENCES, EXEMPTIONS, AND EXCLUSIONS THAT VIRTUALLY NOBODY EXCEPT TAX LAWYERS AND ACCOUNTANTS CAN UNDERSTAND. INDEED, IN A 1975 ADDRESS TO THE TAX FOUNDATION, THEN SECRETARY OF THE TREASURY WILLIAM E. SIMON SAID, "I'M NOT EVEN SURE THE IRS EXPERTS FULLY UNDERSTAND THE SYSTEM ANYMORE. HOW CAN THEY, WHEN THEY ARE DEALING WITH A TAX CODE AND REGULATIONS THAT EXCEED 6,000 PAGES OF FINE PRINT?" (2)

THE CONFUSION AND COMPLEXITY OF THE TAX SYSTEM ARE REFLECTED IN THE FORMS THAT BOTH INDIVIDUALS AND BUSINESSES MUST FILL OUT. IRS PROCURES APPROXIMATELY 240 DIFFERENT MAJOR TAX FORMS AND APPROXIMATELY 180 MISCELLANEOUS FORMS. ALMOST EVERY INDIVIDUAL WAGE EARNER MUST FILL OUT EITHER THE FORM 1040 OR THE "SHORT FORM" (1040A) AND ALSO MAINTAIN TAX RECORDS. (3) MANY AMERICANS GIVE UP ON THE TASK OF FILLING OUT THEIR FORMS, WHICH BY ONE OFFICE OF MANAGEMENT AND BUDGET ESTIMATE TAKES THE AVERAGE PERSON NEARLY THREE HOURS FOR THE FORM 1040, AND SEEK HELP FROM A THIRD PARTY--A LAWYER, ACCOUNTANT, STORE-FRONT TAX PREPARER, OR WHOMEVER. IN THE 1982 FILING SEASON (FOR 1981 FORMS), 32.8 MILLION TAXPAYERS FILING THE FORM 1040 SOUGHT THIRD-PARTY ASSISTANCE; THAT WAS 61 PERCENT OF THE TOTAL FILING THAT FORM. SOME 7.5 MILLION PERSONS FILING THE SHORT FORM (1040A) SOUGHT THIRD-PARTY ASSISTANCE, WHICH WAS 20 PERCENT OF THE TOTAL FILING THAT FORM. OVERALL, 44 PERCENT OF TAXPAYERS FILING THE 1040 OR 1040A NEEDED THIRD-PARTY HELP. (4)

BUSINESS TAXPAYERS MUST SPEND EVEN MORE TIME FILING FEDERAL TAX FORMS. IN 1977, BUSINESSES SPENT AN ESTIMATED 109 MILLION MANHOURS FILLING OUT EMPLOYEE WAGE AND TAX STATEMENTS (FORM W-2) ALONE. AT A MINIMUM, MOST BUSINESSES ARE ALSO REQUIRED TO FILE AN EMPLOYER'S QUARTERLY FEDERAL TAX RETURN (FORM 941) AND A STATEMENT OF WITHHELD INCOME AND FICA TAXES (FORM 501). FURTHER, ALL INCORPORATED BUSINESSES MUST FILE A U.S. CORPORATION INCOME TAX RETURN (FORM 1120), THE CORPORATE EQUIVALENT OF THE FORM 1040. PROPRIETORS OF UNINCORPORATED BUSINESSES TYPICALLY FILE A SCHEDULE C (PROFIT OR LOSS FROM BUSINESS OR PROFESSION) ALONG WITH THEIR PERSONAL INCOME TAX RETURN. (5)

TO FILL OUT ALL OF THESE FORMS IS, FOR MANY BUSINESSES, A MAJOR EXPENSE. FOR THE LARGEST BUSINESSES, TO FILL OUT FEDERAL TAX FORMS AND INFORMATION RETURNS MEANS THE FULL-TIME YEAR-ROUND SERVICES OF TEAMS OF TAX LAWYERS AND ACCOUNTANTS. IN

1976, FOR EXAMPLE, IT COST ONE LARGE MULTINATIONAL CORPORATION $136,960 TO PREPARE THE 18 DIFFERENT FEDERAL TAX REPORTS THAT IT WAS REQUIRED TO FILE. THIS BREAKS DOWN TO AN AVERAGE COST OF $7,609 PER REPORT. (6) SMALL BUSINESSES ARE HIT HARD, TOO. THE NATIONAL FEDERATION OF INDEPENDENT BUSINESSES FOUND THAT, IN 1976, SMALL BUSINESSES NATIONWIDE SPENT MORE THAN $11 BILLION TO HAVE THEIR FEDERAL TAX FORMS PREPARED. (7)

OUT OF CONTROL?

ADMINISTRATION OF THE CURRENT NET INCOME TAX SYSTEM IS BOTH COMPLICATED AND COSTLY. AND IT APPEARS TO BE NEARLY OUT OF CONTROL. THE IRS ESTIMATES OF THE SO-CALLED "TAX GAP" (UNREPORTED AND UNTAXED INCOME OR OVERSTATED DEDUCTIONS) WERE $29 BILLION IN 1973 AND $87 BILLION FOR 1981; A PRELIMINARY IRS ESTIMATE FOR 1985 IS $120 BILLION. (8)

BECAUSE OF THE COMPLEXITY OF THE TAX SYSTEM AND ITS RESULTANT FORMS, IRS MUST OFFER A VARIETY OF SERVICES TO TAXPAYERS TO HELP THEM TO UNDERSTAND THE FORMS THEY MUST FILL OUT. IRS ASSISTED SOME 44.8 MILLION TAXPAYERS IN FY 1981, INCLUDING BOTH TELEPHONE AND WALK-IN CONTACTS. IN FY 1982, THE TAXPAYER SERVICE BUDGET ACTIVITY TOTALLED $230,530,000.

THE COST OF PRINTING FORMS IS ALSO IMPRESSIVE: AN ESTIMATED $28 MILLION TOTAL FOR THE APPROXIMATELY 420 FORMS THAT IRS CURRENTLY PROCURES.

ALL OF THIS EFFORT REQUIRES A LOT OF PEOPLE. IRS MAINTAINS A PERMANENT WORKFORCE OF ABOUT 88,000 PEOPLE, AUGMENTING THIS LEVEL TO JUST OVER 100,000 DURING THE FILING SEASON. THE TOTAL PERSONNEL COSTS OF IRS ARE ABOUT $2 BILLION--OUT OF A TOTAL AGENCY BUDGET THAT WAS $2.48 BILLION IN 1981.

THE COST OF IRS OPERATIONS HITS THE TAXPAYER IN THE POCKETBOOK. THE COMPLEXITY OF THE IRS-ADMINISTERED NET INCOME SYSTEM HITS THE TAXPAYER--WHETHER A WAGE EARNER OR BUSINESS ENTITY--IN THE AREAS OF RECORDKEEPING AND FORM-FILLING. OVERALL, THE FEDERAL TAX REQUIREMENTS ACCOUNTED FOR 41.98 PERCENT OF THE TOTAL PAPERWORK BURDEN GENERATED BY THE FEDERAL GOVERNMENT IN FY 1981. IRS ACHIEVED A 9 PERCENT REDUCTION FOR FY 1982, BUT ITS PERCENTAGE OF THE TOTAL FEDERAL REPORTING BURDEN ACTUALLY ROSE TO 43.80 PERCENT, BASED ON OFFICE OF MANAGEMENT AND BUDGET ESTIMATES.

IN RESPONSE TO IRS REQUIREMENTS, TAXPAYERS FILED APPROXIMATELY 142 MILLION PRIMARY RETURNS IN CALENDAR YEAR 1982 AND 7 MILLION SELECTED SUPPLEMENTAL DOCUMENTS; THE COMBINED TOTAL WAS UP 4 MILLION FROM THE PREVIOUS YEAR. (THESE FIGURES DO NOT INCLUDE, OF COURSE, THE MILLIONS OF OTHER PAYMENT DOCUMENTS AND TAXPAYER CORRESPONDENCE RECEIVED BY IRS.)

THERE IS NO QUESTION THAT THE TIME HAS COME FOR SIMPLIFYING THE ENTIRE FEDERAL TAX SYSTEM. ALREADY IT HAS BECOME A MATTER FOR DEBATE WHETHER THE GOVERNMENT IS SERVING THE PEOPLE OR THE PEOPLE ARE SERVING THE GOVERNMENT.

HOW MUCH LONGER AMERICAN TAXPAYERS ARE GOING TO PUT UP WITH THE MISHMASH OF IRS REGULATIONS AND THE INCONVENIENCE AND EXPENSE OF COMPLYING WITH FEDERAL TAX LAWS IS ANYONE'S GUESS. BUT IF RECENT LOCALIZED OUTBREAKS OF TAXPAYER PROTEST CONTINUE, IT MAY NOT BE LONG BEFORE ALL TAXPAYERS NATIONWIDE STAND UP AND SHOUT, "WE'RE NOT GONNA TAKE IT ANYMORE."

EFFORTS TO SIMPLIFY THE TAX SYSTEM ARE NOT NEW. VARIOUS PROPOSALS HAVE SPRUNG UP IN NEARLY EVERY SESSION OF CONGRESS SINCE THE FIRST MODERN INCOME TAX LAW WAS PASSED IN 1913. BUT, FOR THE MOST PART, TAX LEGISLATION HAS BEEN AIMED AT SIMPLIFYING ONLY PARTICULAR PROVISIONS OF THE TAX LAW. FOR EXAMPLE, THE

INCOME AVERAGING RULES WERE SIMPLIFIED UNDER THE TAX REFORM ACT OF 1969 AND THE REVENUE ACT OF 1971 SIMPLIFIED SOME ASPECTS OF THE DEPRECIATION RULES.

THIS PIECEMEAL APPROACH TO SIMPLIFICATION HAS NOT WORKED. THE TAX STATUTES HAVE BECOME EVEN LENGTHIER AND MORE DIFFICULT TO COMPREHEND. AND WITH NEW TAX LEGISLATION NOW BEING PASSED ALMOST YEARLY, IT HAS BECOME ALL BUT IMPOSSIBLE TO KEEP TRACK OF THE CHANGES IN BOTH THE LAW AND THE FORMS. AND EFFORTS TO SIMPLIFY TAX FORMS, AS THE IRS HAS REPEATEDLY TRIED, ARE NOT ENOUGH. ONE OF THE LATEST IS THE $1.9 MILLION CONTRACT THAT THE AGENCY LET TO THE FIRM OF SIEGEL AND GALE TO SIMPLIFY THE FORM 1040.

IT IS TIME FOR A NEW TAX SYSTEM.

IN SEARCH OF A BETTER WAY

IT SHOULD BE FOR THE GOVERNMENT--AND NOT THE TAXPAYERS--TO COME FORWARD WITH A BETTER WAY TO DESIGN AND MANAGE THE FEDERAL REVENUE-COLLECTING FUNCTION. CONGRESS AND THE IRS ARE THE EXPERTS, CITIZENS ARE NOT.

IN THE ABSENCE OF SUCH REFORM, HOWEVER, IT FALLS TO THE CITIZENS TO PROPOSE THEIR OWN. ONE OF THESE IS THE GROSS INCOME TAX (GIT) SYSTEM, A SIMPLIFIED AND EQUITABLE APPROACH TO TAX COLLECTING AND ADMINISTRATION.

THE CRUCIAL UNDERLYING FLAW IN OUR PRESENT TAX SYSTEM IS THAT IT IS BASED ON NET INCOME. NET INCOME IS A FIGURE ARRIVED AT BY TAXPAYERS AND THEIR ACCOUNTANTS AND DEPENDS PRIMARILY ON THE INGENUITY OF THE TAXPAYER'S ACCOUNTING AND INVESTMENT SYSTEM. BY ITS VERY NATURE, A NET INCOME TAX SYSTEM--WITH ITS COUNTLESS WAYS TO REDUCE TAX LIABILITY--IS INEQUITABLE, HARD TO

ADMINISTER, WASTEFUL IN COMPLIANCE AND OVERHEAD COSTS, AND FRUSTRATING IN ITS COMPLEXITY.

ALL OF THESE PROBLEMS COULD BE SOLVED SIMPLY BY IMPLEMENTING A TAX SYSTEM BASED ON GROSS INCOME. GIT IS JUST SUCH A SYSTEM. IT IS FAIR, IT IS EFFICIENT, IT IS WORKABLE, AND MOST OF ALL, IT IS ESSENTIAL IF WE ARE TO PREVENT A TAXPAYER REVOLUTION AND MASSIVE BREAKDOWN OF GOVERNMENT.

CHANGING OVER FROM THE PRESENT NET INCOME TAX (NIT) SYSTEM TO GIT WOULD BENEFIT EVERYONE--INDIVIDUALS, BUSINESSMEN, THE INTERNAL REVENUE SERVICE, THE ENTIRE NATION.

* FOR EMPLOYERS, GIT WOULD ELIMINATE AN ESTIMATED 90 PERCENT OF ALL RECORDKEEPING AND INTERNAL PAPERWORK REQUIRED FOR INCOME TAX PREPARATION. W-2 FORMS NO LONGER WOULD BE REQUIRED, NOR WOULD QUARTERLY REPORTS TO THE GOVERNMENT OR MONTHLY PAYMENTS. ALL INFORMATION WOULD BE REPORTED BUT ONCE A YEAR. LIKEWISE, TAXES, TOO, ALL WOULD BE PAID AT ONE TIME.

* FOR EMPLOYEES, FEW WOULD HAVE TO FILE AN INCOME TAX RETURN UNDER GIT AND NONE WOULD HAVE TO SUFFER THE FRUSTRATION OF COPING WITH INCOMPREHENSIBLE FORMS AND INSTRUCTIONS.

* FOR THE GOVERNMENT, GIT WOULD MEAN COMPLETE CONTROL OVER HOW MUCH REVENUE IS COLLECTED, AND WHEN, AND WHAT SOCIAL AND ECONOMIC GOALS ARE REALIZED THROUGH THE TAX SYSTEM.

IN ADDITION, THE GIT SYSTEM WOULD INSURE THAT:

* EVERY TAXPAYER--WHETHER AN INDIVIDUAL OR A BUSINESS--WOULD PAY A FAIR SHARE.

* THERE WOULD BE ABSOLUTELY NO "LOOPHOLES," WHICH ALLOW SOME TAXPAYERS TO AVOID PRACTICALLY ALL TAXES EVEN THOUGH THEIR INCOMES MAY BE IN THE MILLIONS OF DOLLARS.

* THE GOVERNMENT WOULD COLLECT AT LEAST AS MUCH REVENUE AS IT DOES UNDER THE PRESENT NIT SYSTEM, BUT AT A VASTLY REDUCED OVERHEAD COST.

* THE TAX SYSTEM NO LONGER WOULD BE A MAJOR CONTRIBUTOR TO THE INSIDIOUS INFLATION THAT IS EATING AWAY MORE AND MORE PROFITS AND SAVINGS EACH YEAR.

IN SHORT, GIT IS AN EQUITABLE, UNCOMPLICATED TAX SYSTEM THAT WOULD GENERATE SUFFICIENT REVENUE TO THE FEDERAL GOVERNMENT DRASTICALLY REDUCING THE DOLLAR, TIME, AND PAPERWORK COSTS INHERENT UNDER THE PRESENT NIT SYSTEM.

HOW WOULD GIT WORK?

UNDER THE GIT SYSTEM, MOST INDIVIDUAL WAGE EARNERS (IWEs) WOULD NOT FILE AN INCOME TAX RETURN. INSTEAD, THE IRS WOULD COLLECT FEDERAL INCOME TAX AND FICA BY TAKING PERCENTAGE OFF THE TOP OF THE GROSS RECEIPTS OF EACH COMPANY OR BUSINESS OPERATING ENTITY (BOE).

ONCE A YEAR, EACH BOE WOULD SUBMIT TO THE IRS BOTH AN INCOME TAX RETURN AND AN INFORMATION RETURN. THE INCOME TAX RETURN, A COPY OF WHICH IS INCLUDED HERE, WOULD SHOW THE BOE'S GROSS RECEIPTS. THE INFORMATION RETURN WOULD SHOW HOW MANY IWEs THE BOE HAD EMPLOYED DURING THE YEAR AND HOW MUCH IT HAD PAID EACH EMPLOYEE. ALONG WITH THESE RETURNS, EACH BOE WOULD SUBMIT TO THE IRS THE AMOUNT OF FEDERAL INCOME TAX IT OWED. THIS AMOUNT WOULD BE BASED ON A PERCENTAGE OF THE BOE'S GROSS RECEIPTS. THE PERCENTAGE, WHICH WOULD BE DETERMINED BY CONGRESS,

WOULD BE THE SAME FOR ALL BUSINESS OPERATING ENTITIES. BECAUSE GIT WOULD BROADEN CONSIDERABLY THE CURRENT TAX BASE, THIS PERCENTAGE, OR TAX RATE, WOULD BE VERY LOW. IT IS ESTIMATED THAT THE TAX RATE WOULD BE IN THE 4-1/2% TO 7-1/2% RANGE. (SEE APPENDIX.)

BASED ON THE INFORMATION IT RECEIVED FROM THE BOE, THE IRS WOULD ALLOCATE TO EACH INDIVIDUAL WAGE EARNER HIS OR HER SHARE OF THE INCOME TAX AND FICA PAID BY THE BOE FOR WHICH HE OR SHE WORKED. THE IRS WOULD THEN SEND EACH IWE A STATEMENT SHOWING HOW MUCH FEDERAL INCOME TAX AND FICA THEY HAD BEEN CREDITED WITH PAYING.

WHAT ABOUT DEDUCTIONS?

EACH YEAR, CONGRESS WOULD ISSUE A LIST OF ITEMS FOR WHICH TAX CREDITS WILL BE GIVEN. CREDITS OFFERED COULD INCLUDE THOSE FOR EMPLOYMENT (HIRING), PURCHASES OF HOMES, CHARITABLE CONTRIBUTIONS, EXPORT SALES, ENERGY SAVING MEASURES, OR VIRTUALLY ANYTHING THAT WOULD BE ECONOMICALLY OR SOCIALLY ADVANTAGEOUS FOR THE NATION.

A BOE WOULD CLAIM ITS TAX CREDITS ON THE TAX RETURN IT FILES WITH THE IRS EACH YEAR. THE BOE WOULD DEDUCT THE AMOUNT OF TAX CREDITS FROM GROSS INCOME LIABILITY, SIMILAR TO THE WAY IT IS DONE TODAY.

AN IWE WISHING TO CLAIM TAX CREDITS WOULD FILL OUT A SIMPLE FORM AND SUBMIT IT TO THE IRS WITH APPROPRIATE SUPPORTING DOCUMENTATION. THE IRS THEN WOULD ISSUE THE IWE A CHECK, OR DIRECT PAYMENT, FOR THE CREDITS CLAIMED. THUS, ONLY THOSE IWES WISHING TO CLAIM TAX CREDITS WOULD HAVE TO SUBMIT A FORM TO THE IRS OR KEEP SUPPORTING RECORDS THROUGHOUT THE YEAR.

WOULD ANYONE ELSE HAVE TO FILE A TAX RETURN?

AN INDIVIDUAL WHO IS SELF-EMPLOYED WOULD FILE AS A BOE. ALSO, ANY PERSON WHO RECEIVED A SUBSTANTIAL AMOUNT OF UNEARNED INCOME WOULD FILE AS A BOE FOR THE YEAR DURING WHICH THAT INCOME WAS RECEIVED. SUCH UNEARNED INCOME, WHICH COULD INCLUDE GIFTS, INHERITANCES, LONG-TERM CAPITAL GAINS, SAVINGS BANK INTEREST, ETC., WOULD BE TAXED AT THE SAME RATE APPLICABLE TO ALL BOEs, I.E., 4-1/2% TO 7-1/2%.

IN ADDITION, SOME HIGH-SALARIED INDIVIDUAL WAGE EARNERS WOULD BE DEFINED AS BOEs FOR TAX PURPOSES. SUCH IWEs, WHO CLEARLY ARE SELLING THEIR EXPERTISE RATHER THAN CONTRIBUTING SIMPLE MANUAL OR MENTAL INPUTS TO THEIR COMPANIES, ARE MORE PROPERLY CONSIDERED BUSINESS ENTITIES. CONGRESS WOULD SET THE SALARY LIMIT ABOVE WHICH AN IWE BECOMES A BOE. IF, SAY, THE LIMIT IS SET AT $50,000, THE IWE WOULD FILE AS A BOE ONLY FOR THE INCOME EARNED ABOVE $50,000. TAX ON THE SALARY UP TO $50,000 WOULD BE ALLOCATED (AS FOR ALL IWEs) ON THE BASIS OF THE TAX AND INFORMATION RETURNS FILED BY THE EMPLOYER.

WOULD IT BE HARD TO CHANGE-OVER FROM NIT TO GIT?

THERE IS NO DOUBT THAT IT WOULD TAKE SOME TIME FOR INDIVIDUALS AND PROPRIETORS OF BUSINESSES TO GET USED TO A TAX SYSTEM WITHOUT SUCH INGRAINED NOTIONS AS DEPRECIATION, DEDUCTIONS, OR CAPITAL LOSS CARRYOVERS.

OF COURSE, THE REASON THESE AND OTHER DEVICES EXIST IS <u>BECAUSE</u> OF THE NIT SYSTEM ITSELF. THE GIT SYSTEM DOES NOT <u>NEED</u> SUCH DEVICES TO ATTAIN FAIRNESS AND EQUITY.

SO, THE FIRST STEP IN CHANGING OVER FROM THE NIT SYSTEM TO THE GIT SYSTEM IS TO UNDERSTAND THAT NO ONE WILL BE LOSING

ANYTHING. IWEs WOULD TAKE HOME THE SAME AMOUNT OF MONEY UNDER GIT AS THEY DO UNDER NIT. THE DIFFERENCE BETWEEN THEIR GROSS AND TAKE-HOME SALARIES UNDER NIT WOULD SIMPLY BECOME THEIR ALLOCATED TAX SHARE UNDER GIT.

LIKEWISE, BUSINESSES WOULD NOT LOSE ANYTHING EITHER UNDER GIT. EVEN IF A PARTICULAR BUSINESS SHOULD END UP PAYING MORE TAXES UNDER GIT, THIS INCREASE WOULD BE MORE THAN OFFSET BY THE SIGNIFICANT SAVINGS THAT WOULD BE REALIZED IN THE YEAR-ROUND COSTS ASSOCIATED WITH TAX REPORTING AND PREPARATION UNDER NIT.

WHY SHOULD WE CHANGE FROM THE NIT SYSTEM TO THE GIT SYSTEM?

1. GIT <u>WOULD REDUCE DRASTICALLY THE COMPLEXITY OF THE TAX SYSTEM</u>. COMPLEXITY IS INHERENT IN ANY TAX SYSTEM BASED ON NET INCOME. UNDER SUCH A SYSTEM, IT BECOMES THE OBJECTIVE OF ALL TAXPAYERS--BUSINESSES AND INDIVIDUALS--TO REDUCE THEIR TAXABLE (NET) INCOME TO THE BAREST MINIMUM. THIS IS ACCOMPLISHED BY USING SUCH DEVICES AS DEDUCTIONS, SHELTERS, ETC.

BECAUSE EVERY TAXPAYER HAS A UNIQUE TAXPAYING SITUATION, COUNTLESS DIFFERENT APPROACHES TO MINIMIZING TAXABLE INCOME HAVE EVOLVED OVER THE YEARS. WHILE CONGRESS HAS PASSED HUNDREDS OF COMPLEX AMENDMENTS TO THE TAX CODE, THE IRS HAS ISSUED EVEN MORE COMPLEX REGULATIONS--ALL IN AN ATTEMPT TO CONTROL THE SITUATION, TO MAKE SURE THAT ONE GROUP DOES NOT BENEFIT UNDULY AT THE EXPENSE OF ANOTHER.

BUT SO LONG AS THE TAX SYSTEM IS BASED ON NET INCOME, CONGRESS AND THE IRS WILL NEVER GAIN CONTROL OF THE SITUATION. THEY WILL CONSTANTLY BE CALLED UPON TO EXTINGUISH--THROUGH YET ANOTHER COMPLEX AMENDMENT REGULATION--WHATEVER BRUSH FIRE EXISTS AT THE TIME.

GIT WOULD ELIMINATE THIS NEVER-ENDING CYCLE OF UNFAIRNESS AND COMPLEXITY. BECAUSE TAXES WOULD BE PAID RIGHT OFF THE TOP OF GROSS INCOME, NO TAXPAYER WOULD BE TREATED PREFERENTIALLY AND THUS NO AMENDMENTS WOULD BE NEEDED TO CORRECT INEQUITIES. THERE SIMPLY WOULD NOT BE ANY UNDER GIT.

2. THE GIT SYSTEM WOULD REDUCE SIGNIFICANTLY THE ASTRONOMICAL COSTS ASSOCIATED WITH FEDERAL TAX COMPLIANCE AND ADMINISTRATION. INDIVIDUALS, BUSINESSES, AND THE GOVERNMENT ALL WOULD REALIZE SUBSTANTIAL SAVINGS UNDER GIT. BY EMPLOYING THE PRINCIPLE OF ALLOCATION, GIT WOULD RELIEVE THE OVERWHELMING MAJORITY OF INDIVIDUAL WAGE EARNERS FROM THE BURDENS OF FILING A FEDERAL INCOME TAX RETURN AND KEEPING TAX RECORDS THROUGHOUT THE YEAR. MOREOVER, THOSE IWEs WHO CURRENTLY RELY ON A PROFESSIONAL TAX PREPARER WOULD REALIZE SIGNIFICANT DOLLAR SAVINGS AS WELL.

THE COST OF FEDERAL TAX COMPLIANCE ALSO WOULD PLUMMET FOR BUSINESSES UNDER GIT. BY ELIMINATING THE NEED TO COMPILE AND REPORT DATA MONTHLY AND QUARTERLY, GIT WOULD REDUCE BUSINESS OVERHEAD TO A FRACTION OF ITS CURRENT LEVEL. IN ADDITION, THOSE TAX LAWYERS AND ACCOUNTANTS WHO CURRENTLY MUST WORK FULL-TIME HANDLING THE TAX MATTERS OF THEIR COMPANIES COULD, UNDER GIT, FOCUS THEIR EFFORTS INSTEAD ON THE REAL PURPOSE OF BUSINESS--CAPITAL FORMATION.

FOR THE GOVERNMENT, THE NIT SYSTEM, WITH ITS COUNTLESS PROVISIONS TO MEET EQUALLY COUNTLESS INDIVIDUAL TAXPAYER SITUATIONS, IS EXTREMELY DIFFICULT AND COSTLY TO ADMINISTER. THE TRUE COST, HOWEVER, WILL NEVER BE KNOWN BECAUSE THE ADMINISTRATIVE COSTS ARE ONLY THE TIP OF THE ICEBERG. THE REALLY HUGE COSTS ARE THE TAXES LOST BECAUSE OF LOOPHOLES. SOME SAY THAT LOOPHOLES ARE NECESSARY TO ACCOMPLISH CERTAIN SOCIAL AND ECONOMIC GOALS. THE FALLACY IN THIS STATEMENT IS THAT, UNDER THE NIT SYSTEM, ONLY CERTAIN CLASSES OF TAXPAYERS CAN TAKE ADVANTAGE OF THESE

LOOPHOLES, SO THAT THE VAST MAJORITY OF TAXPAYERS REAP NO SOCIAL OR ECONOMIC BENEFITS.

THE GIT SYSTEM, WITH ITS SIMPLIFIED, STRAIGHT-FORWARD METHOD FOR PROVIDING TAX CREDITS, ALSO COULD BE USED TO PROMOTE SOCIAL AND ECONOMIC GOALS, BUT WITH MUCH MORE EFFECTIVENESS AND AT A DRASTICALLY REDUCED COST.

3. THE GIT <u>SYSTEM WOULD TAX INDIVIDUALS AND BUSINESSES ON THE BASIS OF THEIR TRUE ABILITY TO PAY</u>. IT IS A CARDINAL DEMOCRATIC PRINCIPLE THAT AN INCOME TAX SHOULD BE BASED ON ABILITY TO PAY. UNDER THE PRESENT NIT SYSTEM, HOWEVER, THE GREATER ONE'S RESOURCES, OR ABILITY TO PAY, THE GREATER ONE'S ABILITY TO AVOID TAXES. THIS IS AN INHERENT WEAKNESS IN ANY TAX SYSTEM BASED ON NET INCOME, BECAUSE EACH INDIVIDUAL TAXPAYER DETERMINES FOR HIMSELF WHAT DEDUCTIONS HE CAN TAKE. THUS, THE GREATER ONE'S RESOURCES, THE MORE LIKELY IT IS THAT TAX LAWYERS AND ACCOUNTANTS CAN BE HIRED TO FIND LOOPHOLES THAT WILL MITIGATE ONE'S TAX LIABILITY.

MOREOVER, UNDER THE PRESENT NIT SYSTEM, IT IS POSSIBLE FOR ALMOST ANY BUSINESS TO EARN A LARGE <u>REAL</u> PROFIT, BUT, BECAUSE OF VARIOUS LOOPHOLES, SHOW--AND PAY TAXES ON--ONLY A SLIGHT <u>NET</u> PROFIT. THIS CAN BE ACCOMPLISHED, FOR INSTANCE, BY SPENDING MOST OF THE FIRM'S PROFITS ON TAX DEDUCTIBLE ITEMS. THUS, UNDER THE PRESENT NIT SYSTEM, IF TWO COMPANIES HAVE EQUAL GROSS RECEIPTS AND ONE SPENDS ITS PROFITS ON TAX DEDUCTIBLE BUSINESS EXPENDITURES WHILE THE OTHER PUTS ITS PROFITS INTO THE BANK, THE FIRST COMPANY WOULD PAY FAR LESS TAX THAN THE SECOND, DESPITE EQUAL ABILITIES TO PAY.

BY PERMITTING ONLY SOME INDIVIDUALS AND BUSINESSES TO REDUCE THEIR TAX LIABILITIES THROUGH VARIOUS TAX DEDUCTIONS AND PREFERENCES, THE CURRENT TAX LAWS AND REGULATIONS UNFAIRLY SHIFT

THE BURDEN FROM ONE SEGMENT OF SOCIETY TO ANOTHER. ALL TAXPAYERS END UP SHOULDERING THE EXPENSES OF THE RELATIVELY FEW WHO CAN TAKE ADVANTAGE OF TAX WRITE-OFFS.

THE GIT SYSTEM WOULD ELIMINATE ALL PREFERENTIAL TREATMENT. EVERY IWE AND BOE WOULD PAY AN EQUAL PERCENTAGE OF TAX ON GROSS EARNINGS. AND IN PLACE OF THE CURRENT ARBITRARY AND UNWIELDY MISHMASH OF DEDUCTIONS, PREFERENCES, AND VARIOUS OTHER LOOPHOLES, IT WOULD BE A MORE LIMITED AND CONTROLLABLE SYSTEM OF TAX CREDITS.

4. GIT WOULD GENERATE AT LEAST AS MUCH, AND PROBABLY MORE, REVENUE AS THE PRESENT NIT SYSTEM. BY ENDING ALL DEDUCTIONS, EXCLUSIONS, SHELTERS, AND VARIOUS OTHER FORMS OF PREFERENTIAL TREATMENT, THE GIT SYSTEM WOULD VASTLY INCREASE THE AMOUNT OF MONEY FLOWING INTO THE FEDERAL TREASURY. NATURALLY, MUCH OF THE EFFECT OF SUCH A GREATLY BROADENED TAX BASE WOULD BE MITIGATED BY THE SHARPLY LOWER TAX RATE THAT WOULD ACCOMPANY SUCH A BROADENING. HOWEVER, BECAUSE THE TAX BASE WOULD BE SO BROAD UNDER GIT, TO EFFECT EVEN A SUBSTANTIAL RISE IN REVENUE WOULD REQUIRE BUT A MINUTE INCREASE OF THE TAX RATE.

MOREOVER, THE GIT SYSTEM WOULD PUT AN END TO THE LOSS EACH YEAR OF MILLIONS--IF NOT BILLIONS--OF DOLLARS THAT ESCAPE THROUGH IMPROPER USE OF DEDUCTIONS AND OTHER TAX PREFERENCES. UNDER THE PRESENT NIT SYSTEM, WITH EACH TAXPAYER ADOPTING A DIFFERENT APPROACH TO MINIMIZING THEIR TAX LIABILITY, THE IRS CANNOT HOPE TO MONITOR TAXPAYER COMPLIANCE EFFECTIVELY. UNDER THE GIT SYSTEM, THE SIMPLE PROCEDURE FOR CLAIMING TAX CREDITS WOULD REDUCE THE LIKELIHOOD OF TAXPAYER MISUNDERSTANDING AND CONSEQUENT MISUSE OF A PROVISION. IN ADDITION, THE GIT SYSTEM, BY PROVIDING FOR A TIGHTLY CONTROLLED, LIMITED NUMBER OF TAX CREDITS, WOULD FACILITATE IRS VERIFICATION OF THEIR PROPER USE.

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MOREOVER, THE GIT SYSTEM WOULD ADD MILLIONS OF DOLLARS IN OVERHEAD SAVINGS. WITH FEWER TAX FORMS TO PRINT, DISTRIBUTE, AND PROCESS, AND LOWER COSTS ALL AROUND FOR INSURING TAX COMPLIANCE, GIT WOULD CONTRIBUTE TO A MORE ABUNDANT FEDERAL COFFER.

5. THE NIT SYSTEM IS HIGHLY INFLATIONARY. ONE OF THE PRIMARY CAUSES OF INFLATION TODAY IS THE NIT SYSTEM. TO COMPLY WITH ALL THE TAX AND INFORMATION REPORTING REQUIREMENTS THROUGHOUT THE YEAR, BUSINESSES MUST INVEST HUGE SUMS FOR THE SERVICES OF BOOKKEEPERS AND TAX ACCOUNTANTS. MOREOVER, BECAUSE THE NIT SYSTEM IS BASED ON NET INCOME, MOST BUSINESSES FIND IT NECESSARY TO MAINTAIN TWO DIFFERENT ACCOUNTING SYSTEMS. WHILE THE FIRST IS USED TO OPERATE THE BUSINESS FROM AN ECONOMIC STANDPOINT, THE SECOND IS USED TO OPERATE THE BUSINESS WITH AN EYE TOWARD TAX CONSEQUENCES. IT IS THE LATTER ACCOUNTING SYSTEM THAT WILL DETERMINE, FOR EXAMPLE, WHETHER A COMPANY WILL BUY OR LEASE PROPERTY OR EQUIPMENT. OFTEN, NUMEROUS TAX LAWYERS AND ACCOUNTANTS ARE NEEDED TO DISCOVER AND IMPLEMENT DEVICES THAT MAY BE USED TO LOWER A COMPANY'S TAX LIABILITY.

THE COST OF ALL THESE TAX-RELATED SERVICES IS, OF COURSE, ADDED TO THE PURCHASE PRICE OF THE GOODS PRODUCED. BUT SINCE NOTHING HAS BEEN ADDED TO THE INTRINSIC VALUE OF THE PRODUCT, THE COST OF THESE SERVICES IS INFLATIONARY.

THE NIT SYSTEM IS INFLATIONARY IN ANOTHER WAY, TOO; NAMELY, BECAUSE OF THE LARGE SUMS OF MONEY THE GOVERNMENT MUST SPEND TO ADMINISTER IT. THIS INCLUDES THE COSTS OF PRINTING AND DISTRIBUTING THE PLETHORA OF IRS TAX FORMS AND INSTRUCTIONAL BOOKLETS AND OF MONITORING TAX COMPLIANCE--A VIRTUALLY IMPOSSIBLE TASK CONSIDERING THE INNUMERABLE DIFFERENT TAXPAYING SITUATIONS OF INDIVIDUALS AND BUSINESSES.

UNDER THE GIT SYSTEM, TAX AND INFORMATION REPORTING REQUIREMENTS WOULD BE REDUCED TO ONCE A YEAR, THEREBY REDUCING SUBSTANTIALLY THE COSTS TO BUSINESS FOR COMPLIANCE. ADDITIONAL SAVINGS WOULD BE REALIZED BY MAINTAINING ONLY ONE ACCOUNTING SYSTEM. BECAUSE TAXES WOULD BE PAID BASED ON AN OBJECTIVE DETERMINATION OF GROSS INCOME--RATHER THAN A SUBJECTIVE DETERMINATION OF WHAT IS NET--COMPANIES WOULD HAVE NO NEED TO OPERATE ON A TAX-CONSEQUENT BASIS. THUS, OVERHEAD COSTS FOR TAX-RELATED EXPENSES WOULD VIRTUALLY DISAPPEAR FROM THE PURCHASE PRICE OF GOODS AND SERVICES.

OVERHEAD COSTS FOR GOVERNMENT ADMINISTRATION OF THE TAX SYSTEM ALSO WOULD TAKE A NOSEDIVE UNDER GIT. FIRST, SINCE MOST INDIVIDUAL WAGE EARNERS WOULD NOT HAVE TO FILE A RETURN, THERE WOULD BE FEWER TAX FORMS TO PRINT, DISTRIBUTE, AND PROCESS. MOREOVER, BECAUSE THE RETURNS FILED BY BOEs WOULD BE SIMPLE TO FILL OUT, THE LIKELIHOOD OF AN ERROR WOULD DECREASE AND SO, THEREFORE, WOULD THE COST OF CORRECTING RETURNS AND COLLECTING THE RIGHT AMOUNTS DUE. FINALLY, AUDITS WOULD BE FAR LESS TIME- (AND DOLLAR-) CONSUMING UNDER GIT. BECAUSE TAXES WOULD BE PAID ON GROSS RECEIPTS, THE NEED TO RULE ON THE LEGITIMACY OF COUNTLESS DIFFERENT KINDS OF DEDUCTIONS WOULD BE ELIMINATED.

THESE ARE ONLY SOME OF THE MANY REASONS WHY GIT MAKES SENSE. FOR ADDITIONAL REASONS AND A MORE TECHNICAL EXAMINATION OF THE GIT SYSTEM, PLEASE FILL OUT AND MAIL FORM PROVIDED.

* * *

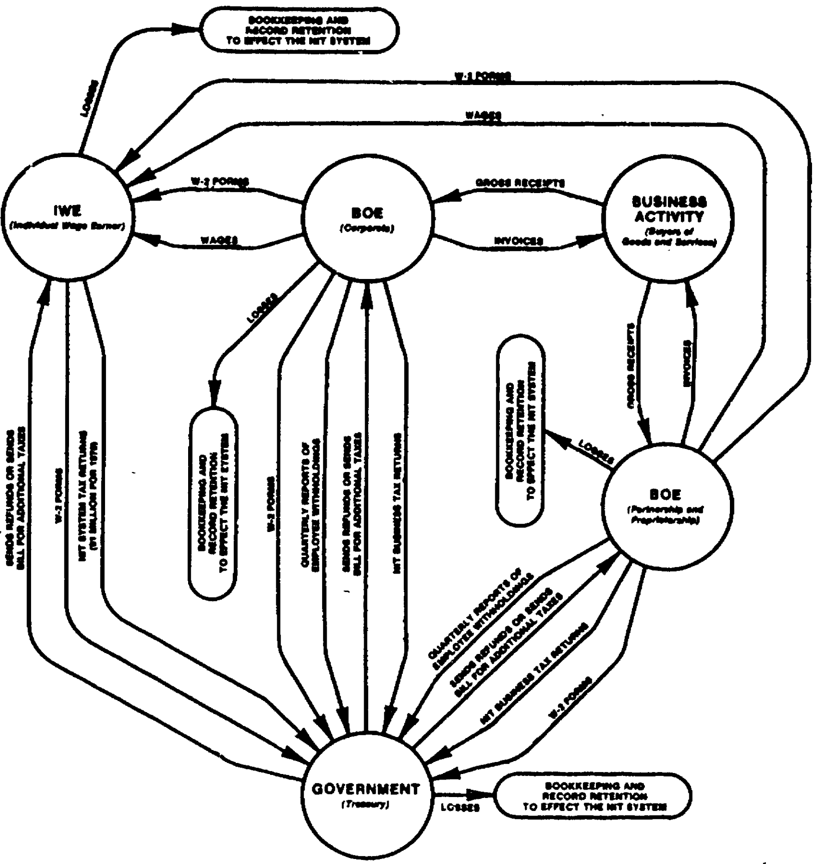
THE UNITED STATES ENJOYS A RICHLY DESERVED WORLDWIDE REPUTATION FOR PRODUCING THE BEST MANAGERIAL TALENT OF ANY ADVANCED INDUSTRIALIZED NATION. THIS IS THE COUNTRY THAT DESIGNED SYSTEMS TO DEVELOP THE ATOMIC BOMB AND TO PUT THE FIRST MAN ON THE MOON.

YET THIS NATION'S GOVERNMENT HAS NOT YET COME UP WITH AN EQUITABLE, RATIONAL TAX SYSTEM THAT CAN BE UNDERSTOOD BY EVERYONE.

THERE CAN BE NO DOUBT THAT CONGRESS POSSESSES THE INGENUITY TO DESIGN A SIMPLE, RATIONAL TAX SYSTEM. ITS ABILITY YEAR AFTER YEAR TO LEGISLATE NEW TAX LOOPHOLES FOR ONE GROUP OR ANOTHER IS EVIDENCE OF THAT. THE TIME HAS COME, HOWEVER, FOR CONGRESS TO APPLY THAT INGENUITY TO CREATING A SYSTEM THAT WILL TAKE THE "OUCH" OUT OF THE TAX BITE, NOT JUST FOR SOME BUT FOR EVERYONE.

THE TWO FOLLOWING PAGES SHOW SCHEMATIC DIAGRAMS OF THE WORK FLOW FOR BOTH THE NIT AND GIT SYSTEMS. FIG. A SHOWS THE NIT SYSTEM. IT IS QUITE EVIDENT THAT WE HAVE PRODUCED AN ADMINISTRATIVE NIGHTMARE. NOW LOOK AT FIG. B. HERE IS THE WORK FLOW FOR GIT. IT IS CLEAN, SIMPLE AND PRODUCES ITS TAX REVENUES AT FAR LESS INFLATIONARY COSTS THAN NIT.

THE NEXT SHOWS AN ILLUSTRATIVE GROSS INCOME TAX RETURN. A STUDY OF THE BOXES SHOWN AROUND THIS FORM WILL SHOW THAT THE GIT SYSTEM CAN ACCOMPLISH THE SAME RESULTS AS OUR PRESENT NIT SYSTEM, BUT AT MUCH LESS COST.

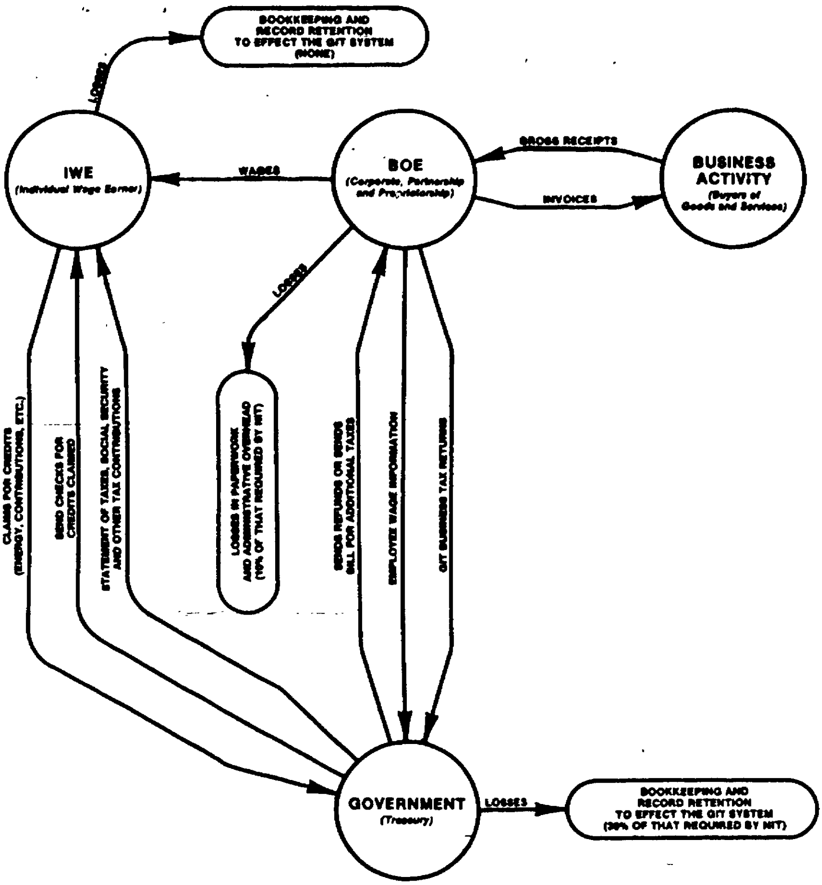


NIT SYSTEM

ADMINISTRATIVE WORK FLOW

Revised 9-1-81

Figure A



GIT SYSTEM

ADMINISTRATIVE WORK FLOW

Figure B

Revised 8-1-81

This ID number would cover every taxpaying entity, whether a corporation, division of a corporation, a professional investor, or an individual operating as a free enterprise.

By paying an income tax on its gross income, a business operating entity (BOE) avoids the massive overhead costs associated with seeking deductions and other tax avoidance devices. Once a BOE files this return and pays the tax due, it can spend the remainder of its receipts any way it chooses. Thus, under GIT, businesses could operate freely on an economic basis rather than on a tax-consequent basis.

BUSINESS GROSS INCOME TAX RETURN

Name ______ Type of Business Operating Entity (BOE) ______ 1

Address ______ City ______ State ______ Zip ______ 2

Taxpayer Number ______ Period of Return: From ______ to ______ 3

This consecutive 12-month period will vary from one BOE to another. By staggering BOE tax reporting and payment dates throughout the year, the GIT system would preserve the Government's cash flow while eliminating interest-free Government borrowing.

Gross Receipts

Sufficient income from any of these sources would make an individual wage earner (IWE) a BOE for tax purposes.

Sale of Goods	$ ______	4
Sale of Services	______	5
Sale of Combination of Goods and Services	______	6
Rentals of Real Estate	______	7
Sale of Real Estate	______	8
Rentals of Other Chattels	______	9
Dividends from Stocks	______	10
Sale of Stocks	______	11
Interest from Bonds	______	12
Sale of Bonds	______	13
Interest Received on Loans	______	14
Interest Received on Savings Accounts	______	15
Inheritances (market value)	______	16
Gifts (market value)	______	17
All other income not reported above	______	18
Salaries or Wages (report only amounts received above $50,000.00)	______	19
Total Gross Receipts	$ ______	20
Cost of Sales	$ ______	21
Gross Income (Line 20 Less Line 21)	$ ______	22
Gross Tax (5% Times Line 22)	$ ______	23

Under the GIT system, income from inheritances and gifts would be taxed at the same rate as all other forms of income. There would be no additional tax burden, as there is under the present system.

This line provides for those cases where an employee earns far in excess of what could be considered fair wages for ordinary manual or mental input. Any employee who earns more than $50,000 per year (or whatever limit Congress sets), and who is thus engaged in the "sale of expertise," would be considered a BOE.

Because GIT would vastly broaden the tax base, the actual rate of taxation required to generate sufficient revenue for the Government would be very low. It is estimated that the tax rate would be from 4½% to 7½%.

Credits

This section may be used to promote any social or economic goals deemed advantageous for the Nation.

Investment	______	24
Employment	______	25
Export Sales	______	26
Other Approved Credits	______	27
Total Credits	$ ______	28
Total Tax (Line 23 Minus Line 28)	$ ______	29

Total Wages Paid to Employees (IWE) for Year of Return	$ ______	30
Total Number of Employees (IWE)	______	31

The information in this section would be used to determine employee allocations for Federal income tax, FICA, and any other funds designated by Congress. This information would be broken down by individual employee on a separate form to account for partial years of employment, overtime, and raises. It is this second form that the IRS would use to allocate individual employee contributions. Once allocated, the IRS would then inform each employee of the amounts they paid into each fund.

FOR IRS USE ONLY

Allocation for Employees Tax Contribution	$ ______	32
Allocation for FICA	$ ______	33
Allocation for Health Care	$ ______	34
Allocation for General Revenue	$ ______	35

The IRS would specify in this section the total allocation for all employees to each fund designated by Congress. The allocation percentages would be monitored closely by Congress and would be changed yearly, as needed.

This section would:
1. Eliminate the need for making out billions of W-2 forms (and related support paperwork) by all BOE's (Business Operating Entities) in the country.
2. Eliminate millions of income tax returns by individuals each year.
3. Finance the Social Security Program out of the same funds from whence it now comes, but by a more direct and less costly route. These funds are the gross income which a BOE uses to pay his share and also the wages from which the IWE pays his share. It all comes from the same pot.
4. Give our Congress complete control and efficiency in operating any social system which must be separately funded.

This illustrative GIT return when plotted on a mathmatical basis follows the form.

$$y = mx \pm b_1 \pm b_2 \pm \ldots b_n$$

where,

y = Revenue (Yield) (line 29)
m = Tax Rate (line 23)
x = Gross Income (line 22)
b_1, b_2 = Tax Expenditures (Credits) (lines 24 thru 27)

The major advantage of the GIT system is that this Straight Line (Flat Rate) formula can be easily computerized. Consequently the Internal Revenue Service could furnish the Congress and the Executive branch with fast printouts of the results of any changes made. With such immediacy of response remedial decisions could be made on an informed basis.

REVISED 7-1-82

REFERENCES

1. Statement by Jerome Kurtz before the Subcommittee on Monetary and Fiscal Policy, Joint Economic Committee, August 19, 1982.

2. Statement by William E. Simon at Tax Foundation's 27th National Conference, New York City, December 3, 1975.

3. U.S. News and World Report, June 26, 1978, p. 58.

4. Public Information Office, IRS, September 24, 1982.

5. Small businesses are required to file form 1120S, U.S. Small Business Corporation Income Tax Return.

6. Buchholz, Rogene, "Corporate Costs for Compliance with Government Regulation of Information," Center for the Study of American Business, Washington University, Working Paper #43, April 1979.

7. National Federation of Independent Business, Fact Book on Small Business, Washington, D.C., February 1979, p. 70.

8. All data in this section are from a letter from Charles W. Wheeler, Assistant to the Commissioner, IRS, to Joseph Foote, dated July 23, 1982.

APPENDIX

GIT RATES NECESSARY TO REPLACE CERTAIN CURRENT TAX FUNCTIONS ARE GIVEN BELOW

ALL INCOME TAXES

LIMITED GIT* RATE	ALL INCLUSIVE** GIT RATE
5.2%	**4.38%**

ALL INCOME TAXES PLUS SOCIAL SECURITY (INSURANCE + WELFARE)

LIMITED GIT* RATE	ALL INCLUSIVE** GIT RATE
7.52%	**6.13%**

ALL INCOME TAXES PLUS SOCIAL SECURITY (WELFARE PORTION ONLY)

LIMITED GIT* RATE	ALL INCLUSIVE** GIT RATE
5.27%	**4.31%**

ALL GOVERNMENT REVENUES

LIMITED GIT* RATE	ALL INCLUSIVE** GIT RATE
8.82%	**7.2%**

* A limited GIT would exempt all wage earners having wages or salaries below $50,000/year.

** An ALL INCLUSIVE GIT would include all wage earners as well as businesses.

14 GOOD REASONS TO SWITCH TO GIT

1. IT IS FAIR AND EQUITABLE TO EVERY TAXPAYING ENTITY, WHETHER IT BE A CORPORATION, AN INDIVIDUAL BUSINESSMAN, AN INVESTOR OR A WAGE EARNER.

2. IT IS A PROGRESSIVE TAX BASED STRICTLY ON THE ABILITY TO PAY.

3. IT IS EASY TO ADMINISTER AND WOULD NOT MAKE TAXPAYERS DEPENDENT ON THE SUBJECTIVE AND ARBITRARY DECISIONS INHERENT IN ANY TAX SYSTEM BASED ON NET INCOME.

4. IT IS A TRUE AND EQUITABLE WAY FOR COMPANIES TO ACCUMULATE CAPITAL. THIS ENCOURAGES RETAINAGE OF FUNDS FOR EXPANSION INVESTMENT, THEREBY CREATING MORE JOBS.

5. IT WOULD ELIMINATE THE SO-CALLED "DOUBLE TAXATION" OF CORPORATIONS. THIS WOULD AGAIN ENCOURAGE RETAINAGE OF FUNDS FOR EXPANSION BECAUSE THERE WOULD BE NO CONFLICT BETWEEN PAYING OUT FOR DIVIDENDS VERSUS RETAINING MONEY FOR INTERNAL USE.

6. IT WOULD ELIMINATE AN ESTIMATED 90% OF THE PAPER WORK FOR BOE'S (BUSINESS OPERATING ENTITIES).

7. IT WOULD ELIMINATE AN ESTIMATED 95% OF THE PAPER WORK FOR IWE'S (INDIVIDUAL WAGE EARNERS)--THEY WOULD NOT FILE A YEARLY TAX RETURN.

8. IT WOULD ALLOW BUSINESS ENTITIES TO OPERATE ON AN ECONOMIC BASIS RATHER THAN ON A TAX CONSEQUENT BASIS.

9. IT WOULD RAISE MORE REVENUE THAN OUR PRESENT "SYSTEM" ALLOWS, WITHOUT SUBSTANTIVE OBJECTIONS FROM THE GENERAL PUBLIC.

10. IT WOULD GIVE EQUAL OPPORTUNITY TO ALL BUSINESS TAXPAYERS. LARGE FIRMS CAN EMPLOY LAWYERS AND ACCOUNTANTS TO FIND ALL AVAILABLE PREFERENCES UNDER THE PRESENT SYSTEM. GIT WOULD ELIMINATE THIS DISCRIMINATION WITHOUT PENALIZING EITHER THE LARGE OR THE SMALL COMPANY.

11. IT WOULD PROVIDE CONGRESS MORE CONTROL OVER THE TAX SYSTEM AND WOULD PERMIT GREATER FLEXIBILITY IN FUNDING FEDERAL PROGRAMS AND PROMOTING SOCIAL AND ECONOMIC GOALS.

12. IT WOULD INSURE THE GOVERNMENT A STEADY INFLOW OF REVENUE AND WOULD DISCONTINUE THE CURRENT PRACTICE OF INTEREST-FREE BORROWING FROM BUSINESSES AND EMPLOYEES.

13. IT WOULD PROVIDE BUSINESSES AND THE GOVERNMENT THE PREDICTABILITY THEY NEED FOR EFFICIENT OPERATION.

14. NO LONGER WOULD ANY WAGE EARNER IN THE COUNTRY HAVE TO FILE A FORM 1040, THUS ELIMINATING THE APRIL 15TH NATIONAL TRAUMA.

The CHAIRMAN. Mr. Herschensohn, do you have a specific plan, or were you just sort of outlining the direction you feel we should go?

Mr. HERSCHENSOHN. Specific, in that the flat-rate tax floats commensurate with the budget of the United States. That would seem to be more important than any other facet. And in doing that we would raise the public perception that taxation is not the evil, it is spending that is the evil, and that there are three ways in which spending has to be taken care of: one by taxation, which as dreadful as it is, is at least honest; one by inflation, which is dishonest; and one by thievery, which should be illegal, which is the national debt.

The CHAIRMAN. Just from the standpoint of interest in whatever we finally may do, whether it is a floating or flat rate or a bumpy flat rate, or whatever, as I understand, there is a great deal of citizen interest in California. You are a commentator on a TV program there, and I assume you have had a number of opportunities to discuss it with taxpayers and others. Is there a great deal of interest?

Mr. HERSCHENSOHN. Senator, tremendous. I don't know of any issue, whether it be anything in foreign affairs or domestic, that has created as much viewer and listener interest and enthusiasm as has this.

I brought, just for your information, a bag full of letters and postcards, I would say 99 percent of which advocate a flat-rate tax.

The CHAIRMAN. Is California generally that far ahead? The percentage is higher there than it is elsewhere.

Mr. HERSCHENSOHN. California is always that far ahead, sir.

The CHAIRMAN. You are sort of leading the charge again? That's interesting.

Mr. HERSCHENSOHN. Yes.

The CHAIRMAN. But I do know, in fact, I participated in a couple of talk shows.

Do you really think when you say "flat rate"—you are probably more specific on the air—does the term "flat rate" really tell anybody very much?

Mr. HERSCHENSOHN. Yes, it does.

The CHAIRMAN. You have so many variations, and people still call it flat rate.

Mr. HERSCHENSOHN. I recognize that, but I am not advocating any of the variations. I am advocating flat and floating—fiscal year to fiscal year.

The CHAIRMAN. Flat and floating rate?

Mr. HERSCHENSOHN. A flat rate for all citizens, all taxpayers, of the United States. That percentage is decided by the forthcoming budget, the forthcoming fiscal year budget.

The CHAIRMAN. But no deductions, no exemptions?

Mr. HERSCHENSOHN. Nothing. Flat.

The CHAIRMAN. Do you see that as maybe unfairly benefiting upper income and penalizing middle income?

Mr. HERSCHENSOHN. No; I don't. No; I don't.

I feel this way, Senator, that anyone has the right to pursue whatever ambition they want. And if someone's ambition is to become a millionaire, that's just fine if that's what that person wants to be. My ambition was in part to be a television commentator. I don't want the Government coming and saying, "Look, you have a 3-minute commentary every night we are going to take a minute and a half away and give it to some other people who don't have that benefit." And those of you who are Senators, I'm sure you don't want the Government saying, "Look, you have a 6-year term; we are going to take 3 years away and give it to those people who don't have that benefit." You worked for it, you should have it. And I feel that way about those who feel that their ambition is to make money. Fine. Let them.

The CHAIRMAN. I wouldn't quarrel with that, except I think now maybe the Tax Code may unfairly help some of those people up the ladder while others are not helped.

Mr. HERSCHENSOHN. But a flat one would not do that. I agree with you, there is no question, there are all kinds of shelters and exclusions and credits, and so on. This would eliminate them.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you, Mr. Chairman.

I would like to thank the panel, each of whom I thought gave some very interesting testimony. In particular I would like to say to Mr. Herschensohn that I think you have your finger on a very important point there; that is, accountability for what we spend.

I would suggest that we could send you some materials on the pay-as-you-go budget, which some of us proposed in various amendments, which would simply say that if you are going to spend more money, you have got to tell people where the tax revenues are going to come from. You would institutionalize that with the floating rate, but I think we're heading in the same direction in trying to provide maximum accountability of Government to the people themselves. So I think yours is very interesting testimony.

Thank you.

Mr. HERSCHENSOHN. Thank you.

Senator GRASSLEY. Mr. Jones, is there any country in the world that such a tax system as you have suggested has been tried?

Mr. JONES. Well, I think Hong Kong, which is not a country but a crown colony, is where I understand Mr. Hall's and Mr. Rabushka's idea started. They have a gross income type tax system.

But we also have a possession of the United States, the Commonwealth of the Northern Marianas. They have a gross income tax [GIT] over there today, and their General Counsel called me one day wanting to know what progress I was making, because the Internal Revenue Service or the Treasury is about to impose the IRC on them, and they are kicking and screaming over there—they don't want it. They want to keep it their way.

I would suggest that might be a good way to enter into a system like GIT, because they are outside of our normal economy. We could continue and modify their system just slightly to make it equal to the system that I am advocating here, and get some really good data for transition's sake.

Senator GRASSLEY. You partially answered my next question when you said that that's one place to look for transitional experience. But have you given any thought to getting from where we are today to what you suggest and how soon that can be done? Let's suppose that we had the votes to do it and it could be done today, how long a period of transition would you advise? Is this something where you end our current system December 31 and institute the new system immediately?

Mr. JONES. Well, you couldn't do that. That would be too traumatic. I have done a lot of thinking on that, and I would say take a 5-year period, and let companies report either way, either under the old system or the new system. That would give them an opportunity to break down these built-in shelters that they have now and phase in to the GIT system. My own company could start the day after tomorrow, but I think it would take about a 5-year transition period.

Senator GRASSLEY. That's all the questions I have, and I'm the last member of the panel.

Mrs. DAVIS. May I ask something, Senator?

I think, too, that one way that this really would work is my idea to exclude everything; because if you start to make one exception or one exemption, then the lobbyists for everyone else are going to say, "Why them? Why not us?" It has to be an all-or-nothing proposition, and if the public gets reeducated on this on a gradual basis, I think it is going to work.

Senator GRASSLEY. Thank you all for your contribution.

The meeting is recessed until tomorrow at 10.

Thank you all very much.

[Whereupon, at 12:39 p.m., the hearing was recessed, to reconvene Thursday, September 30, 1982, at 10 a.m.]

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