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The income-tax system is unfair (equal incomes don't pay equal tax), inefficient (the market knows better where to put capital—than do members of the Finance or Ways and Means Committees), and overly complex (few people fill out their own returns, and tax fraud has reached between $40 billion and $70 billion per year.) By cutting tax rates and eliminating most of the nearly $1 trillion in individual and corporate tax loopholes, we do two things simultaneously. We allow people to keep more of each additional dollar they earn, and we deal a blow to the special interests. As Justice Oliver Wendell Holmes Jr. said, "Taxes are the price we pay for civilization."

The government subsidizes many activities by allowing you to pay less tax if you do them. Buying a home is an example. There, the government allows you to reduce your taxable income by the amount of your mortgage interest and property taxes, which means you pay tax on less income. These tax savings are the government subsidy to home ownership. In any tax reform it would be possible to protect such middle-class "tax expenditures"—that is, deductions, exclusions, and credits; besides mortgage interest, these include charitable contributions, state and local taxes, health insurance, and pension buildup—even as we lowered tax rates. In a system with just three rates, these items could be deductible only against the bottom two; everyone would thus get the subsidy, but for the wealthy it would be worth less. For example, if the rates were 10, 20, and 30 percent, a dollar's worth of deductions would save, at the most, twenty cents in taxes for someone in the 20-percent bracket and ten cents in taxes for someone in the 10-percent bracket. Those in the 30-percent bracket would still get the deduction, but it would be worth only twenty cents. They could not deduct it against the top rate of 30 percent.

In the 1986 tax reform, we cut rates to 15 and 28 percent and eliminated about $30 billion per year in loopholes, and the wealthy, even though the top rate was reduced from 50 percent to 28 percent, ended up paying a bigger percentage of the total income taxes collected.

There are rates that everyone, including most of the wealthy, can agree are fair. I believe that the best tax rate is the lowest tax rate for the greatest number of Americans. Increasing the earned income tax credit assures lower-income working Americans that they, too, can keep more of each dollar they earn. By eliminating most of the tax deductions, exclusions, and credits (now worth $911 billion), we could reduce rates, make the system fairer, and raise revenue. By simply reducing these “expenditures,” or tax subsidies, in the tax code, we could spend more through appropriations for education, health, and pension security.

In addition, by increasing the minimum wage and the earned income tax credit, we could further reduce inequality and give people incentives to work. And more IRS agents and better computer systems would increase tax collection from the wealthy. Commissioner Charles Rossoti says that for an investment of $296 million the service could collect $9 billion more annually.

Another tax innovation would be aimed at people who have only wage, interest, or dividend income and take no itemized deductions. There is no reason for them to fill out tax returns; the IRS has all the information about them that it needs, and it can prepare individual tax returns from those W-2 and 1099 forms and send the returns to the taxpayers. If taxpayers wanted to fill out their own forms at that point, they could; more likely, they would simply sign and return the prepared forms. Not having to pay a tax preparer would amount to a kind of tax cut. California put such an initiative on the ballot in 2004, but groups such as H & R Block with a vested interest in the current system managed to kill it.

If one were bolder, they could take on an even more ambitious and complex tax reform—moving taxation away from work to pollution and natural resources. In general, we ought to tax less whatever we need, such as wages, and tax more whatever is dangerous to us, such as pollution, resource depletion, trans fats, and tobacco. In this vein, we could implement a $1-per-gallon gasoline tax (or an equivalent carbon tax, which is a tax on any energy source that emits carbon dioxide) or equivalent taxes on other major air pollutants: volatile organics, nitrogen oxide, lead, sulfurous dioxide, and particulates. These taxes could be phased in over five years, with the revenue going to reduce employment taxes (Social Security, Medicare, and unemployment insurance) for employees and employers alike. The gasoline or carbon tax would encourage the nation to reduce its dependence on insecure sources of foreign oil, and with payroll taxes now amounting to 15 percent of labor costs, the lower employment taxes would be an incentive for businesses to hire workers. Given where the price of oil is today, there never was a better opportunity to enact such a tax.

Such a shift in taxation—away from jobs and toward pollution, energy, and natural resources—will draw many of the 24 million part-time employed into the full-time workforce and millions more who are not in the labor force will now be more likely to find a job. After a few years of adjustment in the case of a gasoline or carbon tax, cars would be more fuel-efficient, so consumers would pay what they used to pay for the same amount of driving, and the broad middle class would continue to pay lower employment taxes. The result would be increasing demand for goods and services; shrinking dependency payments such as unemployment compensation or welfare; lowered social costs such as crime or avoidable illness; and a more equitable tax system—one that encourage rising employment.

Reducing employment taxes also makes sense on grounds of competitiveness and equity. Employment taxes now hit our most successful companies hardest. A company such as Microsoft or McKinsey need talented people desperately. As a part of the company's compensation package they have to pay enough salary to offset the employment taxes on the employee. If they don't assume the tax costs, the employee can go somewhere else. Meanwhile at a lumber yard where there is an excess of labor the lumber company doesn't have to pay higher wages and the bulk of the employer's taxes hit the worker. Perversely, it is the lowest paid workers and the companies most essential to economic growth that are hit hardest by employment taxes.

Better yet, if politicians wanted a comprehensive and fair way to reduce the deficit and invest in health care, education, and pension security, they could combine income tax reform and gasoline- or pollution-tax increases with a reduction in employment taxes, a 10-percent cut in defense spending, a 30-percent cut in what the federal government spends on corporate subsidies such as mining and digital spectrum, a limit on the corporate deduction for the most expensive medical plans, and a cut in farm subsidies—which today go to only 25 percent of American farmers, with $7 billion of the total $14 billion going to the richest 3 percent, including large agribusiness.

In addition, the budget process should be governed by the pay-as-you-go budget rules that existed in the 1990s. Under those rules, any tax cut or spending increase had to be offset by a spending cut elsewhere in the budget. Finally, the entire federal budget should be on the internet with keyword accessibility. For example, if you searched for "breast cancer" or "housing" you would be directed to all the places in the federal budget where money is spent for those purposes. That way, citizens could have the information with which to understand the trade-offs in taxes and spending and hold their legislators accountable.

The key to passage of these measures would be to have them all in one package, so that choices—between more money for health care, education, and pension security, on the one hand, and spending cuts and higher taxes on the other—could be made clearer. If we included spending cuts or increases in one bill and tax reform in another, the connection between what we were giving up in tax increases would be lost and what we were getting in spending increases. The debate should be about the whole, not the parts. Issues such as sharing the burden fairly between the young and the old, and trade-offs between weapons systems and health care, or corporate welfare and human welfare, would be clearly set out.

Bill Bradley