



Dallas Headquarters:  
14180 Dallas Parkway, Suite 350  
Dallas, TX 75254  
Phone: (972) 386-6272  
<http://www.ncpa.org>

September 24, 2015

## Principles of the Flat Tax

Today's graduated income tax system is a morass of deductions, exemptions, allowances, credits and other loopholes.

- Every year U.S. taxpayers pay an amount equal to 30 percent of total income taxes collected simply to comply with and administer the complex income tax system.<sup>1</sup>
- Administrative costs for the IRS in 2010 were approximately \$12.4 billion.
- Taxpayers spent 6 billion hours yearly complying with the income tax code.
- Studies on the economic burden of the tax system show that the \$1 trillion tax revenue generated through the individual income tax adds a burden of \$110-\$150 billion on taxpayers and the economy.<sup>2</sup>

There is a better way. Under a flat tax, *all* income is taxed, and it is taxed at the same rate. Furthermore, income is taxed only once, at its source, when it is realized.

**All income is taxed, at the same rate, and only once.** For tax year 2013 over 30 percent of individuals claimed itemized deductions with an average individual refund of just over \$2,800. The same year 28.8 million returns claimed an earned income tax credit. Today's deductions, exemptions and loopholes result in more than half of all personal income not being taxed at all. Most flat-tax proposals would require a tax rate of about 17 or 28 percent because they allow two deductions: (1) a generous personal exemption and (2) an immediate write-off of all investments in capital goods. All income is taxed at the same rate. Current marginal income tax rates range from 10 percent to 39.6 percent, making it the most progressive tax in the U.S. second only to the estate tax. Under a revenue-neutral flat tax:

- The last dollar of income is taxed at the same rate as the first taxable dollar of income.
- A dollar of corporate income is taxed at the same rate as a dollar of personal income.

Under the current system, investment income can be taxed two, three or even four times. Income is taxed first at the corporate level. When investors receive income in the form of dividends or interest, it is taxed a second time. If the business is sold, it can be taxed a third time through a capital gains tax. And after the owner's death, the investment can be taxed a fourth time through the inheritance tax. A flat tax system would tax income only once when it is earned.

**All income is taxed at its source.** Under the current tax system, businesses send out billions of forms reporting payment of dividends and interest. Each taxpayer is supposed to be taxed on these payments at that individual's tax rate. A flat tax would eliminate this leakage by taxing business income at its source:

- The corporation (or business) would pay taxes on corporate income and would not be allowed to deduct any interest or dividend payments.
- Since the tax on interest and dividends would be paid at the corporate level individuals would receive interest and dividend income tax free.

**Advantage of the flat tax: fairness.** For personal income taxes, an income exemption (generally included in flat tax plans) would make the tax fair for lower income earners and not penalize those who do not itemize as under the current system (assuming no deductions for mortgages, children, or anything else.) For businesses, profits would be taxed only once – with no taxation of dividends that results in the double taxation of the same income.

<sup>1</sup> Arthur B. Laffer, Ph.D., Wayne H. Winegarden, Ph.D. and John Childs, "The Economic Burden Caused by the Tax Code Complexity," April 2011. Available at <http://www.laffercenter.com/wp-content/uploads/2011/06/2011-Laffer-TaxCodeComplexity.pdf>.

<sup>2</sup> Robert Carroll, "The Excess Burden of Taxes and the Economic Cost of High Tax Rates" *The Tax Foundation* Aug. 14, 2009. Available at <http://taxfoundation.org/article/excess-burden-taxes-and-economic-cost-high-tax-rates>.

**Advantage of the flat tax: simplicity and transparency.** Under a flat tax, most individuals and businesses would fill out a tax return the size of a postcard. The transparency of a flat tax would allow taxpayers to both anticipate tax consequences with an increasing understanding of the government services they are funding.

**Advantage of the flat tax: pro-growth.** Since the flat tax does not tax dividends, distributions, capital gains or any other income not tied to wages, the flat tax is considered pro-savings and pro-investment. If the incentive to invest and save is as high as experts predict it could add as much as 2 percentage points to the nation's economic growth rate.

### "Modified" Flat Tax Plans

Plan and Sponsor	Personal income/payroll taxes	Exemptions	Corporate income tax or "business tax"	Taxes on unearned income (dividends, cap gains, rent, royalties, estate)
<p>"Flat and Fair"</p> <p>Sen. Rand Paul (R-Ky)</p> <p><a href="http://randpaul.com/issue/taxes">http://randpaul.com/issue/taxes</a></p>	<p>-14.5% on wage income.</p> <p>-Replaces payroll taxes.</p>	<p>-\$15,000 standard deduction per filer/\$5,000 exemption per person (family of four-\$50,000).</p> <p>-Retains home mortgage deduction, charitable deduction, child tax credit and EITC.</p>	<p>-Corporate tax replaced with a 14.5% "business transfer tax," on factors of production (profits, rents, royalties) and all labor payments (wages and salaries).</p> <p>-Immediate expensing of capital purchases, no depreciation schedule</p> <p>-No customs, duties of tariffs.</p> <p>-Territorial system of taxation.</p>	<p>-14.5% on all unearned income, dividends, cap gains.</p> <p>-No estate or gift taxes.</p>
<p>"Economic Growth and Family Fairness Tax Reform Plan"</p> <p>Sens. Mike Lee (R-Ut) and Marco Rubio (R-Fl)</p> <p><a href="http://www.rubio.senate.gov">http://www.rubio.senate.gov</a></p> <p>Also, see NCPA publication:</p>	<p>-15% for individuals earning less than \$75,000, couples earning less than \$150,000.</p> <p>-35% for \$75,000+ and \$150,000+</p> <p>-No AMT.</p> <p>-Payroll taxes unchanged, although partial credit available.</p>	<p>-Deductions and exemptions replaced with a \$2,000 personal credit per filer.</p> <p>-Eliminates head of household status.</p> <p>-Additional child tax credit of \$2,500 per qualifying child.</p> <p>-Mortgage interest deduction and charitable deduction available to all filers.</p>	<p>-Corporate tax rate falls to 25%.</p> <p>-Immediate expensing of capital purchases, no depreciation schedule.</p> <p>-Profits taxed only once at entity level.</p> <p>-Transition period allows for 6% tax on repatriated profits, payable over 10 years.</p>	<p>-No tax on interest, dividends and capital gains.</p> <p>-No estate or gift taxes.</p>
<p>H.R. 1040 "Flat Tax Act"</p> <p>Rep. Michael Burgess (R-TX)</p> <p><a href="https://www.govtrack.us">https://www.govtrack.us</a></p>	<p>-19% on wage income the first 2 years, 17% subsequent years.</p> <p>-Does not replace payroll taxes.</p>	<p>-Standard deductions:</p> <p>-\$32,496 married filing jointly or surviving spouse.</p> <p>-\$20,739 head of household.</p> <p>-\$16,248 individual.</p> <p>\$6,998 per dependent.</p>	<p>-19 percent of the business taxable income for the first 2 years, 17% subsequent years.</p> <p>--Deductible expenses include employee wages and benefits.</p>	<p>-No tax on interest, dividends, capital gains.</p> <p>-No estate or gift taxes.</p>