RADICAL SIMPLIFICATION OF THE INCOME TAX
ISSUES AND OPTIONS

William Gale
ABSTRACT

I propose and analyze four major revenue-neutral sets of federal income tax reforms, each of which would create a simpler and more progressive system. A new page on the Urban-Brookings Tax Policy Center Website allows anyone to compare their filing requirements and tax burdens under the alternatives and the current system. Several major thematic conclusions emerge. The fundamental cause of tax complexity is conflict among consensus policy goals, including efficiency and equity. There is massive potential for simplification, but there is no such thing as “just” simplifying the tax code. Even if simplification is the only goal of a reform, it will not be the only effect. Simplification efforts should bear in mind people’s overall interaction with the government, not just with the tax system. The fundamental question is not the overall level of complexity, but whether tax rules (or spending programs or regulations) provide good value for the complexity they create. Although it is easy to write down simple tax systems on paper, it is much harder to enact or maintain such systems in the real world.

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I. Introduction

With apologies to Mark Twain, it is fair to say that tax simplification is like the weather: everyone talks about it, but no one does anything about it. Indeed, legislators often make taxes more complex, despite widespread support for simpler taxes—at least in principle—and despite simplification proposals from both sides of the aisle.

These concerns are not new. Adam Smith, in his 1776 Wealth of Nations, wrote that “…subjecting the people to the frequent visits and the odious examination of the tax gatherers…may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expence, it is certainly equivalent to the expence at which every man would be willing to redeem himself from it.” Thorndike (2023) reports that before Congress had even finished drafting the income tax in 1913, complaints had emerged about its complexity. For comparison with today’s system, the first modern income tax—which only applied to the top 3% of the population—was only 33 lines and 3 pages long and had only one page of instructions.

Tax complexity used to affect only affluent taxpayers with complicated business and investment activities. Nowadays, complexity has become an equal opportunity problem. Low- and middle-income filers struggle with the rules regarding eligibility for the Earned Income Tax Credit and the definition of a qualifying child, which varies across several tax provisions.

Other filers face complexity from the alternative minimum tax; special rules for capital gains, dividends, and business income; itemized deductions; and many other concerns. Filers at all income levels have concerns about accurately interpreting tax rules.

Tax complexity creates many costs. In addition to the time, money, and “vexation” that it causes, complexity also generally makes it easier for taxpayers to manipulate the tax system legally or illegally by re-labeling income or rearranging economic affairs. And, even if taxpayers did not do that, complexity raises suspicions among people that other people are getting away with cheating the system. Tax simplification thus could produce many benefits if it is done well.

This paper is part of a larger project designed to demonstrate both the potential and the pitfalls associated with radical simplification of the federal income tax. The paper reviews issues concerning tax simplification and analyzes several alternative options to reduce complexity and achieve other policy goals. Each alternative option would raise the same amount of revenue as the current system (in 2023) and make taxes more progressive. But they differ from each other and from the current system in terms of overall complexity, the distribution of tax burdens across groups, and the ability of taxpayers to participate in a “no-return” system, or a system where the Treasury can accurately pre-populate returns. To be clear, the alternative systems should not be interpreted as panaceas; rather, they were developed to demonstrate the trade-offs involved in radically simplifying the tax code.

The first option, the “simplified income tax,” would considerably simplify the income tax for most people and maintain its graduated rate structure. The proposal would eliminate all itemized deductions, all personal credits, the section 199a deduction for business, the head of household filing status, and preferential rates for capital gains and dividends. It would create a personal credit of $1,000 for each family member and a work-related credit of 20% of individual earnings up to $20,000, phasing down to zero when individual earnings reach $40,000. Both credits would be refundable, meaning that taxpayers would receive the full credit even if their gross-of-credit tax liability was less than their eligible credits.

The second option, the “modified simplified income tax,” addresses the fact that, although the first proposal greatly simplifies the income tax and is more progressive on an overall basis than the current system, it would nonetheless hurt a substantial share of low- and moderate-income families with children because those families benefit from several provisions in
the current tax code. As a result, the second option is exactly like the first except for one change, designed to help low- and moderate-income families with children. The personal credit would be increased to $2,000 but would phase out beginning at $36,000 for unmarried filers and $72,000 for married filers. As a result, the second alternative helps low- and moderate-income families with children relative to the current system, but it requires some complexity relative to the first option. This illustrates one of the reasons the tax code has gotten more complex: often, attempts to avoid creating ‘losers’ in a tax reform require adding additional provisions and phaseouts.

The third option, “Back to the Future,” incorporates the simplifications in the first approach and raises the standard deduction substantially (to $100,000 for couples and $50,000 for singles from current levels of $27,700 and $13,850), thus removing the obligation to file an income tax form for the vast majority of households. This proposal, based on Graetz (1997, 2010) and Nunns et al. (2022), is called “Back to the Future” because when the income tax was first created in 1913, it applied only to a small slice of the population. To offset the lost revenue from raising the standard deduction, the proposal would set the lowest income tax rate at 25% and create a 10% value-added tax (VAT). To help offset the burdens of the VAT on low- and moderate-income households, the refundable personal credit would rise to $2,800.

The fourth proposal—the “Universal Basic Income” option—combines the simplification of the first proposal and the 25% minimum tax rate and 10% value-added tax of the third proposal to fund a substantial Universal Basic Income (UBI) program that would raise the personal credit to $3,900 per person.6

In conjunction with the publication of this paper, a new page on the Urban-Brookings Tax Policy Center

<table>
<thead>
<tr>
<th>Features of the Simplification Proposals</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td>Repeal itemized deductions</td>
</tr>
<tr>
<td>Repeal section 199a deduction for business income</td>
</tr>
<tr>
<td>Repeal preferential rates for capital gains and dividends</td>
</tr>
<tr>
<td>Repeal all personal income tax credits</td>
</tr>
<tr>
<td>Repeal head of household filing status</td>
</tr>
<tr>
<td>Repeal individual alternative minimum tax</td>
</tr>
<tr>
<td>Introduce refundable work credit</td>
</tr>
<tr>
<td>Introduce refundable personal credit</td>
</tr>
<tr>
<td>Increase the standard deduction</td>
</tr>
<tr>
<td>Introduce 25% minimum tax rate bracket</td>
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<tr>
<td>Introduce a 10% value-added tax</td>
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website (https://tpc-tax-calculator.urban.org) allows anyone who is interested to calculate their taxes under the alternative systems and to compare the filing requirements and tax burdens under the two alternatives to those in the current system.

In addition to the presentation and summary of the simplification options and the creation of the webpage, several other major conclusions emerge from the study. First, there is massive potential for simplification. The tax code is riddled with special provisions: it requires distinctions that are difficult to make and enforce, it requires taxpayers to collect information that the IRS already has; it allows many forms of income to go untaxed or lightly taxed, while imposing heavy burdens on other types of income. Together, these provisions induce people to avoid (legally) and evade (illegally) taxes, which in turn requires enforcement efforts on the part of government. Anyone choosing to simplify taxes could find many ways to do so.

Second, however—and this is a significant caveat—there is no such thing as “just” simplifying the tax code. Even if simplification is the only goal of a reform, it will not be the only effect. Any effort to simplify taxes will have collateral effects on revenue, the distribution of tax burdens, social policy, and/or incentives for economic activity. Some policy changes can make taxes simpler as well as, say, fairer or more conducive to prosperity. Often, however, efforts to simplify taxes will involve trade-offs with other desirable policy goals: for example, many complicated provisions were placed in the code to promote fairness, economic growth, social policy, or tax compliance. Moreover, because taxes are deeply embedded in the nation’s economic, social, and institutional structures, the sweeping changes involved in systematic simplification of the income tax would create transition issues, the need for new definitions, processes, and check points, and possibly even new legal precedents, all of which would take time, effort, and money.

Third, simplification efforts should bear in mind that people’s overall interaction with the government, not just with the tax system, is also relevant. For example, policy makers could convert all tax deductions and credits to equivalent spending programs and require people to sign up with different government agencies to obtain those benefits. The result would be a pyrrhic victory of sorts—people would find their taxes to be simpler, and there may be other reasons for making this change, but obtaining the same benefits as before would be more complex for most people. Indeed, given how much of U.S. social policy is run through the income tax, reducing tax complexity could be an essential part of recent federal government initiatives to reduce the burdens associated with accessing public services (OIRA, 2023). But such tax simplification could also backfire and increase the overall complexity of obtaining benefits if the relevant programs are moved to the spending side and require separate application from the income tax.

Fourth, these considerations imply that the fundamental question is not the overall level of complexity, but whether particular tax provisions, tax systems (or alternative means of providing government services, such as spending or regulations) provide good value for the complexity they create. This depends on the magnitude and incidence of the costs and benefits of complexity, including the extent to which complexity aids in achieving other policy goals.

Finally, although it is easy to write down simple tax systems on paper, it is much harder to enact or maintain such systems in the real world. The tax system did not get complicated by accident: many people have a vested interest in maintaining the particular complexities that provide them with benefits, even if they prefer to reduce overall complexity. The factors that generate complex tax systems—the existence of policy trade-offs, the role of lobbying in the political process, and desire of taxpayers to reduce their own tax burdens—cannot be legislated away. In particular, policymakers’ penchant for turning to the tax code to generate targeted provisions to address various social and economic issues will always be an important constraint on simplification efforts.

The paper proceeds as follows. Section II discusses the dimensions and costs of complexity. Because tax complexity is multi-dimensional, involving effects on taxpayers and the government, it is not always obvious whether one system is more complex than
another. The complexity of a tax system depends on its structural and administrative features. Generally, from a structural perspective, the key to simplification is to impose taxes at source on a broad base at relatively low, flat rates that do not vary by income source, expenditure type, or taxpayer, and with a large standard deduction. Universal exemptions, deductions, or credits are simpler than targeted ones. From an administrative perspective, third-party withholding makes taxes simpler (and reduces evasion). Filing and recordkeeping could be simplified by consideration of “return-free” tax systems and “free filing” options.

Previous work suggests that the cost of complying, administering, and enforcing the federal income tax are significant. For example, according to the IRS, the average taxpayer in 2022 spent 13 hours and $250 to file their taxes (IRS, 2023a). Given that 158 million returns were filed in 2019, the last year for which data was available prior to the Covid-19 pandemic (IRS 2021), the IRS figures imply that Americans spent more than $40 billion and two billion hours just to comply with the individual income tax code. Moreover, these estimates may be a lower bound on the time and money spent: Benzarti (2021) estimates that by 2006, tax filing cost Americans nearly $200 billion, while Brady (2023) suggests that individual and corporate tax complexity combine to cost Americans a staggering $260 billion and 6.5 billion hours today.

Section III discusses why taxes are complicated. It starts by noting that the simplest tax would be an equal per-head levy, and that no country pursues that policy or anything resembling it. However, less extreme systems that nevertheless offer simple taxes could have numerous benefits. They would reduce taxpayers’ costs of complying with the tax system in terms of time, money, and mental anguish. They would likely reduce unintentional tax evasion and increase the likelihood that taxpayers would see the tax system as fair.

Why, then, are taxes so complicated? It turns out that simple taxes have costs as well as benefits. They reduce policymakers’ ability to achieve other goals. Tax rules that increase equity, police tax evasion, or encourage a particular activity often increase complexity. Thus, tax complexity arises as a trade-off between simplicity and other policy goals, along with the lobbying process and influence from special interests. The presence of such policy trade-offs helps explain why per-head taxes, which are widely viewed as unfair, are not more common.

Section IV describes the various complexities involved in understanding and filing income tax forms. Section V describes the reform options noted above. Section VI reports estimates of the proposals’ effects on the distribution of tax burdens and measures of complexity.

Section VII is a short conclusion. Tax simplification is a long-standing issue that garners widespread support, at least in principle, and is technically feasible. But the fact that most existing taxes turn out to be far more complex than originally proposed should serve as a caveat to the view that achieving tax simplification, in the existing or a new tax system, will prove easy or durable.

Appendix 1 discusses “no return” systems, “pre-populated return” systems, and “free filing” options as ways to simplify taxes for many taxpayers. Appendix 2 discusses simplification issues in a national retail sales tax and a Hall-Rabushka flat tax. Both systems are good examples of the ability to write down simple tax systems on paper that would be hard to maintain as simple if they were enacted.
II. Tax Complexity

Tax complexity has many dimensions. For the taxpay-er, complexity involves the costs of filing and record keeping (in terms of time, money, and distress levels), tax avoidance via changes in real activity, tax avoid-ance via changes in the timing or structure of financial activities, and other components. Taxpayers also bear the costs of governmental administration and enforce-ment of tax rules.

As a result, it is not always clear whether one system is simpler than another. For example, consider two tax systems that raise the same amount of revenue. The first system only taxes X, an item that is generally easy to tax (think wages). The second system taxes X and Y, where Y (think capital gains) represents a second component of the tax base and an item that is hard to measure and thus hard to tax. (See Table 1.) Which system is simpler?

If the government only taxes X, filing and record keeping would be very easy for most people. But there are several complications. First, tax rates will have to be higher than in the second system. Because X < X + Y, one needs a higher tax rate on X than on X+Y to generate the same revenue. The higher tax rates will generate more (or more complicated) real responses. Second, because Y is untaxed, taxpayers will try to avoid tax by figuring out ways to convert X into Y. Third, to ensure that taxpayers are not unduly convert-ing X into Y, the government will face higher costs of administering and enforcing the system.

If, instead, the government taxes X and Y (for simplic-ity, assume at the same rate), each item is reversed. Taxpayers will face more difficult filing and record keeping requirements (because they must track Y as well as X). Nevertheless, the system might be sim-pler than the first system when all considerations are taken into account. Because the tax base is larger, the tax rate would be lower than in the first system, so taxpayers would have smaller (less complicated) real responses. In addition, taxpayers would have no tax incentive to shift X into Y so their avoidance costs and government administrative and enforcement costs would be lower.

A. WHICH TAX CODE FEATURES CREATE COMPLEXITY?

The level and distributional burden of tax complexity depends on the structure of the tax system—the tax base, the rate structure, and the allowable deductions, exemptions, and credits—as well as the administrative features—tax withholding and tax filing.

The three most discussed tax bases are income, wages, and consumption. Holding the other features of the tax system constant, income is the most difficult

<table>
<thead>
<tr>
<th>Challenges Associated with Defining Simplicity</th>
<th>Tax Base = X</th>
<th>Tax Base = X + Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of filing and record keeping</td>
<td>Lower for most people</td>
<td>Higher for most people</td>
</tr>
<tr>
<td>Avoidance due to change in real activities</td>
<td>Higher</td>
<td>Lower</td>
</tr>
<tr>
<td>Avoidance due to change in timing or structure of financial issues</td>
<td>Higher</td>
<td>Lower</td>
</tr>
<tr>
<td>Government Administrative and Enforcement Costs</td>
<td>Higher</td>
<td>Lower</td>
</tr>
</tbody>
</table>
of the three bases to tax. Income may be decomposed into its sources—wages and capital income—or its uses—consumption and saving (Slemrod, 1989; Rohaly and Gale, 2004). Taxing wages or consumption directly is a relatively simple, but not taxing capital can generate taxpayer avoidance costs and government administrative and compliance costs. A tax system that taxes some forms of capital income or saving but not others—such as the system in the United States—plausibly generates the highest amount of avoidance, administrative, and compliance costs.

Tax rates are typically either graduated, like the current income tax, or flat, like the Social Security or Medicare payroll tax. The presence of graduated rates gives taxpayers incentives to avoid taxes by shifting income over time or across people. Flat-rate taxes can have lower compliance costs than graduated taxes. And flat-rate taxes allow more efficient administrative structures to function: since the rate does not vary across taxpayers, taxes can be collected at source (i.e., business, rather than having to trace taxes to individuals).

Universal exemptions, deductions, or credits create little complexity. In contrast, targeted provisions require clear definitions of eligible taxpayers and activities and can create compliance headaches. Likewise, the phase-out of such programs can create added complexity.

Finally, different ways of administering taxes affect complexity. Withholding taxes at source reduces compliance costs and evasion rates. Eliminating the requirement to file a tax return via a “no return” system, reducing the costs of filing with a “pre-populated” return system, and/or providing a robust “free filing” program reduces compliance costs for individuals. (See Appendix 1.)

B. THE COSTS OF COMPLEXITY

Compliance costs include the time taxpayers spend preparing and filing tax forms, learning about the law, and maintaining recordkeeping for tax purposes. The costs also include expenditures of time and money by taxpayers to avoid or evade taxes, to have their taxes prepared by others, and to respond to audits, as well as any costs imposed on third parties, such as employers. Administrative costs, although incurred by the government, are ultimately borne by individuals. These costs include the budget of the tax collection agency, and the tax-related budgets of other agencies that help administer tax programs (Slemrod, 1984).

Defining complexity in this manner provides a quantitative measure by which different tax systems can be compared, and by which the administrative aspects of a particular tax system (or provision) can be evaluated relative to the impacts on equity, efficiency, and revenue. But the definition is not ideal.10

First, a particular subsidy could be so complicated that few taxpayers use it. If it were simplified, and enough additional people used the subsidy, total resource costs would rise, even though the subsidy itself had become less complicated (Slemrod, 1989).

Second, permanent and transitory costs may differ. A new tax provision may raise compliance costs temporarily, as people learn about the change, even if it reduces costs in the long term. Likewise, for administrative costs, the capital cost of upgrading IRS computers might appear as a current-year budget expenditure rather than being amortized over time.

Third, only the incremental costs due to taxes should be included. Even with no taxes, firms would need to keep track of income and expenses to calculate profits, and individuals would engage in financial planning.

Fourth, as noted above, focusing solely on tax complexity may generate misleading conclusions. Governments can impose policies via taxes, spending, regulations, or mandates. Any tax provision can be made simpler by eliminating it, but if it then is recreated as a spending program, the overall complexity of government may rise.
1. Estimates of aggregate costs of complexity

As noted earlier, the IRS calculated that the average individual tax return for tax year 2022 took 13 hours and $250 out of pocket for a filer to prepare (IRS, 2023a). Out-of-pocket costs include any expenses incurred by taxpayers to prepare and submit their tax returns, such as tax return preparation and submission fees, postage and photocopying costs, and tax return preparation software costs. This yields a total of about $40 billion in direct costs alone, or 1.5% of individual income tax revenue in 2022—not including the 2.1 billion hours spent on preparing individual tax returns. Hodge (2022) estimated the costs of filing individual income taxes at roughly 5% of individual tax revenue in 2021. Hodge also estimated that the costs of compliance with all individual, corporate, and estate taxes in 2021 were nearly 8% of total revenues (over $300 billion).

A variety of studies from the 1980s and 1990s found a range of results for cost of compliance. The best estimates suggested that costs of compliance in the income tax ranged between 10% and 17% of income tax revenues during that period (Blumenthal and Slemrod, 1992; Gale, 2001; Hall, 1996; Payne, 1993; Slemrod, 1996). Berger et al. (2018) find that compliance costs for individual taxpayers were 6.5% of individual federal tax revenue in 2017. Bosch and Gray (2018) find that compliance costs were 12.0% of individual federal tax revenue in the same year. The Taxpayer Advocate Service (2016) found that compliance with both the individual and corporate income taxes cost taxpayers 10.5% of tax revenue from those taxes in 2015.11

Recent studies have suggested even higher costs of complexity, with Benzarti (2021) estimating the burden rising over time to more than $200 billion in 2006, and Brady (2023) estimating costs in excess of $260 billion and 6.5 billion hours today. Separately, Benzarti (2020) uses a revealed preference approach to study the ‘missing mass’ of itemizers who are just above the level where itemizing would minimize the tax burden to estimate the cost of complexity, finding that complexity costs are nearly 1% of total AGI (~$120 billion in 2019).

The IRS also spends a significant share of its budget and personnel assisting taxpayers with compliance and filling out forms. More than 32,000 out of 85,000 IRS personnel work in ‘filing and account services,’ including more than 16,000 customer service representatives alone. This is nearly double the number of tax examiners (8,677), and more than four times the number of investigations staff (3,111). Clearly, reducing complexity would also free up IRS resources to be used on performing higher-quality investigations, modernizing the taxpayer experience, or other IRS goals.

Benzarti and Wallossek (2023) provide indirect evidence on the costs of complexity. They report the results of a short survey in which majorities of respondents thought that the tax system had become more complex over time and that complexity made evasion easier, not harder. Respondents reported an average willingness to pay of $130 for a simpler tax system and $77 for a pre-populated return (see Appendix 1).

2. Distribution of costs of complexity

The burden of complexity is highest in dollars for higher-income taxpayers, but low-income households face the largest burden as a share of their income. Table 2, based on data from Fichtner et al. (2019) and Marcuss et al. (2013), shows that the time costs, average out-of-pocket costs, and the monetized burden of tax compliance all rise with AGI, but that the burden as a share of AGI is highest for the households with the lowest positive income. In 2013, households with incomes below $10,000 spent about eight hours and $80 on average preparing their income taxes. The median household, with an income of $53,585, spent approximately 13 hours and $200, while those with incomes above $200,000 spent 30 hours and $1250. The highest-income households likely spent significantly more time and money than this, but good data on this group is challenging to collect. Compliance costs also make up a large share of total income for low-income households that claim the EITC or other complicated tax subsidy programs (Burman, 2019).
3. Comparison of the U.S. and other countries

Studies indicate that the U.S. has significantly higher tax compliance costs than other countries. This is due at least in part to the fact that the U.S., almost uniquely among major economies, runs a wide variety of social policies through the tax code (Fichtner et al., 2019).

### TABLE 2

<table>
<thead>
<tr>
<th>AGI ($)</th>
<th>Population (thousands)</th>
<th>Average time (hours)</th>
<th>Average Out-of-Pocket Costs ($)</th>
<th>Average Monetized Burden ($)</th>
<th>Burden/AGI (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Filers</td>
<td>142,985</td>
<td>13</td>
<td>198</td>
<td>373</td>
<td>6.8</td>
</tr>
<tr>
<td>0 or less</td>
<td>2,577</td>
<td>26</td>
<td>243</td>
<td>441</td>
<td>--</td>
</tr>
<tr>
<td>1 to 5,000</td>
<td>9,961</td>
<td>7</td>
<td>73</td>
<td>127</td>
<td>83.3</td>
</tr>
<tr>
<td>5,000 to 10,000</td>
<td>12,278</td>
<td>9</td>
<td>97</td>
<td>164</td>
<td>2.2</td>
</tr>
<tr>
<td>10,000 to 15,000</td>
<td>12,812</td>
<td>10</td>
<td>114</td>
<td>192</td>
<td>1.5</td>
</tr>
<tr>
<td>15,000 to 20,000</td>
<td>11,742</td>
<td>11</td>
<td>124</td>
<td>210</td>
<td>1.2</td>
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<tr>
<td>20,000 to 25,000</td>
<td>10,173</td>
<td>11</td>
<td>128</td>
<td>222</td>
<td>1.0</td>
</tr>
<tr>
<td>25,000 to 30,000</td>
<td>8,961</td>
<td>11</td>
<td>136</td>
<td>240</td>
<td>0.9</td>
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<tr>
<td>30,000 to 40,000</td>
<td>14,620</td>
<td>12</td>
<td>148</td>
<td>268</td>
<td>0.8</td>
</tr>
<tr>
<td>40,000 to 50,000</td>
<td>10,991</td>
<td>13</td>
<td>164</td>
<td>315</td>
<td>0.7</td>
</tr>
<tr>
<td>50,000 to 75,000</td>
<td>18,769</td>
<td>13</td>
<td>192</td>
<td>380</td>
<td>0.6</td>
</tr>
<tr>
<td>75,000 to 100,000</td>
<td>11,828</td>
<td>14</td>
<td>237</td>
<td>480</td>
<td>0.6</td>
</tr>
<tr>
<td>100,000 to 200,000</td>
<td>13,495</td>
<td>15</td>
<td>328</td>
<td>670</td>
<td>0.5</td>
</tr>
<tr>
<td>200,000 and more</td>
<td>4,328</td>
<td>30</td>
<td>1,250</td>
<td>2,331</td>
<td>0.5</td>
</tr>
</tbody>
</table>

**SOURCE:** Fichtner et al. (2019).
The simplest tax would be an equal tax on each person. Filing and record keeping would be minimal. There would be no avoidance and very low administrative costs.14 Yet, it bears emphasis that no taxing jurisdiction in the world imposes such a tax. When England imposed a poll tax temporarily in the 1990s, riots occurred (Hannah, 2020; Keen and Slemrod, 2019).

Even without going to the extreme of a poll tax, however, simple (or simpler) tax systems can generate many benefits. They can minimize taxpayers’ time, financial, and psychological costs of complying with the tax system. Taxpayers are more likely to utilize and comply with tax provisions that they understand. Simpler taxes may even be seen as fairer and so could generate more public support for revenue measures, which would allow for improved delivery of government services. Indeed, the complexity of the system consistently ranks as one of taxpayers’ biggest criticisms of the income tax (Graetz, 1997; Ventry, 2011; Pew Research Center, 2017, 2019).

Why, then, are taxes complicated? The first, and most important, reason is conflict between the consensus goals of tax policy. Although almost everyone agrees that taxes should be simple, most people also agree that taxes should be fair, conducive to economic prosperity, adequate (in terms of revenue raised) and enforceable. Even if all parties agree on these goals, they do not typically agree on the relative importance of each goal or on the best way to achieve them. As a result, policy outcomes usually represent efforts to balance one or more goals against the others.

Sometimes, complexity can help facilitate other policy goals. To make taxes fairer, most countries tailor tax burdens to the characteristics of individual taxpayers. This may improve tax equity, but it also creates complexity. It requires tracing income or consumption from the business sector to the individual. It requires recording and documenting individual characteristics such as marital status, number of dependents, and age, as well as the composition of expenditures or income. It allows tax rates to vary with individual characteristics, creating opportunities for tax avoidance.

At other times, policy makers may create complex provisions to reduce avoidance and evasion or to raise revenues. Taxpayers have every right to reduce their taxes by any legal means. But this activity inevitably raises questions about whether particular activities or expenditures qualify for tax-preferred status. The Treasury Department or the Congress writes rules designed to limit avoidance. Taxpayers in turn respond by inventing transactions or situations to skirt the new rules. This can create a vicious cycle that leads to more and more complex rules and increasingly sophisticated and complex avoidance strategies. For example, suppose policy makers wish to subsidize licensed childcare but not children’s ski lessons in Aspen. The Treasury Department must write a set of rules for qualifying childcare that can apply to every situation that falls between those two extremes and can place each situation explicitly on one side or the other for purposes of eligibility.

Likewise, some complicated provisions were enacted to raise revenue or limit revenue losses. For example, in the Tax Reform Act of 1986, policy makers created several complicated phaseouts and hidden taxes that served to raise revenue and help meet distributional targets.

In this context, tax complexity is like air pollution: it is an unfortunate and undesirable consequence of products or services that we, as a society, desire. Just as the optimal level of air pollution is not zero—since that would mean that many of the goods and services society cherishes could not be produced—the optimal level of tax complexity is not zero. And just as we should seek the fairest and most efficient ways to reduce air pollution, we should also seek the fairest and most effective ways to make taxes simpler.

The second factor that generates tax complexity is the political process. Lobbyists and interest groups pursue...
targeted subsidies that reduce taxes for particular groups or activities. But targeted subsidies inevitably make taxes more complex by creating more distinctions among taxpayers and among sources and uses of income. Indeed, the enactment of subsidies for one group typically generates demand for subsidies for related groups, in the name of equity. Moreover, some professions (especially tax lawyers and tax preparation and advisory services) have an interest in complexity itself, even beyond the dollar value of the tax provisions that introduce complexity. And some politicians who oppose higher tax rates have even suggested that complexity is a good thing insofar as it makes people dislike taxes (Prasad 2019)—as Ronald Reagan famously put it, that “taxes should hurt.”

Third, tax complexity is difficult to measure. Even if policy makers wanted to monitor and reduce the complexity of the tax system, it would be difficult to know how significant their effects would be in the absence of better data. Finally, the economic and business activities are often complex in themselves. Even in the absence of policy conflicts, political lobbying, or measurement issues, complexity may arise simply because the activities the government is trying to tax are complex.

IV. The Income Tax

As noted above, a template for a simpler tax system for individuals is to tax a broad base at a flat rate at source and to provide universal rather than targeted credits and deductions. A tax with that structure reduces the distinctions that the tax system must make and would not require individuals to file returns (though businesses would still need to file).

The current income tax system falls far short of this standard. It taxes a narrow definition of income (that is, it provides many exemptions and exclusions); it provides a variety of targeted credits and deductions; and it imposes taxes at graduated rates that are collected at the individual level rather than at source.

Going through the steps of filling out an income tax form helps explain the complexity. The first step is calculating adjusted gross income (AGI). Taxpayers add up their wages and salaries, business income (other than from corporations), retirement income, interest, dividends, realized capital gains (the difference in price between assets that are sold and their purchase price), farm income, rent, royalties, some Social Security benefits, and a few other items, and adjust this sum for certain alimony payments, IRA contributions, and a few other factors (See Figure 1.)

Taxpayers can then either take the standard deduction or the sum of their itemized deductions, whichever is greater. In 2023, the standard deduction was $13,850 for individuals, $20,800 for heads of households, and $27,700 for married couples filing jointly. Taxpayers can take itemized deductions for mortgage interest (on the first $750,000 of loan principal for a primary residence), up to $10,000 in state and local income and property taxes, charitable contributions, excess medical expenses, and investment interest payments, among other items. About 10% of all tax filers itemized their deductions when filing their 2020 taxes, including more than 60% of those in the top 1% of filers (Tax Policy Center, 2020).

Subtracting deductions from AGI yields taxable income, which faces marginal tax rates ranging from 10% to 37% (rates for married couples filing jointly are shown in Figure 2). Dividends and capital gains are taxed at lower rates, with the top rate peaking at 20 percent. Complex rules allow a 20% deduction in some circumstances for income from pass-through business entities, which include sole proprietorships, partnerships, limited liability companies, and S-corporations (Gale and Krupkin, 2018).
A taxpayer may file as an individual, part of a married couple filing jointly, a married individual filing separately, or a head of household (an unmarried person with children). The tax brackets—the income thresholds at which each new rate kicks in—differ by filing status. As of 2020, the most recent year for which statistics are available, about 72% of those who file taxes (and 79% of all households including non-filers) are in tax brackets of 12% or less. Only 3% of households were in tax brackets above 24 percent.

Applying the tax rates to taxable income yields gross tax liability. Taxpayers may also claim various credits, the largest of which are for earned income and children. Other credits subsidize everything from higher education to home energy efficiency. Tax liability is gross tax liability minus credits. The Earned Income Credit and part of the Child Tax Credit are refundable, meaning that they can reduce one’s tax liability below zero, at which point the taxpayer receives a net payment from the government.

High-income taxpayers—single taxpayers with modified adjusted gross incomes over $200,000 (married couples filing jointly with income above $250,000)—must pay a surtax of 3.8% on net investment income and 0.9% on wages. (Combined with the 2.9% Medicare payroll tax, this adds up to an equivalent 3.8% surtax on wage income). About 0.1% of all taxpayers—all of them upper-middle income or upper-income—also must pay alternative minimum tax (AMT) as of 2020. People have to pay their regular income liability or their AMT liability, whichever is larger. The AMT exempts almost all lower-income and middle-class households by providing a large exemption—in 2023, $81,300 for single taxpayers and $126,500 for married couples filing jointly. It taxes a broader base at flatter rates (26% and 28 percent) than the regular income tax.

Capital gains receive favored tax treatment in several ways. First, gains do not face any tax until or unless they are realized—that is, until the asset is sold. That gives taxpayers the advantages of deferring taxes and timing the sale to offset losses. Second, when they are realized, capital gains on assets held for at least a year are taxed at a maximum rate of 23.8% (combining a capital gains tax rate of 20% and the net investment income tax of 3.8% on high-income households). Third, the “angel of death” loophole means assets that are held until the owner’s death escape all income taxes. The asset’s basis (the purchase price for tax purposes) is “stepped up” to equal its value at the time of the owner’s passing, so neither the owner nor inheritor ever pays income tax on the accrued gains.

### FIGURE 1

**Calculating Income Tax Liability**

1. Select Filing Status
2. Calculate AGI
3. Subtract Adjustments and Deductions
4. Taxable Income
5. Apply Tax Rate Schedule
6. Gross Tax Liability
7. Subtract Credits
8. Net Tax Liability
There is no perfect tax system. Changes that simplify the system will also affect other aspects of taxes. Given the multiple goals of tax policy—including equity, efficiency, administrability and enforcement, adequacy of revenues, and simplicity—it is not surprising that trade-offs exist. Thus, the goal of presenting alternatives for simplification is to help clarify what those trade-offs are. To compare “apples to apples,” the proposed reforms below raise the same amount of revenue as the current income tax under 2023 law. But they differ from each other and from the current system in terms of overall complexity, along with the ability of taxpayers to participate in a no-return system or a system where the Treasury can accurately pre-populate returns. They also differ in the distribution of tax burdens and effective marginal tax rates across households, as described below.

There are many ways to reform the income tax with simplification as a primary objective. In this section, we present four proposals for simplifying the income tax system. Table 3 shows the revenue details for each proposal.

A. ALTERNATIVE 1: SIMPLIFIED INCOME TAX

The first alternative would simplify the income tax but maintain its graduated rate structure. In terms of the filing process that is summarized in Figure 1, the “simplified income tax” proposal would meaningfully simplify every step of the process that contains complexity. The proposal would simplify filing status choices by eliminating the head of household filing option. The proposal would simplify the calculation of AGI by eliminating preferential rates for capital gains and dividends. It would greatly simplify the process of determining deductions (and thus taxable income) by eliminating itemized deduction and eliminating the section 199a deduction for business income. It would have no effect on the already simple task of using a tax table to look up gross tax liabilities given taxable income.

Finally, it would simplify the process of applying credits by eliminating the current EITC, CTC, and other smaller credits and replacing them with a personal credit that would provide $1,000 for each family member (child or adult) and a work-related credit that would provide 20% of individual earnings up to $10,000, phasing out beginning at $15,000 and with the credit reduced to zero when individual earnings reach $25,000. Both credits would be refundable, meaning that taxpayers would receive the full credit even if their gross-of-credit tax liability were less than their eligible credits. Several aspects of this proposal merit discussion. The plan would also eliminate all other credits such as for dependent care and education.

1. Head of Household Status

Repealing the head of household status, which currently applies to unmarried filers with children or other qualifying dependents, would simplify the tax code in meaningful ways. However, it would require some offsetting policy changes to ensure that working-class heads of household do not face a significant tax increase. The presence of head of household status introduces issues of eligibility and double-claiming that lead to significantly more complexity in the tax code. The rules to claim the status are complex, with filers needing to meet nearly a dozen requirements and fill out a form regarding the costs of ‘keeping up a home.’ Often, both separated parents have significant tax incentives to claim HOH status, which may result in double-claiming of benefits.

Another issue with head of household structure is that it introduces an erratic and often opaque benefits structure that broadly rises with income. While it provides significant benefits to single parents, it also provides even more favorable tax treatment to a relatively small number of high-income taxpayers who qualify (Nunns et al. 2016), it can also create large marriage penalties, especially for middle-class and high-income filers, which are generally undesirable (Holtzblatt et al. 2024).
As Nunns et al. (2016) point out, there is no distinction in filing status between married filers with and without children, and no obvious reason why there should be such a distinction in filing status for single filers. Providing one filing status for single individuals would allow benefits for children to be provided separately from other aspects of the tax code and delivered to parents more uniformly.

2. Preferential Rates for Capital Gains and Dividends

The lower tax rates on capital gains and dividends are controversial. There are strong normative arguments in favor of preferential rates, ranging from issues of ‘double taxation’ to the idea that capital gains are not income and thus should not be subject to income taxation (see Cunningham and Schenk (1992) for further discussion). Moreover, in theory high capital gains and dividend tax rates might negatively affect investment and long-run employment, although recent empirical studies of dividend tax cuts suggest that these effects may be very small or nonexistent (Yagan 2015, Alstadsæter et al. 2017).

However, the preferential rates also create a number of problems, and make the tax system markedly more complex. First, by creating an incentive for taxpayers to shift the classification of income from labor to capital, the preferential rates create opportunities for abuse and necessitate highly complex anti-abuse provisions in the tax code. Second, defining precisely what qualifies as dividends and capital gains income is complex—the rules defining capital gains are long and highly technical. If preferential rates were removed, this source of complexity could be erased completely. Finally, because dividend and capital gains income flows disproportionately to the top of the income distribution (Delestre et al. 2022), these tax preferences are primarily used by very wealthy filers and serve to widen gaps in post-tax income and wealth.

Furthermore, many of the issues raised in the literature making the case for capital gains and dividend preferences are less pressing in the current policy environment. After the corporate tax cuts contained in the Tax Cuts and Jobs Act of 2017, double taxation is a less economically salient issue. And since a significant and rising share of the corporate tax burden falls on economic rents rather than the normal return to capital (Gale and Thorpe 2022), higher taxes on capital income will have smaller effects on the real economy than they would if the taxes all fell on the normal return. Overall, the case for preferential rates is not sufficiently strong to outweigh the increases in complexity and tax avoidance that they create.

3. The Deduction for Business Income

The proposal would eliminate the section 199(a) deduction for business income. The 199(a) deduction creates numerous problems (Gale and Haldeman, 2021). First, the rules are inequitable, violating the norms of both horizontal and vertical equity. The deduction implies that a taxpayer’s liability depends not only on the level of income but the form that it takes—wages, qualified business income, or unqualified business income—violating horizontal equity. The benefits of the deduction are weighted very heavily toward very high-income taxpayers, violating vertical equity. JCT (2018) and the Tax Policy Center (2018) found that benefits from the deduction would flow disproportionately to the highest-income taxpayers, with more than half of direct tax benefits flowing to households in the top 1% of the income distribution.

In a recent study, Goodman et al. (2021) also found that the deduction has been ineffective at its stated goal of increasing investment and employment. The authors use administrative tax data to investigate changes in real economic activity associated with the reform and find no evidence of significant changes in physical investment, wages of non-owners, or employment between 2018 and 2021. Intuitively, the deduction has a low “bang for the buck” in terms of investment and employment: business income in a given year is largely the result of investments made in the past. By cutting the tax rate rather than providing direct subsidies to new investment, the deduction provides some incentive to invest now by reducing the cost of new capital investment, but much of the revenue loss will finance windfall gains to business owners who made investments in the past, which won’t increase current investment. A direct subsidy to new investment would have avoided the windfall gains and been more effective.
4. Itemized Deductions

The proposal would eliminate itemized deductions. Eliminating itemized deductions is a key step at the heart of any serious tax simplification effort (Gale, 1997). Although they are immensely popular, they are ineffective and inequitable provisions. The deductions largely subsidize activity that would have occurred anyway. The mortgage interest deduction, for example, has been shown to have little effect on home ownership rates and instead mainly inflates housing prices, and encourages borrowing and larger homes (Gale et al., 2007; Glaeser and Shapiro, 2003; Gruber et al., 2021). The deductions complicate tax filing and enforcement. They erode the tax base and thus require higher tax rates than would otherwise be necessary. They are regressive: only about 9% of all taxpayers itemized in 2020, but 64% of households with income above $500,000 use the deductions, compared with just 1.5% with income below $30,000. And, of course, relative to low-income households, high-income households claim larger deductions and receive more benefit per dollar of deduction (because they face a higher marginal tax rate). As a result, the deductions are often described as “upside down.” The deductions are also unfair in another way. Why should homeowners, merely because they have a large mortgage, be able to deduct up to $10,000 in state and local taxes when renters with similar income cannot?

Finally, the deductions hide subsidies that would be obvious if they were spending programs. Imagine that instead of a mortgage interest deduction, we had a program called “homeowner welfare” in which taxpayers earned a “welfare entitlement” equal to their annual mortgage interest payment times their tax rate. Anyone whose entitlement was below a certain threshold, say $8,000, would receive nothing. Anyone whose entitlement exceeded the threshold would receive the entitlement in cash. This program would be decried as wasteful and a sop to the rich. Yet it is not dissimilar to the way the mortgage interest deduction works.

5. Work and Personal Credits

The proposal would replace the EITC, child tax credit, and other smaller credits with a work credit and a personal credit and would eliminate the Head of Household filing status. Taken together, these changes would significantly simplify filing for families and low-income workers.

There are several problems with the EITC and child credit as they currently stand. First, they are complex. Correctly filling out a tax return requires taxpayers to understand the often-opaque rules surrounding marital status, head of household filing status, gross income, earned income, unearned income, and dependency status. The rules for the EITC run to 18 pages and the entire instruction package is 38 pages long (2022 Publication 596 (irs.gov)). The overlapping child benefits of the EITC and the CTC add unnecessary complexity and make it harder to understand the benefit of each credit.

Second, the EITC provides only limited work incentives for childless workers, with the maximum credit in 2022 for a single worker without children set at just $560, and even those benefits completely phased out at an AGI of just $16,480. Third, both the phase-out of the EITC, which is based on family income rather than individual earnings, and the head of household filing status create marriage penalties (Holtzblatt et al. 2024).

Fourth, many families do not receive the full child credit because their income is too low. While the first $1,400 of the per-child credit is refundable, only families with sufficient tax liability (e.g., sufficiently high incomes) can claim the full $2,000 per child. Only about half of Black and Hispanic children are eligible for the full CTC under current rules, primarily because of this restriction (Goldin and Michelmore, 2022).

The proposed personal credit and work credit would address all these issues. The personal credit would provide a full $1,000 for each family member—child or adult—regardless of family income. The universal and fixed-in-amount nature of the credit would ensure that it reaches a broader spectrum of families (including families who currently cannot receive the nonrefundable portion of current child benefits because their income is too low). This would be a small version of...
a universal basic income (UBI), which is discussed further in the presentation of the third reform proposal.

The work credit would equal 20% of an individual's earnings up to $10,000, with the credit beginning to phase out when earnings reach $15,000. The credit would be fully phased out at earnings of $25,000. Because the credit would be based on individual earnings rather than family AGI (which the current EITC uses), it could be administered outside of the income tax, based on payroll tax receipts. This consideration becomes very important in the third proposal (discussed below), which eliminates the income tax for most taxpayers. The credit would incentivize work better for married couples since a spouse's earnings or family asset income would not induce a phase out of the benefits. By decoupling the work credit from child-related benefits, the alternative would significantly simplify both credits, allowing taxpayers to better understand where their benefits come from. Marriage penalties due to the EITC phase-out or the Head of Household filing status would also be eliminated. Of course, the credit would have to be monitored to ensure compliance, just as the current EITC is.

The substantial simplification of the tax code through the elimination of existing deductions and credits and the transition to simpler personal and work credits would allow many more taxpayers to take advantage of return-free filing. Taxpayers would need to file demographic information to get accurate benefits, but because earnings are reported by employers, tax authorities could calculate a taxpayer's work credit without any further information. We include estimates for the effects of these alternatives on return-free filing below.

B: ALTERNATIVE 2: MODIFIED SIMPLE INCOME TAX

Alternative 1 greatly simplifies the income tax, is progressive on an overall basis but hurts a substantial share of low- and moderate-income families with children because those families benefit from several provisions in the current tax code. Alternative 2 is based on alternative 1 but is designed to help low- and moderate-income families with children. It is exactly like alternative 1, except for the following modifications: the per capita credit would be increased to $2,000 but would phase out beginning at $36,000 for unmarried filers and $72,000 for married filers, with a phaseout rate of 0.4. As shown below, as a result of this change, alternative 2 helps low- and moderate-income families with children, relative to the current system. However, doing so requires more complexity than in the simpler Alternative 1. This illustrates one of the reasons the tax code has gotten more complex: often, attempts to avoid creating ‘losers’ in a tax reform has required adding additional provisions and phaseouts.

C. ALTERNATIVE 3: BACK TO THE FUTURE

The third alternative is based on and similar to a proposal by Graetz (1997, 2010). (See recent analysis by Nunns et al. 2022.) It contains all the simplification options of the first strategy, and further simplifies the income tax through the straightforward mechanism of raising the standard deduction—from its current levels of $27,700 for married couples and $13,850 for single filers—to $100,000 for couples and $50,000 for singles. This vastly simplifies taxes for most people because they would not have to file or pay income taxes if their income was below the standard deduction levels.

When the income tax was first created in 1913, it applied only to a small slice of the population. Thus, this alternative is called “Back to the Future” because it would move the system toward the goal of the income tax only applying to high-income households. It would not reduce the number of taxpayers to only 3% of the population as in 1913, but it would reduce the number of filers substantially.

Obviously, raising the standard deduction would reduce revenues. To offset the revenue loss from raising the standard deduction, there would be two further changes. First, the proposal would replace the 10%, 12%, 22%, and 24% brackets with a 25% rate. This rate, of course, would only apply to income above the standard deduction. Second, the proposal would create a value-added tax (VAT) at a 10% rate. The value-added tax contains all the elements of a tax that is simple for
individuals to comply with—a consumption base and flat tax rate with remittance of taxes at source.

To offset some of the burden of the VAT on low- and moderate-income households, the proposal would raise the refundable personal credit to $2,800 (from $1,000 in the first alternative). The extra $1,800 per person would offset the value-added tax on the first $18,000 of consumption spending (or the first $72,000 for a family of four). Note that the personal credit would still be functional because individuals would file demographic information with the IRS. The work credit would still be functional because it is based on an individual’s earnings (not family earnings or family income) and thus can be administered with payroll tax information. All these features are summarized in Table 3.

1. The Value-Added Tax

A VAT is a consumption tax similar in spirit to a retail sales tax but collected in parts at each stage of production rather than all at once at the retail level (Gale, 2020). Similar to a tax imposed in New Zealand, this VAT would tax a broad base that includes items that other countries’ taxes typically omit, such as education, health care, financial services, and nonprofit institutions. VATs are popular for many reasons. First, and most importantly, VATs can raise a lot of money in a progressive fashion. In 2023, a 10% rate VAT would have raised about 3.8% of GDP (net of offsets from other taxes and spending programs).29

Second, VATs are consistent with an efficient and prosperous economy. Future consumption is funded by existing wealth, future wages, or future excess returns on investments. As a result, a consumption tax effectively imposes a one-time implicit lump-sum tax on a broad measure of wealth existing at the time of implementation.

A VAT also has important efficiency advantages over other types of taxes. Because VATs do not distort saving, investment, or financial decisions, they are more conducive to economic growth than income taxes or wealth taxes are. Because of the unique crediting structure that they employ, VATs are easier to administer and enforce than retail sales taxes. And by using border adjustments that remove taxes on exports but impose taxes on imports, VATs are consistent with other countries’ tax systems and avoid creating distortions in international trade.

The discussion above suggests that, other things equal, the simplest system—ignoring extreme possibilities like a per-head tax—would tax consumption at a flat rate with universal deductions, credits, or exemptions, and with withholding at source. That is essentially what a well-designed value-added tax (with a universal benefit, as in Gale, 2020) would do. Although almost all countries other than the U.S. administer a VAT, few such taxes are implemented as simply as could be.

D. ALTERNATIVE 4: SIMPLIFIED INCOME TAX, VAT, AND A UBI

The fourth proposal builds off the first proposal by simplifying the income tax. It builds off the third proposal by creating a value-added tax and 25% minimum income tax rate. But instead of using the extra revenue to raise the standard deduction (as the third proposal does), the fourth proposal would use the revenue to fund a larger personal credit (a universal basic income), totaling $3,900 per person or $15,600 for a family of four. For purposes of the comparison, the poverty line for a family of four equals $30,000 in 2023.

The concept of a universal basic income has received national attention from across the political spectrum since at least the 1960s (e.g., Friedman, 1962; King Jr., 1968), and has been the subject of particular interest in the last decade as a policy response to rising automation and inequality (e.g., Hoynes and Rothstein, 2019; Hasdell, 2020). Various versions of UBIs have been implemented in places as diverse as Stockton, CA (Tubbs 2021); Manitoba, Canada (Simpson et al. 2017); Alaska (Jones and Marinescu 2022), and rural Kenya (Banerjee et al., 2020), with results suggesting that UBIs can have significant positive effects in reducing poverty, improving health, and raising self-reported well-being without major unemployment effects. The policy has been defended by liberals,
who prize its effectiveness in fighting poverty without work requirements or administrative burdens (Wright, 2020; Bidadanure, 2019), alongside conservatives and libertarians, who see UBI as a way to support families without the paternalistic and intrusive bureaucracy associated with traditional welfare programs (Murray, 2016; Fleischer and Hemel, 2017).

Many economists have also proposed implementing policies similar to a UBI through the tax code. For example, advocates of carbon taxes, including Greg Mankiw and Lawrence Summers, support returning the revenue from a carbon tax to American families via a per capita rebate very similar to a UBI (Long, 2019). Advocates of replacing most of the federal tax system with a national retail sales tax also include a family consumption allowance in their alternatives—another form of UBI (Carter 2023).

Replacing all existing social insurance programs with a UBI, as some conservatives have proposed, would not necessarily deliver the same benefits: as Greenstein (2019) notes, the loss of targeted benefits under such a policy would likely increase rather than reduce poverty. The lack of work incentives in the UBI has also alienated some moderates (see e.g., Kearney and Mogstad, 2019). Yet while support for a UBI varies depending on its design, there is nearly unanimous agreement that replacing complex means-tested credits with one that is universal and refundable would reduce administrative burdens and make taxes simpler. This proposal delivers the benefits of a UBI and does not cut existing social insurance programs, while continuing to incentivize work and dramatically simplifying the tax code. Any reductions in existing social programs could be used to lower tax rates further.

| VI. Effects of the proposals |

To measure the effects of these proposals, we use the Urban-Brookings Tax Policy Center (TPC) microsimulation model. As described in detail in Appendix 3, the model simulates the universe of taxpayers as well as those not required to file, based on public-use tax returns and supplemented with information on non-filers from other sources. It provides estimates of the revenue, distributional, and incentive effects of taxes. The TPC model is similar in most respects to the large-scale microsimulation models employed by CBO (2018), JCT (2013), and the Department of the Treasury (Cronin 2022, Cronin et al. 2013, Power and Frerick 2016).

As shown in Table 3, all four reform options are approximately revenue-neutral (and budget neutral) relative to the existing income tax as of 2023.

A. DISTRIBUTIONAL EFFECTS

A primary question about any tax system is how it places burdens on different groups of taxpayers. Figures 2 and 3 show such distributions, with tax units (filers and non-filers) characterized by their expanded cash income (ECI, see Appendix 3 for definitions). Figure 2 presents results for all households, while Figure 3 restricts the sample to households with children. The leftmost bar in each income group shows that the “simplified income tax” would be quite progressive relative to the current system. After-tax income would rise by almost 30% for tax units with ECI below $10,000 and more than 10% for tax units with ECI between $10,000 and $20,000. The percentage rise in after-tax income is smaller and declining as income rises to $200,000. Tax units with ECI above $200,000 would see their after-tax income fall. Those with ECI above $1,000,000 would see a more than 10% decline in after-tax income. However, the second column in Table 4 shows that among tax units with children, those with ECI above $10,000 would face tax increases on net.

The last observation motivates the “modified simplified income tax.” As described above, under this proposal, the personal credit would be doubled to
$2,000 but would phase out starting at $72,000 for married couples ($36,000 for singles). The third column of Table 4 shows that this reform option would be even more progressive than the "simplified income tax." The fourth column of Table 4 shows that it would raise after-tax income for tax units with children and with ECI below $40,000. On average, it would leave unaffected those units with ECI between $40,000 and $50,000 and would reduce after-tax income for tax units with children and ECI above $50,000. Although it relieves taxes on some moderate-income households with children, this reform may still impose unacceptable burdens on middle-class families with children.

The third proposal, "Back to the Future," addresses this concern by raising the standard deduction, imposing a VAT, setting all income tax rates at 25% at least, and raising the personal credit to $2800. The fifth and sixth columns show that this proposal is quite progressive, on an overall basis and for tax units with children. Among tax units with children, after-tax income rises in income groups below $200,000 and falls substantially for groups with higher income.

The last proposal essentially substitutes a higher personal credit (i.e., a UBI) for the higher standard deduction and 25% rate in "Back to the Future." The last proposal is progressive overall and for tax units with kids. Among tax units with children, those with ECI below $100,000 would see increases in after-tax income on average, those with ECI between $100,000 and $200,000 would see a very small reduction in after-tax income. Those with higher ECI would see large reductions in after-tax income comparable to the changes in "Back to the Future".

B. REPRESENTATIVE FAMILIES

To highlight how filing requirements and tax payments might change for real families under these proposals, we consider the proposals’ effects on three representative households. The first is a middle-income married couple with two children and $100,000 in employment income; the second is a low-income head of household filer with one child and $30,000 in employment income; the third is a high-income couple with no children, $300,000 in employment income, and an additional $100,000 in realized capital gains who itemize their deductions.

Table 5 reports the effects of these proposals on our representative households. Two major trends are immediately apparent. First, all four reforms will simplify taxes dramatically for all households, and especially simplify the filing and record keeping process for the low- and middle-income families. The high-income household will still face some complexity (and remain ineligible for a pre-populated return) because of their investment income, illustrating the limits to simplification for households with more complicated sources of earnings. Second, all proposals -and especially 'Back to the Future' and UBI- will have significant distributional effects. Relative to 2023 law, after-tax income rises by 6% ($5,729) for the middle-income family and 6.2% ($2,041) for the head of household in the UBI scenario but falls by 10% ($33,457) for the high-income couple.

These results reflect the tradeoffs faced under any revenue-constrained tax reform: the funding necessary to pay for the UBI or increased standard deduction must come from somewhere in the tax base, and in the case of our reforms, this burden falls primarily on the top of the income distribution. However, alternative simplification proposals would imply different distributional effects. Moreover, these estimates do not account for the time and money spent on tax preparation under the current system, which has meaningful effects on leisure and disposable after-tax income.

C. COMPLEXITY MEASURES

The reduction in complexity created by the elimination of all existing deductions and credits (and replacement with two simple refundable credits) in the system is hard to measure. It would clearly save taxpayers time, money, and mental anguish.

As a proxy, we report how many people would not have to file income tax returns in the first place. A good metric for this question is the share of tax units with income below the standard deduction. Under current law, about 22% of tax units have gross income less than the standard deduction. Of course, many additional tax units owe no income tax due to the refund-
### Impact on Revenues, CY2023

<table>
<thead>
<tr>
<th>Description</th>
<th>Simplified Income Tax</th>
<th>Modified Simplified Income Tax</th>
<th>Back To the Future</th>
<th>Universal Basic Income</th>
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<tr>
<td><strong>Income Tax Reform</strong></td>
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<td>1) Repeal itemized deductions</td>
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<td>2) Repeal Sec199A Deduction for Qualified Business Income**</td>
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<td>3) Repeal preferential rates on capital gains dividends</td>
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<tr>
<td>5) Repeal head of household rates and standard deduction</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>6) Repeal AMT</td>
<td>-3</td>
<td>-3</td>
<td>-3</td>
<td>-3</td>
</tr>
<tr>
<td>7) Increase Standard Deduction ($100k for MFJ / $50k for Singles)</td>
<td></td>
<td></td>
<td>-812</td>
<td></td>
</tr>
<tr>
<td>8) Introduce 25% minimum statutory rate</td>
<td></td>
<td></td>
<td>420</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal Income Tax Changes</strong></td>
<td><strong>422</strong></td>
<td><strong>422</strong></td>
<td><strong>30</strong></td>
<td><strong>422</strong></td>
</tr>
<tr>
<td><strong>Refundable Credits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9) Per capita refundable credit (i.e., UBI)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of $1000</td>
<td></td>
<td></td>
<td>-342</td>
<td></td>
</tr>
<tr>
<td>of $2000 with 40% phaseout rate. PO starts at $36K unmarried, $72K married</td>
<td></td>
<td></td>
<td>-344</td>
<td></td>
</tr>
<tr>
<td>of $2800</td>
<td></td>
<td></td>
<td>-957</td>
<td></td>
</tr>
<tr>
<td>of $3900</td>
<td></td>
<td></td>
<td>-1,333</td>
<td></td>
</tr>
<tr>
<td>10) Refundable earnings credit</td>
<td>-79</td>
<td>-79</td>
<td>-79</td>
<td>-79</td>
</tr>
<tr>
<td><strong>Subtotal Refundable Credits</strong></td>
<td><strong>-420</strong></td>
<td><strong>-422</strong></td>
<td><strong>-1,035</strong></td>
<td><strong>-1,412</strong></td>
</tr>
<tr>
<td><strong>VAT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11) 10% (exclusive rate VAT) Gross Revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11.1) VAT revenue offset</td>
<td></td>
<td>-501</td>
<td>-513</td>
<td></td>
</tr>
<tr>
<td>11.2) VAT spending offset</td>
<td></td>
<td>-200</td>
<td>-200</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal VAT</strong></td>
<td><strong>0</strong></td>
<td><strong>0</strong></td>
<td><strong>1,004</strong></td>
<td><strong>993</strong></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>2</strong></td>
<td><strong>0</strong></td>
<td><strong>-2</strong></td>
<td><strong>3</strong></td>
</tr>
</tbody>
</table>
able credits. Under plans 1, 2, and 4, the number of tax units with gross income below the standard deduction falls slightly, to about 20%, because of the removal of the head of household status. Under reform option 3, "Back to the Future," the large increase in the standard deduction means that 64% of tax units have income below the standard deduction.

In addition, the changes would make a substantial difference in terms of the need for record keeping. Compliance costs for many taxpayers, especially those who itemize, are primarily driven by record keeping (Benzarti 2020). By eliminating itemized deductions, all simplification proposals would dramatically reduce the need for detailed records, which currently cost taxpayers tens of billions of dollars each year. Meanwhile, even lower-income taxpayers who do not itemize face significant record keeping burdens for the child tax credit and EITC, reinforced by some of the highest audit rates of any taxpayers in the country (Davis-Nozemack 2012). By moving to simplified family and work credits, the vast majority of this burden would be erased. For most families without business income or capital gains, record-keeping requirements would become as easy as keeping track of an annual W-2.

FIGURE 2

Percent change in after-tax income resulting from simplification proposals
Grouped by income range of individuals/households

Note: Estimated effects for each case are calculated using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0323-2), described in detail in Appendix 3. Underlying data is presented in Table 4.
Percent change in after-tax income resulting from simplification proposals, tax units with children

Grouped by income range of individuals/households with children

- Simplified
- Modified Simplified
- Back to the Future
- UBI

Note: Sample includes only households with dependent children (generally either heads of household or married couples filing jointly). Estimated effects for each case are calculated using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0323-2), described in detail in Appendix 3. Underlying data is presented in Table 4.
<table>
<thead>
<tr>
<th>Expanded Cash Income Level (thousands of 2019 dollars)</th>
<th>Simplified Income Tax</th>
<th>Modified Simplified Income Tax</th>
<th>Back To the Future</th>
<th>Universal Basic Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>With Children</td>
<td>All</td>
<td>With Children</td>
<td>All</td>
</tr>
<tr>
<td>Less than 10</td>
<td>29.7</td>
<td>22.3</td>
<td>52.3</td>
<td>55</td>
</tr>
<tr>
<td>10-20</td>
<td>10.6</td>
<td>-0.3</td>
<td>19.2</td>
<td>13.6</td>
</tr>
<tr>
<td>20-30</td>
<td>3.7</td>
<td>-6.9</td>
<td>10</td>
<td>3.2</td>
</tr>
<tr>
<td>30-40</td>
<td>0.7</td>
<td>-7.7</td>
<td>5.8</td>
<td>0.4</td>
</tr>
<tr>
<td>40-50</td>
<td>0.6</td>
<td>-6</td>
<td>4.1</td>
<td>0</td>
</tr>
<tr>
<td>50-75</td>
<td>0.7</td>
<td>-3.2</td>
<td>1.5</td>
<td>-1</td>
</tr>
<tr>
<td>75-100</td>
<td>0.6</td>
<td>-1.5</td>
<td>0.5</td>
<td>-0.9</td>
</tr>
<tr>
<td>100-200</td>
<td>0.1</td>
<td>-0.7</td>
<td>-1.2</td>
<td>-2.7</td>
</tr>
<tr>
<td>200-500</td>
<td>-0.7</td>
<td>-0.5</td>
<td>-1.8</td>
<td>-2.2</td>
</tr>
<tr>
<td>500-1,000</td>
<td>-2.3</td>
<td>-1.5</td>
<td>-2.9</td>
<td>-2.3</td>
</tr>
<tr>
<td>More than 1,000</td>
<td>-10.3</td>
<td>-8.4</td>
<td>-10.4</td>
<td>-8.6</td>
</tr>
</tbody>
</table>

Note: Estimated effects for each case are calculated using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0323-2), described in detail in Appendix 3. Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative AGI are excluded. After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate tax; excise taxes; and, in cases 3 and 4, estimated VAT payments.
<table>
<thead>
<tr>
<th>Panel A: Middle-Income Family</th>
<th>No return?</th>
<th>Eligible for pre-populated return?</th>
<th>No itemized deductions?</th>
<th>All credits universal?</th>
<th>Income after federal tax</th>
<th>Change in after-tax income (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baseline</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>$95,764</td>
<td>N/A</td>
</tr>
<tr>
<td>Simplified Income Tax</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>$95,764</td>
<td>0%</td>
</tr>
<tr>
<td>Modified Simplified Income Tax</td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td>$91,764</td>
<td>-4.5%</td>
</tr>
<tr>
<td>Back to the Future</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>$100,845</td>
<td>5.8%</td>
</tr>
<tr>
<td>Universal Basic Income</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>$97,393</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Note: All income estimates are calculated using the online calculator available at https://tpc-tax-calculator.urban.org. Calculated after-tax income is after all federal taxes and transfers, including payroll taxes (which are not affected by any of the plans). VAT is applied to 10% of all income after federal, state, and local taxes, including payroll taxes, less estimated savings.

* Exact amounts will differ depending on what itemized deductions are taken; for simplicity, we assume the couple has $50,000 in itemized deductions.
As a purely technical matter, tax complexity and tax evasion can be reduced, and tax administration can be made more just and efficient. As a political and policy matter, however, making these improvements has proven quite difficult. Efforts to simplify the tax system typically run up against conflict with other tax policy goals, political factors, taxpayers’ efforts to avoid and evade taxes, and revenue requirements. Each of these factors tends to shape the base, credits, deductions, rate structure and administrative aspects of the tax system in ways that raise complexity. Efforts to reduce evasion sometimes run into similar problems. Yet to the extent that simplicity is a goal of tax reform, many improvements could still be made within the existing system.

There are, of course, countless ways to simplify taxes. An alternative not explored above would be to move to individual-based taxation instead of family-based taxation (Rosen 1977, Liebman and Ramsey 2019). Many countries tax on an individual basis, which eliminates marriage penalties and bonuses and reduces the marginal tax rate facing the second earner in a family. However, individual taxation violates the commonly held idea that families with the same income should pay the same tax. There are also issues with allocating capital income among spouses and conflicts with community property laws in many states (Congressional Budget Office 1999). Moreover, most of the gains in simplicity from moving to individual taxation would be achieved by adopting any of the alternatives described above.

Pure versions of both the national retail sales tax and the flat tax could be vastly simpler than even an improved income tax. But realistic versions of the flat tax and especially the sales tax would require tax rates much higher than advertised by their proponents. These higher rates complicate tax compliance and enforcement. The sales tax would face potentially serious problems with enforceability and political pressure for exemptions. The flat tax would face the same political pressures, and while enforceability is not a major issue, the tax would likely become significantly more complex than currently proposed. Both proposals obtain simplification in large part by embracing provisions and changes that no Congress has ever remotely considered.

Thus, simplification is an important goal of tax reform, but lasting and significant simplification may prove difficult to establish. Policy makers and voters should, therefore, weigh the costs and benefits of simplification against the other goals of tax policy.
The costs of tax complexity could be reduced for many taxpayers with the introduction of no-return systems, government-populated returns, and/or “free filing” systems.

A. NO-RETURN SYSTEMS

In systems where individuals do not have to file any return, people’s exact tax liability must be withheld from payments—wages, interest, etc.—that they receive. The withholding could be done on a cumulative basis throughout the year or via adjustment of withholding in the final period of the year. Such a system would eliminate the need to file returns for people who could qualify for the system. However, taxpayers would still have to report basic demographic information to either their employers or the tax agency in order to calculate withholding allowances (Gale and Holtzblatt, 1997).

Clearly, such a system could only work well in relatively simple tax situations and tax rules. Taxes on earnings could be withheld under a “pay-as-you earn” approach. Interest and dividend income could be taxed at flat rates with taxes withheld at source (Gale and Holtzblatt, 1997). A return-free system would apply to more households if the unit of taxation were the individual rather than the family. But it would be hard to apply a return-free income tax to everyone: Taxpayers who earn self-employment income or receive capital gains would still have to file a return.

Return-free systems do exist in many countries around the world, in varying forms, but would be hard to implement under the current American tax code, which contains features like different filing status, targeted credits, progressive rates, taxation of capital income, itemized deductions, and other factors that make it difficult to withhold the exact amount of tax liability for most taxpayers.

B. PRE-POPULATED FORMS

Having the government pre-populate returns is a feasible alternative to exact withholding. In the so-called tax agency reconciliation (TAR) model, taxpayers would give the IRS basic information about their employment and demographic status. The agency would collect information from employers (wages), financial institutions (interest, dividends, mortgage interest payments), and other entities and provide a preliminary draft of the taxpayer’s return. The taxpayer would review the return, add or adjust items that are missing or incorrect (for example, self-employment income, capital gains income, or charitable contributions that have not been reported to the IRS) and submit the corrected return. A TAR could accommodate a progressive tax rate structure, income from multiple sources, and joint filing (Gale and Holtzblatt, 1997). The basic idea is to save taxpayers time, money, and aggravation as the IRS-supplied return would allow taxpayers to edit a “first draft” of their returns rather than having to construct everything from scratch.

Denmark and Sweden have TAR systems, and Finland and Norway have experimented with this approach (Goolsbee, 2006). As of 2007, all individual taxpayers in Denmark and Sweden received a draft completed return from their tax reconciliation agency; 78% of Danish taxpayers and 50% of Swedish taxpayers accepted that return with no adjustments (Holtzblatt, 2007). All these countries are smaller than the United States and have simpler tax codes.

In the U.S., Colorado and California have implemented return-free filing trials. The Colorado program, called “File4Me,” ran from 1999 to 2002 and remained small (Treasury, 2003). The California program, ReadyReturn, shows both the opportunities and the challenges that such a program would face on a national scale. The program was only available to taxpayers with the simplest filing status (single people with wage income only). Participants could submit the prepared return, with or without edits, or choose to file on their own. While many users reported that ReadyReturn saved them time and energy, most participants chose to file on their own. (However, a significant share had already filed their taxes by the time they received the prefilled return (Goolsbee, 2006).) Between 2005 and 2012, the
program attracted more users, nearly all of whom reported that the system was helpful—indeed, only 0.3% of ReadyReturn filings contained errors compared with 3.1% of returns in the control group. Nevertheless, the program ended in 2013, in the face of difficulty of expanding to cover more complex situations, public distrust, and fierce and often misleading lobbying by anti-tax conservatives and the tax preparation industry (Day, 2014; Ahern, 2007).

A TAR system in the U.S. could accommodate a substantial number of taxpayers. With some modifications to the tax system, 50% of filers could be transitioned to a return-free system (Gale and Holtzblatt, 1997). The withholding system would have to be modified to accommodate dependent filers, two-earner couples who file jointly, and filers with multiple jobs, but after reforms, return-free filing could account for some deductions and credits in addition to regular taxes on wage and salary income. However, some forms of income and deductions would be difficult to incorporate into a return-free system, including rents and royalty income, alimony, and business deductions.

Treasury (2003) finds that a return-free system would be possible to implement in the U.S. after simplification of the tax system. Transitioning the unit of taxation to the individual, for example, would eliminate the need to adjust withholding for two-earner couples. Introducing a return-free system without first simplifying the tax system, however, would introduce significant costs to tax administration and would, importantly, switch those costs from the taxpayer to other parties—including employers, financial institutions, state governments, and the IRS—without eliminating the burdens.

Simplified returns and pre-populated 1040s could also significantly reduce the burden placed on taxpayers without unduly burdening the IRS. The IRS could introduce return-free filing in waves according to the complexity of the transition to the new system, allowing first taxpayers with only W-2s, then those with 1099 and other sources of withholdable income to request return-free tax filing (Goolsbee, 2006). However, the administrative costs of distributing simplified returns to taxpayers well ahead of the April 15 deadline necessitates modernization to accelerate the process. The return deadline could be delayed for those filling out pre-populated returns, or providers of information returns could be asked to submit information earlier than they do now (Goodman et al., forthcoming). With these reforms in place, between 41 and 48% of filers in 2019 could have had their Form 1040 successfully pre-populated using information returns and their Form 1040 from past years.

Just as E-filing spread from being a curiosity to being ubiquitous over 20 years, it seems plausible that once government-populated returns were in place for some people, there would be improvements over time in the administration of the program, taxpayer trust, and taxpayer satisfaction with the program, so that its scope could widen to include more and more taxpayers (Gale, 2009).

The effects on evasion of pre-populating tax forms are unclear. It could reduce evasion to the extent that taxpayers keep poor records, or it could increase evasion by giving taxpayers’ a heads-up on what information the IRS does not have.

C. FREE FILING

The Inflation Reduction Act of 2022 authorized the IRS to investigate the idea of the government providing an IRS-run free direct e-file tax return system (“direct file” for short). Although tax preparation firms do provide such an option for moderate-income taxpayers, these ‘free-file’ options are often difficult for taxpayers to find and use—indeed, firms have been subject to lawsuits for intentionally drawing customers away from the free filing option—and are limited to taxpayers with income below a certain threshold (currently $73,000). A Government Accountability Office (2022) study found that in 2020, despite almost 70% of taxpayers being eligible for at least one free file option, less than 3% of taxpayers took advantage of these services. IRS surveys indicate some taxpayer reluctance to embrace an IRS-run system but also substantial taxpayer interest in using the system (IRS, 2023b). This bifurcation is not surprising given some public mistrust of the IRS and given the costs of filing electronically with tax preparation firms, respectively. Of course, there would
be some added administrative costs for the IRS. But the establishment of an easily accessible free filing tool would reduce monetary costs for many taxpayers.

The IRS will run a pilot of its direct file system in 2024 to test its potential with members of the public.

Appendix 2: Complexity and Fundamental Tax Reform

A. NATIONAL RETAIL SALES TAX

A national retail sales tax has been proposed most recently by Congressman Buddy Carter (R-GA), and by a group called Americans for Fair Taxation (AFT). The base of the sales tax would be broad, including most domestic private consumption in the United States and investment and consumption expenditures by federal, state, and local governments. The “Fair Tax” would apply to some sectors that are typically exempt from sales taxes at the state level, such as housing. Rent payments by consumers would be subject to tax, while the imputed rent homeowners pay themselves would be exempt. New home sales would be taxed, but sales of existing homes would not. The base would also include financial service fees. All fees paid directly for services, as well as implicit fees built into interest payments, would be taxed, with the sales tax applied to interest payments exceeding a basic interest rate determined by Treasury rates. This would apply to all interest payments, including on credit card and mortgage debt. The base of the sales tax would exclude some goods and services. Both private and state and locally provided education and training services would be exempt under the theory that they represent investments in human capital. In addition, food produced and consumed on farms would be exempt for administrative reasons. Lastly, the Fair Tax would not apply to state and local sales taxes, but it would apply to state and local government consumption and investment spending.

The sales tax would provide a demogrant (a universal basic income) to each household roughly based on the federal poverty level for that household, multiplied by the sales tax rate. States would collect the sales tax, and businesses and states would be reimbursed for tax collection efforts.

1. Required Tax Rates

The required tax rate in a national retail sales tax merits attention. Tax rates can be described in two ways. For example, suppose a good costs $100, not including taxes, and there is a $30 sales tax placed on the item. The “tax-exclusive” rate is 30 percent, since the tax is 30% of the selling price, excluding the tax. This rate is calculated as \( T/P \), where \( T \) is the total tax payment and \( P \) is the pre-sales-tax price. The “tax-inclusive” rate would be about 23 percent, since the tax is 23% of the total payment, including the tax. This rate is calculated as \( T/(P+T) \). Sales taxes are typically quoted in tax-exclusive rates; this corresponds to the percentage “mark-up” at the cash register. Income taxes, however, are typically quoted at tax-inclusive rates. The reported tax-inclusive rate will always be lower than the tax-exclusive rate and the difference rises as tax rates rise.

The Fair Tax bill put forward by Rep. Carter assumes a 23% tax-inclusive rate (30% tax-exclusive). The actual required rate would be much higher, however, for several reasons (Gale 2005, Gale and Pomerleau 2023, Paull 2000, President’s Commission on Tax Reform 2005). First, the plans stipulate that government must pay sales tax to itself on its own purchases but fails to allow for an increase in the real cost of maintaining government services. Second, the plan does not allow for any avoidance or evasion, though it is universally acknowledged that both will occur. Allowing for a 17% evasion and avoidance rate (as compared to just an evasion rate of 17% in the income tax) raises the required tax-inclusive rate to 33.7% in 2023.
and the tax-exclusive rate to 50.9 percent. Third, the plan proposes to tax an extremely broad measure of consumption, but political and administrative factors would very likely require a narrower base. Conservative adjustments for these factors raise the tax-inclusive rate to 45.6% and the tax-exclusive rate to 83.7% (Gale and Pomerleau, 2023).

2. Sources of Complexity

As a flat-rate consumption tax with a universal demogrant, the sales tax contains many of the features that generate simpler taxes. In principle, the simplicity gains could be impressive. Most individuals would no longer need to keep tax records, know the tax law, or file returns. Only those sole proprietorships, partnerships, and S and C corporations that made retail sales would have to file. The complexity of filing a return would decline dramatically as well.

Nevertheless, an NRST could create new areas of complexity. The demogrant is based on the HHS poverty guidelines, which rise less than proportionally with the number of family members. For example, this year the poverty level is $14,580 for a single individual, plus $5,140 for each additional family member. Thus, the poverty level for a family of four is $30,000, just over twice the level for an individual. This structure will create incentives in many households for citizens to try to claim the demogrant as individuals rather than families.

Another area of potential complexity stems from tax avoidance and evasion behavior. The primary way to avoid sales taxes would be to combine business activity with personal consumption. For example, individuals may seek to register as firms, individuals may seek to purchase their own consumption goods using a business certificate, and employers might buy goods for their workers in lieu of wage compensation (GAO, 1998). Ensuring that all business purchases are not taxed and all consumer purchases are taxed would require recordkeeping by all businesses, even though only retailers would have to remit taxes in a pure retail sales tax. The AFT alternative deviates from a pure retail sales tax by requiring that taxes be paid on many input purchases and that vendors file explicit claims to receive rebates on their business purchases. This would raise compliance costs further.

A second source of tax avoidance and evasion concerns the importation of goods and services from abroad. Imported purchases of up to $2,000 per year per taxpayer would be exempt from the sales tax. This feature is likely to be exploited fully by many taxpayers, not because they travel abroad but because it would be very simple for firms to set up offshore affiliates, warehouses, or mail-order houses and ship goods to domestic customers. Moreover, it would be very difficult to monitor such arrangements and it seems quite likely that taxpayers could end up importing more than $2,000 per person on a tax-exempt basis. Some related evidence on the potential extent of these problems comes from the experience with state-level “use” taxes under which taxpayers voluntarily make tax payments on goods purchased in other states. Enforcement of such taxes has been “dismal at best” (Murray, 1997). The development of electronic commerce could raise many additional avoidance and evasion problems for the sales tax.

3. Compliance Cost Estimates

There are no rigorous estimates of the compliance and administrative costs associated with a high-rate NRST. Some evidence is available with respect to state sales taxes. Slemrod and Bakija (1996) report that administrative costs were between 0.4 and 1.0% of sales tax revenues in a sample of eight states, and compliance costs were between 2.0-3.8% of revenues in seven states. Hall (1996) cites a Price-Waterhouse study that found that retailers spent $4.4 billion complying with state retail sales taxes in 1990. Adjusting for increased retail sales between 1990 and 1995, he asserts an NRST with no demogrant would have administrative costs of $4.9 billion.

Unfortunately, as Slemrod and Bakija (1996) note, compliance cost estimates from state sales taxes are likely to vastly underestimate the analogous costs in an NRST for several reasons. First, at 4 and 6 percent, state sales tax rates are an order of magnitude lower than the required rate in an NRST. The higher rates in an NRST would encourage more taxpayers to engage
in time-consuming taxpayer avoidance and evasion activities than under the existing state sales taxes, and this, in turn, would increase the required tax rate and compliance and administrative costs. Second, state sales tax bases are very different from the proposed federal base. States sales taxes typically include a significant amount of business purchases (Ring, 1999). This reduces compliance costs, since distinguishing business and retail sales is costly. To avoid taxing business in an NRST may require all businesses to file returns and receive rebates, which would raise costs. State sales taxes often exclude hard-to-tax sectors. All states exempt financial services from their retail sales taxes, but the NRST would not. Third, states do not provide demogrants.

On the other hand, states often exempt from taxation goods such as food, housing, rent, and health care, for political or social reasons. This increases compliance costs relative to taxing a broader base because defining the boundaries of the exemption (for example, distinguishing “food” and “candy”) can be difficult, and recordkeeping requirements can be extensive. However, if an NRST required high rates, there would be massive political pressure to exempt goods like food, health care, and rent.

B. FLAT TAX

Originally developed by Robert Hall and Alvin Rabushka (1983, 1995), the flat tax has been proposed in legislative form by Rep. Richard Armey, R-Tex., and Sen. Richard Shelby, R-Ala. Under the flat tax, businesses would pay taxes on the difference between gross sales (including business-to-business transactions) and the sum of wages, pension contributions, and purchases from other businesses, including the cost of materials, services, and capital goods. Individuals would pay taxes on their wages and pension disbursements, less exemptions of $21,400 for a married couple ($10,700 for single filers) and $5,000 for each dependent. Both individuals and businesses would pay the same flat tax rate, estimated by Treasury (1996) to be 20.8% (tax-inclusive). As with the sales tax, realistic versions of the flat tax will require higher rates. Unlike the sales tax, however, the required rate estimate for the flat tax already incorporates evasion and avoidance and does not assume that government tries to raise net revenue by taxing itself. The only significant adjustments are for transition relief and the possible retention of some major deductions and credits due to political pressures. Adjusting for those factors, the required rates range between 21% and 32% (Aaron and Gale, 1997).

1. Sources of Complexity

As with the sales tax, the proposed flat tax would change the tax base to consumption,33 flatten tax rates, eliminate all deductions and credits in the tax code, and vastly simplify tax compliance. For taxpayers who were not self-employed, the individual filing requirement could probably be eliminated. For those that did have to file, the tax form could be a relatively short postcard with simple calculations. The tax would eliminate individual-level taxation of capital gains, interest and dividends, and the individual AMT.

Any well-functioning business already retains records of wages, material costs, and investments, so tax filing would impose little additional cost. The flat tax would eliminate the differential treatment of debt versus equity, the uniform capitalization rules, the corporate alternative minimum tax, depreciation schedules, rules regarding defining a capital good versus a current input, depletion allowances, corporate subsidies and credits, the potential to arbitrage across different accounting systems, and a host of other issues. The tax distortions currently caused by inflation would vanish.

Nevertheless, the flat tax would retain some existing sources of complexity (Graetz, 1997) and exacerbate others. These include rules regarding independent contractors versus employees, qualified dependents, tax withholding for domestic help, home office deductions, taxation of the self-employed, and non-conformity between state and federal taxes. It would also create entirely new areas of complexity, and the types of complexity it would abolish could easily creep back into the code.

A potentially more troubling issue is that, since the flat tax makes different distinctions than the existing system does, the flat tax will create new “pressure points,” and so could create a host of new compli-
ance and sheltering issues. For example, under the existing income tax, a firm must pay taxes on interest income as well as income from sales of goods. In the business portion of the flat tax, receipts from sales of goods and services are taxable, but interest income is not. This creates an important incentive in transactions between businesses subject to the flat tax and entities not subject to the business tax (households, governments, nonprofits, and foreigners): the business would like to label as much cash inflow as possible as “interest income.” The other party (not subject to the business tax component of the flat tax) is indifferent to such labeling.

The same possibility occurs for cash outflows from businesses. Outflows that are labeled as purchases of goods and services or capital investments are deductible, while outflows that are labeled interest payments are not deductible. This creates obvious incentives for businesses to label as “purchases” as much of their cash outflow as possible, and possibly seriously erode the tax base and tax revenues. Thus, while it equates the tax treatment of debt and equity flows, the flat tax creates a new wedge between inflows labeled “sales” and those labeled “interest,” and a new wedge between outflows labeled “purchases” and those labeled “interest expense.” Concerns that these wedges would be easily manipulated led McLure and Zodrow (1996) to conclude that the business tax “contains unacceptable opportunities for abuse.”

Another new area of complexity concerns wages, fringe benefits, and current operating expenses. Under the current system, all are deductible to firms. Under the flat tax, however, fringe benefits are not deductible. Gruber and Poterba (1996) speculate that this wedge could bring back the “company doctor.” In the flat tax, a firm’s contribution for health insurance would not be deductible, but its payment for in-house doctors, nurses, and medical equipment would be deductible. The treatment of travel and food expenses might also cause problems. To the extent they are a cost of doing business, the expenses should be deducted in the flat tax. To the extent they are a fringe benefit, they should not. Making this determination may prove difficult.

Feld (1995) highlights a variety of additional concerns with the business tax, including the role of in-kind transfers to a corporation, the definition of a business input (and the possible need to exempt passive assets from the definition), and possibly complex rules for hedging transactions to distinguish those that are part of the business from those that are investments by the individual.

To be clear, all the concerns noted above (and others) could be resolved by writing carefully detailed rules covering each contingency. But of course that is what the current system already does. There is little reason to believe that the ultimate resolution of most of these issues will be simpler under the flat tax than in the current system. Feld (1995) concludes that to avoid losing revenues, the flat tax will either generate complicated business transactions (to skirt the simple rules) or complicated tax laws (to reduce the gaming possibilities), or both.

2. Compliance Cost Estimates

Slemrod (1996) and Hall (1996) have attempted to quantify the compliance costs of the flat tax. Both authors’ estimates ignore transition issues and the potential reemergence of social policy. Using the ADL model for taxpayer hours described above and valuing taxpayer time at $39.60 per hour, Hall estimates that the costs of recordkeeping, learning about the tax law, form preparation, and packaging/sending would equal $8.4 billion. The projected 93 million individual returns are estimated to take an average of one hour and eight minutes, while the projected 24.4 million business returns are estimated to take an average of three hours and 24 minutes.

Hall’s estimates seem both too large in some respects and too small in others. For example, valuing individuals’ time at $15 per hour and business time at $25 per hour, as Slemrod does, would reduce the estimate by about half. On the other hand, some of the time estimates seem implausibly low, and possibly off by orders of magnitude. Individual taxpayers are estimated to spend an average of 2.4 minutes per year doing record keeping for tax purposes. Businesses are estimated to spend only 2.3 hours per year on record-keeping for tax purposes.
Remarkably, especially in light of the discussion above on possible areas of complexity, businesses are estimated to spend an average of only 18 minutes learning about the tax law, and 24 minutes gathering all the relevant documents and preparing the return. In addition, Hall’s estimate leaves out many components of compliance costs, such as tax planning and auditing.

Slemrod concludes (1996, p. 375) that “it is impossible to confidently forecast the collection cost of the business part of the flat tax on the basis of observable systems, because none exists.” Instead, he offers an educated guess that the flat tax would cut business compliance costs (which were $17 billion in the individual income tax and $20 billion in the corporate tax) by one-third and cut individual filing costs by 70% (from $33 billion to $10 billion), for total compliance costs of about $35 billion. This is $35 billion less than his compliance cost estimate for the income tax, or about 0.5% of GDP in 1995.

## Appendix 3: The Tax Policy Center Microsimulation Model

This appendix summarizes the Urban-Brookings Tax Policy Center (TPC) microsimulation model, focusing on features used to undertake the analysis in this paper. The TPC model is similar in most respects to the large-scale microsimulation models employed by CBO (2018), JCT (2013), and the Department of the Treasury (Cronin 2022, Cronin et al. 2013, Power and Frerick 2016).

### A. SPECIFICATION

**Taxes covered:** The model covers all major federal taxes, including individual income, corporate income, payroll, estate and gift, and various excise taxes.

**Time period:** The model produces revenue and distributional estimates for a nationally representative sample of tax units for each year from 2011 to 2031. We focus on calendar year 2023.

**Coverage and unit of analysis:** The model calculates federal tax burdens for a representative sample of all tax units. A tax unit is defined as an individual or married couple that is required to file a tax return, or that would be required to file a tax return if their income were high enough, along with all dependents of that individual or married couple.

**Data sources:** The model’s primary data source is the 2006 Public Use File from the Statistics of Income Division of the Internal Revenue Service, which provides detailed information on federal income tax returns for more than 145,000 households from 2003 and 2006. A nationally representative sample is created in a series of steps where (a) non-filers and information on people’s age and other demographic characteristics are added to the files, based on statistical merges with the Current Population Survey; (b) the data are “aged” to represent 2019 income and demographics, using data from a variety of sources, and (c) a constrained optimization algorithm reweights the records to match an extensive set of about 100 national targets (Khitratrakun, Mermin, and Francis 2016). The inclusion of non-filers allows estimation of the distributional impacts of the corporate tax to include the impact on the wages of tax units who do not file returns.

Because the tax returns contain no direct information about wealth holdings, SCF data is used to impute, for each tax unit, ownership and amounts held for 18 categories of assets and debt and a comprehensive set of pension and retirement savings variables. By design, the SCF excludes the Forbes 400. To account for this, for each member of the list, the model creates a tax unit using the wealth data assigned by Forbes and demographic variables based on a matching procedure with other tax units in the tax return data.
Income classifier: A distributional model must have a classifier by which to rank households. A desirable classifier corresponds as closely as possible to a taxpayer’s economic well-being before taxes and is stable with respect to tax policy changes. Adjusted gross income (AGI), for example, is a poor measure by these criteria. It omits many forms of economic income, and its definition is not robust to some changes in tax law. More broadly, any income measure that closely aligns with tax rules will likely be a poor measure. Recognizing these concerns, in 2013, TPC developed an income concept called “expanded cash income” (ECI, Rosenberg 2013). ECI is a broad measure of pre-tax income. Besides AGI, ECI includes a variety of sources of cash income (e.g., employer and employee contributions to payroll tax and retirement plans, inside buildup in retirement plans, tax-exempt interest) as well as near-cash items such as SNAP (formerly food stamps) receipts and employer-provided health insurance and it includes an imputation of corporate tax liability, based on the corporate tax incidence assumptions discussed below. The CBO, JCT, and Treasury models use similarly broad income measures.36

Composition of Corporate Tax Base: In the TPC model base case specification, 60% of the corporate tax base is assigned to excess returns and 40% to normal returns. (Nunns 2012). Normal returns derive from the opportunity cost of delaying consumption and the reward for bearing risk and so are allocated to individuals based on items like interest income and a portion of equity returns. Excess returns come from several sources, including monopoly power, control of natural resources, luck, and other factors. Returns from corporate stocks (dividends and capital gains) are divided between normal and excess returns in a 40/60 ratio, the same ratio that the corporate tax base is divided, and allocated to individuals.

Incidence: The burden of income taxes and excise taxes are assumed to be borne by the payor. The burden of both employer and employee payroll taxes are assumed to be borne by the worker. The corporate tax on the normal return is split equally between all labor, in proportion to labor income, and all capital owners, in proportion to capital income, based on a review of the literature described in Nunns (2012). Taxes on excess returns are assumed to be borne by shareholders in proportion to their equity holdings, consistent with Cronin (2022), Cronin et al. (2013), Power and Frerick (2016), Nunns (2012), and others.

Behavioral Responses: The model allows for some behavioral responses, can provide estimates of revenue, distributional, and incentive effects of tax proposals. In this paper, however, because we examine changes in incidence assumptions rather than changes in policy, there are no behavioral or revenue effects in our analysis.

Distributional Measures: The model calculates several distributional measures for each scenario. In each case, we present the distribution of the corporate tax burden across ECI classes.
References


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Endnotes

1. It is not even clear, however, that Twain actually made such a comment about the weather. See https://www.bartleby.com/lit-hub/respectfully-quoted/mark-twain-18351910-17/.

2. For recent proposals, see the "Tax Filing Simplification Act of 2022," introduced by Elizabeth Warren (2022), and the 2018 Economic Report of the President (Council of Economic Advisors 2018, page 41).


4. For a PDF of the first income tax form, see 86626fd2c93c905f88f2668d09b19b28.pdf (taxfoundation.org). The 3 percent figure is based on Hollenbeck and Kahr (2008), who note that in 1917, the first year of the modern income tax, 3.5 million returns were filed (relative to a total US population of just over 103 million).

5. More than a fifth of filers who would be eligible for the EITC do not claim the credit (IRS 2022); it is unclear how much of this effect is due to complexity, taxpayer ignorance of the credit, people not having to file forms, or other factors.

6. An important caveat to all the reform proposals is that the simplification effects of the reforms are amplified if the states make corresponding reforms. Alternatively, much of the simplification effects of the third reform option, "Back to the Future," would be nullified if states did not reform their tax systems. Thus, if Congress chose to enact a reform like the third option, it would likely also want to include financial incentives for the states to make corresponding changes to their own income taxes.

7. As one simple example, the “flat tax,” as it was originally proposed, would have implicitly renegotiated every alimony agreement in the country by changing alimony payments from being deductible to the payor and taxable to the recipient to being nondeductible to the payor and non-taxable for the recipient. This could be addressed with a simple adjustment that maintained the then-current treatment. But if such an adjustment is made to reverse every change that a simple tax system would make relative to the existing system, one would end up back at the existing system.

8. Moreover, the relevant gains and losses due to simplification are social in nature, rather than private. Suppose everyone had to fill out five extra lines of the tax form to receive a $1,000 credit. Each person might regard that as "good complexity," worth the cost of providing extra information. But, holding overall tax revenues constant, the revenue would still have to be raised from somewhere — that is, everyone's tax "cut" would have to come from a higher initial (pre-credit) tax liability. As a result, net taxes would be the same as before, but taxes would be more complex. Thus, in this case at least, even though everyone might be willing to fill out five lines to get $1,000, the social perspective would indicate that such complexity is worse than useless if the government faces an overall revenue constraint.

9. Including the time and expenses that businesses incur for tax filing would more than double these cost estimates (Marcuss et al., 2013).

10. Benzarti and Wallossek (2023) provide a different definition of complexity, namely, the number of words in the tax code. They find that by this measure complexity has increased over time and across countries. They acknowledge that this measure may be flawed — for example, it might take more words rather than less to carefully and clearly explain a provision, which would make the tax system less complicated.

11. Another estimate placed total direct out-of-pocket costs at well over 1.6 percent of individual income tax revenue in 1989 – a figure that does not include the economic value of the 27.4 hours spent by each taxpayer preparing their return (Blumenthal and Slemrod, 1992). As a less formal but perhaps more compelling demonstration of tax complexity, for several years Money Magazine would ask 40-50 tax preparers to prepare a made-up relatively complex return. In a typical year, every tax preparer came back with a different amount of estimated tax liability. See for example https://money.cnn.com/magazines/moneymag/money-mag_archive/1992/03/01/87178/index.htm for the 'tax return test' from 1992.
The monetized burden of compliance is the sum of the out-of-pocket costs and the economic value of the time costs of filing. To combine the time and out-of-pocket costs into a single estimate of compliance costs in dollars, the time estimates must be monetized. The monetization method may have a large impact on the final results: methods like those in Fichtner et al. which monetize time more for higher-income taxpayers will necessarily find higher burdens at the top (and lower burdens at the bottom) than those that assume a constant value of time. There are good philosophical arguments for each position: see Tranmer et al. (2005) for a useful review of the literature in the context of health economics.

Note that these figures may be imprecise for higher-income households, as Marcuss et al. (2013) use a log-linear specification which tends to underestimate costs at the very top. See Contos et al. (2009) for a discussion of these issues. Moreover, their magnitude has almost certainly risen over time, and changes to the tax code driven by TCJA may have influenced the distribution of burdens in ways unaccounted for here.

Enforcement costs might be an issue if many people attempted to evade the tax, but that does not seem to be reason why this tax is not imposed more frequently than it is, so is ignored in this subsection.

See, for example, the discussion of the historical evolution of taxes on two-earner married couples, one-earner married couples, and singles in Holtzblatt et al. (2024).

See, for example, Intuit's opposition to tax simplification and return-free filing, detailed in Day (2013). For an academic treatment of this issue in the context of tax law, see Thorndike and Mehrotra (2018).

Slemrod (2005) shows that a measure of complexity in state income tax systems is positively related with legislators' salaries, a higher top tax rate, and liberal ideology of legislators, and negatively correlated with voter turnout. Improvements in computer technology have also facilitated complexity, by making filing easier (Bankman 2008, Walker 2022).

A $1 deduction reduces taxable income by $1, reducing tax liability by the marginal tax rate times $1. In contrast, a $1 credit reduces tax liability by a dollar, if the taxpayer has positive tax liability. If the credit is “refundable,” it reduces tax liability by $1, even if the taxpayer owes no taxes – that is, it increases cash paid by the government to the taxpayer by $1.

To see how this works, note that a married couple filing jointly with two children and wages of $100,000 in 2023 would have taxable income of $72,300 if they take the standard deduction, so they would be in the 12 percent tax bracket – that is the rate they would face on the next dollar of income. They would face gross income tax liability of $8,236 (the sum of 10 percent on the first $22,000 of taxable income and 12 percent on the next $50,300). They would be eligible for $4,000 in child credits, which would reduce their net tax liability to $4,236. However, if the same couple had income of $60,000 (taxable income of $32,300 after taking standard deduction), gross income tax liability would be $3,436. With a refundable CTC, they would receive the full credit amount, and have a net liability of $-564 – that is, they would receive $564 from the government. But if the credit were nonrefundable, their total tax bill would be lowered to zero but no further. In effect, they would only gain $3,436 from the $4,000 tax credit because their income was too low to receive the full benefit. Under current law, which is somewhere in between these extremes, $1400 of the credit is refundable per child. In practice, this means that most low-income families are still unable to claim the full credit (Goldin and Michelmore, 2022).

Many people confuse getting a refund with the issues regarding refundable credits. Taxpayers receive refunds when the amount of taxes that have been withheld exceed their ultimate tax liability. Refundable credits, in contrast, refer to whether the taxpayer can receive the whole tax credit even if the credit amount is larger than their pre-credit tax liability.

In 2023, the tax rate on most long-term capital gains (and qualified dividends) was zero for joint taxpayers with total taxable income of $89,250 or less, 15 percent for those with taxable income between $89,250 and $553,850, and 20 percent for those with taxable income above $553,850.

Journalist and commentator Michael Kinsley first coined the term "angel of death" (Kinsley 1987). To illustrate the loophole, consider someone who buys stock for $100. After 20 years, the stock is worth $1,000.
If the owner sells it at that point, the capital gains tax would apply to $900. If the owner instead dies at that point, no tax is paid on the $900 capital gain – by the owner or the inheritor, regardless of if or when the inheritor sells the asset.

More generally, the proposals have the same effect on federal and state budgets as the existing system. The broader issues with respect to budgets, as opposed to just revenue, stem from the fact that the value-added tax that is proposed below could change the price level.

See Joint Committee on Taxation (2001), President’s Advisory Panel (2005), and Treasury (2003), among others.

One common argument is that part of the capital gain is due to inflation and is thus not income. However, the tax preferences for capital gains apply to long-term capital gains (those held for more than a year) and the share that represents inflation generally falls as the holding period lengthens (Burman 2010). Moreover, adjusting all forms of capital income and expense for inflation (e.g., the mortgage interest deduction would be reduced) would add substantial complexity.

See https://www.irs.gov/pub/irs-pdf/p550.pdf pp. 48-68. For an example of the complexity of these rules, see the discussion of “Long-term debt instruments issued after May 27, 1969,” which reads as follows: “If you hold one of these debt instruments, you must include a part of OID [Original Issue Discount] in your gross income each year you own the instrument. Your basis in that debt instrument is increased by the amount of OID that you have included in your gross income... If you sell or trade the debt instrument before maturity, your gain is a capital gain. However, if at the time the instrument was originally issued there was an intention to call it before its maturity, your gain is generally ordinary income to the extent of the entire OID reduced by any amounts of OID previously includible in your income.” This is by no means a cherry-picked example: many provisions are similarly complex, primarily to avoid income-shifting abuse.

Nevertheless, it is worth pointing out that in recent years, the government has resorted to direct payment to individuals of rebates (for example, in 2009) or crisis payments (for example, in 2020). Those efforts would be harder to implement in a short time period if people did not regularly file tax returns.

This estimate is derived from the TPC estimate of the revenue raised by a VAT, about $1 trillion (see Table 3) divided by estimated 2023 GDP of $26,238 (CBO 2023).

For a complete model summary, see https://www.taxpolicycenter.org/resources/brief-description-tax-model.

Most notably, Intuit settled for over $140 million amidst reports of this behavior: see e.g., https://www.nbcnews.com/business/consumer/turbo-tax-settlement-how-to-receive-payment-rcna27474.

This Appendix is based largely on Fichtner, Gale, and Trinca (2019). See also Department of the Treasury (2003), Gale (2009), Gale and Holtzblatt (1997), and Goolsbee (2006).

The flat tax is a bifurcated value-added tax. The business base is all value-added except wages, which are taxed at the individual level.

For a complete model summary, see https://www.taxpolicycenter.org/resources/brief-description-tax-model.

The 2006 PUF was the most representative available PUF when TPC revised the tax model’s core data file in 2015. The PUF for 2007 was judged to be from too much of a "boom" year and the one from 2008 was judged to be from a recession year.

On average, ECI is about one-third larger than AGI. The percentage difference between ECI and AGI steadily declines as ECI rises, with ECI being almost double AGI in the bottom income quintile (measured by ECI) compared to about 18 percent higher in the top 1 percent. The biggest difference between ECI and a Haig-Simons measure of income is that the latter would include unrealized capital gains on housing, financial assets, and businesses.