

# Radical Simplification of the Income Tax: Issues and Options

William Gale

Brookings and Urban-Brookings Tax Policy Center

March 19, 2024

# Introduction

Taxes have always been “too complicated”

- Adam Smith
- 1913 income tax
- Jimmy Carter
- William Simon

This is a good time to talk about simplification

- Tax season
- 2025 right around the corner

Spoiler Alert: No magic bullet

Brookings and TPC do not take Institutional positions

# Outline

- Four overarching themes
- Four caveats
- Four questions
- Four proposals
- Four conclusions

# Four Overarching Themes

- Massive potential for simplification
- No such thing as “just” simplifying the system
- Simplifying “taxes” versus “interactions with the government”
- Key question: Marginal (social) value of complexity

# Four Caveats

Focusing on simplification related to

- Federal taxes, not state
- Individual income tax, not corporate
- Costs for individuals, not the IRS
- Most people, not all

## Question 1: Why are taxes complex?

- Why don't we just have the simplest system – a head tax?
- Trade-offs among policy goals
- Lobbying process
- Hard to measure
- The world is complicated (Finance, Childcare)

## Question 2: How should we measure complexity?

- Standard metrics
  - Sum of administrative and compliance costs (Slemrod 1984)
  - Number of words in the code (Benzarti)
- Conventional and useful measures, but not ideal

## Question 2: How should we measure complexity? (continued)

- Unconventional metric
  - A survey by Cash App [shows that 54%](#) of Generation Z and 38% of Millennials report that the stress of filing taxes has either brought them to tears in the past or they expect tears this year.
  - One in four Gen Z-ers reported a need for help from a therapist to recover from the experience



## Question 3: Why is complexity a problem?

- Imposes tangible costs on individuals
  - 3-17% of income tax revenues
  - Regressive, but larger absolute costs among high-income households
  - Higher in the US than other countries (b/c of social policy in the tax code)
- Creates intangible costs
  - Can facilitate avoidance and evasion (and reduce ability to achieve policy goals)
  - Can make people think that others are (unfairly) avoiding and evading
- People are willing to pay for simpler taxes, but not that much
  - \$130, on average, about what a commercial tax preparer charges (Benzarti)

## Question 4: Which features of the code affect complexity?

- Structural
  - Base – Broad versus Narrow
  - Rates – Flat versus Graduated
  - Deductions, credits – Universal versus Targeted
- Administrative
  - Withholding at source
  - Filing practices – pre-populating or no-return systems

## Four proposals

- Apples-to-apples comparison with the current system
  - Each option is revenue- (or budget) neutral relative to 2023 system
- Each is more progressive than the 2023 system
- Good ideas, hopefully; but not cure-alls
  - Help illustrate the trade-offs
  - Meant to be a menu of options

# Proposal 1 – Simplified Income Tax

## Repeal

- All itemized deductions
- All preferential rates – capital gains, dividends, section 199a
- Alternative minimum tax
- All credits
- Head of household filing status

## Introduce

- Personal credit – \$1,000 per person, including children
- Work credit – 20% of one's earnings up to 20k, phased out by \$40k
- Both are fully refundable

# Simplified Income Tax – Continued

- The tax calculation process is simplified
  - Choose filing status – Married or Not
  - Report sources and amounts of income
  - Claim standard deduction, personal credit(s), and (if applicable) work credits
  - Look up tax amount
- Notes
  - Still a progressive income tax
  - Still provides support for low-income HH, HH with children, and work
  - Still “high end” complexity

# Itemized deductions

- The higher standard deduction introduced in 2017 means that ID are used predominantly by high-income households.
- Mortgage Interest:
  - Mainly raises prices not homeownership rates
  - If structured as a “homeowner welfare” spending program, it would be embarrassing
- Charitable contributions:
  - Hardest call, could consider modification

# Preferential rates

- Capital gains
  - Lower CG rates are the mother of all tax shelters
  - Revenue estimates include change in realization behavior
  - Broader reform could include taxing capital gains at death
- Section 199a
  - Intended to create parity with respect to corporate rate but is:
  - Expensive
  - Extremely regressive
  - Complex
  - Inconsistent with horizontal equity with respect to wages

## Head of household/EITC/CTC

- HOH benefit structure rises with income
- EITC
  - Comingles work and child benefits
  - Complex rules and phaseout
  - Low benefits for childless workers
- CTC does not reach many families because their income is too low



# The new personal credit and work credit

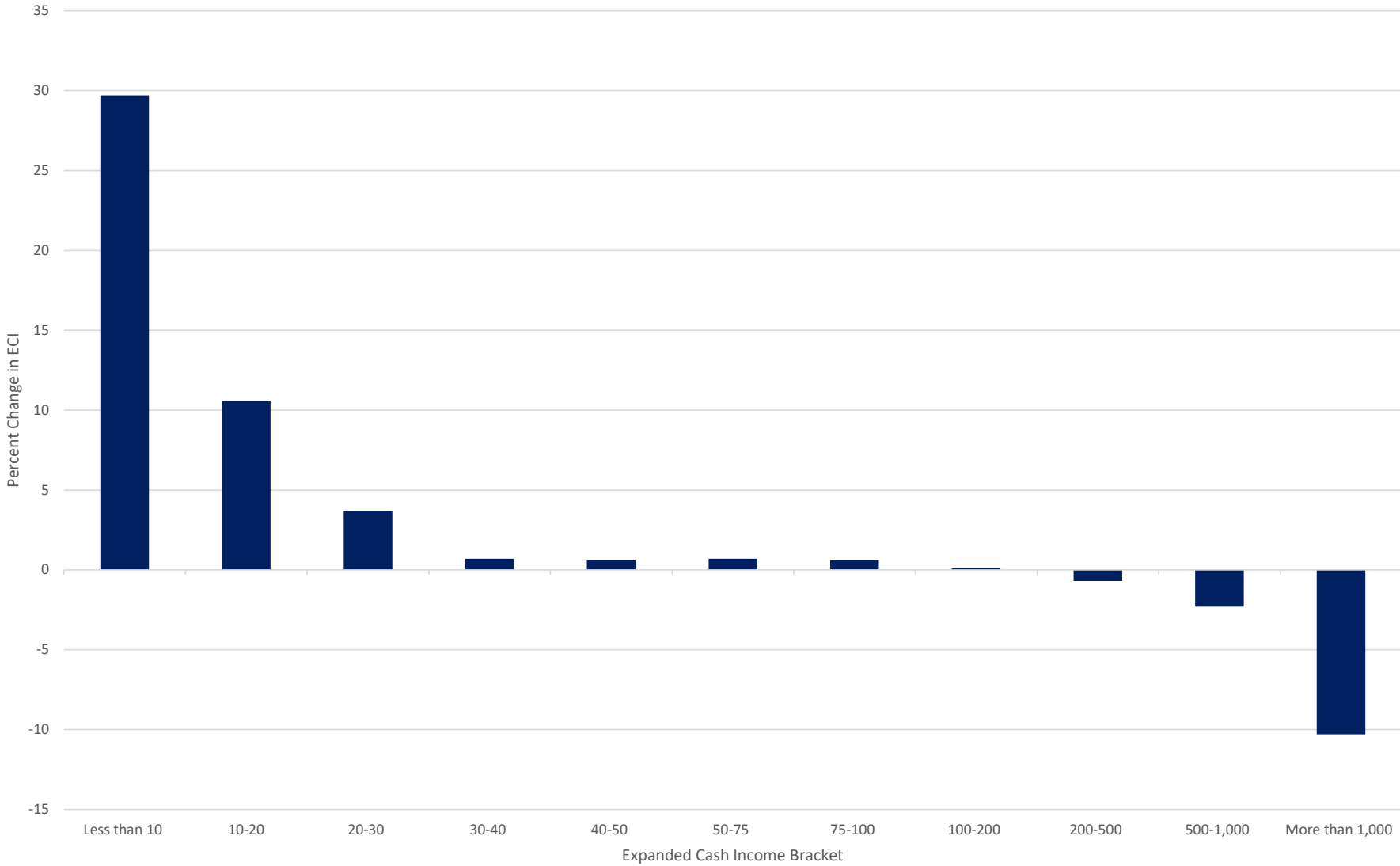
## Personal credit

- \$1,000 per person (including children) in Proposal 1
- Fully refundable / mini version of Universal Basic Income (UBI)

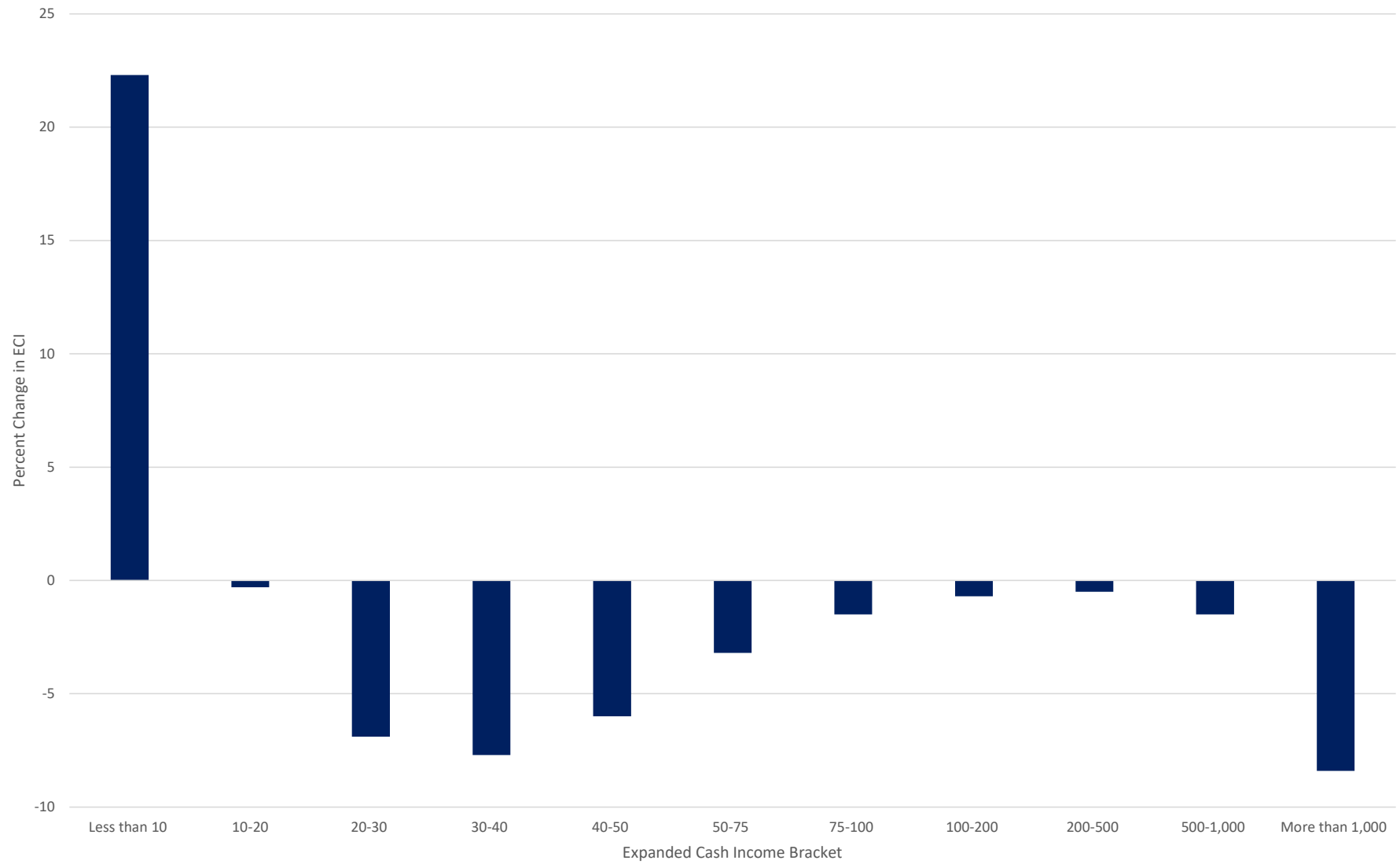
## Work credit

- Depends only on individual earnings
- Could be administered entirely outside the income tax
- But some high-income households would receive it

Simplified Income Tax: Effects on All Filers



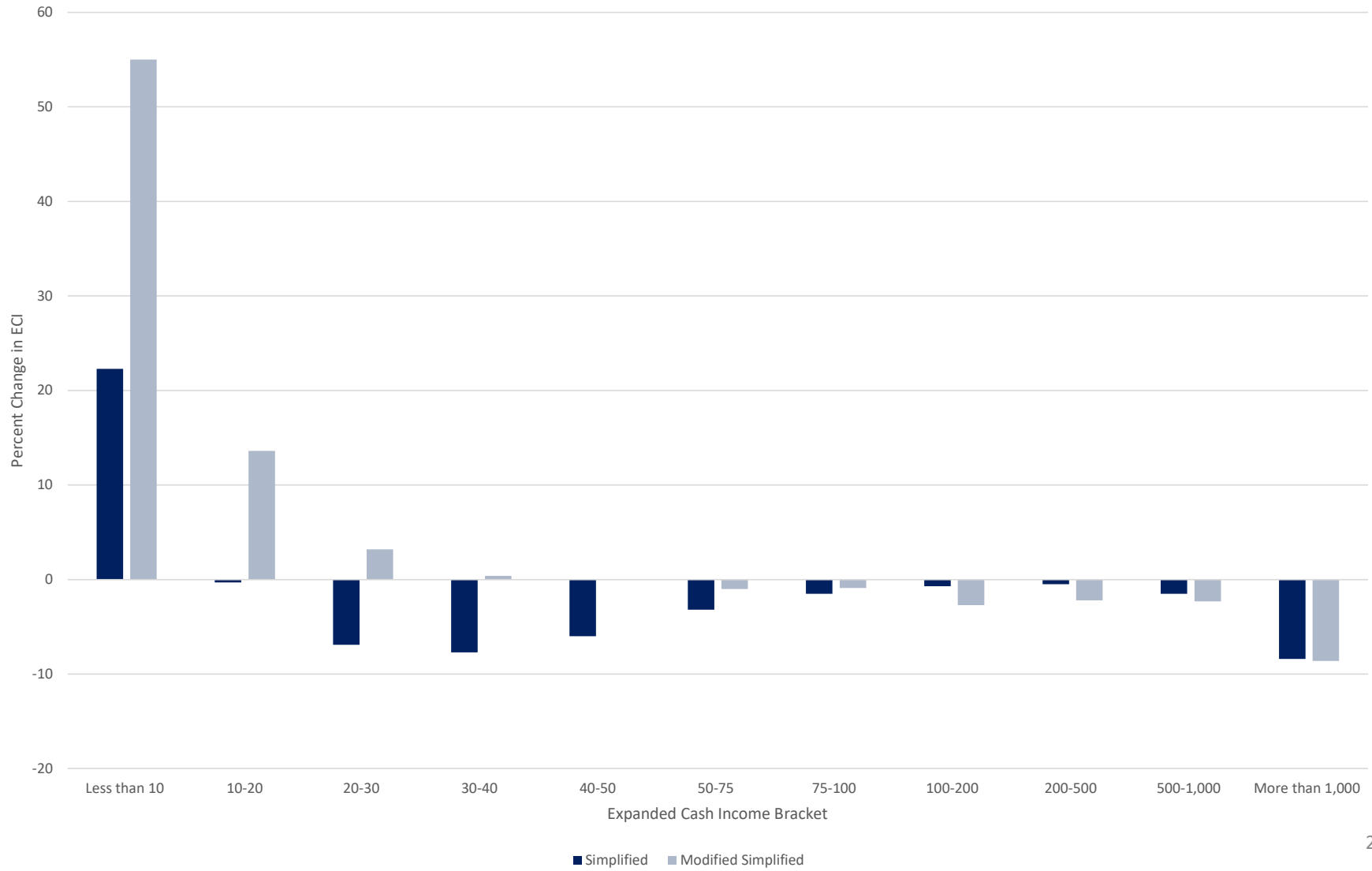
### Simplified Income Tax: Effects on Filers with Children



## Proposal 2 – Modified, Simplified Income Tax

- Same as Proposal 1, except
- Personal credit is \$2,000 per person
  - Phase out starts at 72k married (36k single) at a rate of 0.4
  - E.G., phase out is complete at 92k (married, two kids)
- Trade-offs

### Modified Simplified Income Tax: Effects on Filers with Children



## Proposal 3 – Back to the Future (based on Graetz 1997)

- Same changes as in Proposal 1
- Raise the standard deduction to \$100k married (\$50k single)
- Create a 10% VAT
- To make those changes work, in terms of revenue and distribution:
  - Raise all <25% tax rates to 25% (to apply to income above 100k/50k)
  - Raise the personal credit to \$2,800

# Raising the Standard Deduction

- A simple way to remove many people from the need to file tax returns
  - Filing requirements typically key to SD amount
  - TCJA raised the standard deduction and substantially reduced the probability of itemizing
- With an SD of \$100k / \$50k, almost two-thirds of all tax filing units would not need to file
  - Would make the income tax a levy on middle- and upper-income households
  - More like what it used to be (hence “Back to the Future”)

## Value-Added Tax (VAT)

- Sales tax collected in chunks at each stage of production (rather than all at the retail stage)
- In place everywhere except the US
- Substantial revenue
- Does not distort saving, investment choices
- Administrable, enforceable
- Needs to have a broad base to remain simple (New Zealand, not Europe)



## Proposal 4 – “UBI”

- Same as Proposal 3, except
- Don’t raise the standard deduction
- Instead, raise the personal credit to \$3,900
  - (compared to \$2,800 in Proposal 3)

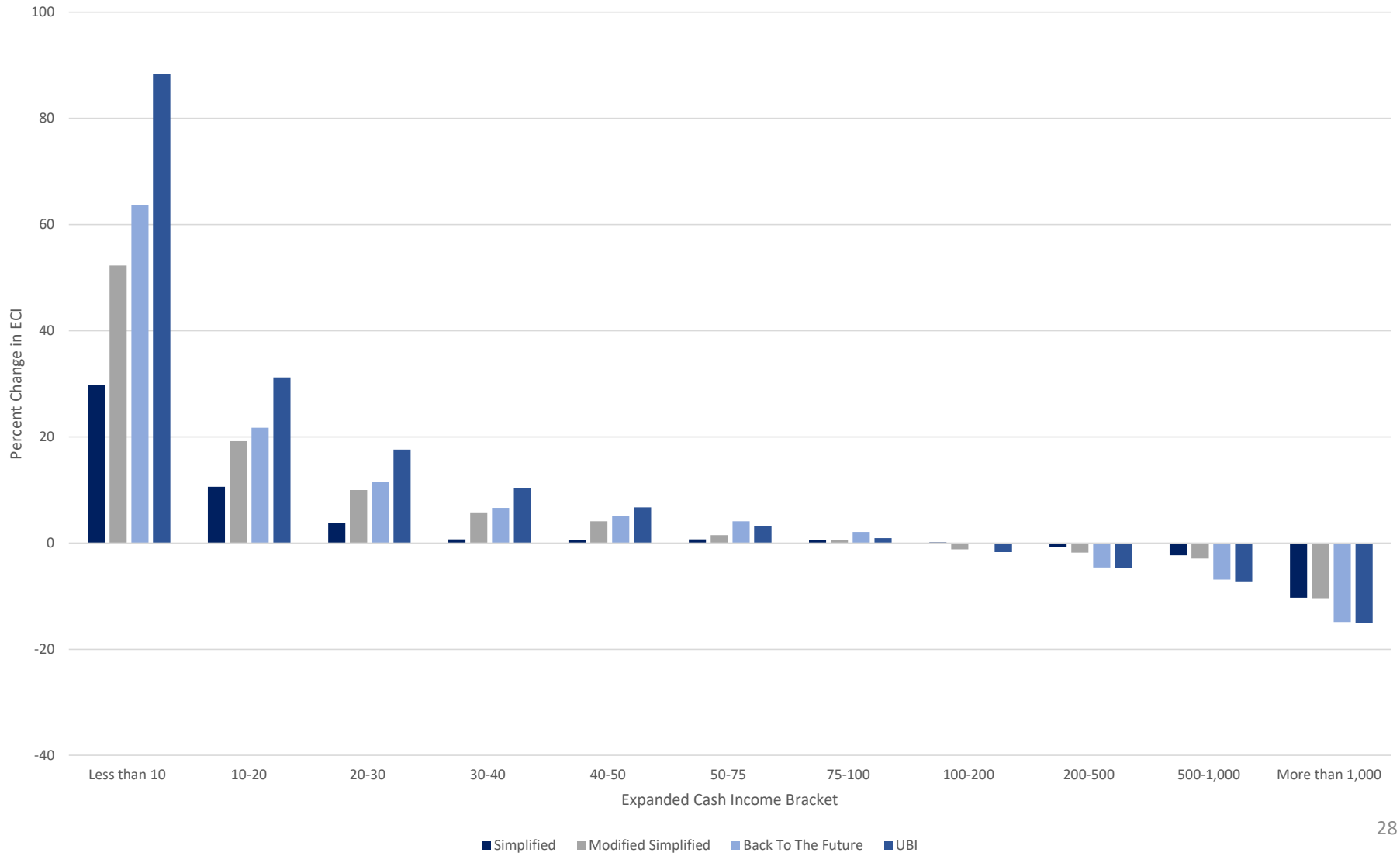
# Universal Basic Income

- All the proposals contain refundable credits, which are UBI's, so it is a matter of degree to call this proposal a UBI.
- Under Proposal 4, a family of four would receive \$15,600 per year before having to pay income tax and VAT.
- UBIs have attracted support from the right and the left
- Supported by many recently in the context of using carbon tax revenues

# Four proposals

	<i>Simplified Income Tax</i>	<i>Modified Simplified Income Tax</i>	<i>Back to the Future</i>	<i>Simplified Income Tax, VAT, UBI</i>
Repeal itemized deductions	x	x	x	x
Repeal section 199a deduction for business income	x	x	x	x
Repeal preferential rates for capital gains and dividends	x	x	x	x
Repeal all personal income tax credits	x	x	x	x
Repeal head of household filing status	x	x	x	x
Repeal individual alternative minimum tax	x	x	x	x
Introduce refundable work credit	x	x	x	x
Introduce refundable personal credit	\$1,000	<b>\$2,000 but phased out</b>	<b>\$2,800</b>	<b>\$3,900</b>
Increase the standard deduction			<b>to \$100k for couples</b>	
Introduce 25% minimum tax rate bracket			<b>x</b>	<b>x</b>
Introduce a 10% value-added tax			<b>x</b>	<b>x</b>

### Effects of All Simplification Proposals



# Effects on complexity

- Filing requirement – if income is above the standard deduction
  - About 22% of tax units avoid having to file under current law
  - Under proposal 3, about 64% would avoid having to file
- Record-keeping requirements
  - A major part of compliance costs (Slemrod, Benzarti)
  - Would be reduced substantially under all four proposals
- Ability to have return “successfully” pre-populated would rise dramatically
  - People are willing to pay for pre-populated returns (about \$77)
  - Both liberals and conservatives willing to pay (Benzarti and Wallossek)

## Four Conclusions

- We know how to do simplify taxes
- Simplification (and Direct File) would help a lot of people
- If simplification were easy politically, it would already have been done
- But everything is on the table in 2025 and simplification is a better idea than many others floating around.

## Some Resources

- TAX CALCULATOR:

- <https://tpc-tax-calculator.urban.org/>

- PAPER:

- <https://www.brookings.edu/articles/radical-simplification-of-the-income-tax-issues-and-options/>

# Calculating Income Tax

