

The Flat Tax

Background

Since 1945, the U.S. federal tax code has grown from 8,200 pages to almost 72,000 pages.ⁱ According to an April 2011 report by the Laffer Center for Supply-Side Economics, individuals and business collectively spent more than 6 billion hours complying with this code, at a cost of \$431 billion per year.ⁱⁱ As the code has grown in length and complexity, it has also allowed those with strong political connections and deep pockets to get special breaks that are unavailable to average workers and businesses.ⁱⁱⁱ

Because of the problems of complexity and inequity with the current tax code, there has been considerable interest over the past 20 years to move to a simpler and fairer tax code. One solution is the flat tax which treats all taxpayers equally by requiring them to pay a fixed tax rate, regardless of their level of income.

What is a Flat Tax?

A true flat tax would be one tax rate that is applied to all income with no exceptions. Unlike progressive or regressive taxes, which vary according to income, flat taxes are enacted at one constant rate, usually 20 percent or less. While many flat tax plans have been proposed over the last two decades, most of them have several features in common:

- A single flat rate: Most flat taxes have a single rate of less than 20 percent. By doing this, flat taxes avoid the problem of high marginal tax rates by reducing penalties against work, risk taking and entrepreneurship.
- Simplicity: Complexity is a hidden tax that requires record-keeping, form preparation, lawyers, accountants and other resources to comply with the current system.

ISSUE SNAPSHOT

A true flat tax would be one tax rate that is applied to all income with no exceptions.

A flat tax would not tax savings and investment, promoting job creating and capital formation.

Only income earned inside the national borders of the United States would be taxed.

- Elimination of special preferences: With a flat tax, there are no provisions that give preferential treatment to particular persons, businesses, or activities. Politicians could no longer pick winners or losers, reward friends or punish enemies. By eliminating these preferences, much of the problem of tax complexity is solved.
- No double taxation of saving and investment: Under the current federal tax code, Americans are double taxed on their capital gains, their savings, their dividends, and even when they die. A flat tax taxes income only once, which promotes more job creation and capital formation.
- Territorial taxation: With a flat tax, only the income earned inside the national borders of the US would be taxed. By doing away with “worldwide taxation,” businesses and individuals could compete on a fairer playing field around the world.
- Family-friendly: The only “loophole” in most flat tax plans is for family size. In this case, larger families would have a larger exemption, allowing them to not pay taxes until their annual income reached a certain level, such as \$30,000 or more.

GUIDE TO THE ISSUES

How Would a Flat Tax Affect Alabama?

While the specific benefits of a flat tax to Alabamians would depend upon the model that was ultimately adopted, several calculators have been developed to illustrate the differences in federal taxes that would be paid.^{iv}

In 2009, the median income for a family in Alabama was \$50,779.^v Under the current tax code, a married couple with two children filing jointly in a 15 percent tax bracket would have to pay \$5,292 (see Table 1).^{vi} With the three other flat tax models—the Arme y, the Forbes, and the Gramm—their taxes would be only \$2,971; \$2,376; or \$2,445 for a savings of between 44 percent and 55 percent. Interestingly, all three models tax at a higher rate—17 percent for both the Arme y and Forbes models, and 16 percent for the Gramm—yet because of the flat rate, the typical family would keep as much as \$2,900 of their income. Similar savings apply to single parents and families without children.

Table 1: Effects of Flat Tax on Federal Income Taxes, by Family Type

Family Type	Income	Federal Taxes Owed			
		Current System	Arme y Flat Tax	Forbes Flat Tax	Gramm Flat Tax
Married Couple Filing Jointly, Two Children	\$50,779	\$5,292	\$2,971	\$2,376	\$2,445
Single Parent, One Child	\$30,000	\$2,925	\$1,675	\$1,972	\$1,680
Married Couple Filing Jointly, No Children	\$80,000	\$14,390	\$9,741	\$9,146	\$8,720

Arguments against a Flat Tax

Although the flat tax is a significant improvement over the existing tax code, it is not perfect:

- By expanding the tax base to include every level of income, the tax burden shifts from those who are most able to pay—the rich—to those are least able to pay—the poor.
- Because interest and dividends are no longer taxed, the “idle rich” can continue to grow wealthier while the working population—the lower and middle

class—supports them. Some flat tax programs avoid this issue, though, by offering exemptions or tax credits for low-income households.^{vii}

- If a pure flat tax was enacted which did not offer deductions for charitable giving, it is possible that such giving could decrease. However, charitable giving could also increase because taxpayers would have more disposable income at their discretion.^{viii}

There will never be a tax that is good for the economy. But the flat tax moves the system much closer to where it should be—raising the revenues that government demands, but in the least destructive and least intrusive way possible.^{ix}

ⁱ “The Growing Complexity of the U.S. Federal Tax Code.” Political Calculations (website). March 11, 2010. Available at <http://tinyurl.com/3v9khaw>. Access verified May 3, 2011.

ⁱⁱ Arthur B. Laffer, Wayne H. Winegarden, and John Childs, “The Economic Burden Caused by Tax Code Complexity.” Laffer Center for Supply-Side Economics, April 2011. Available at <http://tinyurl.com/5swbymf>. Access verified April 15, 2011.

ⁱⁱⁱ Daniel Mitchell, “A Brief Guide to the Flat Tax.” The Heritage Foundation, *Backgrounder #1866*, July 7, 2005. Available at <http://tinyurl.com/27q57oa>. Access verified May 3, 2011.

^{iv} “Arme y / Forbes / Gramm Tax Proposal.” www.mortgage-calculators.org (interactive website). Available at <http://tinyurl.com/3le2z3t>. Access verified May 3, 2011.

^v “Table B19001: Household Income in the Past 12 Months (in 2009 Inflation-Adjusted Dollars).” U.S. Census Bureau, American Community Survey (interactive database). Available at <http://tinyurl.com/ufd9>. Access verified May 3, 2011.

^{vi} These calculations assume the following: deductions = \$7,000; exemptions = \$10,000; taxable income = \$35,279; tax bracket = 15 percent.

^{vii} Tony Moreno, “What is a Flat Tax System?” About.com (website). Available at <http://tinyurl.com/63kmydp>. Access verified May 3, 2011.

^{viii} “The Flat Tax: Is it Really All Bad?” The Political Panorama (blog). Available at <http://tinyurl.com/3khj9qs>. Access verified May 3, 2011.

^{ix} Daniel Mitchell, “Flat Tax is the Way of the Future.” The Heritage Foundation, Commentary, March 20, 2006. Available at <http://tinyurl.com/3c4hptx>. Access verified May 3, 2011.