Flat Tax Reform: Implications for the United States

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Abstract

Flat tax reform is a policy ideal that has garnered significant attention and criticism since Hall and Rabushka (1985) published their first treatise on the matter. Over the course of the following decades, an abundance of flat tax proposals have emerged that pay homage to their seminal work. Topics examined will include the politics of tax reform, modern principles of taxation, tax reform lessons from other countries, an overview of American tax policy, including critiques of the current system, introduction of the flat tax, and contemporary flat tax proposals.

Introduction to the Flat Tax

In its earliest and most complete form, the flat tax emerged in the early 1980s from Hall and Rabushka (1985) of the Hoover Institution (Gale, 1999). Their seminal work is considered the starting point for discussion of flat tax policy.

The Hall-Rabushka Flat Tax

When Hall and Rabushka (1985) went public with their vision for taxation in the 1980s, they garnered significant attention, specifically for the part of their tax proposal that stated individuals and businesses could file their returns on a form the size of a postcard. Compared to the current tax system that amounts of more than 9 million words, such a claim seemed ludicrous (Forbes, 2005).

According to Gale (1999), the cornerstone of their initial proposal involved levying a 19% tax on all business income, with deductions for wages, pension contributions, materials costs, and capital investments. They proposed a 19% income tax on individual wages and pension benefits on incomes over $25,500 for a family of four, and recommended no other tax, or deductions (1999). This author notes that the scope and originality of their proposal made it an effective blueprint for future flat tax proposals such as the one introduced by Representative Richard Armey (R-TX), Senator Richard Shelby (R-AL), and former presidential candidate Steve Forbes (R).

In addition to these proposals, Princeton Economist David Bradford authored a plan that would add progressivity on the individual income side and match a flat rate on the corporate side equivalent to the highest individual bracket. The key takeaway is the impact of the Hall-Rabushka (1985) tax plan in directing discussion about tax reform. Compared to spending several hours each year filing taxes, most Americans would find such a tax proposal which simplifies forms and saves them money very attractive. However, the latter part of this equation sparks a majority of the political angst over tax reform.

Evaluating the Flat Tax

When evaluating the flat tax, or any tax for that matter, the key question is relatively simple: who will benefit and who will not? For example, under most flat tax systems, lower income families and individuals are no longer eligible to receive an array of tax credits and subsidies reflecting their low income status and therefore do not obtain a net benefit (1999). Their tax situation changes dramatically under a flat tax because, instead of receiving a net gain in governmental tax benefits, low-income brackets are now subject to an income tax that demands the same percentage of tax required of those in the top tax bracket. Even if such a tax system seemed *fair*, critics claim they are prohibitively regressive, as they force low-income earners to bear a disproportionately large share of tax liability. Such a tax arrangement is unacceptable for more progressive liberals.

Flat tax regressivity. This term harkens back to partisan criticism from Left-wing legislators and economists who posit that any regressive tax system is bound to harm the poor because it extracts a greater percentage of tax from low-income taxpayers. While it is difficult to argue against the regressive nature of flat tax approaches, a degree of subjectivity surrounds the claim that the poor are harmed. For example, many flat tax approaches establish an exemption threshold designed to maintain a 0% income tax rate for America’s lowest earners. Because of this setup, adverse tax consequences are mitigated for the bottom brackets. However, in the minds of many policymakers, the dichotomy between winners vs. losers is expanded to include *wins-the-most* vs. *wins-the-*

least. Though difficult for many people to grasp, a simple example comparing a progressive tax with a flat tax approach should clarify the difficulty.

Consider a progressive income tax system with three brackets: 12% for the bottom bracket, 18% for the middle bracket, and 25% for the top bracket. Imagine a state legislature has just approved a flat tax system that replaces the current progressive code with one all-encompassing 11% bracket. Under such a system, each of the income brackets *benefits* because they are required to pay a smaller share of their income to their state government. Nevertheless, some legislators will voice opposition, claiming that a flat tax is regressive because it imposes a greater financial burden on the bottom tax bracket; every taxpayer is now subject to the same income tax rate, and the highest earners have gained an unfair advantage over their poorer counterparts. This simple example highlights the fact that even in a tax proposal where everyone wins in the form of paying less taxes, someone always loses. The constituency who *loses*, of course, is the group that *wins the least*. Thus, tremendous subjectivity exists in the process of determining winners and losers in tax reform.

The Politics of Tax Reform

Before an analysis of comprehensive tax reform can be conducted, it is important to first discuss the current political landscape. In her article "The Politics of Tax Reform," Tammy Frisby (2013) examines many of the political factors that could hinder or promote the enactment of sweeping tax reform. She notes that, since 1986 — the last time comprehensive tax reform was accomplished — there have been more than 15,000 updates to the U.S. tax code. Based upon this information, she argues that the United States has relied upon a binge of temporary tax policies to promote long-term economic growth. In addition, *tax extenders* — a set of tax provisions that mostly impact businesses — along with the Bush tax cuts of the last decade, reflect the deep, partisan rifts that make consensus tax reform such a challenging endeavor (2013). This current legislative predicament serves as a backdrop to determine the feasibility of various potential tax reforms.

The Fiscal Cliff

While the fiscal cliff of 2013 has already passed, it still represents the reliance America's legislators placed upon small, temporary tax reforms to spur economic growth. Frisby (2013) provides detailed financial statistics on what the fiscal cliff once entailed. Specifically, these tax changes included increases in marginal income tax rates and expiration of tax provisions such as the American Opportunity Tax Credit, Child Tax Credit, itemized deduction and personal exemption phase-outs, and the 2 % payroll tax holiday (2013). She surmised that this bevy of expiring temporary tax provisions could catalyze discussions about enacting permanent tax reform. Further progression, however, may be dictated by the end goals Congress sets for this reform effort.

Additional Revenue vs. Revenue Neutrality

There is considerable debate on whether tax reform efforts should focus on raising additional revenue or being revenue neutral. According to Dubay and Burton (2015), sound tax policy reform should not become a vehicle to raise additional government revenues. Instead, tax reform should set specific revenue targets that are benchmarked to traditional historic or economic metrics. Frisby (2013) believes this debate poses the greatest difficulty for advancing a comprehensive tax policy. She explains that prior to the comprehensive tax reform of 1986, Congress agreed on the ultimate goal of revenue neutrality — that is, domestic tax reform should neither increase nor decrease federal tax revenues. Thus, the overarching question answered by the 1986 deal was how to *redistribute* the total tax burden (2013). However, since 2013, political factors exist that make the net revenue question difficult to answer.

Simply stated, since 1986, the legislative obstacles to answering this question have fallen on bitter, partisan divides. Frisby (2013) notes that Democrats have determined that tax reform ought to be a vehicle to address a revenue shortfall that threatens their policy agenda. Therefore, tax reform that raises additional federal revenue has become their new sacred policy. Republicans, on the other hand, are vehemently opposed to the notion that Capitol Hill needs more taxpayer money. Instead of focusing upon a revenue shortfall, America must address spending excesses, and a tax system that punishes its most productive members. Clearly, both parties are at odds regarding the ideological framework that should guide tax reform.

Static vs. Dynamic Scoring

Another significant and somewhat partisan question surrounding tax reform is whether static or dynamic scoring should be used to determine the effects of proposed tax policies. Frisby (2013) describes dynamic scoring as a long-term forecasting approach that includes variables such as changes in individual and firm behavior, attributable to tax incentives. Dynamic scoring attempts to predict macroeconomic variables such as GDP growth and has found favor among conservative legislators and supply-side economists who contend it creates a more complete picture from which to evaluate proposed fiscal policy (2013). However, there are other reasons to consider relative to the partisan breakdown over static and dynamic scoring.

Since dynamic scoring incorporates broader economic variables and concludes that tax rate reductions will lead to increased economic growth and by default, increased tax revenues, Republicans generally support it because it matches their economic worldview (2013). Unfortunately, for those on the political right, dynamic scoring is not the approach leading fiscal authorities use when evaluating tax reform. According to Frisby (2013), the Congressional Budget Office (CBO) employs a method of analysis that, while accounting for changes in individual and firm behavior, does not factor additional change in key macroeconomic variables (notably GDP growth). Thus, another legislative battle could ensue over replacing the CBO's static method with the more supply-side-friendly dynamic approach.

Corporate vs. Individual Tax Code Reform

In addition to disagreement relative to temporary tax provisions, revenue neutrality, and dynamic scoring, another issue that plagues tax reform efforts is determining the relationship between individual and corporate tax reform. Frisby (2013) notes that in 1986, when a dual approach to tax reform was accomplished, net revenue neutrality was sought across both halves of the tax spectrum. She adds that in practical terms, this strategy resulted in corporations receiving a $120 billion tax penalty over five years in order to absorb rate reductions on the individual side. There are a few reasons why such an approach would be difficult to execute today.

First, there is bipartisan consensus that America's current corporate tax system stifles competition in the international marketplace (2013). Therefore, it is reasonable to assume that any attempt at comprehensive tax reform would include reducing the corporate tax burden. Should revenue neutrality become the goal of future tax reform, such an approach would need to address the question of the rate of corporate taxation necessary to offset individual tax revenues. In other words, how much more are individuals, and businesses that file in the same category, going to be taxed? According to Frisby (2013), the answer to this question would depend upon how tax reform is distributed across various sections of the individual tax code.

Different policies impact the amount individuals ultimately contribute in taxes, but according to Frisby (2013), there are four provisions that will prove difficult to legislate around: the capital gains rate, the home mortgage interest deduction (MID), the Alternative Minimum Tax (AMT), and the Earned Income Tax Credit (EITC). The capital gains rate is of particular partisan relevance. She notes that Democrats view rate increases in this category as a lucrative revenue-raising opportunity, while Republicans view such a strategy with disdain. The MID also presents bipartisan wrangling. Frisby (2013) comments that reducing this deduction could reduce the total real estate value of a home — a move that could trigger a lobbyist backlash. Removing the EITC — a provision that enables millions of lower-income Americans to avoid paying taxes — though it would augment federal revenues, pruning this tax provision would appear to put Capitol Hill at odds with America's working poor (2013). For these reasons, advancing meaningful tax reform at the individual level is fraught with challenges.

State vs. Federal Prerogatives

The relationship between federal and state interests is another issue to consider when advancing tax reform. The most recent economic crisis in 2007 prompted some state governments to raise taxes to address budgetary shortfalls (2013). Under current law, individuals are allowed to deduct state income taxes from their adjusted gross income in their federal tax forms (2013). However, a popular measure to squeeze more revenue from individual taxpayers involves reducing or eliminating this deduction, which essentially raises the taxable income of many Americans (2013). The conflict of interest arises when legislators from high-tax states, seeking to protect the earnings of their constituents, fight to keep this deduction. This is another hurdle legislators must overcome in their efforts to build consensus around comprehensive tax reform.

Why Tax Reform is Challenging

These previous examples demonstrate that tax reform is challenging — plain and simple. Howard Gleckman (2016), a *Forbes* contributor, highlights the dichotomy between tough talk and making tough decisions when it comes to tax reform. To construct the situation, he reminds readers about the recently introduced GOP tax platform of June 2016. In this plan, calls to simplify the current tax system through three tax brackets instead of seven, rate cuts, and subsidy expirations abound. Gleckman (2016) notes further that subsidies to citrus farmers, nuclear power plant operators, irrigation and ditch companies, and Olympic medalists are among the several new subsidies being approved by the GOP. In this situation, GOP talk fails to match GOP action, hence the title of his article: “How Dead Citrus Trees Beat Tax Reform Every Time.”

In spite of the incongruence between calls for tax reform and legislation that actually make it to the Oval Office, good intentions abound in this policy arena. For example, in their 2016 tax platform, “A Better Way,” House Republicans agree that special interest deductions and credits pose a serious problem, as they incentivize businesses to base strategies on tax law as opposed to free market economics. Due to these current circumstances, they assert that a tax-driven reallocation of resources actually misallocates productive capital, dampens economic growth, and negatively affects public perceptions of tax law fairness. There are a few important takeaways from this GOP platform, specifically the assertion that many tax deductions and credits distort free market economics by altering or incentivizing business and individual behavior. This concept will be discussed in further detail; however, the claim that such policies ultimately cause a misallocation of financial capital represents a position held by a large contingency of scholars and economists. Therefore, it will continue to be revisited throughout the course of this paper.

Modern Principles of Taxation

Amidst all of the political wrangling over tax reform, there ought to exist a set of bipartisan principles that unite decision makers in their efforts to advance change. Stefan Mihu (2011) addresses this concern in his article “Reforming the Tax Code: Modern Principles of Taxation,” by proposing that profitability, ability to pay, economic efficiency, economic growth, correlating tax revenue to budgetary needs, stability, simplicity, low administration costs, and neutrality should frame debates over tax reform. The following section unpacks the article’s most relevant principles as they relate to American tax reform.

Profit vs. Ability to Pay

The principles of *profit* and *ability to pay* represent different ends of the economic ideological spectrum. Mihu (2011) notes that adherence to the profit principle views taxation as a proportional investment — the more an individual contributes, the more he or she will be eligible to receive. This principle seems to be at odds with America’s current progressive income tax system and more in congruence with a flat tax arrangement. Adherence to an ability-to-pay principle, on the other hand, implies that individual contributions should be matched to their current economic wellbeing; in other words, governments should be proactive in using tax policy to redistribute a nation's resources (2011). Analyzing the tax policies of different countries provides insight into which principle they employ.

Economic Efficiency and Growth

Economic efficiency and growth are rather straightforward principles. Using tax policy to promote economic efficiency suggests that legislators should not be in the business of rewarding specific industries or product categories at the expense of others (2011). Dubay and Burton (2015) add more detail, noting that tax systems should not be economically destructive. Rather, they should complement the mechanisms of a free market economy. The Cato Handbook for Policymakers adds that efficient tax systems should reduce economic distortions that currently impact taxpayer decisions relative to working, saving, and investing (Boaz, 2008). When governments create market distortions through tax policies, efficiency suffers, as the following example highlights.

For example, if a government offers a generous tax subsidy to domestic agricultural producers not offered to foreign producers of similar products, a market distortion is created. Mihu (2011) adds that market distortions decrease economic efficiency by impacting a firm's incentive to innovate and individuals' purchasing decisions. Instead of purchasing goods and services that offer the highest exchange value, if the distortions are large enough, individuals may be prompted to purchase based upon which product is the most subsidized, or which results in the least economic penalty.

Such systems tend to limit consumer choice, stifle competition, and promote a costly, inefficient allocation of resources. Therefore, tax subsidies and similar types of provisions are not conducive to economic growth.

Stability and Simplicity

According to Mihu (2011), stability and simplicity represent two more economic pillars tax systems should be based on. He describes stability as implying that the revenue stream from taxation should remain constant from year to year, and reflect macroeconomic indicators such as GDP growth. Continuous rate and policy changes and other structural tax innovations create a sense of economic trepidation that disincentivize investment and decrease fiscal efficiency because they inject uncertainty into the system. The principle of simplicity is also critical, as complex tax systems like America's create unnecessarily high compliance costs and a proportionally high cost of collecting and administering tax law. Dubay and Burton (2015) also cite simplicity as a critical component of successful tax systems, noting that simpler tax policies create an environment of transparency and lead to lower compliance costs. To reiterate, each of these principles demonstrates ideals that any significant tax reform should hope to realize.

Tax Reform Lessons from other Countries

The Polish Business Flat Tax

In 2004, Poland implemented an optional flat tax for business incomes that dropped the highest marginal rate from 40% to 19% (Kopczuk, 2015). The unique aspect of this proposal involved giving businesses a choice between a progressive tax system and a flat tax system. This uniqueness gave policymakers and researchers a baseline from which to study the impacts of different taxation systems in the same country at the same time.

Supporters of flat tax proposals often contend that these systems may reduce tax evasion/avoidance and increase reported incomes. Evidence from Poland’s tax reform revealed that reported business income increased 48% within the statistical sample size, lending credence to the argument that flatter tax systems increase compliance, while simultaneously decreasing participation in the gray, or underground, economy (Kopczuk, 2015).

Russian Flat Tax Reform and Informal Employment

In 2001, Russia introduced reform that flattened income tax rates by replacing its progressive structure with one flat rate of 13% (Slonimczyk, 2011). According to this author, payroll taxes were also modified into a single social tax with regressive implications. These reforms had the effect of disincentivizing marginal income misreporting due to the elimination of multiple tax brackets. One concern raised by these reforms, and flat tax reform in general, is how they affect informal employment.

According to Slonimczyk (2011), informality in the labor market characterizes economies in many developing countries. Russia is no exception, and serves to illustrate the problems post-Warsaw Pact nations faced in regulating their unofficial, or *shadow*, economies. Flat tax proponents have often argued that excessive state intervention in economies incentivizes black market growth. Therefore, Russia’s implementation of a flat tax system gave economists an opportunity to test this assertion.

There are different scholarly interpretations of informal employment that make analyzing the phenomenon difficult. Slonimczyk (2011) analyzed the tax impact of

Russia's reform on five aspects of informality, the most relevant of which is *informal irregularity* — a subset that displays a higher likelihood of tax avoidance and noncompliance. Regarding this category, he found that by 2002, the phenomenon was estimated to have decreased by 5.5%, and by 2009, eight years after the reforms, affected individuals were 16.6% less likely to engage in informal irregular activities. These results carry implications for other countries considering flat tax reform, particularly the United States. Knowing that tax reform in general, and flat tax reform in particular, empirically evidences the ability to alter behaviors and increase compliance should inspire legislators to continue to advance it.

Other Flat Tax Lessons

When Hall and Rabushka (1985) published their seminal work on flat tax reform, critics questioned the real-world applicability of their proposal. According to Mitchell (2007), these critiques were valid at the time because most flat tax jurisdictions were small nations such as Hong Kong and the Island of Jersey. However, he adds that after the collapse of the Soviet Union, several nations under the Iron Curtain adopted flat tax systems, including Estonia, Latvia, Lithuania, and even Russia. Since that time, more than 30 nations and territories now have flat tax systems of varying degrees. The relative success and popularity of these reforms continues to be analyzed by economists and policy experts.

American Taxation

Historical Overview

In the years leading up to 2016, a bipartisan consensus has emerged that recognizes the imperative of enacting comprehensive tax reform. Despite this initial recognition, consensus breaks down into fierce, partisan squabbling. However, in order to understand why tax reform has taken center stage politically, it is important to understand how the American tax system developed into the complexity that exists today.

It is widely agreed that taxation played a significant role in kindling the fires of the American Revolution. However, what is less recognized is the fact that the taxes levied by the British Crown in 1775 pale in comparison to America's current tax system. Jones, Thomas, and Lang (2012) note that Article 1, Section 8 of the U.S. Constitution gave Congress authority to levy taxes for *common defense* and *general welfare* of the nation. Certainly, the ambiguity of these terms has been open to significant debate. However, there is no explicit mention of an income tax in this section of the Constitution. In fact, these authors add that the first income taxes were not introduced until the American Civil War, some eighty years later, and were repealed in 1872. It was not until the passage of the 16^{th} Amendment in 1913 that a federal income tax was established as Constitutional law.

As the federal bureaucracy grew, lawmakers realized that tariffs and excise taxes were insufficient sources of revenue (Jones et al., 2012). The passage of the 16^{th} Amendment coincided with the outbreak of World War I, and gave Congress powers to "lay and collect taxes on incomes, from whatever source derived" (as cited in Jones et al., 2012, p. 2). In spite of this broad congressional mandate, enforcement mechanisms were virtually nonexistent and only 6-7% of the eligible tax base prepared filings through the 1920s (The SET Tax, 2006).

According to Jones, Thomas, and Lang (2012), as the Roaring Twenties quickly faded into the Great Depression, income tax rates continued to increase in tandem with efforts to enforce compliance. These trends culminated with the establishment of the Internal Revenue Code in 1939, which consolidated the entirety of American tax law (The SET Tax, 2006). This watermark consolidation, along with the expansion of federal authority during World War II, set a path for decades of federal tax expansion that has resulted in the current state of American tax law.

Criticisms of the Current System

The American Tax Code endures a bevy of criticisms from politicians, corporations, and individual taxpayers. This diverse constituency claims the current system is complex, inefficient, unfair, and incentivizes tax avoidance/evasion (Jones et al., 2012). Steve Forbes (2005), a vocal proponent of tax reform, noted how the Declaration of Independence has 1,300 words and the Bible has 773,000 words, while the federal tax code is 9 million words and rising. Forbes' comment highlights some initial frustrations Americans have with the U.S. tax code.

Complexity. In line with Forbes' earlier comments, critics contend the American tax system is too complex. The Cato Handbook for Policymakers notes that 37% of federal taxes are hidden (Boaz, 2008). When taxpayers cannot easily determine how much they actually contribute to the government, they conclude the cost of government to be artificially low, and consequently demand more of it. This lack of transparency incentivizes governments to adopt more tax policies that are difficult to understand and apply.

Foster (2011) noted that the abundance of contradictory deductions, exemptions, and credits makes filing taxes a frustrating process. In addition, The New York State Society of Certified Public Accountants (NYSSCPA) noted the added confusion of properly identifying and applying tax credits and tax deductions as a point of contention (The SET Tax, 2006). Also, the deductions language behind *caps* and *phase-outs* introduces another layer of uncertainty that is difficult for taxpayers to understand without professional consultation (Jones et al., 2012). The AMT imposes additional difficulty in determining what one actually owes. Jones et al. (2012) report that the AMT, with its different, complicated criteria, forces taxpayers to use two sets of rules just to prove their exemption from the policy. Both of these examples illuminate the complexity of the current system.

Inefficiency. Another experiential criticism of the current tax system is its inefficiency, in large part, due to its complexity. To further this point, Mitchell (2005) noted that taxpayers commit roughly 6.6 billion hours each year to filing their tax returns. From the available tax base, this figure implies that individual American taxpayers devote 45+ hours each year to filing their taxes (Cruz, 2016). To continue, 6.6 billion hours spent filing taxes equates to 6.6 billion hours in lost labor productivity. Therefore, it is accurate to suggest the current tax system has codified inefficiency into the law of the land.

Many reformers point to the double taxation of dividend income as another example of inefficiency (Jones et al., 2012). This policy has long drawn the ire of fiscal conservatives who support tax policies designed to unshackle corporate income for future investment. They contend not only that double taxation is inefficient, but also claim it unfairly burdens corporations. This last contention leads to the next major criticism: unfairness.

Unfairness. Critics from both sides of the political aisle contend, for various reasons, that the current tax system is unfair. However, the term *fair* almost always allows for a high degree of subjective interpretation. For example, James Surowiecki (2010) cites the following facts covering the last twenty-five years: 1) the top 1% of income earners has seen its share of the national individual income double, 2) the top 0.1% has tripled this same share, and 3) this same group earns as much as the bottom 120 million taxpayers (p. 33). Due to this perceived *unfairness*, he claims that a growing income gap between America's highest earners and the rest of the nation merits an increasingly complex tax system to address this wealth inequality. This situation highlights a unique example where complexity and fairness fail to meet. Surowiecki's solution to this unfairness would be to increase the number of tax brackets at the top end of the income spectrum in order to extract a higher percentage of wealth from these taxpayers — proportional to their income gains over the last twenty-five years. As contemporary tax research reveals, it is clear just how contentious, and partisan, the issue of *fairness* is.

Current Trends in Tax Reform

A Better Way – House GOP

One of the most recent American tax reform proposals came on June 24, 2016 from Rep. James Renacci (R-OH) of the House Ways and Means Committee. His proposal, backed by House Republicans, is a consumption tax with several significant changes to current tax law ("Tax Reform Proposals Emerge," 2016). First, his proposal calls for reducing the number of income tax brackets from seven to three, with the highest bracket set at 33%. Second, all existing itemized deductions would be eliminated, except charitable contributions and the mortgage interest deduction. He adds that the estate tax, generation skipping transfer taxes, and the AMT would all be repealed. Lastly, tax benefits for families in the higher education context would be streamlined and the IRS would be reorganized and held accountable to the Taxpayer Bill of Rights (2016). While these updates represent largely partisan reforms to the tax code, they still echo principles of simplicity, stability, and economic efficiency. Nevertheless, any further advancement of this proposal will face stiff Democratic opposition.

The Simple Flat Tax Plan – Ted Cruz

A flat tax reform plan was promoted by Senator Ted Cruz (R-TX) during his failed bid for the 2016 Presidency with several major overhauls worth addressing. First, Senator Cruz's (2016) plan seeks to collapse the seven income tax brackets into one base with a 10% rate. With a $36,000 exemption threshold for a family of four, his plan bears resemblance to the Hall-Rabushka (1985) model presented some thirty years ago. However, as a reflection of the current political climate, Senator Cruz's proposal preserves the Child Tax Credit, modernizes the EITC, and maintains deductions for charity and mortgage interest. Most significantly, his plan calls for abolition of the IRS — a rallying point for conservatives.

The purported benefits of his plan are compelling. They include raising GDP 13.9% above what is currently projected, increasing average wages 12.2% over the next ten years, and creating nearly 4.9 million jobs. While these figures are certainly open to scrutiny, the Cruz tax plan indicates that flat tax reforms are alive and well in the minds of many legislators and think tanks in Washington, D.C.

A Fairer Tax System – Hillary Clinton

One of the developing trends in recent election cycles is the nature and evaluation of the presidential candidates' tax plans. 2016 has been no exception, with major party candidates pitching their new proposals to the American public. Hillary Clinton's 2016 tax plan has been analyzed by various groups, including economist Kyle Pomerleau and Senior Fellow Michael Schuyler (2016). These authors note that Clinton's plan entails increasing the number of income tax brackets to eight, with marginal rates set at 10%, 15%, 25%, 28%, 33%, 35%, 39.6%, and 43.6% respectively. Specific to her plan is the addition of an eighth bracket for America's highest earners ($5 million and above) with an income tax of 43.6%. In addition, they note that her plan establishes a 30% minimum tax on filers with $1 million+ AGI, caps itemized deductions at 28%, and increases the Estate Tax to 2009 levels at 45%. While Clinton's plan does little to address the complexity of the current tax system, it attempts to rectify perceived *unfairness* through some of these redistributive policies.

Cato Handbook for Policymakers

Several tax reform recommendations have come from the Cato Institute, an American think tank that promotes conservative principles including limited government, free market economics, and individual liberty. The Cato Handbook for policymakers recommends significant reforms such as reducing the number of income tax brackets to two, with rates of 15% and 25%, and eliminating virtually all deductions and credits (Boaz, 2008). While not a pure flat tax, this proposal seeks to *flatten* tax rates and broaden the applicable tax base. The institute also recommends cutting the federal corporate income tax rate to 15%, liberalizing rules on contributions and withdrawals for Roth IRAs, and replacing business depreciation with capital expensing. Again, the chief aims of these recommendations are increased simplicity and efficiency, two scholarly pillars of modern tax reform.

The New Flat Tax

Another variation of flat tax reform was proposed by J. D. Foster (2011) of the *Heritage Foundation*. His flat tax rate is based on data indicating that the federal government is entitled to 18.5% of a nation's annual wealth under normal economic conditions. Thus, tax revenues would be capped at this metric. He estimates that, in order to achieve this tax revenue, individual and final business tax rates will settle around 28% with a deduction for annual savings. His plan also includes credits for purchasing health insurance and retaining the EITC, as well as deductions for college expenses, charitable contributions, and mortgage interest. As far as corporate taxation is concerned, Foster advocates that the corporate rate equal the individual rate, including a credit for R&D, and elimination of double taxation on dividends. This plan, while more complex than other *postcard* flat-tax schemes, carries a notion of passibility many others lack.

Conclusions and Further Study

Tax reform, and particularly flat tax reform, has become a polarizing topic in 2016. Areas analyzed included some of the political maneuvering that impacts this policy objective, including debates over the fiscal cliff, the question of revenue neutrality, the use of static vs. dynamic scoring in policy evaluation, corporate vs. individual tax reform, and the balancing of federal and state prerogatives. An analysis of each of these factors reveals deep divides, some partisan and some policy, that frame the greater issue and explains why advancing any measure of tax reform is so challenging.

The first section set the stage for a formal introduction of the flat tax, beginning with the Hall-Rabushka (1985) model. This section noted the impact their taxation vision had on many subsequent flat tax proposals. In addition, this section addressed criticisms that flat tax systems are inherently regressive. While this argument was found to have merit, a subjective analysis in determining *winners vs. losers* showed that partisan interpretation trumps objective reality.

The next section sought to reveal basic taxation principles that could guide legislators and be embraced by the general public. These principles included profitability, ability to pay, economic efficiency, economic growth, stability, simplicity, and neutrality. This section revealed that, although a majority of individuals can agree on the efficacy of these principles, arguments ensue when these terms have to be specifically defined and strategically aligned in the form of comprehensive tax reform.

Also discussed were flat tax reform lessons from other countries such as Poland and Russia. Poland introduced business flat tax policy as an option and not a mandate, giving economists an opportunity to contrast the effects of two different tax systems simultaneously in the same country. Some of these successes merit consideration for adopting an optional flat tax in the United States of America in order to give policy experts time to evaluate the advantages and disadvantages of both options. In Russia, it was found that flat tax reform can reduce and disincentivize informal employment. Informal employment is often linked to adoption of a range of negative tax practices such as tax avoidance and tax evasion. Knowledge that simpler, flatter tax systems may increase taxpayer transparency, and reported incomes, is a strong argument for adoption in the U.S.

A brief historical overview of U.S. taxation policy revealed a narrative that began with limited governmental authority in tax matters and, with the help of many transformative historical events, culminated in a tax collecting machine that exerts a high degree of influence over citizens' lives. The growth of this tax collecting machine elicits criticism from a bevy of fronts, and which target its perceived complexity, inefficiency, and unfairness. However, it was found that while bipartisan agreement exists relative to each of these criticisms, different tax solutions have been proposed on a politically partisan basis.

The final section of this research examined tax proposals from a variety of sources. Since 2016 is an election year, taxation proposals from different candidates were evaluated. Ted Cruz's 10% flat tax bore little resemblance to Hillary Clinton's expansion of the tax bracket and its progressive structure. Of course, this outcome was easy to predict given the divergent ideological underpinnings of each of these proposals.

The variety of different tax proposals that launched in 2016 provide fertile ground for further study. Future research should employ and expand empirical analysis in order to forecast the economic effects of political and scholarly tax proposals. In addition, future research should continue to analyze the effects of flat tax policies in other nations, examining how they function in concert with other economic policies. Such an approach would enhance the reputation of tax policy research in the greater macroeconomic field. In spite of the many legislative failures to advance comprehensive tax reform since 1986, this paper revealed that flat tax reform is still part of the legislative pulse beating in Capitol Hill.

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