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Taming the Tax Beast:  
*The Need for Public Involvement in the Politics of Tax Reform*

Douglas P. Tehero*

As the U.S. federal income tax system continues in a downward spiral, becoming a voluminous and indecipherable “beast,” growing public cynicism toward the system suggests that a social and economic crisis may be looming on the horizon.

In the wake of Hurricane Katrina’s devastating blow to the Gulf Coast states during the summer of 2005, Americans saw firsthand the excessive red tape and widespread failures that occurred at nearly every level of federal, state, and local disaster recovery agencies. In the firestorm of controversy that followed, unchecked partisan politics successfully shifted the national spotlight toward lambasting the guiltiest of the culprits instead of identifying consensus solutions to improve a broken system desperately in need of repair.

Three months later, a second event occurred that failed to draw the same level of national attention as Katrina. This came despite its direct impact on an American institution every bit as crippled as the federal disaster relief system, but whose reach is felt by a much larger percentage of the population. On November 1, 2005, the members of the President’s Panel on Federal Tax Reform submitted their final report to the Secretary of the Treasury. The panel’s findings included two separate proposals for fundamental tax reform that could significantly impact every individual in the country—taxpayers and nontaxpayers alike. Yet the news surrounding this event quickly faded into obscurity, having failed to inspire any measurable increase in public discourse. This occurred despite the fact that a recent poll showed that 77

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percent of respondents believe the federal tax system to be in need of either major changes or a complete overhaul.\(^1\)

These figures suggest that although a significant portion of the population believes the tax system is in need of fundamental reform, few individuals are interested in becoming personally involved. This growing trend of cynicism in the general public has allowed the tax reform debate to be monopolized by the same parties that benefit the most from the existing system.

This article will attempt to establish such an understanding by an in-depth examination of the current system's flaws—using the standards of equality, certainty, convenience, efficiency, and adequacy as a framework—and by encouraging action on the part of taxpayers through increased awareness of the various tax reform proposals that seek to remedy the problem.

**What's Wrong with the Current System?**

Arguably the most well-known and frequently cited criteria for evaluating tax policy are the Canons of Taxation, proposed by the famed economist Adam Smith in his 1776 work, *Wealth of Nations*. Through this examination of economic theory and European history, Smith permanently changed the face of Western economic policy and its impact on every aspect of the financial market—including taxation. He identified four characteristics that he argued were crucial elements to creating an effective tax: equality (fairness), certainty, convenience, and efficiency.\(^2\) Although these standards have proven their continued relevance over the last three centuries, the evolution of the modern commercial system has revealed them to be incomplete. As will be shown hereafter, a complete analysis of modern taxation policy necessitates the inclusion of at least one additional standard: adequacy.

Using these five characteristics as a framework, I will show that the existing income tax structure is an immense failure—both to the people who labor under it and to the government whose revenue it supplies.

*Equality.* According to Smith, a tax should be considered equitable if its burden falls upon individuals in proportion to their ability to pay. In more


simple terms, he believed that the rich should pay more taxes than the poor. This maxim is for all intents a foregone conclusion in modern political debate; fixed taxes—those for which the burden falls equally on each taxpayer regardless of his income or consumption level—are virtually non-existent in modern U.S. taxation policy.

Accordingly, the more controversial equality-related dilemma posed to politicians today does not deal with the issue of whether the wealthy should pay more than the poor, but how much more they should pay. The progressivity of a tax is determined based on the percentage of total income that the various economic classes remit as taxes. A tax that takes a larger percentage of total income from those in the lower class than higher class is referred to as a regressive tax. The Social Security payroll tax is a prime example of a regressive tax. During 2006, the first $90,000 of a taxpayer’s income is subject to a fixed 6.2 percent tax. Therefore, assuming that Taxpayer A earns $50,000 during 2005, he can expect a Social Security tax burden of $3,100—exactly 6.2 percent of his income. Meanwhile, if Taxpayer B earns $150,000 during 2006, only the first $94,200 of that income is taxable for Social Security. Her tax liability will be $5,840.40—only 3.89 percent of her income.

A proportional tax (commonly referred to as a flat tax) is one for which all individuals pay an equal portion of their earnings as taxes, regardless of income level. The most common example of a flat tax in the existing tax structure is the sales tax that many states charge for retail purchases.

By contrast, the progressive tax is one that takes a larger share of total earnings from those in the upper economic classes. This is the most common type of tax under the U.S. tax structure and includes the federal income tax, which is classified as a bracketed progressive tax. Under this structure, the government collects an increasingly larger portion of a taxpayer’s earnings as his income level rises. In other words, the rate at which an individual pays becomes significantly more relevant than the amount that he pays.

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1 A notable exception from American history is the poll tax that many states used during the nineteenth and twentieth centuries. This type of tax was subsequently outlawed with the ratification of the Twenty-Fourth Amendment in 1964.

While many Americans are generally supportive of a progressive income tax structure, it is also well acknowledged to have been used as an implement of class warfare. T. Coleman Andrews, who served as the Commissioner of Internal Revenue from 1953-1955, decried what he saw as a corrupt system that at its peak took as much as 94 percent of an individual’s paycheck. A firm anticomunist, Andrews sharply reminded an American public in the midst of the infamous Red Scare that Karl Marx identified a steeply graduated income tax structure as an essential step toward creating a communist society.

Today, Andrews would likely find himself in the minority. When individuals were asked in a recent poll how fairly the poor, middle class, and upper class were contributing toward federal taxes, more than one-half stated that the poor were paying too much in taxes while over two-thirds felt that the upper class was not paying its fair share. This unabashed yearning for a more progressive tax structure likely comes from a lack of exposure to the actual figures. The Tax Foundation—a nonpartisan tax research organization formed in 1937 to “educate taxpayers about sound tax policy and the size of the tax burden borne by Americans at all levels of government”—calculated that nearly 80 percent of total income tax revenues received by the IRS during 2004 were paid by the top 20 percent of filers. At the same time, 32 percent of filers, approximately 42.5 million, had no tax liability after deductions and credits (i.e., they received a complete refund).

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This includes President George W. Bush, a fiscal conservative who called for the creation of a tax structure that would “share the burdens and benefits . . . in an appropriately progressive manner.” Executive Order: President’s Advisory Panel on Federal Tax Reform, Jan. 7, 2005, available at http://www.whitehouse.gov/news/releases/2005/01/20050107-1.html.


11 Scott A. Hodge, Putting a Face on America’s Tax Returns, 5-6 Tax Foundation (2005).
Much of the blame for this apparent discrepancy can be attributed to the politicians and special interest groups who have staked their political survival on convincing the public that its tax burden is somehow the direct result of oppression from "the upper class." These modern-day Robin Hoods have become particularly successful at inspiring class envy, masterfully contrasting tales of the plight of everyday citizens with headline-grabbing news stories about tax breaks for the rich, illegal corporate tax shelters, or loopholes for the politically well connected.

Perhaps the most eloquent endorsement of this generalization came during the 2004 presidential primaries. As a part of his "Two Americas" campaign platform, former Senator John Edwards stated the following:

"Today, under George W. Bush, there are two Americas, not one: One America that does the work, another that reaps the reward. One America that pays the taxes, another America that gets the tax breaks. One America—middle-class America—whose needs Washington has long forgotten, another America—narrow-interest America—whose every wish is Washington's command."

Senator Edwards is among the long list of politicians and special interest groups who have become extremely adept at garnering support by invoking the public's sense of injustice with strong-worded generalizations, thus reinforcing the myth that such occurrences are the rule rather than the exception.

Data from another recent poll suggests this strategy is working. Respondents were asked who they thought pays more in federal income taxes as a percentage of income—themselves or millionaire Donald Trump. Fifty-nine percent selected themselves. Actual data compiled from individual returns filed in 2003 suggests quite the opposite. Those ranked in the top 1 percent based on gross income—which likely includes Mr. Trump—paid an average tax rate that was more than twice as high as the national average rate.

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1 John Edwards, Senator, Address at Des Moines, IA: Two Americas (December 29, 2003).
2 Dalbec & Wang at 9.
One particularly crucial element of these figures must be considered with additional attention—the use of the average tax rate as a metric for comparison between income groups. This figure is calculated by dividing the total amount of tax due after all exemptions, deductions, and credits by total income. Accordingly, the implement (or abuse) of tax breaks or loopholes has already been factored into the calculation of average tax rates. This suggests that however prevalent or widespread the use of tax write-offs by the ultra-rich, the wealthiest of the upper class are nonetheless paying twice as large a portion of their income in taxes as is the average middle-class American.

This is not, by any means, to suggest that the increasingly pervasive use of tax loopholes is not a problem. Tax loopholes are the primary cause behind the shrinking tax base, which, as will be discussed later in this paper, represents one of the greatest flaws with the existing system. It is this author’s opinion, however, that the use of a radically progressive tax structure to counterbalance a shrinking tax base is neither effective nor is it equitable.

*Certainty.* Smith argued that even more dangerous than a tax system built on inequality is one that includes even the smallest degree of uncertainty. For a tax to meet Smith’s criteria for certainty, it must be unambiguous how, when, and how much a taxpayer must pay. Furthermore, it must be clear not only to the taxpayer, but to other interested parties as well. It may be safely proposed that there would be far less suspicion and distrust of those in higher tax brackets if the method used to calculate the income tax was more readily understood by the common man.

Unfortunately, the Internal Revenue Code (hereafter referred to as the IRC) has become progressively more complicated and ambiguous with each session of Congress, causing an ever-increasing number of taxpayers to turn the task of preparing their income tax returns over to professional firms. In fact, the stock value in H&R Block climbed 20 percent in 1993 within the first month of new federal income tax revisions under speculation that tax

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1 Not to be confused with marginal tax rate, which represents the percent of taxes to be paid on the next dollar of income. In 2003, the highest marginal tax rate was 35 percent.

2 Smith at 778.
preparation firms would soon become the only group able to successfully navigate the IRC.16

Such may not necessarily be the case. In 1998, Money magazine published its eighth update of a popular article that exposed inconsistencies and errors in returns prepared by various tax professionals. Its publishers sent the financial information of a fictitious family to sixty firms and compared the information from the tax returns they received back. Surprisingly, of the forty-six returns that were completed, no two contained the same figure for tax liability and no single return arrived at what independent analysts considered "the right answer." Errors ranged from an underpayment of $3,000 to an overpayment of more than $30,000.17

Comically, it was perhaps for this reason that famed physicist Albert Einstein is reported to have stated, "the hardest thing in the world to understand is the income tax."18

Much of the existing structure's ambiguity stems from the sheer volume of code that taxpayers must sift through. In 1954, the year in which the income tax became the federal government's primary source of income, the IRC contained roughly 172,000 words. By 2005, it had ballooned to nearly 1.3 million words in length.19 It should be noted that this figure excludes the attendant regulations that supplement the tax code; the inclusion of regulations raises the word count over 9 million words.20 To put such volume into proper perspective, the King James version of the Holy Bible contains "only" 788,280 words.21

17 Joan Caplin, 6 Mistakes Even the Tax Pros Make, 27 Money, 104 (Mar 1998).
Robert Hall and Alvin Rabushka, Senior Fellows of Stanford University's Hoover Institution and authors of *The Flat Tax*, cited an excerpt from *The Federalist Papers*, no. 62, to sum up the primary problem with the IRC:

It will be of little avail to the people, that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood; if they be repealed or revised before they are promulgated, or undergo such incessant changes that no man, who knows what the law is to-day, can guess what it will be tomorrow.\(^\text{22}\)

An additional element of certainty that is not typically discussed relates to the transparency of a taxation structure. The visibility of a tax to the general public is an essential element to maintaining accountability from the government. The argument follows that as individuals become fully aware of how significantly they are funding the government’s everyday operations, they will begin to demand more results and less bureaucratic waste. This notion draws intense criticism from the legislators and enforcement officials charged with designing and collecting the tax. These groups argue that increased visibility of taxes only causes higher rates of tax evasion.

As a result, most Americans have little idea of the extent to which they ultimately bear the burden of the cost of governance. Much of this expense is embedded within payroll taxes and other corporate taxes. Michael L. Marlow of the Tax Foundation defines corporations as “legal structures that provide the nexus for individuals acting in different capacities to accomplish their goals.”\(^\text{23}\) Accordingly, while a corporation may remit taxes to the government, the burden of the tax falls on its owners, employees, and consumers. For example, it has been suggested that an employee bears the burden for not only the portion of payroll taxes that he pays, but for the portion his employer pays as well. Given these figures, the average American pays more in payroll taxes than income taxes each year.\(^\text{24}\)

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Furthermore, it is estimated that embedded taxes make up as much as 25 percent of the retail price for goods and services in the marketplace—including necessities purchased by the poor and middle class.\(^2\) While the topic of corporate tax reform falls outside the scope of this paper, it is worth noting that when the same Gallup poll previously cited asked respondents if they felt corporations were paying their fair share, 69 percent stated that corporations were paying too little.\(^2\) This data suggests that the public has overwhelmingly embraced the myth that increases to corporate tax rates will reduce individuals' tax burdens.

Convenience. Smith's idea of a convenient tax was one that fell due at a time and in a manner that was not overly burdensome to the taxpayer. Due to the aforementioned complexity and length of the IRC, the most telling sign of its burdensome nature may be the drain of many taxpayers' most valuable asset—their time.

Numerous inquiries have been made to estimate the amount of time that Americans spend every year complying with the income tax code. Using methodology that incorporated the Estimated Preparation Times published by the IRS for its various forms and a historic breakdown of how taxpayers prepare their returns, the Tax Foundation calculated the total time spent to prepare 2002 tax returns at approximately 5.8 billion hours. Put in perspective, this equates to an entire year's work for 2.9 million full-time employees—nearly 3 million after including the 82,000 workers employed full time by the IRS during 2003.\(^2\) While actual figures may be slightly lower due to technological factors such as tax preparation software and the increased use of E-File,\(^2\) it may still be safely declared that convenience is by no means a hallmark of the U.S. federal income tax structure.

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\(^{2}\) Boozt & Linder at 54.
\(^{4}\) Calculations based on a 40 hour work week with 2 weeks off per year.
\(^{6}\) I.R.S., e-file for Individual Taxpayers, http://www.irs.gov/efile/article/0,,id=118508,00.html (68.5 million returns were filed using e-File in 2004, an increase of 11.3 percent increase over the prior year).
Efficiency. According to traditional standards established by Smith, a tax is said to be efficient if it has a neutral effect on the marketplace. However, most economists agree that complete neutrality is not achievable; the fact that the income tax is levied against income-producing activities indelibly binds the two factors together. Furthermore, the administration costs associated with tax compliance—such as 5.8 billion hours of wasted productivity that could have been spent producing income—represent a significant drain on the economy.

Economists' estimates for the costs of the federal income tax system are staggering; approximations suggest that over $265 billion was lost in 2005 alone as a result of the tax system. This includes direct and indirect costs resulting from tax planning expenses, wasted marketplace productivity, overhead costs (i.e., the IRS operating budget), audits and litigation expenses, and revenue lost from tax evasion and underground transactions.

The actual cost is much higher as this figure fails to reflect the unquantifiable costs resulting from lost investment. Formally referred to as disincentive costs, this group includes the additional investments that were foregone because of tax compliance. Laws of economics dictate that production is at its peak potential when the marginal benefit of each dollar (or hour) invested equals the marginal cost—if it were greater, more could be invested; if it were less, the investment would be operating at a loss. Income taxes upset this equilibrium by artificially inflating the marginal cost. The result is that less time and money are invested into the marketplace than is economically optimal.

Disincentive costs take the form of hours of overtime that aren't worked out of fear of moving up a tax bracket, small businesses that are not formed because of overly complex IRS reporting burdens, and dollars of capital that would otherwise be invested in the corporate markets were it not for double-taxation on corporate income.

This phenomenon has been well documented in U.S. history. In 1917, less than five years after the adoption of the income tax, Congress increased the marginal rates for the top bracket to 77 percent—eleven times as high as they had been in 1913. During the 1920s the Secretary of the Treasury reduced the top bracket rate to 25 percent. Despite this reduction to less than one-third of

Moody at 2.
its peak rate, total income tax revenues increased by 3 percent, with a significantly higher portion of total tax revenues coming from upper-income taxpayers. In other words, the Treasury successfully made the tax burden more progressive by reducing the tax rate for the wealthiest individuals.

The obvious impact that tax policy has on the economy has not gone unnoticed by politicians. By giving preferential tax treatment to certain types of transactions, policymakers could encourage behavior deemed socially beneficial—including homeownership or charitable giving. Accordingly, when issuing the Executive Order that formally created the Tax Reform Advisory Panel, President George W. Bush made sure to emphasize that a simplified tax structure should continue to recognize the importance of these two popular tax breaks.

Unfortunately, the influential nature of tax legislation has also resulted in widespread abuse by special interest groups who have successfully lobbied to include preferential tax treatment for select groups. These groups include fishermen, farmers, owners of alternative-fuel vehicles, displaced factory workers, and owners of municipal bonds. As will be discussed in the following section, such widespread proliferation of tax breaks that benefit so few individuals results in higher tax rates for the rest of the country.

Adequacy. Although Smith limited his Canons of Taxation to the preceding four, commonsense dictates the necessity of an additional characteristic for a good tax policy: adequacy, or the ability to raise sufficient revenue to fund operations of the government. Adequacy is thus by nature directly correlated with the size of government. Although over 200 years of political debates have sought to sway public opinion regarding the merits of “big government” or “little government,” this debate falls beyond the scope of this paper. However, regardless of which political ideology may be more popular in any given year,

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81 Hall & Rabushka, What's Fair about Taxes?
83 Curtis S. Dubay, et al., Special Report No. 135, Tax Foundation (April 2005) (it is worth highlighting the Americans as a whole will contribute an estimated 29.1 percent of their total income in the form of federal, state and local taxes during 2005. Measured in terms of time, Americans will contribute the equivalent of 100 percent of all earnings from the period between January 1 and April 17).
the federal income tax structure has repeatedly failed to provide a sufficient source of revenue to fund the operations of government. Data from the Congressional Budget Office indicates that the government has operated on a budget deficit for thirty-five of the last forty years.\(^6\)

Much of this budgetary crisis is the direct result of what is referred to as a shrinking tax base—an alarming trend that finds a decreasing pool of taxpayers needing to pay increasingly higher tax rates to keep the proverbial ship afloat.

To understand this trend, it is important to evaluate the basic formula for government revenue: Revenue = Tax Base \(\times\) Tax Rate. Essentially, a tax base is a potential source of income while the tax rate represents the economic burden that falls on that source. Increases in revenue are achieved either through increases in the tax base (exploitation of new sources of tax income) or by increasing the tax rate. Similarly, a reduction to either the tax base or tax rate creates an overall decrease in government revenue.

This same relationship has also been used to rebalance the existing tax structure while maintaining a fixed level of revenue—commonly referred to as a revenue-neutral change. As these changes are constrained by the laws of mathematics, any decrease in the total tax base must be compensated by an increase in the overall tax rate, and vice versa.

This mathematical constraint is especially important as it relates to tax breaks and loopholes. These much-maligned intricacies of the IRC are in fact nothing more than tax bases that have been declared tax-free as the result of legislation. This may occur as the result of a government initiative to encourage a particular behavior, such as the home mortgage interest deduction previously discussed, or it may be the result of lobbying by a special interest group that stands to benefit from it the most. Either way these reductions to the tax base cause a net decrease in government revenue that must be compensated by a corresponding increase in tax rates—although such increases often occur elsewhere within the system. Essentially, if the government maintains a fixed level of revenue, someone (or everyone) must pay more to replace the potential revenue that is lost to tax breaks and loopholes.

The steadily shrinking tax base is undoubtedly a key contributor to many of the equity-related problems previously discussed. Highly publicized revelations of tax loopholes afforded to a supposed elite class of wealthy Americans have strengthened class envy and cynicism among the general public. As a result, politicians have responded with an even larger number of tax breaks aimed at relieving the poor and working class. However, as is the case with all tax breaks, the result has only further reduced the size of the tax base. In addition to the 42.5 million people who filed tax returns in 2004 and received a complete refund, an estimated 15 million potential filers did not meet the minimum income requirements and thus were not required to file a return or remit any taxes. After including the members of these groups' households, the Tax Foundation estimates that roughly 120 million Americans—40 percent of the U.S. population—are currently living outside of the reach of the federal income tax system. 

How Do We Fix the System?

Hopefully, by now it should be evident that the existing federal income tax structure is in dire need of repair. For this reason, President Bush issued the executive order calling for the creation of the Tax Reform Panel in January 2005. Over the following ten months, this bipartisan committee spoke with economists, Treasury Department officials, special interest groups and common taxpayers in an effort to analyze the existing tax structure and seek viable reform alternatives. As part of its analysis, the committee considered several popular tax reform proposals that had surfaced during the 1980s and 1990s. The resulting 272 page report submitted to the Treasury Department in November 2005 combined key elements from several of the existing reform proposals, creating two new hybrid plans for fundamental reform.

A common characteristic to each reform proposal is an emphasis on taxing consumption, which can be defined as income less savings. Proponents of consumption taxation suggest that whereas an income tax collects from individuals according to what they put in to the economy, a consumption tax collects based on what individuals take from it. In practice, the existing income tax structure can not be said to be entirely income

Scott A. Hodge, *Putting a Face on America's Tax Returns*, Tax Foundation, 8 (2005).*
or consumption-based given its inconsistent approach toward taxing or exempting personal savings.

Where these reform plans differ is in the suggested approach to achieve a true consumption tax. Additionally, each plan features a unique implementation strategy to improve compliance, equity, and simplicity. These strategies vary in terms of their complexity, from relatively standard changes to a fundamental overhaul.

While an in-depth analysis and accompanying recommendation regarding each leading tax reform proposal falls beyond the scope of this paper, it is the author's belief that a brief review of these proposals may reinforce the stated objective of educating taxpayers and encouraging public discourse in the tax reform process. Accordingly, the following is a summary of the current reform proposals, as well as a brief analysis of their strengths and weaknesses:

Simplification. One of the two proposals suggested by the Tax Reform Panel is the Simplified Income Tax Plan. This proposal would retain the existing framework for income tax while “trimming the fat” from the IRC such as loopholes and tax breaks that benefit relatively small groups of taxpayers. It would repeal the vastly unpopular and complex Alternative Minimum Tax (AMT) that otherwise threatens to affect 50 million taxpayers by the year 2015. Tax treatment for charitable contributions and home mortgage interest would be restructured to benefit taxpayers in all brackets, rather than only those who itemize their deductions. Additionally, the Simplified Plan increases the thresholds for tax-free savings accounts, allowing taxpayers to shield a larger portion of their retirement or personal savings from taxation.

While acknowledging the significant benefits that would result from the adoption of the Simplified Plan, its critics suggest that its reliance on existing tax framework makes it vulnerable to future alterations. Such was the fate of the Tax Reform Act (TRA) of 1986. Although the TRA successfully altered a complicated tax structure that had long been hostile to economic development, it was effectively subverted and “undone” within a decade by the Omnibus Budget Reconciliation Acts of 1987, 1990, and

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It is estimated that somewhere between 10,000 and 14,000 changes have been made to the tax code since the Tax Reform Act of 1986. As such, the primary weakness of reform via simplification is its impermanent nature.

Flat Tax. Perhaps the most well-known proposal for tax reform is the flat tax, thanks largely to Steve Forbes. During the 1996 and 2000 Republican presidential primaries, Forbes brought the national spotlight on the flat tax, and interest in it has continued to grow. While there are many varieties of the flat tax, the most popular is the proposal first drafted by Robert Hall and Alvin Rabushka of Stanford University in 1981.

Substantially, the flat tax is a more radical form of the tax simplification model; it maintains the basic structure of the income tax: tax-free treatment of certain forms of savings (a hybrid income-consumption tax, much like the existing system), a standard deduction and personal exemptions that factor in the number of individuals per household. Visibly absent, however, are the miscellaneous loopholes, brackets, deductions, and credits that make the existing code so complicated. Every taxpayer would pay the same uniform rate for all earnings in her exemption for living expenses. Under Forbes’s plan, individuals wary of losing valuable deductions would even be able to elect to use the old system.

Its proponents claim that the flat tax would so streamline the income tax code that an individual tax return would conceivably fit on a form the size of a postcard, saving taxpayers and the government billions of dollars in direct and indirect costs each year. Additionally, they point to the apparent success of the flat tax in Eastern European countries such as Russia, which saw a dramatic surge in tax revenues during its first year under a flat tax.

Critics of the flat tax argue that its apparent success in Eastern Europe has been overstated. The International Monetary Fund sponsored a study to further evaluate the effects of the flat tax on the Russian economy. Its findings
suggested that the surge in tax revenues was due primarily to marketwide growth unrelated to taxation policy.\footnote{Id. at 43.}

Additionally, there is speculation that widespread elimination of tax deductions would reduce incentives for taxpayers to engage in socially beneficial behavior such as home-ownership and charitable contributions. Analysts have estimated the decrease to be as much as 22 percent.\footnote{Henry J. Aaron & William G. Gale, \textit{Economic Effects of Fundamental Tax Reform}, Tax Analysts, Nov. 25, 1996, at 973.} In the state of Utah, this issue was thrust to the forefront of the tax debate when the state proposed a flat state income tax during the 2005 legislative session. The proposal was met with opposition from The Church of Jesus Christ of Latter-day Saints, the largest religious denomination in Utah.\footnote{It should be disclosed that BYU is a private school owned and operated by The Church of Jesus Christ of Latter-day Saints.} The church, which rarely takes an official position on political issues, voiced its “support of retaining a state tax deduction for charitable giving.” Furthermore, its spokesman suggested that a well-structured tax code could encourage good behavior while positively influencing society in areas not limited to economic growth. The state responded by seeking to incorporate select deductions into a flat tax framework.\footnote{Paul T. Mcro, \textit{Cross Country: In Utah, the Flat Tax Doesn’t Have a Prayer}, Wall Street Journal, Oct. 27, 2005, at A21.}

\textit{Value Added Tax.} The Value Added Tax (VAT) has become increasingly popular across Western Europe in recent years. A VAT is an incremental tax (similar to a sales tax) that is added to the cost of goods and services at every point in the supply chain. Whereas a sales tax is remitted only by the end consumer, a VAT is remitted from each taxpayer involved in the production and consumption of the good or service.

Although the VAT has never been tried in the U.S., the Growth and Investment Tax Plan proposed by the President’s Tax Reform Panel incorporates a VAT with a simplified version of the existing income tax structure. Critics have been quick to point out a hybrid income tax / VAT structure would do little to reduce the complexity or costs of compliance of the existing system.
To consumer advocates, the VAT's most troubling aspect is its embedded nature, which defies the notion of transparency in taxation structure. Most economists would agree that the increase in consumer prices caused by a VAT would ultimately be borne by the consumer, although the majority of VAT proceeds would be remitted by corporations. This scenario effectively blinds taxpayers to their respective burden, allowing the government to increase it with few visible effects. Nobel-prize winning economist Milton Friedman stated that "the VAT is the most efficient way to raise revenue for the government. It is also the most effective way to increase the size of the government."³⁶

National Retail Sales Tax. By far, the most sweeping and radical proposal currently being debated is the National Retail Sales Tax (NRST). The most popular form of this proposal, the FairTax, calls for the complete repeal of all personal and corporate income taxes, as well as payroll, estate, and capital gains taxes, which would be replaced by a single sales tax charged nationwide on retail purchases. Congressman John Linder, the primary sponsor of the FairTax, estimates that a flat tax of 23 percent on the purchase of all goods and services would produce the necessary revenues to replace all of the aforementioned taxes while stimulating unprecedented economic growth.⁷ Additionally, the government would provide a monthly "prebate" to each taxpayer for necessary expenditures, causing proponents of the FairTax to argue that it is completely voluntary—only purchases in excess of the monthly necessity allowance represent a true tax burden.

The FairTax boasts several attractive propositions. Principally, the FairTax would eliminate all embedded corporate taxes, creating a tax structure unprecedented in terms of transparency. As previously stated, each taxpayer would know exactly how much he contributed to fund the operations of the government and would likely be more interested in how his contributions were spent. Furthermore, supporters argue that because it is strictly consumption that is taxed, the FairTax would virtually eliminate noncompliance, as individuals who had previously avoided reporting income would find themselves unable to avoid paying taxes on their everyday purchases.

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⁷ Boortz & Linder at 154.
⁸ Boortz & Linder at 148.
Critics allege that noncompliance would continue, transitioning instead from tax shelters to black markets, where tax profits that would otherwise go to the government would be split between retailers and consumers. Additionally, success for the FairTax relies on the political necessity of repealing the Sixteenth Amendment, which granted Congress the right to impose an income tax. It is highly unlikely that taxpayers would support creation of a national sales tax until this vital step had been accomplished.

Critics also point out that the proposed tax rate of 23 percent is implicitly computed (as opposed to explicitly, as is the case with existing sales taxes). Whereas a 23 percent explicit tax would add 23 cents of tax to every dollar spent, an implicit tax would add 23 cents to every 77 cents spent— for a total of one dollar. Explicitly computed, the FairTax would increase retail prices by nearly 30 percent.

**Why Isn't Anything Being Done?**

Given the wealth of evidence that suggests the need for fundamental reform, and given the variety of proposals available, it would appear that the era of over-complexity and inefficiency in the federal tax structure is approaching its finale. However, the lack of public discourse surrounding recent developments in tax reform suggests that the public is disinterested, perhaps assuming that the Congress is in the process of fixing the problem.

Unfortunately, reform progress in Washington has long been mired by Beltway politics. In an article written in the *Wall Street Journal*, economist Milton Friedman suggested that the problem stems from a misconception about the "true" purpose of the tax structure:

> The political function of the income taxes, which is served by their being complex, is to provide a means whereby the members of Congress who have anything whatsoever to do with taxation can raise campaign funds. That is what supports the army of lobbyists in Washington who are seeking to produce changes in the income tax, to introduce special privileges or exemptions for their clients, or to have what they regard as special burdens on their clients removed. [Fundamental tax reform] would offer nothing that any lobbyist could hope to achieve since the structure of the tax is so simple and straightforward."\(^*\)

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As a result of apathy, cynicism, and general ignorance, the public has allowed the tax reform debate to be monopolized by the same parties that benefit the most from a broken system. Not surprisingly then, despite numerous calls for sweeping reforms, the system remains in dire need of repair.

**Conclusion**

The current U.S. individual income tax structure is clearly in need of change. Despite thousands of alterations and numerous attempts at simplification, the system is responsible for economic and social burdens that can only be described as unquantifiable. Accordingly, public disdain for the tax code is at an all-time high, with figures suggesting that nearly 80 percent of the population believes that the income tax structure is in need of major reform.

Such reform will never occur until the general public assumes a prominent role in the tax debate. This paper has documented the pervasive flaws of the existing tax structure and identified alternative proposals currently at the forefront of the reform debate. Edward J. McCaffery, a law professor at the University of Southern California Law School and a scholar in the field of tax reform, states that the single most important element missing from true reform is the inclusion of common people. He writes: "If [the] anger against the status quo can be translated into a popular and understandable program, then the people can get behind tax reform."  

Ultimately, however, taxpayers in the United States have to decide between two options: wait around for the bureaucratic red tape to clear and hope the problem is fixed before a crisis surfaces or get informed, take action, and become a part of the solution. The author's hope is that this article will help people choose the latter.

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