Order Code IB95060

Issue Brief for Congress
Received through the CRS Web

Flat Tax Proposals and Fundamental Tax Reform: An Overview

Updated August 30, 2002

James M. Bickley
Government and Finance Division

CONTENTS

Flat Tax Proposals and Fundamental Tax Reform: An Overview

SUMMARY

The idea of replacing our current income tax system with a "flat-rate tax" is receiving renewed congressional interest. Although referred to as "flat-rate taxes," many of the current proposals go much further than merely adopting a flat rate tax structure. Some involve significant income tax base broadening while others entail changing the tax base from income to consumption.

Proponents of these tax revisions are often concerned with simplifying the tax system, making the government less intrusive, and creating an environment more conducive to saving. Critics are concerned with the distributional consequences and transitional costs of a dramatic change in the tax system.

Most observers believe that the problems and complexities of our current tax system are not primarily related to the number of tax rates, but rather stem from difficulties associated with measuring the tax base.

Most of the recent tax reform proposals (the Armey, the Shelby, the English, the Specter, the Tauzin, the Linder, and the Souder plans) would change the tax base from income to consumption.

One or more of four major types of broad-based consumption taxes are included in these congressional tax proposals: the value-added tax (VAT), the retail sales tax, the consumed-income tax, and the flat tax based on a proposal formulated by Robert E. Hall and Alvin Rabushka, two senior fellows scholars at the Hoover Institution.

Other tax reform proposals focus on income as the base. The Gephardt proposal would keep income as the tax base but broaden the base and lower the tax rates. Representative Crane's proposal would levy a tax on the earned income of each individual as a replacement for the current individual income tax, corporate income tax, and estate and gift tax. Former Representative Snowbarger's proposal would permit each taxpayer to choose between the current individual income tax or an alternative individual tax with a flat rate. Senator Dorgan's proposal would allow most taxpayers to choose between the current individual tax system and his "shortcut" tax plan under which taxes withheld would equal the employee's tax liability.

MOST RECENT DEVELOPMENTS

On July 25, 2002, nine Members of the Subcommittee on Commerce, Trade, and Consumer Protection wrote the Bush Administration requesting help to protect U.S. online vendors from a new European Union directive that will impose a VAT on the sales of certain electronic commerce products on July 1, 2003.

BACKGROUND AND ANALYSIS

Currently, fundamental tax reform is a major congressional issue. Most proposals would change the tax base from income to consumption.

The Relationship Between Income and Consumption

Although our current tax structure is referred to as an income tax, it actually contains elements of both an income- and a consumption-based tax. For example, the current tax system includes in its tax base wages, interest, dividends, and capital gains, all of which are consistent with an income tax. At the same time, however, the current tax system excludes some savings, such as pension and Individual Retirement Account contributions, which is consistent with a tax using a consumption base.

The easiest way to understand the differences between the income and consumption tax bases is to define and understand the economic concept of income. In its broadest sense, income is a measure of the command over resources that an individual acquires during a given time period. Conceptually, there are two options an individual can exercise with regard to his income: he can consume it or he can save it. This theoretical relationship between income, consumption, and saving allows a very useful accounting identity to be established; income, by definition, must equal consumption plus saving. It follows that a tax that has a measure of comprehensive income applies to both consumption and savings. A consumption tax, however, applies to income minus saving.

A consumption tax can be levied at the individual level in a form very similar to the current system. An individual would add up all of his income in the same way as he does now under the income tax but then would subtract out his net savings (saving minus borrowing). The result of these calculations would be the consumption base on which tax is assessed. Equivalently, a consumption tax can also be collected at the retail level in the form of a sales tax or at each stage of the production process in the form of a value-added tax (VAT).

Regardless of the form or point where a consumption tax is collected, it is ultimately paid by the individual doing the consuming. It should be noted that consumption, in the economy as a whole, is smaller than income. Thus, to raise equal amounts of revenue in a given year, tax rates on a comprehensive consumption base would have to be higher than the tax rates on a comprehensive income base.

What Should Be Taxed?

Should the tax base be income or consumption? Is one inherently superior to the other? How do they stack up in terms of simplicity, fairness, and efficiency — the three standards by which tax systems are generally assessed? There appears to be insufficient theoretical or empirical evidence to conclude that a consumption-based tax is inherently superior to an income-based tax or vice versa.

One issue associated with the choice of a tax base is equity — how the tax burden will be distributed across income classes and different types of taxpayers. For example, a tax is "progressive" if its burden rises as incomes rise. While some types of consumption taxes can be designed to achieve any desired level of progressivity with respect to consumption alone, their progressivity with respect to income could only be approximated. Also, a consumption tax would involve a redistribution of the tax burden by age group, with the young and old generally bearing more of the total burden than those in their prime earning years. And the transition from an income-based tax to a consumption-based tax would have the potential for creating windfall gains for some taxpayers and losses for others.

A definitive assessment cannot be made of the effects of taxing consumption on either economic efficiency or the aggregate level of savings. Although the current tax system's distortions of the relative attractiveness of present and future consumption (saving) would be eliminated, to raise the same amount of tax revenue, a consumption-based tax would require an increase in marginal tax rates (since consumption is smaller than income). This action, in turn, would increase the current system's distortion between the attractiveness of market and nonmarket activities. The net effect on overall economic efficiency cannot be ascertained theoretically. In addition, economic theory indicates a consumption tax would not necessarily produce an increase in saving. The increase in after tax income might reduce saving, while the increase in the return to saving may increase it; the net result is uncertain.

A positive aspect of a consumption-based tax is the ease with which the individual and corporate tax systems could be integrated. In addition, the problems introduced by separate provisions for capital gains, attempts to distinguish between real and nominal income, and depreciation procedures would essentially be eliminated. It is doubtful, however, that a consumption-based tax would have much effect on the complexities introduced into the system to promote specific social and economic goals. Many of the same factors that influenced the design of the current income tax system would exert the same influences on the final design of a consumption tax.

Whether one prefers income or consumption, one tax rate or multiple tax rates, the critical point to remember is that the benefits to be derived from tax revision would result from defining the tax base more comprehensively than it is under current law. A tax with a base that is comprehensively defined would prove more equitable and efficient than a tax with a less comprehensively defined base.

Types of Broad-Based Consumption Taxes

There are four major types of broad-based consumption taxes that are included in congressional tax proposals: the value-added tax (VAT), the retail sales tax, the consumed-income tax, and the flat tax based on a proposal formulated by Robert I. Hall and Alvin Rabushka, two senior fellows scholars at the Hoover Institution.

Value-Added Tax

A value-added tax is a tax, levied at each stage of production, on firms' value added. The value added of a firm is the difference between a firm's sales and a firm's purchases of inputs from other firms. The VAT is collected by each firm at every stage of production.

There are three alternative methods of calculating VAT: the credit method, the subtraction method, and the addition method. Under the credit method, the firm calculates the VAT to be remitted to the government by a two-step process. First, the firm multiplies its sales by the tax rate to calculate VAT collected on sales. Second, the firm credits VAT paid on inputs against VAT collected on sales and remits this difference to the government. The firm calculates its VAT liability before setting its prices to fully shift the VAT to the buyer. Under the credit-invoice method, a type of credit method, the firm is required to show VAT separately on all sales invoices and to calculate the VAT credit on inputs by adding all VAT shown on purchase invoices.

Under the subtraction method, the firm calculates its value added by subtracting its cost of taxed inputs from its sales. Next, the firm determines its VAT liability by multiplying its value added by the VAT rate. Under the addition method, the firm calculates its value added by adding all payments for untaxed inputs (e.g., wages and profits). Next, the firm multiplies its value added by the VAT rate to calculate VAT to be remitted to the government.

Retail Sales Tax

In contrast to a VAT, a retail sales tax is a consumption tax levied at only a single stage of production, the retail stage. The retailer collects a specific percentage markup in the retail price of a good or service which is then remitted to the tax authorities.

Consumed-Income Tax

Under this consumption tax, taxpayers would keep their assets in an account equivalent to a current IRA (individual retirement account). Net contributions to this account (contributions less withdrawals) would be deducted from income to determine the level of consumed-income. In contrast to a VAT or sales tax, policymakers would have the option of applying a progressive rate structure to the level of consumed-income. Each individual would be responsible for calculating his consumed-income and paying his tax obligation.

Flat Tax (Hall/Rabushka Concept)

A flat tax could be levied based on the proposal formulated by Robert E. Hall and Alvin Rabushka, two senior fellows scholars at the Hoover Institution. Their proposal would have two components: a wage tax and a cash-flow tax on businesses. (A wage tax is a tax only on wages; a cash-flow tax is generally a tax on gross receipts minus all outlays.) It is essentially a modified VAT, with wages and pensions subtracted from the VAT base and taxed at the individual level. Under a standard VAT, a firm would not subtract its wage and pension contributions when calculating its tax base. Under this proposal, some wage income would not be included in the tax base because of exemptions. But, under a standard VAT, all wage income would be included in the tax base.

International Comparisons

There are two major distinctions between recent flat tax proposals for the United States that would change the tax base from income to consumption and the current tax systems of other developed nations. First, although the United States is the only developed nation without a broad-based consumption tax at the national level, other developed nations adopted broad-based consumption taxes as adjuncts rather than as replacements for their income-based taxes. Most of the congressional proposals would replace our current income taxes with consumption taxes, rather than use consumption taxes as adjuncts to our current income-based system.

Second, all developed nations with VATs, except Japan, calculate their VATs using the credit-invoice method. Most of the current U.S. flat tax proposals, which include VAT components, however, would use the subtraction method of calculation.

Other Types of Fundamental Tax Reform

Two other types of fundamental tax reform are income tax reform and a tax plan that gives taxpayers a choice of systems.

Income Tax Reform: Base Broadening

Income tax base broadening would involve eliminating most tax preferences, increasing the standard deduction and personal exemption allowances, and reducing tax rates. House Minority Leader Gephardt's proposal is in this category.

Option of the Current or an Alternative Income Tax System

Two proposals would give taxpayers the option of either paying taxes under the current income tax or paying a flat rate income tax. Former Representative Snowbarger's proposal and Senator Dorgan's proposal are in this category.

Description of Selected Proposals

Eleven flat tax (or modified flat tax) proposals are receiving the most congressional attention. Seven of the proposals (the Armey, the Shelby, the English, the Specter, the Tauzin, the Linder, and the Souder plans) would change the tax base from income to consumption. Representative Gephardt's proposal would keep income as the tax base. Representative Crane's proposal would levy a tax on the earned income of each individual as a replacement for the current individual income tax, corporate income tax, and estate and gift tax. Former Representative Snowbarger's proposal would allow each taxpayer to choose between the current individual income tax return and an alternative individual income tax return with a flat rate. Senator Dorgan's proposal would allow most taxpayers to choose between the current individual tax system and his "shortcut" tax plan under which taxes withheld would equal the employee's tax liability. While some of these plans are more detailed than others, none of the proposals has the level of detail that would be required to make a plan operational. Many difficult details and transitional considerations have yet to be addressed. Some proposals have been formulated into bills introduced in the 105th, 106th, or 107th Congresses. After the heading of each proposal, the most recent bill introduced is specified by its number.

The Armey Proposal

H.R. 1040 in the 107th Congress. (An identical bill was introduced in the House by Senator Shelby.) The flat tax proposal of House Majority Leader Armey is modeled after a proposal formulated in 1981 by Robert E. Hall and Alvin Rabushka, two senior fellows at the Hoover Institution. The Armey flat tax would levy a consumption tax as a replacement for the individual and corporate income taxes, and the estate and gift taxes.

This proposal would have two components: a wage tax and a cash-flow tax on businesses. It is essentially a modified VAT, with wages and pensions subtracted from the VAT base and taxed at the individual level. (Under a normal VAT, a firm would not subtract its wage and pension contributions when calculating its tax base.) Under this proposal, some wage income would not be included in the tax base because of exemptions. But, under a VAT all wage income would be included in the tax base.

Initially the individual wage tax would be levied at a 19% rate, but after December 31, 2002, when the tax is fully phased in, this rate would decline to 17%. The individual wage tax would be levied on all wages, salaries, and pensions. In addition, government employees and employees of nonprofit organizations would have to add to their wage tax base the imputed value of their fringe benefits.

The individual wage tax would not be levied on Social Security receipts. Thus, the current partial taxation of Social Security payments to high income households would be repealed. Social Security contributions would continue to be taxed; that is, they would not be deductible and would be made out of after tax income. Firms would pay the business tax on their Social Security contributions. Individuals would pay the wage tax on their Social Security contributions. The individual wage tax would have no deductions but would have the following exemptions:

- $24,600 for a married couple filing jointly;
- $15,700 for a single head of household;
- $12,300 for a single person; and
- $5,300 for each dependent.

All exemptions would be indexed for inflation.

Initially businesses would pay a tax of 19% (declining to 17% in after December 31, 2002) on the difference (if positive) between gross revenue and the sum of purchases from other firms, wage payments, and pension contributions. This business tax would cover corporations, partnerships, and sole proprietorships. Pension contributions would be deductible but there would be no deductions for fringe benefits. In addition, state and local taxes (including income taxes) and payroll taxes would not be deductible.

The Shelby Proposal

S. 1040 in the 107th Congress. Senator Shelby and House Majority Leader Armey have introduced companion bills in the 107th Congress (H.R. 1040 and S. 1040). Since these bills are identical, the reader should read the preceding Armey proposal to understand the proposal of Senator Shelby.

The English Proposal

H.R. 86 in the 107th Congress. This proposal of Representative English (Simplified USA Tax) is based on the Domenici-Nunn proposal. The *corporate income tax* would be replaced by a cash-flow business tax (a subtraction-method VAT). The gross tax base (value-added) would equal gross receipts less purchases from other firms. The tentative tax would be determined by multiplying the value-added by the appropriate tax rate. A tax rate of 8% would apply to the first $150,000 of a business's value-added, and a tax rate of 12% would apply to all of the business's value-added over $150,000. A business tax rate of 12% would apply to all imports. A credit for the 7.65% employer-paid OASDHI payroll tax (commonly called FICA or the Social Security tax) would be subtracted from the tentative tax to calculate the business's tax liability for the year.

The *individual income tax* would be replaced by a tax on consumed-income. An individual's tax liability would be calculated by (1) calculating gross income, (2) subtracting exemptions and deductions, (3) applying a progressive rate structure to the difference, and (4) subtracting a credit for the 7.65% employer-paid OASDHI payroll tax payments. Gross income would equal wages and salaries plus interest, dividends, pension receipts, and amounts received from the sale of stock and other assets. Deduction would be allowed for charitable contributions, home mortgage interest, and higher education tuition. Deductions would also be allowed for retirement-oriented 401(k) contributions and IRAs for lower income families.

The Simplified USA Tax eliminates the double taxation of savings by allowing everyone to contribute after-tax income to a USA Roth IRA which is a universal savings vehicle. After five years, accumulated principal and earnings on principal can be withdrawn on a tax-free basis at any time and for any purpose. The federal estate and gift tax would be repealed.

The Specter Proposal

S. 822 in the 106th Congress. The flat tax proposal of Senator Specter also is modeled after the Hall-Rabushka proposal and thus is similar to that of Representative Armey. The Specter flat rate consumption tax would replace the federal individual and corporate income taxes.

This proposal would have two components: a wage tax and a cash-flow tax on businesses. It is essentially a modified VAT, with wages and pensions subtracted from the VAT base and taxed at the individual level.

The individual wage tax would be levied at a 20% rate on all wages, salaries, and pensions. In addition, government employees and employees of nonprofits would have to add to their wage base the imputed value of their fringe benefits. The individual wage tax would have "standard deductions" that would equal the sum of the "basic standard deduction" and the "additional standard deduction."

The "basic standard deduction" would depend on filing status. For tax year 2000, the basic standard deduction would be the following:

- $17,500 for a joint return;
- $17,500 for a surviving spouse;
- $15,000 for a head of household;
- $10,000 for a married taxpayer filing separately; and
- $10,000 for a single taxpayer.

The "additional standard deduction" would be an amount equal to $5,000 times the number of dependents of the taxpayer. All deductions would be indexed for inflation.

Individuals would be allowed to deduct up to $2,500 ($1,250 in the case of a married individual filing a separate return) annually for charitable contributions. Individuals also would be allowed to deduct "qualified residence interest" on acquisition indebtedness not exceeding $100,000 ($50,000 in the case of a married individual filing a separate return).

The business tax would be levied at a 20% tax rate on gross revenue less the sum of purchases from other firms, wage payments, and pension contributions. Purchases from other firms would include capital goods. If the business' aggregate deductions exceed gross revenue, then the excess of aggregate deductions can be carried forward to the next year and increased by a percentage equal to the 3-month Treasury rate for the last month of the taxable year.

The Tauzin Proposal

H.R. 2717 in the 107th Congress. This proposal would replace the personal and corporate income taxes, estate and gift taxes and all non-trust dedicated excise taxes with a 15% national retail sales tax. Each qualified family unit would receive a sales tax rebate equal to the product of the sales tax rate and the lesser of the poverty level (adjusted for the number of dependents claimed) or the wage income of the family unit. The rebate amount would be included in each paycheck for that pay period. Any business required to collect and remit the sales tax would keep 0.5% of tax receipts to offset compliance costs. Any state choosing to do so could administer, collect and enforce the sales tax. To qualify as an "administering state," a state would have to conform its sales tax base to the federal base. Administering states could retain an administration fee equal to 1% of the amounts otherwise required to be remitted to the United States. A super majority vote of two-thirds of both Houses of Congress would be necessary to raise the sales tax rate or to create any exemptions to the sales tax.

The Linder Proposal

H.R. 2525 in the 107th Congress. This proposal repeals the individual income tax, the corporate income tax, all payroll taxes, the self-employment tax, and the estate and gift taxes and levies a 23% national retail sales tax as a replacement beginning in calendar year 2003. Every family would receive a rebate of the sales tax on spending up to the federal poverty level (plus an extra amount to prevent any marriage penalty). The Social Security Administration would provide a monthly sales tax rebate to registered qualified families. The 23% national retail sales would not be levied on exports. The sales tax would be separately stated and charged. Social Security and Medicare benefits would remain the same with payroll tax revenue replaced by some of the revenue from the retail sales tax. States could elect to collect the national retail sales tax on behalf of the federal government in exchange for a fee. Taxpayers rights provisions are incorporated into the act.

The Gephardt Proposal

H.R. 3620 in the 105th Congress. House Minority Leader Gephardt's calls his proposal the "10% tax." Unlike most proposals, this proposal would reform the current income tax base rather than changing to a consumption base. The taxable income base for individuals under this proposal includes all items of income currently taxed (salaries and wages, investment income, capital gains, business profit or loss, etc.) plus employee fringe benefits (other than health insurance), employer pension plan contribution, and tax-exempt state and local interest. Social Security benefits would be included to the same limited extent as they are under current law. Deductions from gross income (called "above-the-line" deductions, as distinct from the itemized deductions taken from adjusted gross income) would be allowed for alimony paid, one-half of the self-employment tax, investment interest, and job-related expenses. The only itemized deduction allowed would be home mortgage interest. Since pension contributions would be make taxable, an exclusion would be allowed from pension income for the previously taxed contributions, the way annuities are taxed under current law. Accumulated earnings under pension plans, IRAs, and life insurance policies would remain tax-deferred, as under current law. The only credits allowed would be the earned income tax credit (EITC) and the foreign tax credit.

The standard deduction and personal exemption allowances would be increased and tax rates would be decreased from current law. In addition, the "marriage tax penalty" arising from these factors would be eliminated by making the joint filer allowances and tax brackets exactly twice those of a single filer. "Head-of-household" filers, which are single individuals with dependent children, would receive allowances and the first two tax brackets halfway in between the amounts for single and joint taxpayers; the higher tax brackets are equal the single-filer brackets. There would be no separate tax rates for capital gains.

The tax-free allowances would be:

- $9,000 for a joint return;
- $6,600 for a head of household;
- $4,500 for an individual; in addition
- $2,900 for each personal exemption.

The tax rate schedule would be:

- 10% marginal rate: married (joint) $0-$46,000; head of household $0-$32,000; single $0-$23,000.

- 20% marginal rate: married (joint) $46,000-$80,000; head of household $32,000-$40,000; single $23,000-$40,000.

- 26% marginal rate: married (joint) $80,000-$150,000; head of household $40,000-$75,000; single $40,000-$75,000.

- 32% marginal rate: married (joint) $150,000-$275,000; head of household $75,000-$137,500; single $75,000-$137.000.

- 34% marginal rate: married (joint) over $275,000; head of household over $137,500; single over $137,500.

This proposal would reduce "corporate welfare" by more than $50 billion. The plan apparently retains payroll and other taxes as under the current system. The plan is said to be revenue-neutral, to allow a post-card sized tax return for some taxpayers, and to require no return at all for over one-half of individual taxpayers. It also stipulates that future changes in tax rates could be made only by national referendum.

The Souder Proposal

H.R. 2971 in the 105th Congress. This proposal would repeal the corporate income tax and the individual income tax and replace these taxes with a flat rate tax of 20% only on the earned income of individuals and on business taxable income. For the individual income tax, there would be a standard deduction equal to:

- $16,500 for a joint return;
- $14,000 for a head of household;
- $9,500 for an individual; in addition
- $4,500 for each dependent.

Interest of the first $100,000 of a home mortgage would be deductible, and there would be an unlimited deduction for charitable contributions.

Business taxable income is defined as gross income less the cost of business inputs, employees' wages and contributions to qualified retirement plans, and the cost of tangible personal and real property. For any taxable year, if aggregate business deductions exceed deductions then the business may carryover the excess deductions (plus interest) to the succeeding taxable year.

The Crane Proposal

H.R. 2313 in the 107th Congress. This proposal would repeal the corporate income tax, the individual income tax, the estate and gift tax, and replace these taxes with a flat rate tax of 10% on individuals' earned income. The first $10,000 in earned income would be exempt from taxation. This exemption level would be indexed for taxable years after December 31, 2001, for changes in the consumer price index. Earned income would be defined as the sum of wages, salaries, and other employee compensation; the amount of the taxpayer's net earnings from self-employment; and the amount of dividends that are from a personal service corporation or that are otherwise directly or indirectly compensation for services. Fringe benefits included in earned income would be valued at the cost to the employer. This proposal would establish an amnesty for all prior tax liability attributable to legal activities.

The Snowbarger Proposal

H.R. 2685 in the 105th Congress. Former Representative Snowbarger's proposal would allow each taxpayer to choose between the current individual income tax return and an alternative individual income tax return with a flat rate of 20% on taxable income (adjusted gross income minus the FAIR standard deduction). The FAIR standard deduction would equal the sum of the basic standard deduction plus the additional standard deduction.

The basic standard deduction would be

- $21,400 in the case of either a joint return or a surviving spouse;
- $14,000 in the case of a head of household;
- $10,700 in the case of an individual who is not married and who is not a surviving spouse or head of household, or who is a married individual filing a separate return.

The additional standard deduction would be

- $5,000 for each dependent.

In calculating the FAIR standard deduction, an individual's taxable income includes the taxable income of each dependent child who has not attained age 14 as of the close of the taxable year. The dollar amount relating to the FAIR deduction would be indexed to changes in the consumer price index (CPI).

A married couple must file a joint return in order to be able to select the flat alternative individual return. A three-fifths vote (super majority) of both Houses of Congress would be required to increase the tax rate, levy an additional tax rate, or reduce the FAIR deduction.

The Dorgan Proposal

S. 551 in the 107th Congress. Under this "Fair and Simple Shortcut Tax Plan," most employees would be allowed to provide employers with additional information on their W-4 (deduction) Form. For example, whether the employee is a homeowner. Single taxpayers earning up to $50,000 in annual wage income (and with nonwage income of up to $2,500) and married couples filing jointly with up to $100,000 in annual wage income (and with nonwage income of up to $5,000) could choose the "shortcut" tax plan. The employer would file the W-4 Forms with the federal government. The employer would compute family deductions, factor in a deductions for home mortgage interest and property taxes, and determine the amount of federal income tax to withhold by taking 15% of wages after deductions less the child care credit. Under this "shortcut" plan, the amount of tax withheld would equal the employee's tax liability, and consequently, the employee would not have to file a tax return. If the employee calculates that his tax liability would be less under the current income tax, he would still have the option of filling out and filing a tax return rather than paying tax under the "shortcut" plan. Senator Dorgan believes that up to 70 million taxpayers would be relieved from having to file a yearly federal individual income tax return.

Senator Dorgan's proposal would also make five other changes in the current tax code. First, the first $1 million in self-employment income would be exempt from the alternative minimum tax (AMT). Second, a taxpayer, who cannot use the shortcut method, would be allowed a tax credit for 50% of the costs (maximum of $200) of paying a preparer if the tax return is filed electronically. Third, during the first year to cover start- up costs, a business would be allowed a tax credit equal to the lesser of $1,000 or 50% of the costs of complying with the exact withholding option. Fourth, the marriage penalty would be reduced by making the standard deduction for married couples filing jointly double the amount available for single filers. Fifth, taxpayers would be offered a substantial incentive for savings and investment by exempting up to $500 of dividend and interest income for an individual and up to $1,000 for a couple.

LEGISLATION

H.R. 86 (English)

Simplified USA Tax Act of 2001. Replaces the individual income tax, the corporate income tax, and the estate and gift taxes with a border-adjustable business tax (subtraction-method VAT) and a progressive consumed-income tax. Individuals may utilize the equivalent of universal Roth IRAs to encourage savings. Introduced January 3, 2001; referred to House Committee on Ways.

H.R. 1040 (Armey)

Freedom and Fairness Restoration Act of 2001. Repeals the corporate income tax, the individual income tax, and the estate and gift tax; and replaces these taxes with a flat rate consumption tax of 17%. Introduced March 15, 2001; referred to the Committee on Ways and Means and the Committee on Rules.

H.R. 2313 (Crane)

Crane Tithe Tax Act of 2001. Repeals the individual income tax, the corporate income tax, and the estate and gift tax, and replaces these taxes with a flat rate tax of 10% on individuals' earned income. Provides for amnesty for all tax liability for prior years. Introduced June 26, 2001; referred to House Committee on Ways and Means.

H.R. 2525 (Linder)

Fair Tax Act of 2001. Repeals the individual income tax, the corporate income tax, all payroll taxes, the self-employment tax, and the estate and gift taxes and levies a 23% national retail sales tax as a replacement. Every family would receive a rebate of the sales tax on spending up to the federal poverty level (plus an extra amount to prevent any marriage penalty). Introduced July 17, 2001; referred to the House Committee on Ways and Means.

H.R. 2717 (Tauzin)

Individual Tax Freedom Act of 2001. Effective July 1, 2003, levies a 15% national retail sales tax as a replacement for the individual and corporate income taxes, the estate and gift taxes, and certain excise taxes. This national retail sales tax would be administered primarily by the states. Introduced August 2, 2001; referred to the House Committee on Ways and Means and the House Rules Committee.

H.R. 4716 (DeMint)

Date Certain Tax Code Replacement Act. Establishes within the legislative branch a National Commission on Tax Reform and Simplification that shall review and and submit to Congress a report on (1) the present structure and provisions of the Internal Revenue Code; (2) whether tax systems imposed under the laws of other countries could provide more efficient, simple, and fair methods of funding the revenue requirements of the government; (3) whether the income tax should be replaced with a tax imposed in a different manner or on a different base; and (4) whether the Internal Revenue Code can be simplified, absent wholesale restructuring or replacement. Authorizes appropriations for the Commission. Any new federal tax system would require approval by Congress no later than July 4, 2005. If a new federal tax system is not approved by July 4, 2005, then Congress would be required to vote to reauthorize the Internal Revenue Code of 1986. Introduced May 14, 2002; referred to the House Committee on Ways and Means.

S. 551 (Dorgan)

Fair and Simple Shortcut Tax Plan. Amends the Internal Revenue Code of 1986 to simplify the individual income tax by providing an election for eligible individuals to only be subject to a 15% tax on wage income with a tax return free filing system. Introduced March 15, 2001; referred to the Committee on Finance.

S. 1040 (Shelby)

Freedom and Fairness Restoration Act of 2001. Repeals the corporate income tax, the individual income tax, and the estate and gift tax; and replaces these taxes with a flat rate consumption tax of 17%. Introduced June 14, 2001; referred to the Committee on Finance.

For Additional Reading

CRS Products

CRS Report RL30351. *Consumption Taxes and the Level and Composition of Saving*, by Steven Maguire.

CRS Report 98-248. *A Federal Tax on Consumed Income: Background and Analysis*, by Gregg A. Esenwein.

CRS Report 98-529. *Flat Tax: An Overview of Selected Policy Issues Relevant to the Hall-Rabushka Proposal*, by James M. Bickley.

CRS Report 95-1141. *The Flat Tax and Other Proposals: Who Will Bear the Tax Burden?* by Jane G. Gravelle.

CRS Report 96-315. *The Flat Tax and Other Reform Proposals: Overview of the Issues*, by Gregg A. Esenwein and Jane G. Gravelle.

CRS Report 98-901. *Short-run Macroeconomic Effects of Fundamental Tax Reform*, by Thomas G. Woodward and Jane G. Gravelle.

CRS Issue Brief IB91078. *Value-added Tax as a New Revenue Source*, by James M. Bickley.

CRS Issue Brief IB92069. *A Value-added Tax Contrasted with a National Sales Tax*, by James M. Bickley.