

100 Million Unnecessary Returns

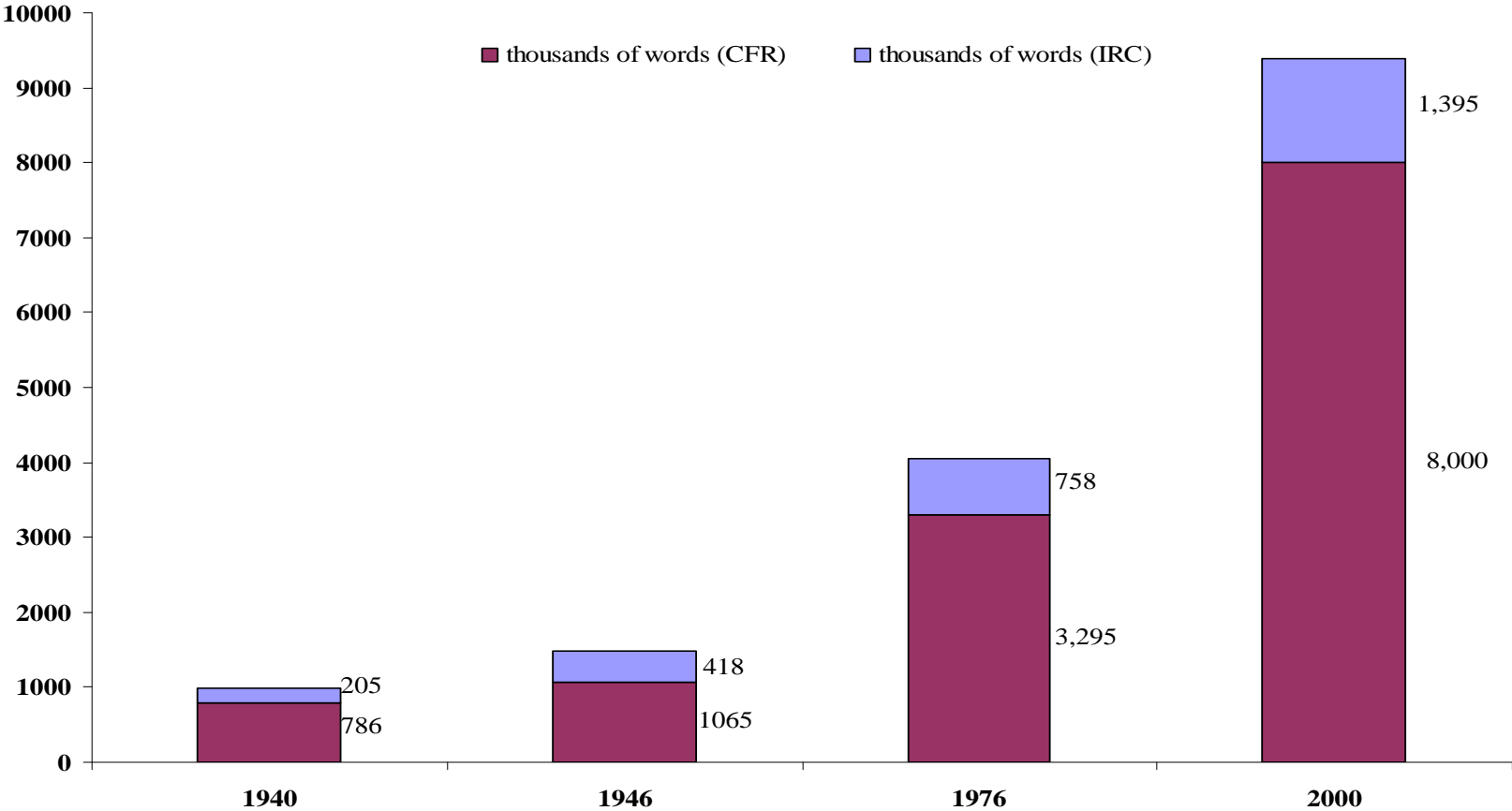
A Simple, Fair, and
Competitive Tax Plan
for the United States

Michael J. Graetz



The Ever-Growing Complexity of the Income Tax: Growth of the Code and Regulations over Time

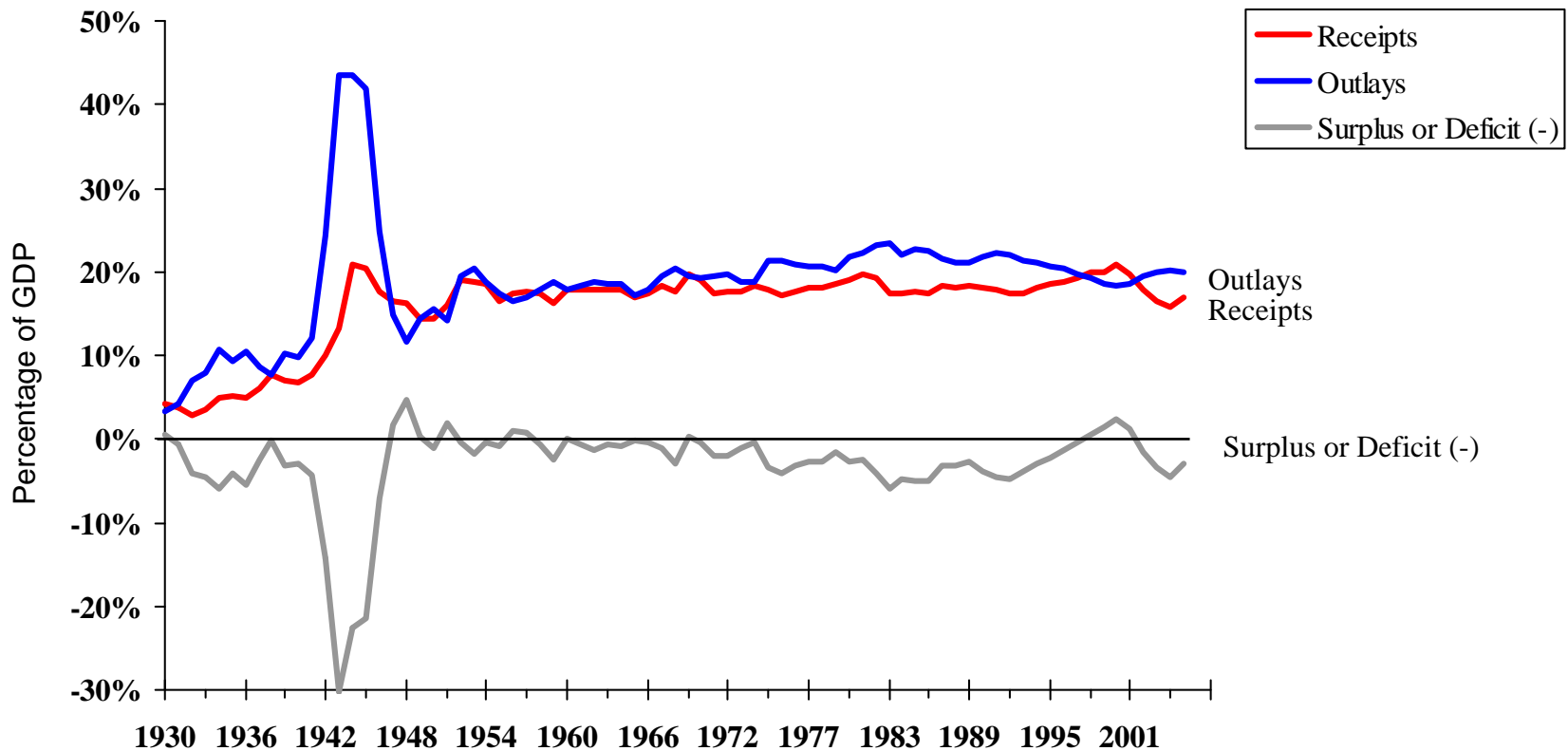
Approximate Words in the Internal Revenue Code and Regulations



Source: Prof. Michael J. Graetz, Yale Law School. Calculations based on U.S.C. (1940, CCH 1952) and C.F.R. (1940, 1949) and Tax Foundation calculations, based on West's Internal Revenue Code and Federal Tax Regulations (1975), Study of the Overall State of the Federal Tax System, 4 (2001).

Money in, Money Out – Overview: Federal Receipts and Expenditures over Time

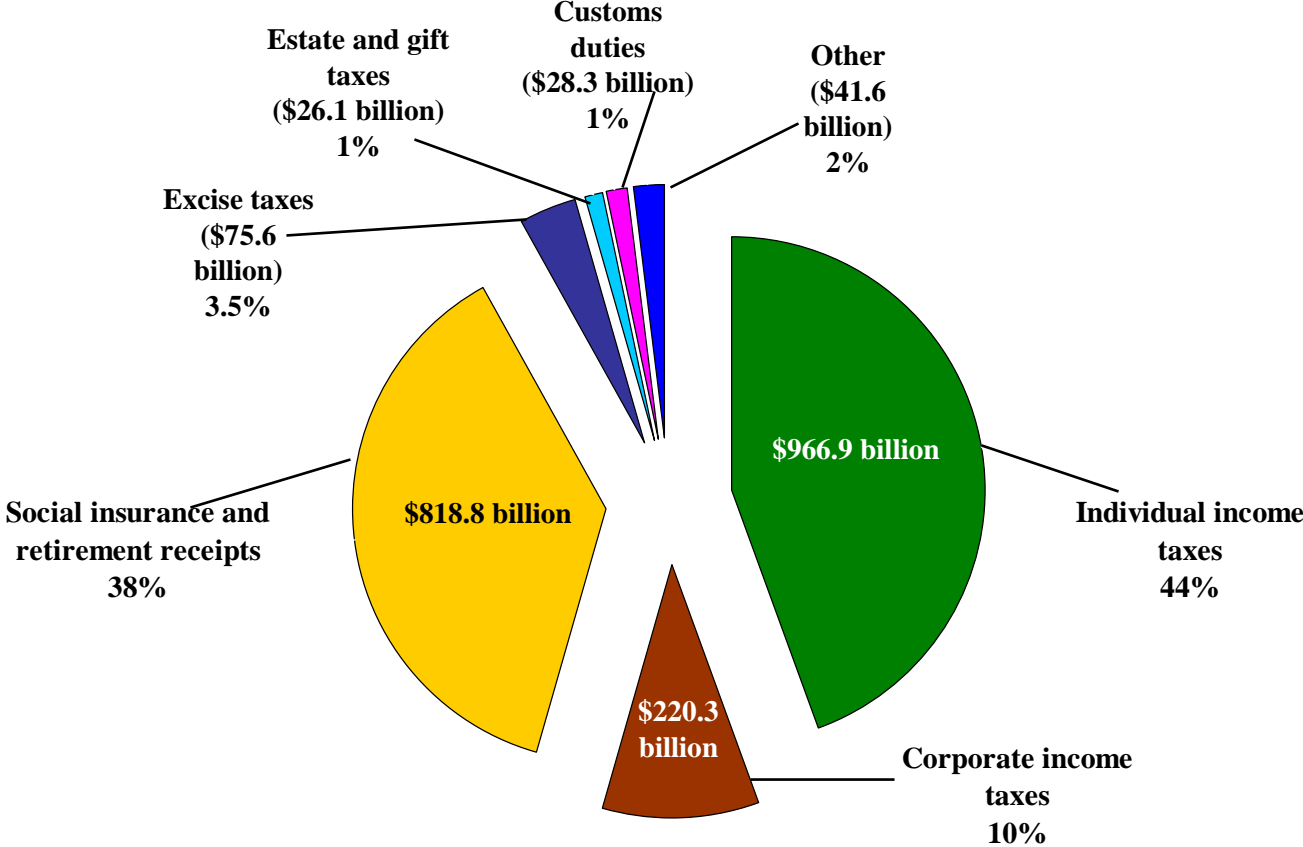
Federal receipts, outlays, and surpluses or deficits as a percent of GDP: 1930-2005



Source: Office of Management and Budget, Budget for Fiscal Year 2006, Historical Tables 23-24 tbl. 1.2.

Money In: Today's Federal Revenues and Their Sources

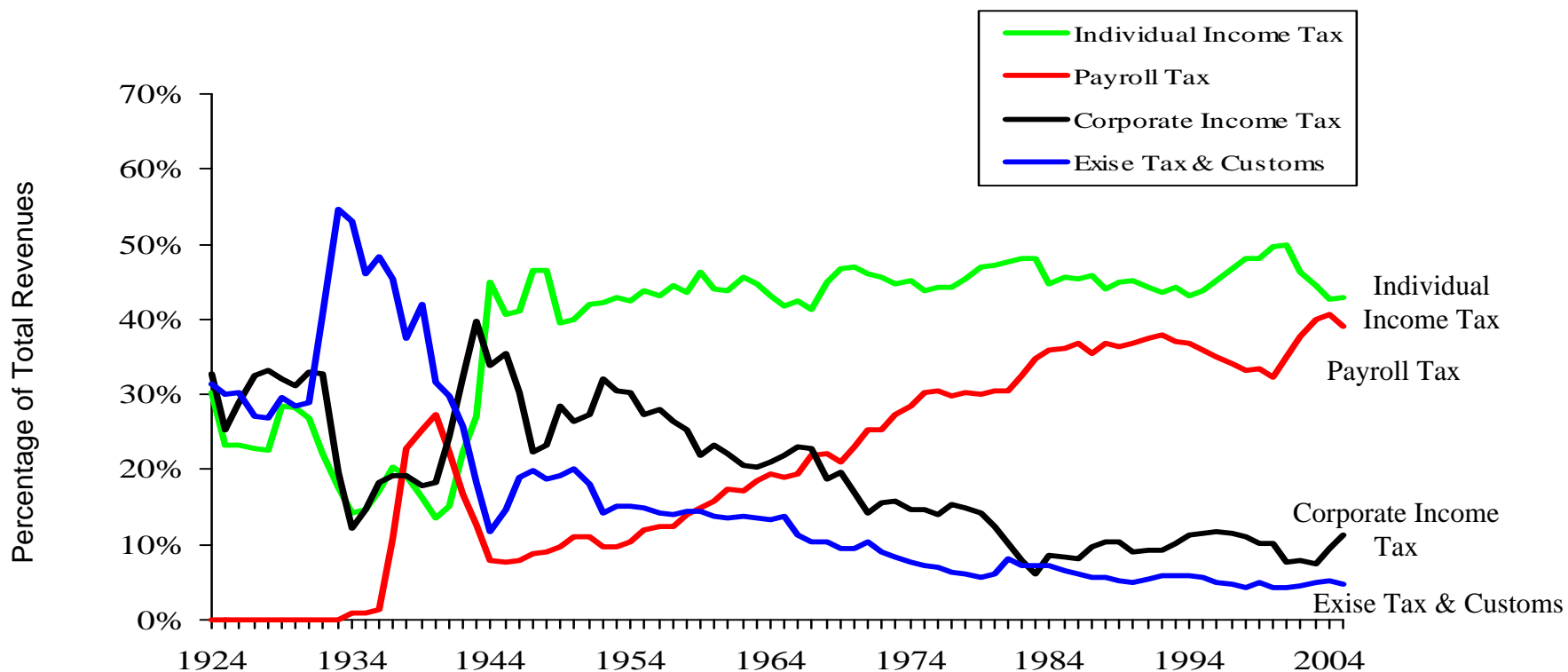
FY 2006 Budget (\$2.18 Trillion in Projected Receipts)



Source: Office of Management and Budget, Budget for Fiscal Year 2006.

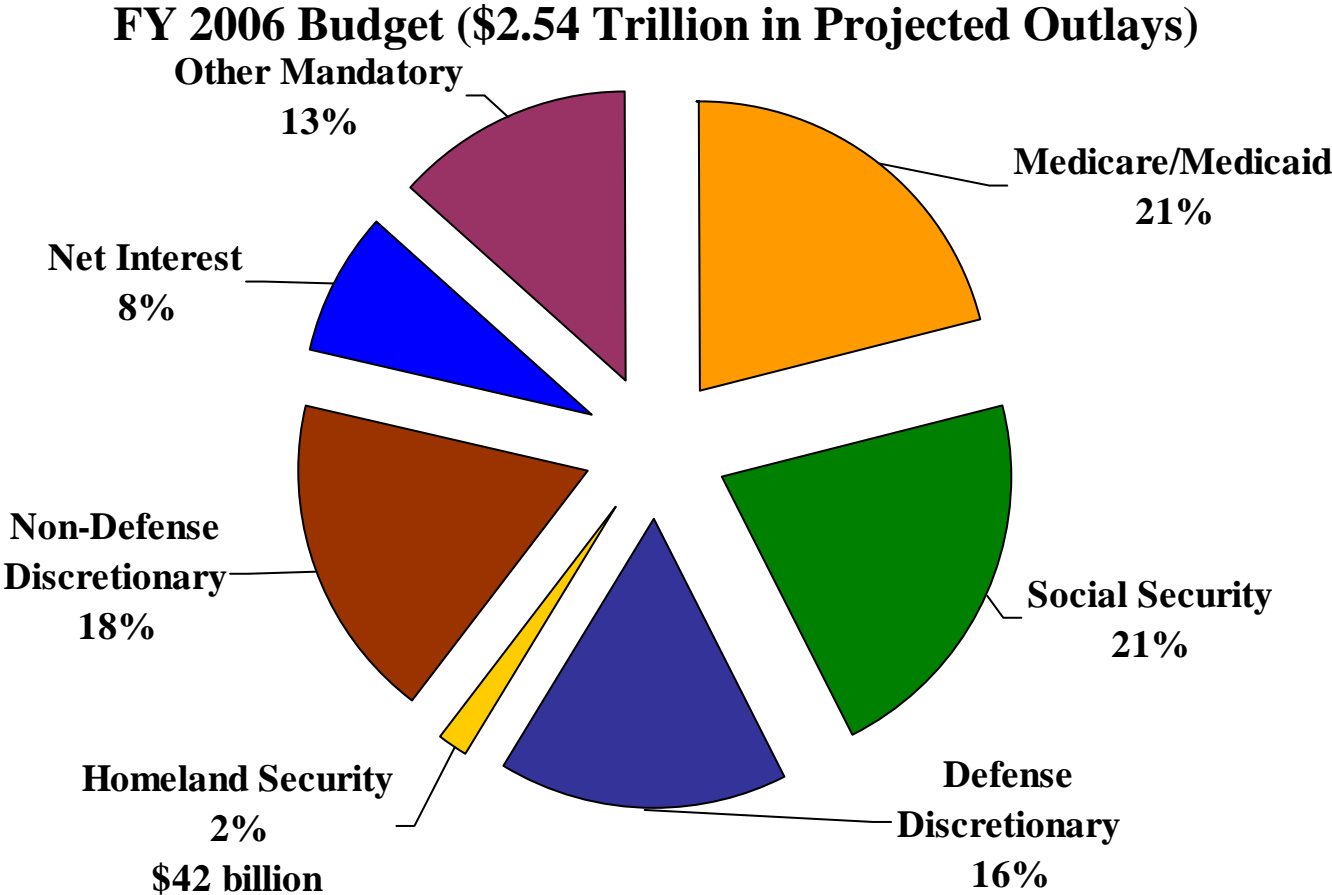
Money In: Federal Tax Receipts by Source

Federal receipts by source, as a percentage of total revenue: 1924-2004



Source: Office of Management and Budget, Budget for Fiscal Year 2006, Historical Tables 31-32 tbl. 2.3, 44-45 tbl. 2.5.

Money Out: Today's Federal Government - An Insurance Company with an Army

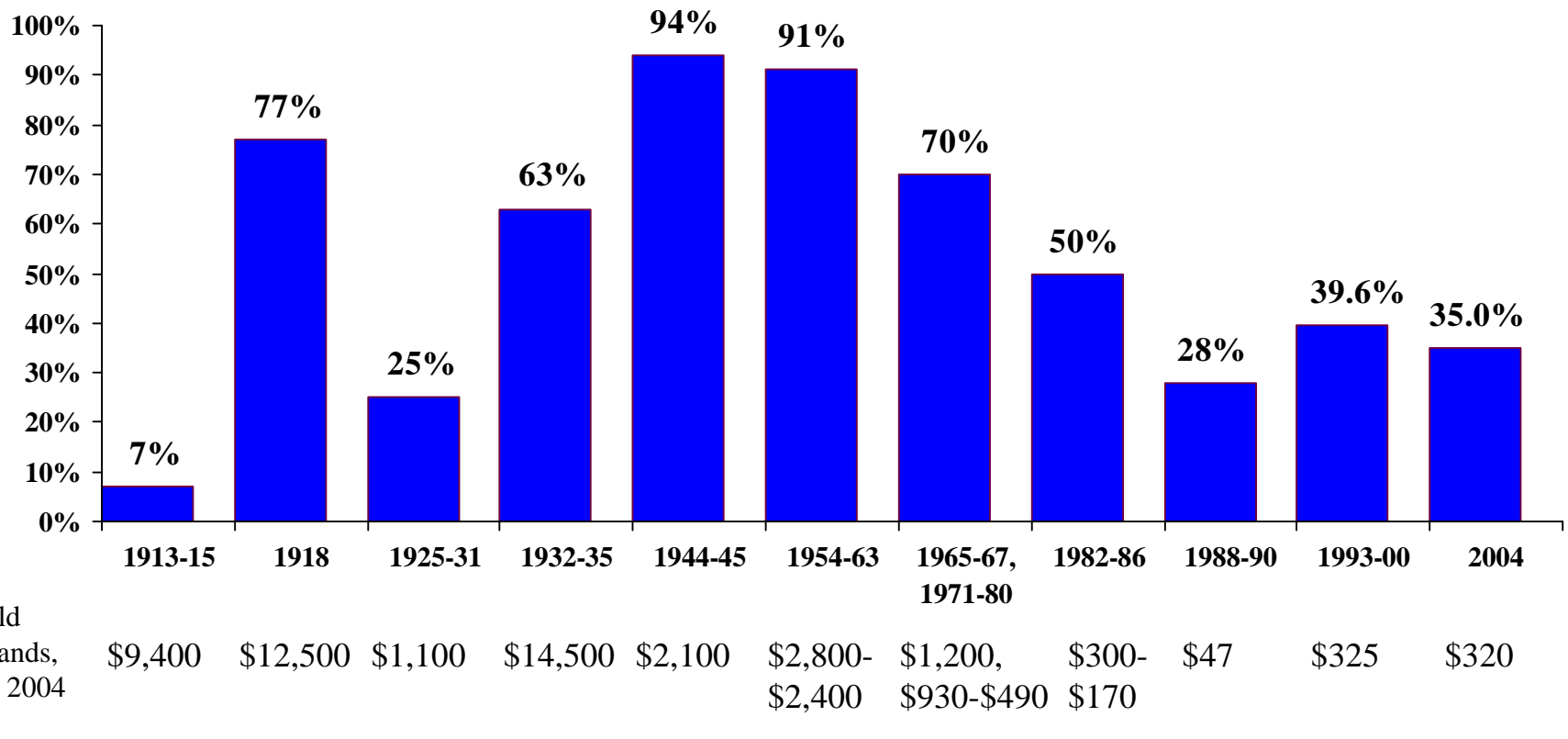


Note: "Other mandatory" includes various education and training programs, federal employee retirement and disability, unemployment compensation, food and nutrition assistance, supplemental security income, the earned income tax credit, payments to states for foster care/adoption assistance, housing assistance, and other federal programs. Medicare/Medicaid outlays include federal spending on the state children's health insurance fund.

Source: Office of Management and Budget, Budget for Fiscal Year 2006.

Top Marginal Individual Income Tax Rates for Selected Periods

Top U.S. marginal individual income tax rates and top bracket thresholds in selected years between 1913 and 2003

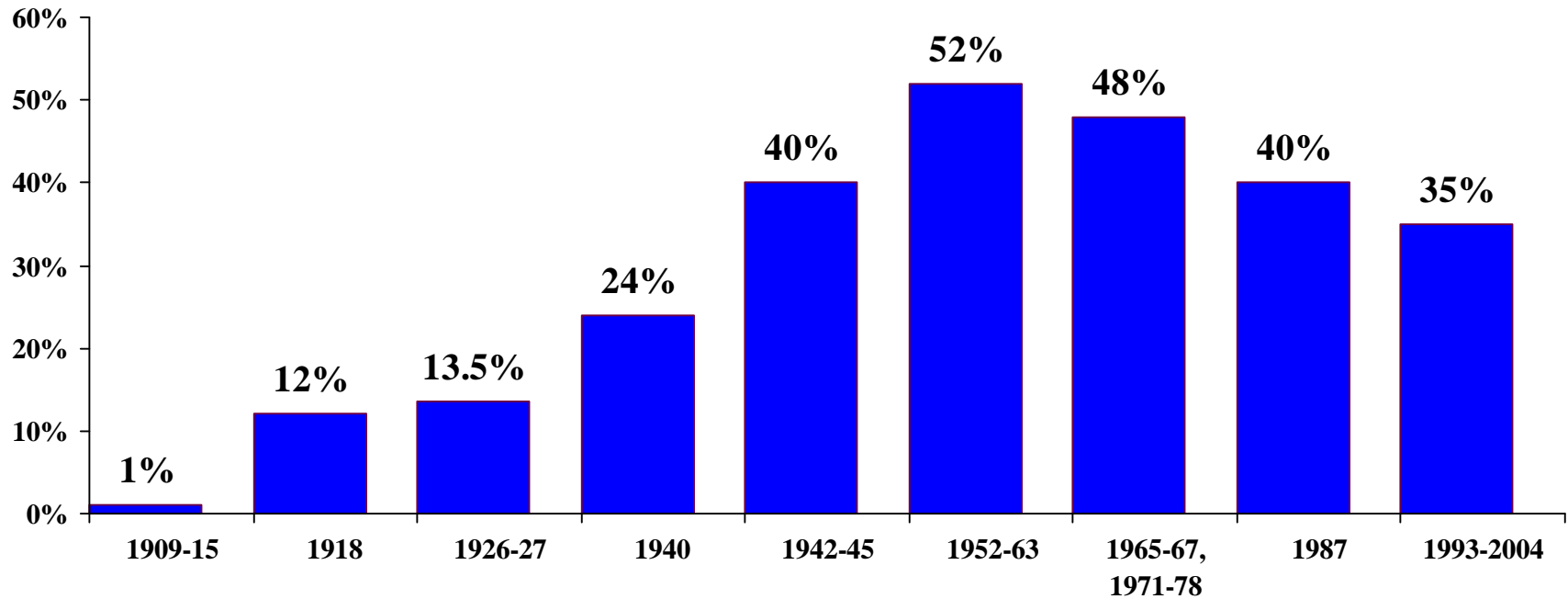


Note: The top marginal rate in 1929 was 24%. For 1988-1990, some taxpayers faced a 33% marginal tax rate in an income bracket below the one cited for the 28% rate. However, the marginal rate returned to 28% above this 33% bracket, so that for all sufficiently high incomes, 28% was the marginal rate. Range in top bracket threshold for 1954-63, 1965-1967, and 1971-78 due principally to inflation. Range in top bracket threshold for 1982-1986 due principally to legislative changes in top bracket threshold.

Source: IRS, Statistics of Income Bulletin app. A (Winter 2002-2003).

Top Marginal Corporate Income Tax Rates for Selected Periods

Top U.S. corporate tax rates in selected years between 1909 and 2004



Note: In 1940, 1942-45, 1987, and 1993-2002, some corporate taxpayers in income ranges below the highest bracket faced a higher tax rate than the rates represented above.

Source: IRS, Statistics of Income Bulletin 287-90 tbl. 1 (Fall 2003).

Highest Rates of Income Tax: U.S. and Selected Trading Partners

Personal Income Tax Rates

Country	Rate	Threshold in \$ (using PPP*)
Germany	51.2%	\$ 59,214
Japan	47.1%	\$ 159,730
Canada	46.4%	\$ 85,991
Italy	46.1%	\$ 93,769
United States	41.4%	\$ 319,749
United Kingdom	40.0%	\$ 55,081
France	37.9%	\$ 85,779

Corporate Income Tax Rates

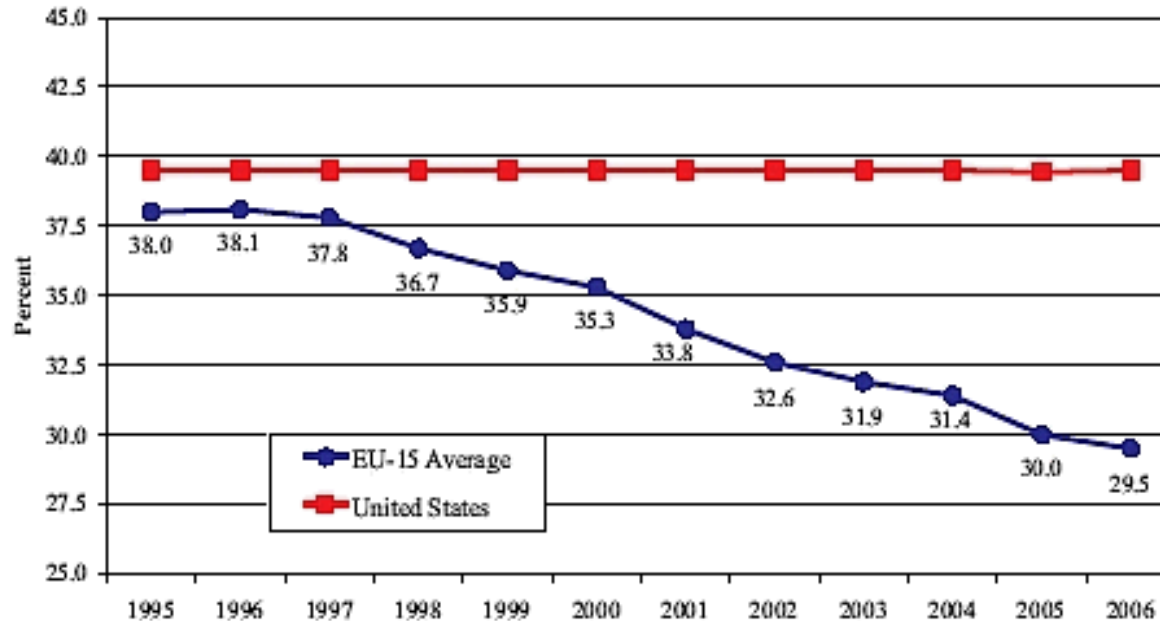
Country	Rate
Japan	40%
United States	39.4%
Germany	39%
Canada	36%
France	35%
Italy	33%
United Kingdom	30.0%

*Purchasing Power Parity

Note: 2003 data. All rates include the rates of sub-central governments. The individual income threshold is the amount of earnings at which the reported combined top marginal rate is first observed. Germany's corporate income tax rates include the regional trade tax and the surcharge while Italy's rates do not include the regional business tax. Since 2003, Germany has moved to lower its corporate tax rate. Ireland's corporate tax rate in 2003 was 12.5%.

Source: OECD Tax Database, tbls. I4, I5.

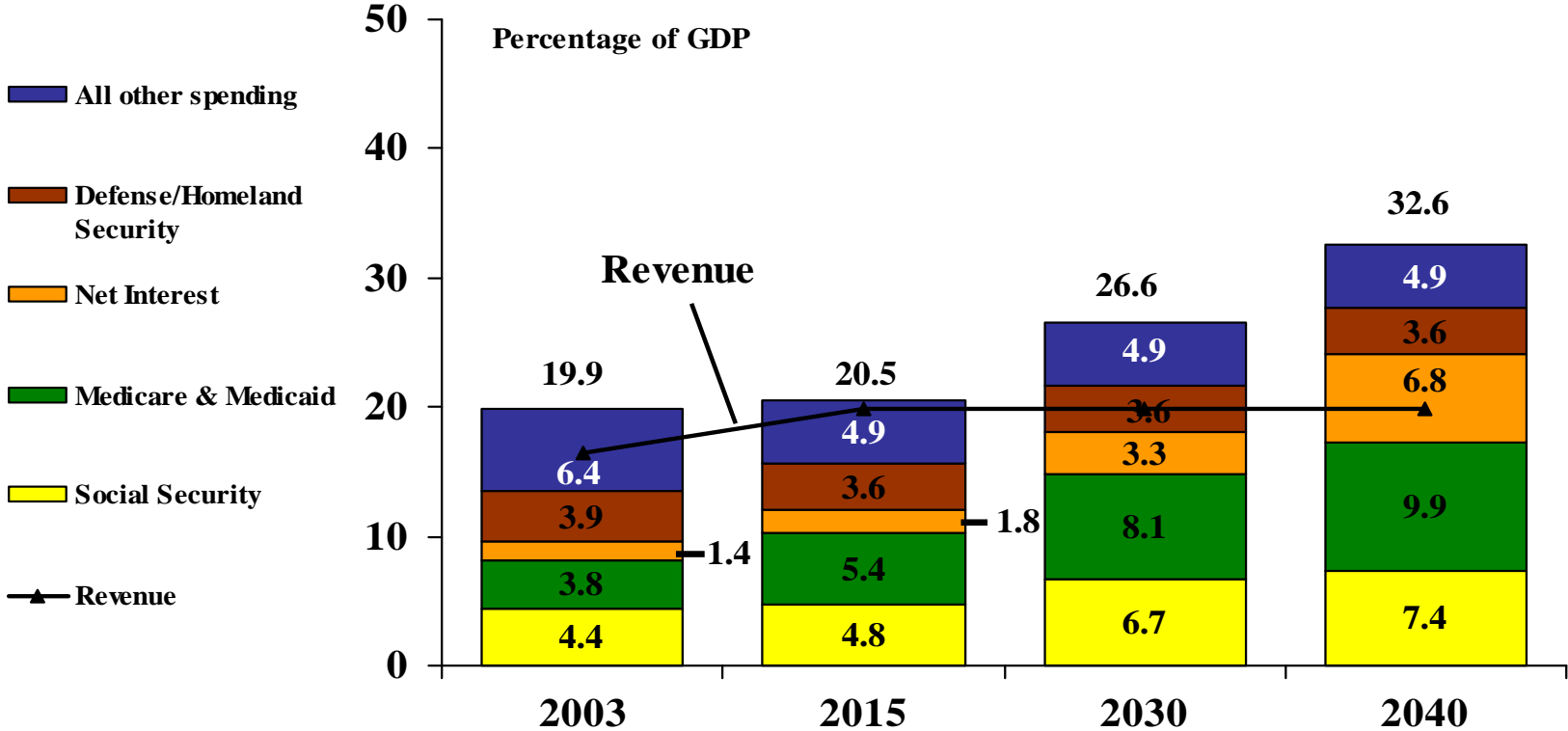
Statutory Tax Rates 1995-2006



Source: Simple average EU rates are directly from European Commission, Directorate-General, Taxation and Customs Union, *Structures of the Taxation System in the European Union, 2006 Edition, Data 1995-2004, Table 11-5 1, "Top Statutory Tax Rate on Corporate Income."* The U.S. rate is the top U.S. statutory rate of 35%, plus an average state statutory rate of 4.5%, as described in "On Corporate Tax Reform, Europe Surpasses the U.S." *Tax Notes*, May 29, 2006, p. 992, *Doc 2006-10099* [\[PDF\]](#), or 2006 *TNT 103-5*.

The Long Term Fiscal Outlook: Projecting Beyond the Budget Window

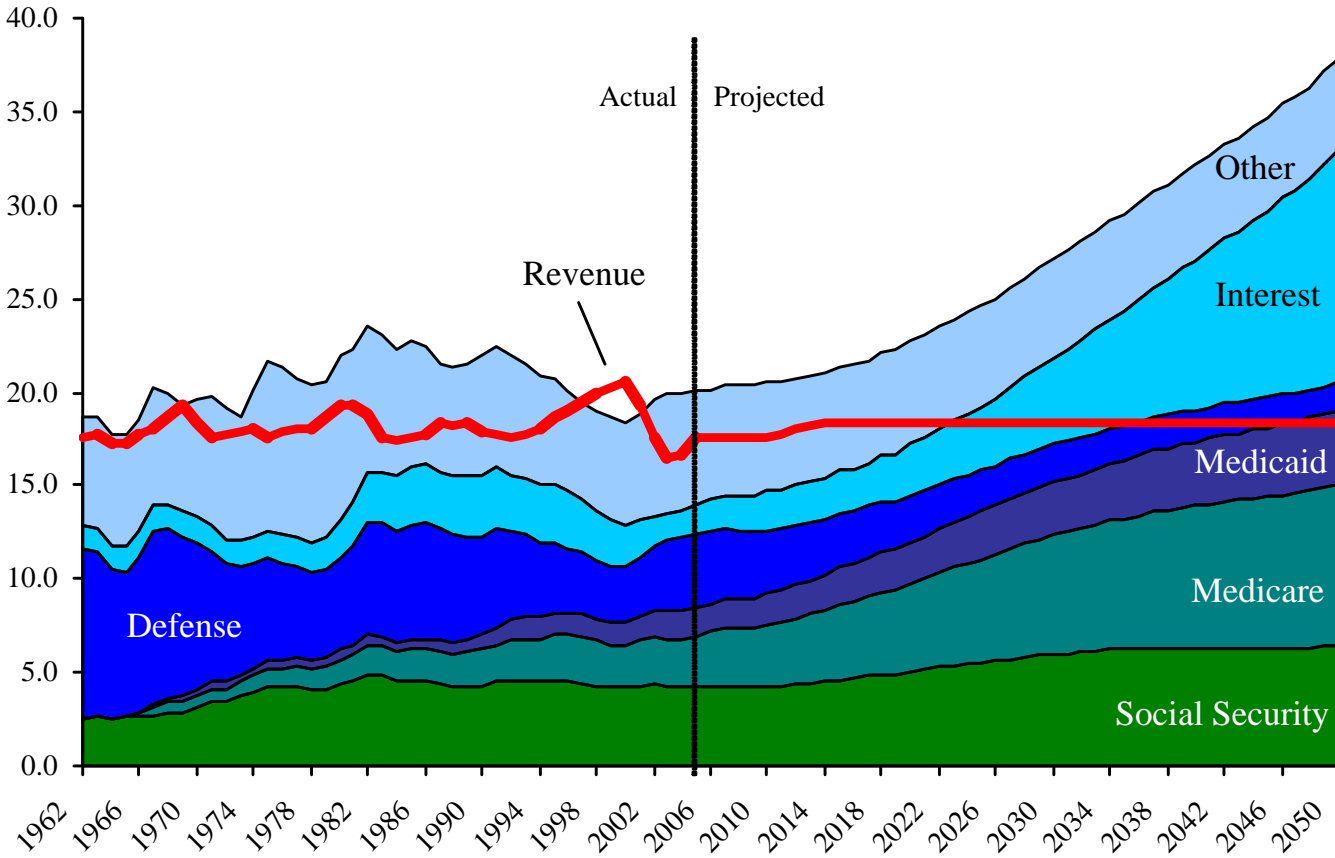
Composition of federal spending as a share of GDP, assuming discretionary spending grows with inflation until 2014 and with GDP thereafter, and all tax cut provisions expire (GAO Analysis)



Note: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant at 19.8%.

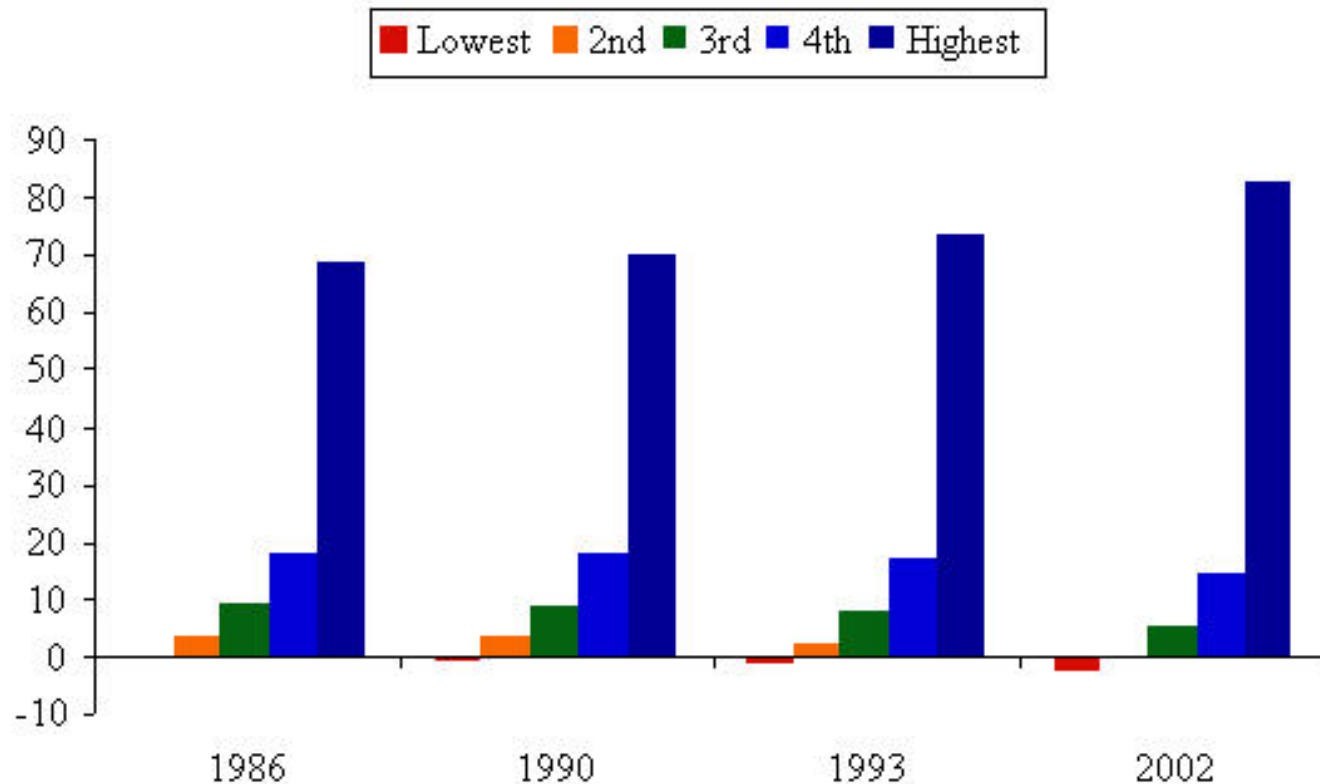
Source: GAO's baseline extended simulation as of Sept. 2004 available at <http://www.gao.gov/special.pubs/longterm/dgdps.pdf>.

The Long Term Fiscal Outlook: Social Security, Medicare and Medicaid Spending as a Percent of GDP over Time



Note: Reflects CBO’s intermediate-spending trajectory, which assumes that spending per Medicare enrollee, grows one percentage point faster than per capita GDP (compared to 2.9% today); that defense spending gradually returns to its historical real level, and that non-defense discretionary spending and other mandatory spending remain at their historical levels as a share of GDP. *Source:* Congressional Budget Office (CBO), The Long-Term Budget Outlook (Dec. 2005).

Who Pays: Percentage Share of Income Tax Liability by Quintile



Source: Computed using Internal Revenue Service statistics, available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=98123,00.html>.

Who Pays: Distribution of Federal Income Tax Burden, 2006, by Income Percentile

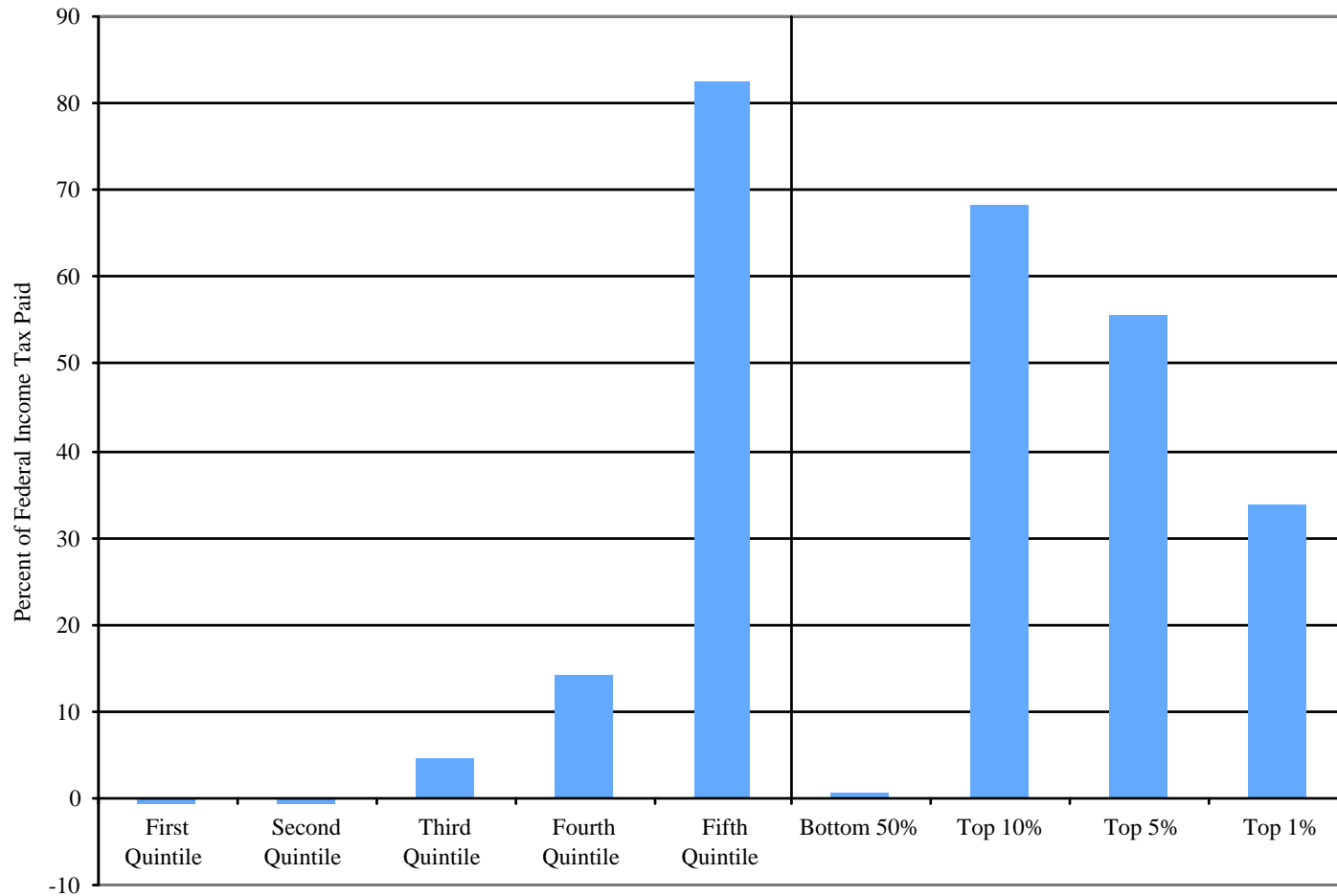
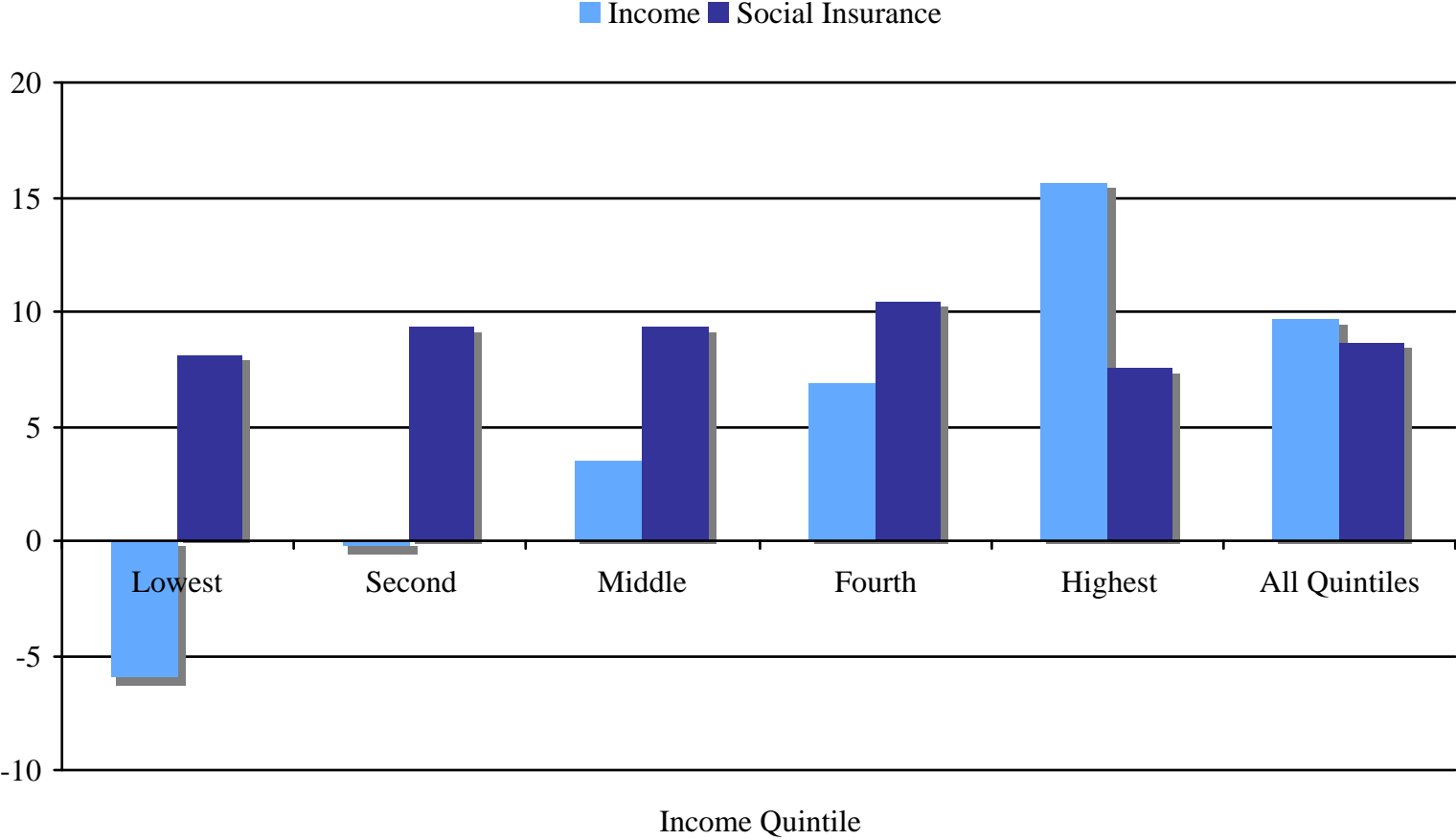


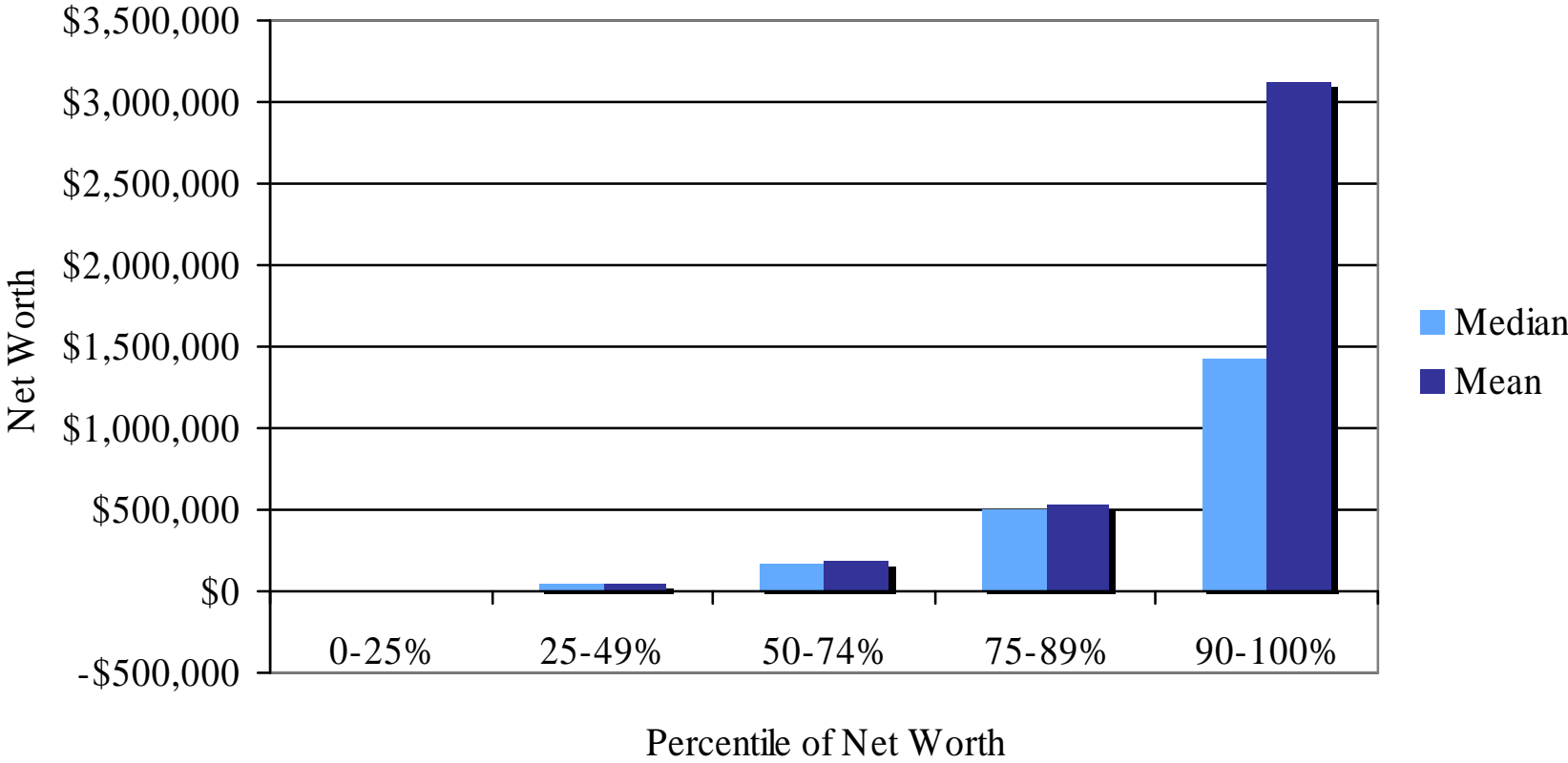
Chart Source: President's Tax Reform Panel, Figure A.1. 2006 mean household income in dollars by quintile: 1st 11,352; 2nd 28,777; 3rd 48,223; 4th 76,329; 5th 168,170. Source: United States Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States, 2006, Table A-3.

Who Pays: Effective Federal Individual and Social Insurance Tax Rates, 2002



Source: Congressional Budget Office, "Historical Effective Federal Tax Rates: 1979 to 2002" (2005).

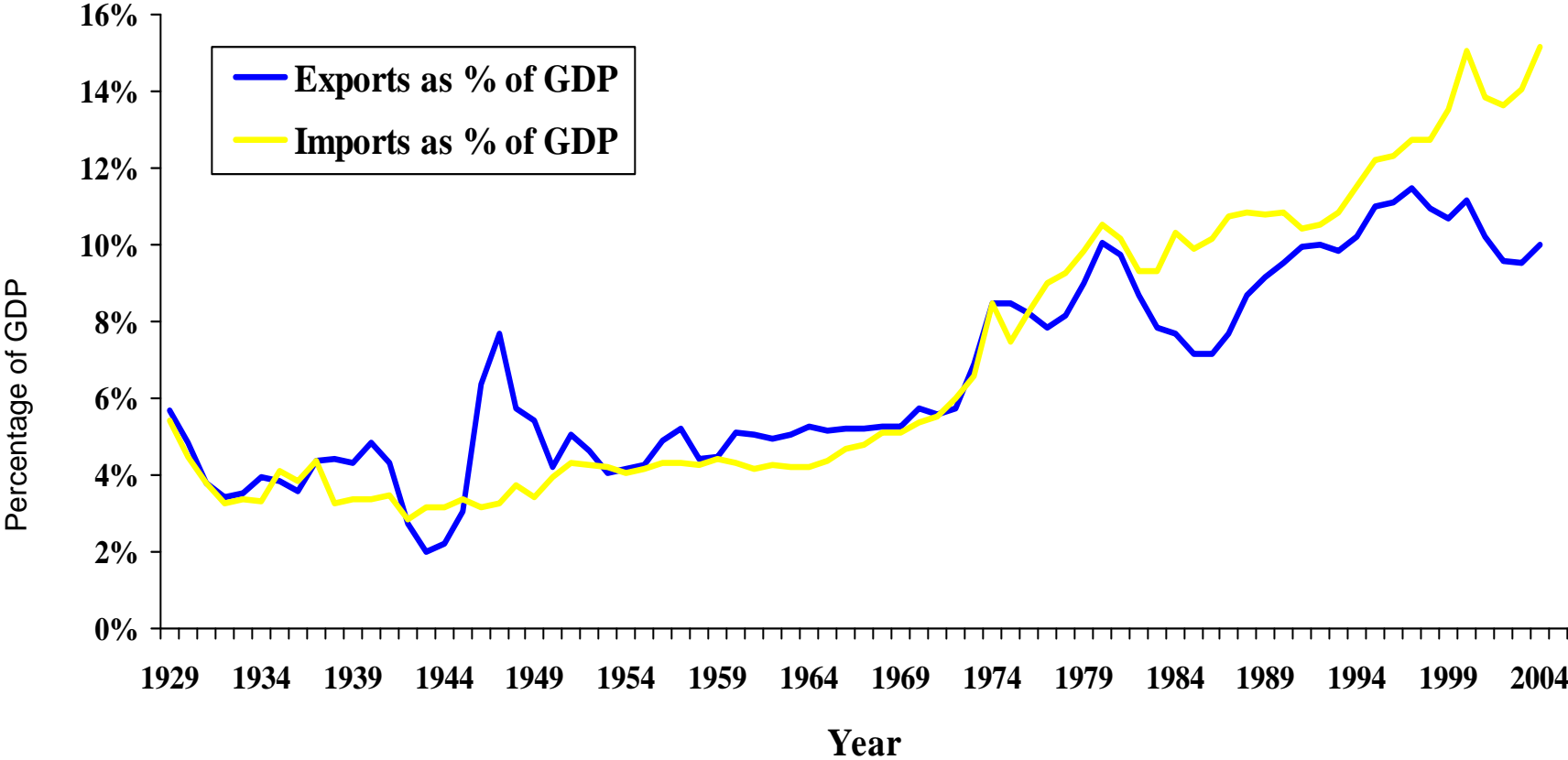
Who Owns Assets: Net Worth by Percentile, 2004



Source: Federal Reserve Board Survey of Consumer Finances, 2004.

Global Trade: U.S. Imports and Exports over Time

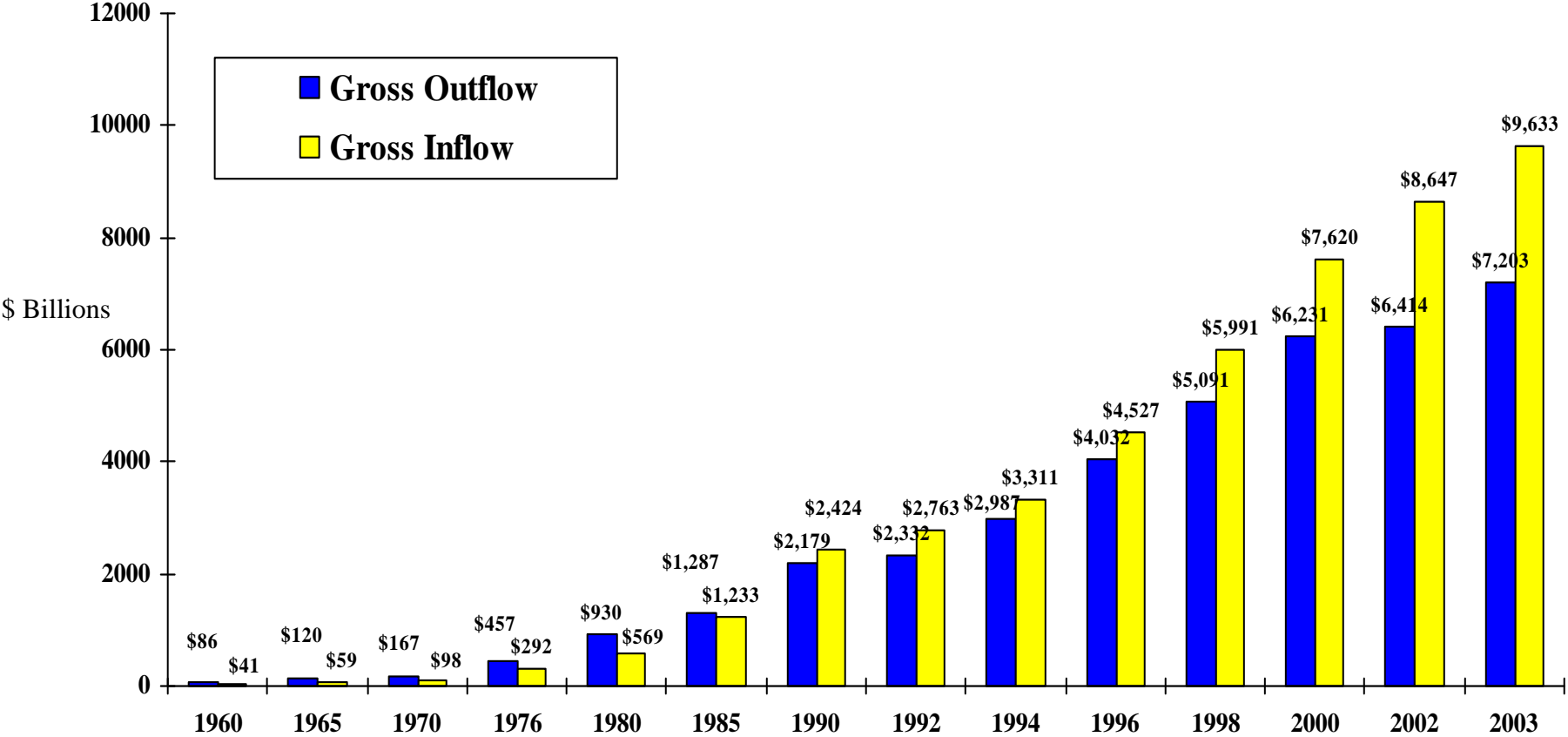
Global Trade: U.S. imports and exports as a percentage of gross domestic product: 1929-2004



Source: U.S. Department of Treasury, Bureau of Economic Analysis, National Economic Accounts, National Income and Product Accounts tbl. 1.1.5 Gross Domestic Product (last revised on January 28, 2005).

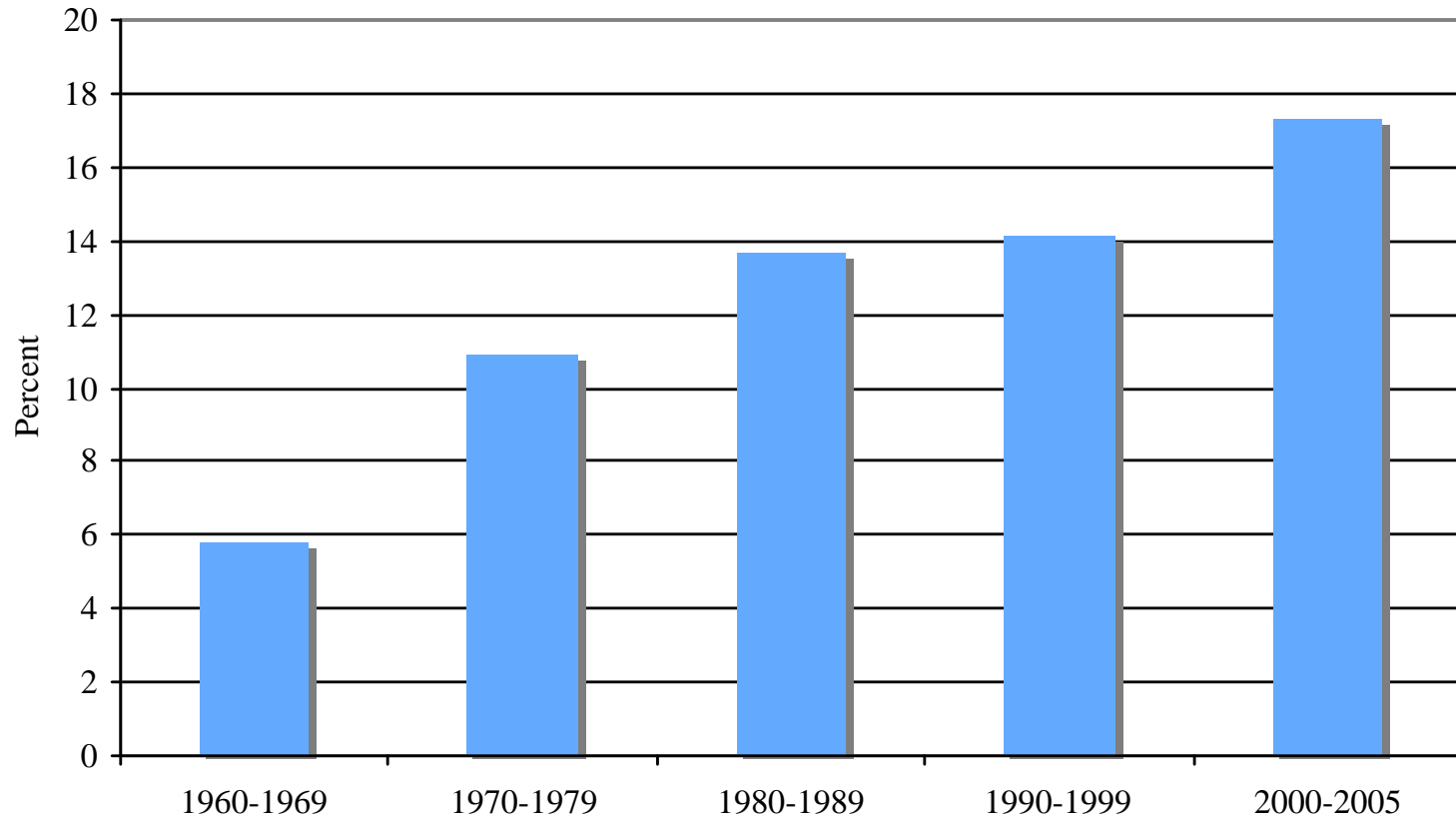
Globalization: Investment Flows into and out of the U.S. over Time

U.S.-owned assets abroad and foreign-owned assets in the U.S. using current-cost accounting method



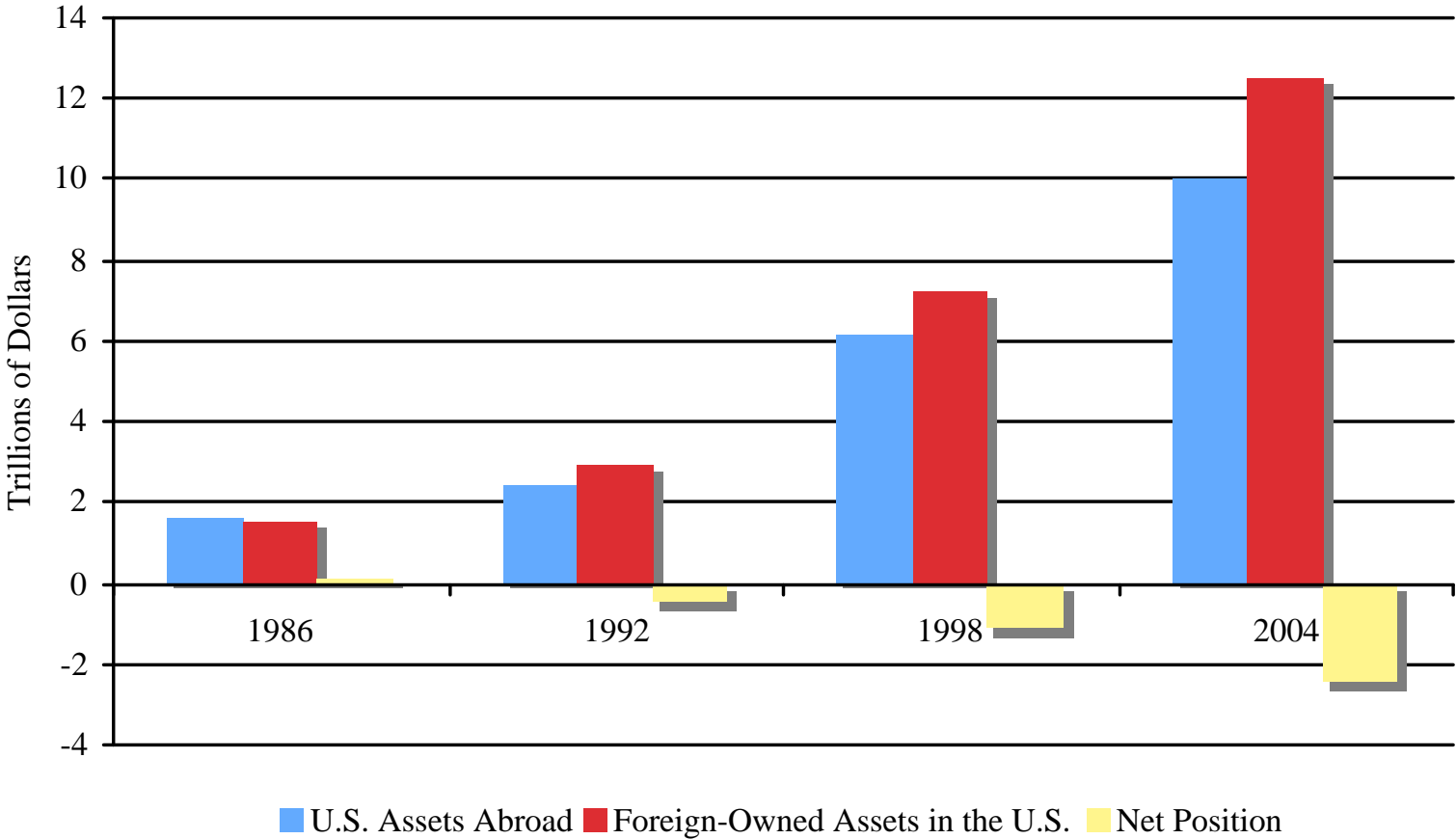
Source: U.S. Department of Commerce, Bureau of Economic Analysis, data available at <http://www.bea.gov/beatdi/home/iip.htm>; Survey of Current Business, October 1972, Volume 52, Number 10, "The International Investment Position of the United States: Developments in 1971" by Russell Scholl.

Globalization: Share of U.S. Corporate Profits from Foreign Sources



Source: PricewaterhouseCoopers, "United States in the World Economy: 1960-2005", on file with author.

Globalization: U.S. International Investment Position

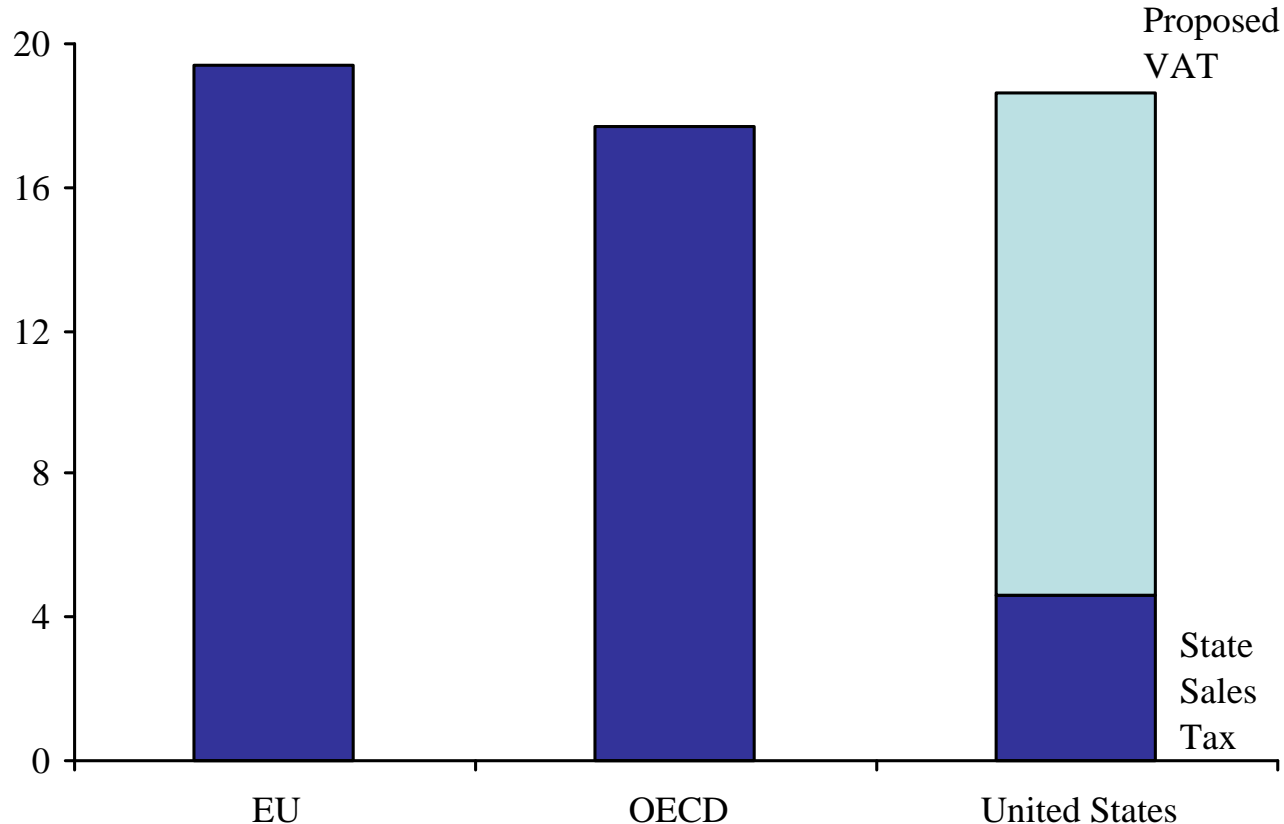


Source: U.S. Bureau of Economic Analysis.

The Proposal: Four Essential Pieces

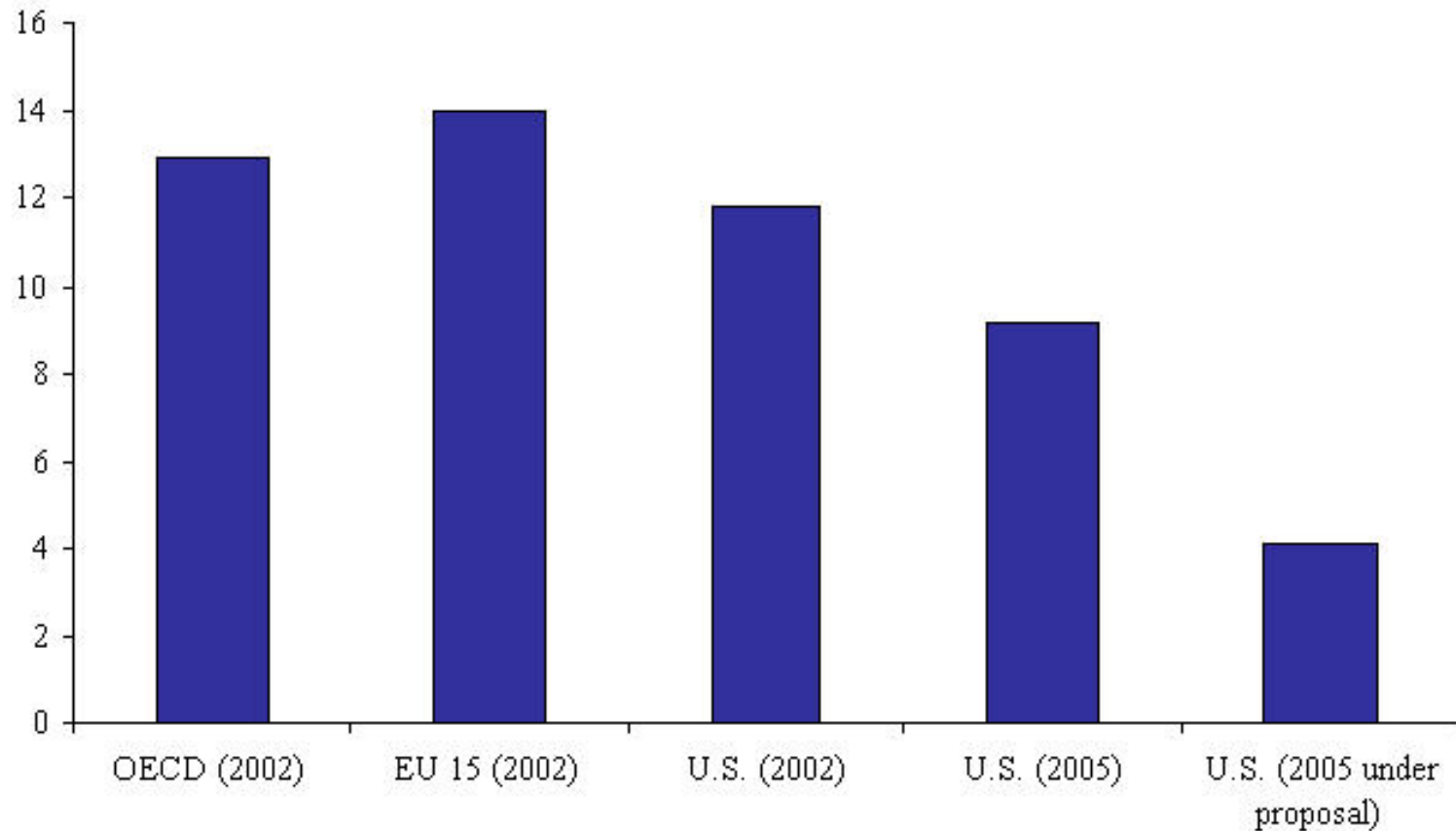
- Enact a Value Added Tax at a 10-14% Rate
- Exempt the first \$100,000 of family income and lower the individual income tax rate to 25%
- Lower the corporate income tax rate to 15%
- Replace the EITC and give families VAT tax relief through payroll tax offsets and smart cards

The Proposal: Consumption (VAT) Tax Rates in the EU, OECD members, and U.S.: 2000 (unweighted rate averages)



Source: Consumption Tax Trends 2001 (OECD) Table 3.5; U.S. computations based on data from <http://salestaxinstitute.com> (visited 12/01/2006).

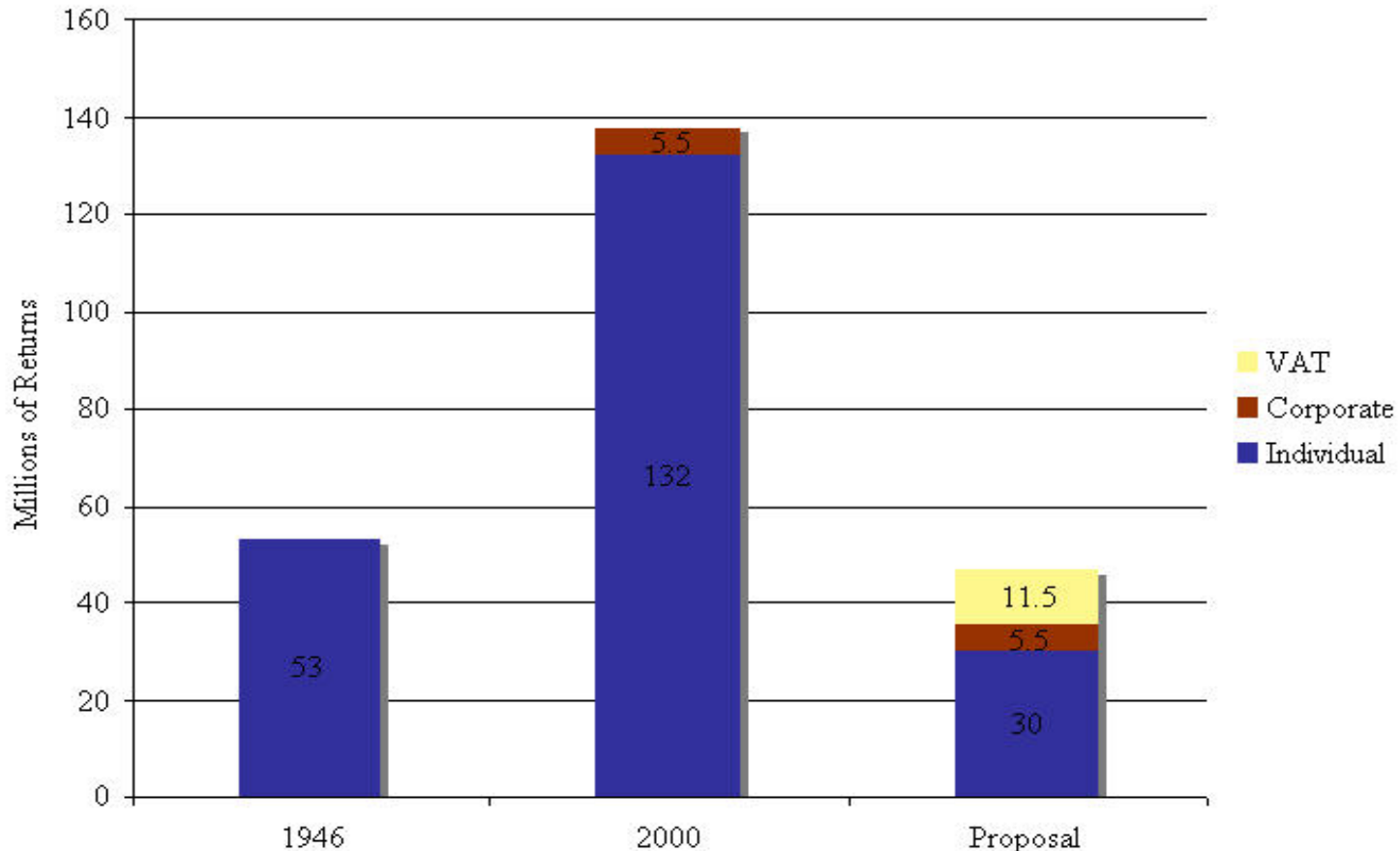
The Proposal: Income Tax Revenue as a Percentage of GDP



Source: OECD Revenue Statistics (2004, release 1); U.S. figures for 2005 are author's estimates.

Note: OECD reports U.S. revenue for 2003 as 10.9% of GDP.

The Proposal: Number of Income Tax Returns Under Current Law and the Proposed Competitive Tax Plan



Note: GAO has estimated that an exemption for small businesses with gross receipts of \$100,000 or less would reduce the required number of VAT returns from 25 million to 9 million. We assume here that such a small business exemption would be included in a VAT and show 11.5 million VAT returns filed, since some small businesses will opt into the VAT to obtain refunds and to account for growth since the GAO report was published. VAT Administrative Costs, GAO/GGD-93-78 (1993) at 62.

Sources: 1946 - Statistical Abstract of the United States (1956); 2004 - Internal Revenue Service Statistics of Income Bulletin (2004); Proposal - Treasury estimates (individual), author estimate (corporate, and updated GAO estimate (VAT).

Key Advantages of the Competitive Tax Plan

Elimination of 100 million of 135 million income tax returns would reduce compliance and administration costs and counteract cynicism generated by income tax complexity.

The new tax system would encourage saving and investment in the United States, stimulating economic growth and creating additional jobs for American workers.

The 15-20% corporate income tax rate would be among the lowest in the world and would mitigate many of the most vexing issues of international tax policy.

Key Advantages of the Competitive Tax Plan

This plan avoids the difficult issues of transition to an entirely new system that have haunted other proposals to move away from the income tax.

With far fewer income tax filers and an administrable VAT, this system would reduce the IRS workload so that it can do its job.

With few Americans filing tax returns, there will be less temptation for political tinkering with the tax system.

By combining taxes commonly used throughout the world, this system facilitates international coordination and fits well within existing international tax and trade agreements