

## The Alternative Maximum Tax

By STEPHEN MOORE

The vast majority of taxpayers and economists agree that a simple flat-rate tax system would be vastly superior to the 5.5-million-word Internal Revenue Code we tolerate today. Yet the political obstacles to common-sense simplification have so far proved insurmountable.

The flat tax has lost some of its appeal with voters for two reasons. First, although most Americans are hugely attracted to the concept of a flat tax that could be calculated on a postcard, they are not enthusiastic about parting with such sacred-cow deductions as those for mortgage interest, charitable donations and health benefits. Special-interest groups with a stake in preserving the current system—from H&R Block to the housing and insurance industries to Wall Street's municipal bond traders to Washington lobbyists who make their living chiseling out tax shelters—have persuaded voters to stick with the devil they know.

### Economic Boost

Second, although the flat tax would greatly boost the overall economy, it would still create winners and losers. Some industries—such as high-technology companies and start-up firms—would do exceptionally well under the flat tax. But others, such as life-insurance companies, banks and accounting firms, might get hurt in the short term. Similarly, some taxpayers would pay less tax; others, with large deductions, would owe more. Any policy proposal that creates large identifiable losers is poison in Washington.

Fortunately, these objections to the flat tax can be very easily trumped with one small addition: What's missing from the flat tax is the right to choose. Why not allow every taxpayer to choose between the current income tax system and an alternative maximum tax—call it the Maxtax—with a flat rate of 25% of gross income? Only one deduction would be permitted under the Maxtax: a credit for the payroll tax paid—7.65% for a salaried worker and 15.3% for a self-employed worker. Corporations could also bypass the Byzantine corporate income tax laws and pay a 25%

maximum tax on their gross income with a credit for any payroll tax paid.

The Maxtax has several advantages over other current tax-reform proposals. First, unlike the flat tax, the Maxtax would not require complex transition rules or costly phase-outs of current deductions. Rather, Congress could implement the Maxtax immediately with an amendment tacked on to the end of the 9,000-page Internal Revenue Code: "Any individual or business has the option of bypassing all

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the preceding requirements, regulations and instructions and instead paying a tax of 25% of gross income earned during the year, minus a tax credit for any payroll tax paid." This single sentence is all that is required for a truly revolutionary simplification of America's income tax system.

Unlike the flat tax, the alternative maximum tax produces only winners—no losers. Not a single American family or business would be required to pay even a penny more tax than they do now, because the Maxtax would be entirely voluntary.

The Maxtax should blunt the opposition from special interest groups, because it does not end a single deduction, loophole or credit in the tax code. All deductions in the current system would be retained—for taxpayers who chose to take them. Homeowners could still take advantage of the mortgage interest deduction; tax-oppressed New Yorkers and Californians could still deduct their steep state and local income taxes; large families could deduct their children and so on. If these and other tax write-offs are as indispensable to taxpayers as H&R Block, the National Association of Realtors and the Clinton Treasury Department say they are, then Americans will surely not choose to give them up.

What is more likely, however, is that millions of taxpaying workers and businesses would enthusiastically opt for the

Maxtax alternative—even many who might face a slightly higher tax liability. Americans now spend an estimated 5.5 billion hours a year complying with the income tax code. The nonpartisan Tax Foundation estimates that compliance costs extract \$157 billion a year from the U.S. economy—the equivalent of a week's worth of national output down the drain. Assuming that the Maxtax might slash these economywide compliance costs by at least two-thirds, the annual windfall gain of \$100 bil-

lion or more could be shared by the government, in the form of higher voluntary tax payments, and taxpayers, in the form of lower compliance costs and immeasurably less aggravation. For example, in 1993 Mobil Oil Company paid \$15 million in tax preparation costs. In theory, Mobil should be willing to pay up to \$15 million in extra tax to the government in exchange for avoiding these compliance costs.

Finally, in an era when the guiding orthodoxy of economic policy in Washington is class warfare, the Maxtax can be easily defended on "fairness" grounds. A 1995 Reader's Digest poll asked Americans, "What is the highest percentage of income that is fair for a family of four making \$200,000 to pay in all taxes?" The median response—across racial, economic, age, sex, ideological and educational lines—was 25%. A subsequent GrassRoots Research poll last March discovered that a majority of Americans would favor a constitutional amendment that would prohibit federal, state and local taxes from taking "a combined total of more than 25% of anyone's income in taxes." The Maxtax would partially codify Americans' definition of tax fairness—although not entirely because the Maxtax puts a 25% cap only on federal income and payroll taxes.

Because the Maxtax creates a credit for the regressive payroll tax (which expires

after \$62,000 of income), it lowers marginal tax rates for virtually all taxpayers, thus increasing the rewards for work, saving and investment. The current income tax rate of 28% for middle-income households earning \$40,000 a year would fall to 17.5% (25% minus 7.5% payroll tax)—or to 10% if the worker were self-employed. The top income tax rate of 39.6%, the 28% capital gains tax and the confiscatory 55% estate and gift taxes would all fall to 25%.

### Ferocious Opposition

Milton Friedman predicted with great prescience on these very pages just over a year ago that although the flat tax has great merit, "there is next to no chance that Congress will enact this tax system" over the ferocious opposition of Washington's army of special interests. In a contest between Washington and America, Washington almost always prevails.

Against such long odds, Dick Armeey, Steve Forbes, Bill Archer and others have heroically advanced the cause of a simple, fair and pro-growth tax system. What is

### How to Calculate Your Alternative Maximum Tax

1. Gross income in 1997	\$ _____
a) Wages and salaries	_____
b) Pensions	_____
c) Capital gains	_____
d) Dividends and interest	_____
e) Gifts and bequests	_____
f) Government benefits received	_____
g) Total gross income (add lines 1a through 1f)	_____
2. Total federal tax (multiply line 1g by 25%)	_____
3. Payroll tax paid during the year	_____
4. Total income tax (line 2 minus line 3)	\$ _____

needed to jump-start their proposals is one final principle for tax reform: the freedom to choose. The Maxtax does not burn and bury the tax code, it simply renders it irrelevant.

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