

A Discussion of the Progressive and Flat Income Taxes

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Flat Income Taxes**

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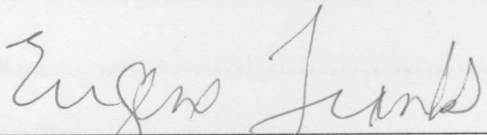
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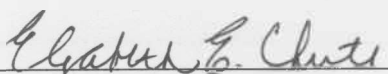
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Thesis Statement

"'Tis true that governments cannot be supported without great charge, and it is fit [that] everyone who enjoys a share of protection should pay out of his estate his proportion of the maintenance of it" (Locke). Federal income taxes and tax preparation serve as a vital and important portion of the United States' economy and the functioning of the federal government. Millions of individuals and businesses spend large quantities of time, money, and effort to effectively measure income to remit their share to the federal government. The issues regarding income tax preparation have an influence far beyond the federal budget, tax refunds, and tax payments. Federal taxes, at least indirectly, impact every portion of American citizens' lives and every business that has operations in the country. The complexity of the tax code is a source of frustration, anger, and sheer hatred for many Americans. A survey created for the Tax Foundation, "Attitudes on Tax and Wealth Issues," stated that 70 percent of those surveyed either "dislike or hate" doing their income taxes (Dalbec, 2005). Eighty-one percent also believe that "the current federal income tax [code] is very/somewhat complex" (Dalbec, 2005). In addition, 77 percent attest to the perspective that "the federal tax system should be completely overhauled [or that it] needs major changes" (Dalbec, 2005). But frustrated taxpayers are not the only concern in this matter as "The economy is dramatically affected by the state of tax law" (Moody, 2001). A constantly changing tax system, coupled with increasing complexity, can make long-term business planning and investing somewhat difficult. There are a multitude of possible tax systems, the most common being the progressive income tax and the flat income tax. This thesis will discuss the current progressive system in the United States and a flat income tax scheme. The

History of the Federal Income Tax

From the birth of the United States, the populace has frequently fought the government in tax issues, both as colonies and states. The Stamp Act, levied by the British government in an effort to fund the expensive empire, acted as one of the numerous catalysts for the Revolutionary War. The act required all legal documents in the colonies to be written on stamped paper, paper bearing an embossing of “proof that the tax [on the item] had been paid” (Revolutionary America, Stamp Act, 1765, 2005). The stamp tax was a direct tax levied on the colonies, collected internally and remitted to the British government. Because a direct tax is “levied directly on the income or capital of a person or organization rather than a part of the price of goods or services,” and was placed upon such an important item for the colonies, it affirmed the people’s position against direct taxation (Direct Tax, 2003). The tax also accentuated the fact that the colonies had no elected representation in the British Parliament, reminding the colonists that the direct tax was enforced without their consultation or permission.

When the United States Constitution was signed on September 17, 1787, the Founding Fathers had several specific ideas about the levying of taxes in the future. Under Article One, Section Nine, the Constitution states that “No Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken” (U.S. Constitution). For the next 122 years, this statement was construed to mean that direct income taxes were not under the powers of the United States government. The Sixty-first Congress proposed and spearheaded the sixteenth amendment, so “Congress [should] have [the] power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and

without regard to any census or enumeration,” ratified on February 3, 1913 (U.S. Constitution). As soon as the nationwide income tax became legal, income tax laws became complicated. A mere year after the income tax was instituted, “Experts complained about the complexity of the federal income tax system” (Moody, 2000). One of the largest intricacies of the graduated income tax is the fact that “there are so many different types and sources of income, that it becomes extremely tricky to define” income itself (Moody, 2000).

Social and Economic Results of the Progressive Code

In the United States, the tax code has been utilized to enforce social and political agendas in addition to collecting government revenues. Over the past 92 years, politicians, lobbyists, interest groups, and citizens have used the income tax system to achieve personal goals. The Tax Foundation completes an annual study that measures the distribution of taxes paid to the federal government versus its spending on the states, and it states that “the nation is not only redistributing income from the prosperous to the poor, but from the middle-income residents of high-cost states to the middle-income residents of low-cost states [because of] a steeply progressive federal income tax” (Sagoo, 2004). Because “both of the federal government’s largest revenue raisers, the individual income tax and the payroll tax, are levied as a percentage of income, states with high income per capita will also have high federal tax collections per capita” (Sagoo, 2004). As a result of the higher federal tax collections, the wealthier states and their populations actually support other less financially strong states with their contributions. In the 2003 fiscal year, the top ten states garnering the most federal spending received anywhere from \$1.52 (Kentucky) to \$1.99 (New Mexico) for every dollar that their citizens remitted to

the federal tax system (Sagoo, 2004). On the reverse, the ten states collecting the lowest quantities of federal spending were only awarded \$0.57 (New Jersey) to \$0.80 (Colorado and New York) (Sagoo, 2004). The disparity in spending occurs because the “states with a high average cost of living and commensurately higher incomes pay vastly higher federal taxes, payments that are unlikely to ever be matched by federal spending directed to those states” (Sagoo, 2004).

In fiscal year 2003, \$1.747 trillion was collected by the federal government in the form of individual income tax, corporate income tax, social insurance taxes, excise taxes, estate and gift taxes, and customs duties (Sagoo, 2004). Individual income taxes and social insurance taxes provided most of the almost \$2 trillion in revenue for the government with \$793.7 billion and \$713 billion, respectively (Sagoo, 2004). If the entire tax burden were to be divided by the United States population, it becomes “\$6,025 for every man, woman, and child in the country for 2003” (Sagoo, 2004). Almost 32 percent of those who filed a tax return in 2003, or over 41 million filers, incurred zero income tax liability once they took advantage of the myriad of deductions and credits offered by the tax system, so the sum of \$1.747 trillion was paid by a significantly lower number of tax filers (Hodge, 2005A). For the fiscal year 2004, the total federal tax burden increased to almost \$1.845 trillion (Sagoo, 2004), while the numbers of filers with zero tax liability climbed to an estimated 42.5 million, or over 32 percent of tax returns filed, once the filers had taken advantage of the deductions and credits available to them (Hodge, 2005A). To add an additional issue, only an estimated 543,000 new taxpayers were added to the federal tax roles, while an estimated 1.5 million filers were removed from tax liabilities between 2003 and 2004, a net loss of almost one million filers. These quantities

give credence to the perspective that “America has become divided between a growing class of people who pay no income taxes and a shrinking class of people who are bearing the lion’s share of the burden” (Hodge, 2005A).

A progressive system of taxation is designed to help society through encouraging certain behaviors and enforcing social policy through fiscal policy. According to J. Scott Moody, “the income tax code today is a hodgepodge of deductions and credits that have nothing to do with raising revenue for government operations.” In addition, “these tax code items not only reduce revenues, but at the same time needlessly increase the complexity of the tax code.” Moody also asserts that many of the deductions and credits do not reach the bulk of the paying filers because “the benefits are concentrated on a relatively small group of taxpayers while the costs are spread amongst everyone else” (Moody, 2000). Many of the most commonly used standard deductions are “socially conscious” and beneficial to individuals that fit the social model and the virtues of the “best” social class in America, including those for “home mortgage interest, health care expenditures, and the child tax credit” (Moody, 2000). Deductions and credits attempt to reward certain social behaviors, such as marriage, higher education, and charitable contributions. The dependency exemption encourages caring for children, infirm or elderly family members, as well as family members and friends who are not able to live on their own without financial or living assistance. If the qualifications for dependency are met, the taxpayer receives a reduction in taxable income of \$3,200 per dependent in 2005 (Willis 3-10, 2006). Though small, these deductions enable a parent, or parents, to better provide for their nuclear and extended family through a reduction in taxable income. As a result, society as a whole benefits because the costs of caring for

individuals are not divided among the rest of the populace through increased taxes to pay for the higher cost of human services.

The non-paying filers are typically women that are young, low-income, part-time workers with their own households. These filers usually receive the \$1,000 per child tax credit in addition to the Earned Income Credit, and 91 percent of these filers earn less than \$30,000 per year (Hodge, 2005A). The Earned Income Credit is “a tax credit for certain people who work and have earned income under \$35,458” (Publication 596, 2004). The amount of the credit depends on the individual’s or household’s filing status, number of dependent children, and levels of income. For example, an individual with “more than one qualifying child and earning less than \$34,458” in adjusted gross income can take the credit (Publication 596, 2004). The maximum amount of the possible credit is \$4,300, which can decrease one’s tax burden substantially, provided that the filer’s household fulfills the qualifications (Publication 596, 2004). The child tax credit can decrease the tax burden of a household up to several thousand dollars, depending on the qualifications of the particular family. As of 2003, the child tax credit is \$1,000 per qualified child under 17 (Hodge, 2005A). According to Hodge, \$33 billion was refunded due to the Earned Income Credit and taxpayers were able to decrease their taxes by \$9 billion as a result of the child credit (Hodge, 2005A).

Another example of social encouragement through the tax code is the charitable donation deduction. To encourage people to donate funds to charitable institutions, the federal government allows taxpayers to deduct monies, determined by an existing formula, from their taxable income, as long as the taxpayer itemizes their deductions. The standard deduction of \$4,850 for a single individual or \$9,700 for a married couple filing

jointly for 2004, and \$5,000 and \$10,000 respectively for 2005, accounts for a charitable deduction among additional otherwise deductible expenses if the dollar amounts of the filer's itemized deductions are more than the standard deductions (Willis 3-7, 2006). If the filer itemizes their deductions on Schedule A, they may benefit more from the charitable deduction, thereby reducing taxable income. When adding their deductions together to receive the benefit for donations over \$250, the donor must receive a statement from the charitable organization (Moody, 2001).

Charitable institutions for tax purposes include "Federal, state, and local governments and organizations organized and operated only for charitable, religious, educational, scientific, or literary purposes, or for the prevention of cruelty to children or animals," and are required to maintain detailed records of their activities and donations (McKenzie). If the institution's mission is altered, even minimally, the organization can lose its status as a charitable institution, severely impacting its effectiveness and ability to function in society. To obtain the beneficial tax status to not remit income tax, "charitable organizations have to go through an approval process administered by the IRS before a contribution by an individual can be legally declared as a charitable deduction," creating a need for more work hours for the Internal Revenue Service, individuals, businesses, and the institutions they assist (Moody, 2001). Though the IRS does not investigate every different contribution to every organization, most charitable institutions must submit, on an annual basis, statements of the total donations and contributions to the organization. The entanglement increases in the code because only certain contributions to qualified institutions are acceptable for the taxpayer's deduction, and an individual is not able to deduct their time or services. Though the taxpayer cannot receive a deduction for time or

services, the taxpayer is able to deduct any expenses that he or she incurred while giving the services or time to the qualified organization (McKenzie). Publications 526 and 561 from the IRS are prepared solely for the purpose of assisting “donors and appraisers determine the value of property (other than cash) that is given to qualified organizations,” giving instructions on valuation of donations and to determine the amount of the deduction that a taxpayer can receive (Publication 561, 2005).

A side effect of the progressive tax system in this country is that it cannot account for the cost of living issues and the resulting diverse wage levels for the same types of work and for the same basic standard of living. The Tax Foundation’s research ascertained that in order for “the typical dual income, childless married couple in America” to remain at the ‘middle class’ standard of living, the couple must have a combined income of \$67,315 in Houston, Texas, \$74,443 in Milwaukee, Wisconsin, \$100,079 in Orange County, California, \$135,003 in San Francisco, California, and \$162,974 in Manhattan, New York (Hodge, 2005B). In the United States “the wealthiest 20 percent of taxpayers-those earning more than roughly \$68,000-now pay over eighty percent of all the income taxes” (Hodge 2005B). But since “the typical dual-income, childless married couple in American earns roughly \$74,443...with a tax liability of \$8,081 and an effective federal income tax rate of 10.4 percent,” the cost of living discrepancies are apparent (Hodge, 2005B).

Naturally, as salaries increase, an individual’s position in income levels across the country changes. The average middle-class couple mentioned above earning \$68,000, and living in Houston, is among the top twenty-five percent of taxpayers. The same couple is in the top twenty percent in Milwaukee (national average), top ten percent in

Orange County, five percent in San Francisco, and finally, the top three percent of all taxpayers across the country with 'middle class income' in Manhattan, New York. With these annual incomes, the couple in Houston pays an effective tax rate of 10.4 percent per year, increasing to an effective rate of 19.1 percent in Manhattan. The couple in Milwaukee has a 10.9 effective tax rate, which is the national average. The housing market often reflects the cost of living in an area, so a four bedroom, two and a half bathroom house in Houston may cost \$144,708 (New Home Source), while a four bedroom, two bathroom house in Upper Manhattan may cost around \$1,849,000 (Property Retriever). It is not just housing costs that are higher in certain areas, but the cost of basic necessities, utilities, vehicles, transportation, state taxes, property taxes, insurance, entertainment, and luxury items often increase. These differences in cities make it difficult to effectively compare the standards of living. The progressive tax system has difficulty contending with such differences throughout the country among members of the same social class. According to Hodge, the cost of living discrepancies cause members of the middle class "in high-cost metropolitan areas [that] have correspondingly high nominal incomes, but average living standards" to have their salaries redistributed to areas that are less expensive in which to live (Hodge, 2005B). Itemized deductions are able to alleviate some of the discrepancies because itemized deductions such as home mortgage interest, personal property taxes, charitable deductions, and state and local income taxes can be used to reduce taxable income.

The "statistically wealthiest twenty percent of taxpayers [are often] older workers, at or nearing their peak earning years, are college educated and have professional jobs, and have business income" (Hodge, 2005B). It is logical that wage-earners at their peak

earning years would pay the most in income taxes, merely because they are earning more, and it is a rational assumption that those with more education will often have higher wages because they are able to secure better employment. This group of taxpayers often has some disposable income that they invest for retirement or to provide for their children's education. According to Hodge, "these families are taxed at the highest income tax rates because [the] progressive tax rate system is not fully adjusted for such things as cost of living, age, education, or the number of incomes in a household" (Hodge, 2005B).

The Taxpayer Advocate Service is an independent organization inside the Internal Revenue Service with the mission to help individuals solve problems that they have with the IRS. It advocates potential changes to decrease taxpayer problems, and defines the Alternative Minimum Tax as one of the two biggest issues that taxpayers face (National Taxpayer Advocate Releases Report to Congress, Cites AMT as a Top Problem Facing Taxpayers, 2004). The reason "the AMT was originally enacted [was] to prevent wealthy taxpayers from avoiding tax liability through the use of tax avoidance techniques" (National Taxpayer Advocate Releases Report to Congress, Cites AMT as a Top Problem Facing Taxpayers, 2004). Because of rising incomes across the country, the AMT "now affects substantial numbers of middle-income taxpayers and will, absent a change of law, affect more than 30 million taxpayers by 2010" (National Taxpayer Advocate Releases Report to Congress, Cites AMT as a Top Problem Facing Taxpayers, 2004). Currently, this tax affects four percent of the middle class, those with incomes ranging from \$100,000 to \$500,000. Some believe it may potentially reach 20 percent of all taxpayers in the future (Wolk, 2005).

The current tax code “gives preferential treatment to some kinds of income and allows special deductions and credits for some kinds of expenses” (Alternative Minimum Tax, 2004). Taxpayers who are able to benefit from these items may have to pay the additional Alternative Minimum Tax (Alternative Minimum Tax, 2004). This additional and distinct computation actually “eliminates many deductions and credits and creates a tax liability for an individual who would otherwise pay little or no tax” (Alternative Minimum Tax, 2004). Unless the federal government changes the AMT, within five years, Wolk states that “‘virtually all’ middle-class families with two or more kids will be subject to the tax,” and it will influence numerous filers not intended to come under its jurisdiction (Wolk, 2005).

Another dimension of the progressive tax system is of course, the federal income tax rates. The Internal Revenue Service provides tax rate schedules that enable a filer to select the correct tax after taxable income has been calculated. The table as shown in Appendix A, lists taxable income in \$50 increments to ensure accurate calculations. The base tax rate is 10 percent, followed by the marginal tax rates of 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent (Personal Income Tax Tables). The tables change yearly because the thresholds for the tax tiers are indexed for inflation. As a result, the income at the highest marginal tax bracket of thirty-five percent for a single individual was \$311,950 in 2003 and \$326,450 in the year 2005 (Personal Income Tax Tables). There are several schedules depending on the taxpayer’s filing status. Schedule X is comprised of the tax rates that apply to a single individual paying federal income taxes, Schedule Y-1 is used by a married couple filing jointly or a qualified widow/widower, a married couple filing separately uses Schedule Y-2, and Schedule Z applies to an

individual filing as a Head of Household (Personal Income Tax Tables). Therefore understanding the rules that apply to the schedules increases complexity in the process.

Complexity of the Progressive Code

The American tax code has grown in density and volume since its institution in 1913. The Tax Reform Act of 1969 was touted “as the legislation that infused much needless complexity,” and the Tax Reform Act of 1986 (TRA ’86) with the goal of tax simplification actually “brought tax levels to an unprecedented level [of complexity],” according to senior corporate tax officers (Moody, 2001). Tax reformers have an ambitious goal that is quite daunting. The United States Congress must write rules to cover every contingency, item, and possibility that millions of taxpayers may conceivably use or bring to the attention of the IRS. For example, for the valuation of charitable donations, the tax code has a multitude of items, including “household goods, used clothing, jewelry, gems, paintings, antiques, other objects of art, collections, cars, boats, aircrafts, inventory, stocks, bonds, real estate, business interest, annuities, life insurance, and property” (Publication 561, 2005). In order to receive the charitable deduction, most of these items must be appraised by a qualified professional. Publication 561 stipulates that for jewelry and gems alone, “the appraisal should describe, among other things, the style of the jewelry, the cut and setting of the gem, and whether it is now in fashion. If not in fashion, the possibility of having the property redesigned, recut, or reset should be reported in the appraisal. The stone's coloring, weight, cut, brilliance, and flaws should [also] be reported and analyzed” (Publication 561, 2005). For each piece of jewelry or single gem, these procedures must be followed in order to receive a deduction, and the

item must be donated to an institution that remains in good standing as a charitable organization. This example indicates the complexities of the charitable deduction.

The original Internal Revenue Act encompassed over 600 pages at its inception in 1954. By the end of 1955, the Internal Revenue Code comprised 409,000 words, with 172,000 words alone devoted to income taxes (Moody, 2001). Forty-five years later, the entire tax code numbered 1,670,000 words, and income taxes utilized 982,000 words of it (Moody, 2001). The regulations written to “provide taxpayers with the ‘guidance’ they need to calculate their taxable income” are even more copious. In 1955, regulations supplemental to the tax code numbered 1,033,000 words, and 7,307,000 in 2000 (Moody, 2001). The IRS has also issued numerous publications, papers, bulletins, reports, and forms in order to facilitate the preparation of tax returns. One of the most important disclosures the IRS releases is a yearly compilation of the changes in law, explanations of terms in the tax code, computations of taxes, and problems that individual taxpayers have encountered. Publication 17 is another booklet printed by the federal government every year to help individuals prepare their tax returns, answering questions about filing information, filing status, and rights of the taxpayer.

Compliance Costs with the Progressive Code

Because of the intricacy of the tax code, the costs of income tax compliance are high. The costs of following the tax codes are not limited merely to the working hours lost in extra paperwork, records, and filing, but are the economic expenses of “overhead and opportunity costs” (Moody, 2000). Imbedded within these costs are “the economically sterile exercises of tax planning, compliance, and litigation” (Moody,

2000). Congress has the ability to change the tax law, adding some uncertainty to tax planning.

Another hidden cost in the American tax code involves the costs of “record keeping, education, form preparation, and packaging/sending” the tax information to the Federal, and often state, governments (Moody, 2000). According to the Tax Foundation, “every hour or dollar spent complying with the tax code represents resources that could have been spent tending to business problems, adding value to the economy while doing the work that the taxpayer is [skilled in].” Moody suggests that in 1999, “individuals and businesses spent over 4.3 billion hours complying with the federal income tax [code]” for a cost of \$125 billion (Moody, 2000). Compliance costs continue to rise because “in 2002, individuals, businesses, and non-profits [spent] an estimated 5.8 billion hours complying with the federal income tax code, at an estimated cost of over \$194 billion” (Moody, 2002A). This translates to the taxpayer spending over \$0.20 as a “tax compliance surcharge for every dollar the income tax system collects,” culminating as a high cost of compliance for society as a whole (Moody, 2002A). When measured “by income level...[the compliance costs] take a bigger toll on low-income taxpayers as a percentage of income than it does on high-income taxpayers” (Moody, 2002A). As a result, for every \$1000 of income, the states of Montana, Wyoming, and Utah are struck with “the highest compliance costs, while California, Massachusetts, and Connecticut face the lowest” (Moody, 2002A). In order to provide the poor or moderate-income people and families across the country with tax assistance, “volunteers sponsored by various organizations receive training to help prepare basic tax returns in communities across the country, [with] VITA sites generally located [in] community and neighborhood

centers, libraries, schools, shopping malls, and other convenient locations” (Free Tax Return Preparation for You by Volunteers). VITA, or the Volunteer Income Tax Assistance Program, “offers free tax help to low- to moderate-income (\$37,000 and below) people who cannot prepare their own tax returns” (Free Tax Return Preparation for You by Volunteers).

Small businesses, the “lifeblood” of the entrepreneurial spirit and the American economy, and small corporations are often faced with the highest costs of compliance with the tax code, and “small corporations (those with less than \$1 million in assets) spent at least twenty-seven times more on compliance as a percentage of assets than the largest U.S. corporations” in the year 2000 (Moody, 2002B). As with any segment of the economy, “economies of scale exist in tax compliance” (Moody, 2002B). For example, a small business or sole proprietorship might devote twenty hours to tax compliance, including record keeping, studying the tax system, learning the software programs management utilizes for preparation, completing the forms, and planning for any tax consequences. A massive corporation might spend 1000 hours on the same tasks, but in a large enterprise, the sales and production divisions are usually separated from the administrative and financial sections, therefore allowing the company to continue at full capacity without diminishing productivity. The small business is struck harder with the lost twenty hours because it cannot delegate the necessary tasks to as knowledgeable preparers. A small business likely has far less tax issues and complexities than a large corporation or business, but many small firms lack the additional income to train their employees in the necessary tax matters or to hire outside help. Acting in accordance with the tax code is not a simple matter of understanding and studying the tax code for a single

occasion, but is actually “an ongoing process of keeping up-to-date with the latest legislative changes, regulatory changes and tax court rulings (Moody, 2002B). This only compounds the issue because “on average, every section of the Internal Revenue Code is amended once every four years,” requiring filers to have more knowledge about the issues they face, and to study the code on a yearly basis to remain abreast of the changes (Moody, 2002B).

Scott Moody of the Tax Foundation reports that because “the tax code is almost always in a state of fluctuation, such instability also spills over into the tax courts” (Moody, 2002B). Individuals and businesses may dispute the dollars owed to the Internal Revenue Service, especially when the costs are related to recent changes in the code. One of the most tested portions of the progressive tax code is the questionable write-off of expenses, often uncovered in an IRS audit for both individuals and businesses. The Internal Revenue Service brings code violators to tax court if the IRS and the taxpayer cannot resolve the dispute in mediation or settle it outside of the court system. This is an especially pertinent issue for small businesses because it usually takes a minimum of three years for the issue to go to court, and small businesses especially “are at an inherent disadvantage not only in terms of the necessary fiscal commitments but also in the necessary time commitments that such litigation entails” (Moody, 2002B). According to “Helpful Hints on Finding a Tax or IRS Attorney,” court costs quickly compound into hundreds of thousands of dollars, potentially millions over the period of time to get the case on the court dockets and subsequently heard. The tax attorney must research, evaluate, and plan each individual case while on retainer by the client, which is usually quickly compounded by hourly billings (Helpful Hints on Finding a Tax or IRS

Attorney). Even if the company wins and the IRS pays their court fees, the business has lost money from the lost business time and energy involved in the court case. The opportunity costs mount in the period while the company is under the scrutiny of the Internal Revenue Service because the company often has to front the costs to the lawyers, which are funds that the business could have invested in other prospective ventures, such as bonds or stocks of other companies or new capital projects for their enterprise. In 2004, 500 cases were heard and received either an opinion or memorandum in the United States Tax Court alone (Historic Opinions). Whether the firm wins or loses the tax compliance issue, the firm will still inevitably lose.

Preparing income tax returns under the current tax system is one of the major sources of revenue for the accounting profession as a whole. In the year 2002, there were an estimated 1.1 millions of accountants and auditors across the United States (Accountant, 2004). Many accountants, especially certified public accountants, perform a plethora of duties, ranging in the fields "of accounting, auditing, tax, and consulting activities for their clients, who may be corporations, governments, nonprofit organizations, or individuals" (Accountants and Auditors, 2004). There are public accountants who work exclusively on tax issues, including recommending tax advantages or warning taxpayers of disadvantages of business decisions, and preparing tax returns (Accountants and Auditors, 2004). The accounting firms may be operated by single individuals or increase in size to hundreds of employees in firms such as the current "Big Four" (Accountants and Auditors, 2004). The accountants who choose to devote their efforts and skills to tax preparation have the option to obtain three additional designations by the Accreditation Council for Accountancy and Taxation, a satellite organization of

the National Society of Public Accountants (Accountants and Auditors, 2004). These designations include Accredited Business Accountant, Accredited Tax Advisor, and Accredited Tax Preparer (Accountants and Auditors, 2004). But accountants are not the only preparers of tax returns for individuals and businesses. Tax preparers include accountants and many others such as attorneys, enrolled agents, and companies such as H & R Block, Jackson Hewitt offices, Liberty Tax Service Offices. In the year 2004 alone, H & R Block had revenues of over \$4.2 billion, with net income of almost \$700 million (2004 Annual Report, 2004). Jackson Hewitt Tax Service reported over \$205 million in income in the fiscal year of May 2003 through April 2004 (Income Statement for Jackson Hewitt Tax, 2005). Software written for individuals, businesses, and tax preparers such as TurboTax, Lacerte Software, and ProSeries, are also gaining in popularity, and serve as a booming business within the tax preparation field.

Overview of the Flat Income Tax

Another option for the federal income tax system rather than the current progressive marginal tax code is the institution of a federal flat income tax. This idea has waxed and waned in favor, creating enormous controversy in politics, economics, social planning, political parties, social classes, academia, and even between regular individuals in everyday life. Political campaigns for the presidency have been waged by individuals such as Steve Forbes with the flat tax as a driving issue in their campaigns. A reason that some want to institute a flat income tax is because they believe that it is more fair and equal to all taxpayers in America. Those against a flat income tax system state that such a tax is unfair and regressive, unfairly burdening the poor and not exacting enough from the rich in order to fund the government and country. According to the Tax Foundation

and Scott Hodge, from an economic perspective, "tax policy should only be a means of raising sufficient funds for the government...[and] should not be a tool for social policy- either to punish one group of taxpayers or enrich another group" (Hodge, 2005B).

Two flat income tax methods are quite different and have different implications for the taxpayer. The first flat income tax has all of the citizens under its jurisdiction pay a certain percentage of their taxable income to the government regardless of income levels while the other has only taxable income above a certain wage floor subject to a single income tax. For example, if the federal government decided to set the tax rate at seventeen percent, every taxpayer in the United States would pay exactly seventeen percent of their income to the federal government. Therefore a taxpayer earning \$10 million annually would pay \$1,700,000 in taxes while a taxpayer who earned \$10 annually would pay \$1.70. Using the alternative method, the government would create a floor so every citizen only pays taxes on their income over the amount, with the floor influenced by such measures as the Consumer Price Index to adequately ascertain fair levels. For example, with a seventeen percent flat income tax, there could be a wage floor of \$30,000 per year for a four-person household to give families a measure of relief for basic living expenses. As a result, the flat income tax plan would adjust the wage floor for household size, and a four-person household would have a higher income threshold than a single taxpayer or a smaller family. All income below \$30,000 per year for the household would be exempt from federal income tax, and any income above \$30,000 a year would be taxed at a flat rate of seventeen percent. If the household earned \$10,000,000 during the year, the household would pay \$1,694,900 to the federal government, if the earnings were \$50,000 a year, the tax would be \$3,400, and no taxes

would be owed by the household making \$30,000 or less per year. These figures are a simplistic explanation of the possibilities of a flat income tax. Depending on the federal government's specifications, the income under the flat tax code can be all income including wages, salaries, pensions, payments, gifts, inheritances, dividends, recognized capital gains, and any other foreseeable source of income. But the government could also remove certain types of income from the equation such as Social Security payments and pensions, which would increase complexity.

Current Flat Tax Systems

According to Steve Forbes, flat income tax systems have been instituted in countries such as Hong Kong, Russia, Lithuania, Latvia, Estonia, Ukraine, Slovakia, Romania, Serbia and Georgia (Forbes, 2005), and are debated within individual states across the United States. Though the countries previously mentioned are not extremely affluent or heavily populated, they are important because the flat income tax has actually been instituted. The flat tax was enacted in 2004 in Slovakia, with numerous objectives for fiscal and economic reform including “[reducing] the general government deficit while simultaneously decreasing public expenditures as a share of GDP, health care reform, pension reform, social assistance reform, and public administration reform” (Jakoby, 2005). The goals were also to provide tax fairness, exclusively utilizing the tax law for fiscal rather than social purposes, and removing problems and issues of the country's tax law by instituting the flat income tax in Slovakia (Jakoby, 2005). The government of Slovakia succeeded in decreasing the number of income tax rates from eighteen to one rate of 19 percent for individuals, corporations, and value added taxes, with little or no special taxes and rates (Jakoby, 2005). The government also eliminated

many of the most problematic points of the system, especially double taxation, such as the dividend tax, inheritance tax, real estate transfer tax, and the gift tax (Jakoby, 2005). With the creation of a single, “but much higher tax-free threshold [and] introducing [an] annual child tax credit,” coupled with a dramatically simplified income tax system, the country was rated higher for investing, employment is expected to improve, and there have been “improved incentives for entrepreneurship and investment,” bettering the overall business climate of the country, assisted by the fact that estimated and budgeted revenues were in line with the actual revenues collected (Jakoby, 2005).

Trickle-Down Theory of Economics

The trickle-down theory of economics holds that if taxes for investment and business are lifted or lessened, business and the economy improves. If investors know that dividends or capital gains will not be as heavily taxed, they are more likely to put their funds into investments. As people invest more, businesses have increased funds to better the businesses, and the economy slowly improves. If citizens and taxpayers do not have to pay as much to the government in income taxes, they are more likely to spend more, enhancing the economy as a whole. Jakoby believes countries that lower and/or flatten their income tax structures often see a period of sustained growth and increased business, expanding the overall economic climate of a country (Jakoby, 2005). Forbes suggests that “every time the tax burden on the American people has been reduced, better-paying jobs and new businesses were created, incomes rose, and the standard of living improved” (Forbes, 2005). “When President John F. Kennedy enacted across-the-board tax reductions, the economy boomed... federal receipts mushroomed” (Forbes, 2005). The economic boost did not occur solely because income taxes were decreased,

but correlated with the economic issues of the time relating to the Vietnam War. Because taxes help to shape people's behavior and decisions, a change in the tax code can help influence the government's revenue as shown in 1997 when President Clinton and Congress "cut the capital gains tax rate from 28% to 20%," and contrary to critical perspectives, "revenues from capital gains increased dramatically," instead of government "revenues [dropping] and deficits [increasing]" (Forbes, 2005). This phenomenon was also assisted by the explosion of the stock market and economic boom at the time and may not be entirely attributable to the rate change.

Social and Economic Results of a Flat Income Tax

The Tax Foundation believes that "the only way to mitigate the punishing effects of our current progressive rate structure...is to enact a single-rate tax levied on consumption or on incomes" (Hodge, 2005B). This is a contentious issue, but both the positive and negative points of the flat tax issue must be addressed in order to give credence to all perspectives. If a flat rate were to be enacted by the federal government, Hodge suggests that it "should be set [at] a low rate, applied to a broad base, and have as few deductions as politically possible," solving the issues of the complexity, volume, and lost productivity with the current progressive system (Hodge, 2005B). The "typical taxpayer filing the regular Form 1040 and reporting income from work, dividends and capital gains [that] spends an estimated 26 hours and 48 minutes each year completing his return" could put forth his/her time in activities that he/she is better suited to or enjoys more, whether it be spending time with his/her family or building rock walls in his/her yard and gardening (Forbes, 2005). Forbes reports that there is "a proliferation of what are referred to as 'abusive' tax shelters, convoluted entities and transactions created for

the sole purpose of avoiding taxes. Since 1993, the government has lost \$85 billion in tax revenue because of these abusive tax shelters” (Forbes, 2005). If the tax structure was leveled and a flat tax created, it could substantially decrease “the possibility of clever minds setting up complicated tax-[cheating] schemes. The code would be too transparent, too simple to hide tax liabilities,” (Forbes, 2005) and could decrease tax cheating and evasion dramatically.

A change in the progressive tax system would almost invariably benefit the wealthy. This is unacceptable to many social thinkers because social policy dictates that individuals should assist those in need. Some may also argue that individuals, who are perceived to receive more benefits from the government because of their elevated wealth, should redistribute some of their assets and wealth to the less fortunate. The federal government can use the tax code to redistribute wealth through higher taxes levied on the rich which are then returned to the poor in the form of social programs and monetary payments. In contrast, a flat income tax is regressive if not properly allocated. For example, if every person who earned income in the United States was taxed a flat rate of seventeen percent, it would adversely impact the poor. An individual earning \$10,000,000 annually and paying the federal government \$1,700,000 would not have to change their standards of living, but if the individual makes \$10,000 per year, the \$1,700 in income taxes will be a burden to them, especially if the individual is supporting an infirm spouse and/or children. In the progressive system, this head of household would likely pay nothing to the government, and perhaps even receive funds back because of the earned income credit.

The statistics of poverty and wealth are staggering. As of July 26, 2005, the U.S. Census Bureau estimates that there were 296,721,822 individuals living in the United States, with an increase of an individual every 11 seconds between births, death, and migration of immigrants both in and out of the United States (Dynamic POPClocks, 2003). Of these 296.7 million people, roughly 35.9 million are under the official Federal poverty level, or 12.5% percent of the population (USA Statistics in Brief—Income, 2005). In 2003, the median household income was \$43,318, and the medium family income was \$52,680 (USA Statistics in Brief—Income, 2005). The computation for the federal poverty level includes the number of people living in a household. If a person under the age of 65 earns less than \$9,573 per year, that person is considered poor (Poverty Thresholds, 2003, 2004). This amount of income is less than an individual working forty hours per week for 52 weeks earns at the federal minimum wage of \$5.15 (Poverty Thresholds, 2003, 2004). A household is poor if there are two members under the age of 65 with a combined yearly income of \$12,384. The poverty thresholds increase depending on the number and age of the related children living in the home (Poverty Thresholds, 2003, 2004). For example, a family of five persons (two adults and three children), has a poverty level of \$21,959 (Poverty Thresholds, 2003, 2004). Without consideration of other taxes, if the family makes \$35,572 per year and their federal income tax bill was \$6,047 (17 percent), the family would only net \$29,525 per year or slightly over \$2,460 per month. This amount would have to provide for housing, food, basic necessities, clothing, medical and dental treatment, utilities, phone service, insurance, a vehicle, and education. Households below the Federal poverty level may receive benefits from the government to help the household meet these needs. Federal

social programs often use the federal poverty level as a measure for benefits for programs such as food stamps, housing programs, and Medicaid. With the current tax system, such a family would receive numerous credits and deductions to reduce their tax liability. However, \$35,572 per year income might comfortably provide for a single individual in many areas of the country. The extremely wealthy can live comfortably and may not blink at dropping "\$5 million on a birthday party" for themselves as Steve Forbes' father did in Tangiers (Steve Forbes' Skeleton Closet, 2003), but other Americans are desperately eking out their existence on pocket change. A CEO of a multi-billion dollar company can make millions of dollars a year in salaries, bonuses, and stock options, while some of the corporation's employees earn minimum wage with little or no benefits. A flat income tax without a reasonable wage floor would adversely affect the poor who must to retain a higher percentage of their income to provide for their basic needs, the resulting tax being regressive rather than proportional or progressive.

According to Scott Hodge, individuals in the middle class are those with incomes in the statistical middle twenty percent of incomes who earn between \$25,000 and \$42,000 a year (Hodge, 2005B). If their income was taxed at the flat rate of seventeen percent, the tax burden would be from \$4,250 to \$7,140 per year without a wage floor. Under the current system, if this income was for an individual, he or she would face a base rate of ten percent plus a marginal rate of fifteen or twenty-five percent depending on their income level. In 2005, the individual's estimated tax burden using the standard deduction could range from \$3,385 to \$7,165. For the current middle class, a flat income tax without a wage floor would create a heavier tax burden for them.

The flat income tax would also influence the charitable deduction. The state of Utah is currently considering a flat income tax (Rose, 2005). The Tax Reform Task Force in the Utah state government agreed to recommend that the state of Utah institute a 4 percent flat tax that is based on the federal adjusted gross income, eliminating exemptions and deductions from the state income tax code (Rose, 2005). The main group opposing the proposal is the Church of Jesus Christ of Latter-day Saints (LDS) (Rose, 2005). The LDS Church argues that "For the overall good of the citizenry, the state tax system should continue to provide tax deductions for charitable giving-including religious contributions [because] charitable contributions help provide for society's poor and needy, education and the arts, and other important social needs" (Rose, 2005). Charitable organizations are concerned that removing the charitable deduction from the tax code will discourage charitable giving (Rose, 2005). The Utah Taxpayers Association argues that the state's tax policies should be economic decisions only and not be influenced by charitable contributions (Rose, 2005). Some citizens may give to charitable and religious organizations regardless of the tax benefits, but other individuals and businesses in this country may use the tax benefit of charitable contributions to reduce their tax liabilities and would not contribute without this incentive. Given that charitable organizations use the contributions to fulfill their mission and better lives, they are concerned that their revenue would decrease without the charitable deduction. For this reason, charitable organizations continue to fight to retain the charitable deduction.

Another argument by the proponents of the flat income tax is the probability that such a tax would decrease tax fraud and lessen tax leakage. However, some individuals and businesses in the United States will avoid paying taxes, whether it is legal or not. As

a result of the institution of the flat income tax, some individuals and businesses would likely create new methods to circumvent paying their share of income taxes. At present, companies use ingenious methods of hiding income and losses in order to present the company in the most advantageous fiscal light to investors and the government. Examples of income tax fraud are numerous, and include dubious deductions, capitalization rather than expensing or vice versa, and determining false depreciation on assets. All of these incorrect accounting procedures and schemes alter the tax liabilities owed to the government, resulting in tax fraud. The Criminal Investigation (CI) division of the Internal Revenue Service investigates tax fraud and includes various programs to assist in tax compliance (Program and Emphasis Areas for CI). The CI division of Abusive Tax Schemes investigates and prosecutes those that use "sophisticated arrangements that take advantage of the financial secrecy laws of some foreign jurisdictions and the availability of credit/debit cards issued from offshore financial institutions" (Program and Emphasis Areas for CI). The General Tax Fraud division is "directed at the portion of American taxpayers who willfully and intentionally violate their known legal duty of voluntarily filing income tax returns and/or paying the correct amount of income, employment, or excise taxes" because "these individuals pose a serious threat to tax administration and the American economy" (Program and Emphasis Areas for CI). There are a series of other tax-related divisions that include non-filer enforcement, public corruption tax crimes, and the questionable refund program. In fiscal year 2005, the IRS initiated 197 investigations and recommended 126 prosecutions. Of those, 70 were indicted, and sentences included terms in federal prisons, halfway houses, home detentions, or a combination of these for an average of 38 months per criminal

(Program and Emphasis Areas for CI). The IRS also has a corporate fraud program that investigates violations of the federal tax code with fraudulent individual and corporate tax returns, in cooperation with regional fraud task forces across the country (Program and Emphasis Areas for CI). One of the 2005 indictments included Metabolife International, Inc. which was found guilty of filing false corporate tax returns and was ordered to pay criminal fines of \$600,000. The company evaded \$339,000 in corporate income taxes by not reporting income, falsely classifying income as repayment of shareholder loans, and classifying distributions to Metabolife's principals as sales returns and allowances (Program and Emphasis Areas for CI). Another case involved a Chicago businessman who admitted to five counts of mail and wire fraud, and an additional count of money laundering. He was required to pay over \$10 million in restitution and serve 63 months in prison for his fraudulent activities.

While there are a multitude of complexities and possibilities within the current tax code for tax fraud as exemplified above, there could still be fraud and income manipulation within a flat tax system. The means Metabolife International, Incorporated used could still exist within a flat tax system. There are numerous corporations and businesses that give their top level employees stock, stock options, and bonuses in addition to their salaries. If a company compensated its highest level employees with material objects or properties, they could avoid taxes unless these gifts were required to be reported as income.

A company could also structure their business and financial statements to have as little income as possible by investing most of their available income into capital assets to avoid income tax. Forbes stipulates that there would be "a 17% rate on profits;

deductions for salaries and the costs of materials and services necessary to produce the company's goods and/or services; and immediate expensing of investments--no more depreciation schedules" (Forbes, 2005). By purchasing more property, plant, and equipment, which would be expensed, a company could avoid paying income taxes, at least in the short term. In addition, Forbes suggests that a business would "carry [any losses] forward to apply against future profits" (Forbes, 2005). As these small examples show, there are a myriad of ways to avoid paying taxes, whether it is a simple or complicated system, flat or progressive. Though it may be easier to hide income and avoid paying taxes under a complicated system, individuals and businesses will still find different ways to avoid taxes, even with a simplified system where every person and business completes only a postcard-sized tax form.

In order to adequately assess the social and economic results of a flat income tax, one must ascertain the fiscal implications of the flat income tax. As it is difficult to project the tax revenue of a flat tax perspective, this thesis will use seventeen percent of Gross Domestic Product (GDP) to illustrate the tax's fiscal results. In 2004, the estimated GDP's purchasing power parity for the United States totaled \$11.75 trillion (The United States, 2005). Therefore, a seventeen percent flat tax with zero deductions, credits, or exempt income could total about \$1.997 trillion in receipts for the Federal government. This is higher than the actual receipts in 2004 of \$1.845 trillion. In Forbes' tax plan, Steve Forbes suggests that "exemptions for individuals and children would be expanded so that a family of four would pay no federal income taxes on its first \$46,165 of income," (Forbes, 2005). In order for this to function, there would need to be calculated levels of exemptions for household size and a consistent analysis of the cost of living in

order to determine the adequate exemptions. Changing exemptions complicates the projection of total income taxes the government would receive under a flat income tax.

To exemplify the fluidity of a flat tax, if the federal flat income tax were actually fifteen percent rather than seventeen percent, the resulting income change would be enormous. For example, the individual earning \$350,000 per year would pay about \$52,500 in taxes in a given year. The median income levels of the American middle class of \$25,000 to \$42,000 would pay \$3,750 to \$6,300 in taxes. It is obvious that even a two percent decrease in the flat tax rate has important results for the individual and the government. Fifteen percent of the estimated GDP in 2004 is \$1.7625 trillion, a \$235 billion decrease from the seventeen percent calculation, and an \$83 billion decrease compared to actual receipts in 2004.

In the current administration, President Bush's Advisory Panel on Federal Tax Reform "required that any proposal crafted by these experts must be 'revenue neutral' -- meaning, the new tax system must raise the same amount of tax revenue as the old system" (Atkins, 2005). If the flat tax rate was instituted to be revenue neutral, there would theoretically be no effect on government revenue; and no changes in government funding and the federal budget. While a tax system might be revenue neutral to the government's budget, it would likely "shift the tax burden considerably, creating lots of winners and losers" (Atkins, 2005). Without a wage floor or family exemption, the tax burden would be shifted onto the largest sections of the population and types of businesses, hurting the poor, lower class, middle class, and small businesses. The upper middle and upper classes, a much lower percentage of actual taxpayers, would benefit from a flat tax, with or without a wage floor. They would be paying a lower percentage of

taxes and face a decreased tax burden to the government. Most impoverished people who currently do not pay taxes because of various exemptions and deduction would be placed back onto the tax roles. Likewise, the lower middle class, many of whom are single-parent families with children and without funds to spare, would also face an increased tax bill. With reduced income for the lower social classes, the demand would increase for social programs, government assistance, and relief. Families and individuals that were likely eking by under the current tax structure would need increased government assistance just to feed, clothe, and shelter themselves.

If there is a wage floor before income is taxed, perhaps relating to the federal poverty levels, the social consequences would not be as painful for the lower classes. As the level of the wage floor increases, more people are removed from the income tax system. The federal poverty levels, such as those listed in Appendix D for the tax year 2003, could serve as the basis for exemptions, indexed every year for inflation and economic changes. The federal government would need to continuously adjust the federal poverty levels in relation to the economy and the changing face of the American populace. The household could calculate their tax burden based on the number of people residing in it, just as they do under the present dependent rules. All income up to the dollar amount of the federal poverty level would be exempt from the flat tax percentage levied across the board on American taxpayers. For example, under the 2003 poverty thresholds, a household of five persons, three of them children under eighteen, would have a wage floor of \$21,959. If the family made \$50,000 with a flat tax rate of seventeen percent, only the remaining \$28,041 would be taxed. The household of five would have a tax burden of \$4,767. If a single individual under the age of sixty-five living alone made

\$50,000, he or she would have the first \$9,573 of their income exempt from taxes with a tax burden of \$6,873. Therefore, families would still be given higher tax exemptions for marriage and children, the socially desirable action, and the system would be reasonably fair. This would help the lower social classes because the exemptions would significantly reduce their taxable income and therefore their tax burdens. These exemptions would have little effect for the wealthy because the household of five persons earning \$10,000,000 annually would still have a wage floor of \$21,959. As a result, taxable income would constitute \$9,978,041 with a tax bill of \$1,696,267 rather than \$1,700,000, a difference of \$3,733.

This introduces a minor level of complexity into the tax code, but the social benefits of a wage floor outweigh the complexity it would cause. The poverty levels also differ according to county and state because of the differences in cost of living. As income theoretically matches the cost of living, poverty levels increase in areas of high costs of living. Because of this, individuals and businesses can choose to alter their behavior, residences, workplaces, etc., just to obtain the benefits of the lower or higher (depending on the individual's or business's circumstances) poverty level. Every change made to increase fairness or make the system more applicable to everyone makes the entire flat tax idea more complicated, going against the purpose of simplifying the tax code.

In order to make the flat tax work, there must be a single, flat income tax rate for individuals and businesses, with one exemption per household, its quantity to be determined by what is just for household sizes. The federal government's census bureau could study, calculate, and determine the levels necessary for the flat tax to function well,

for both the citizens and taxpayers of the United States as well as the government.

Perhaps a portion of the budget for the Internal Revenue Service could be diverted to determining the quantities of income that should be exempt from taxation in different households. The IRS could work in conjunction with the Federal Census Bureau to adequately stipulate fair income thresholds for households.

With a change in the federal income tax system, social institutions could encounter changes and difficulties. Charitable organizations, as previously mentioned, are not the only social institutions that would be influenced by a drastic change in the income tax system. Every institution funded by or related to the federal government might face changes. Social welfare programs and assistance programs may need to be increased if the flat tax were instituted without a wage floor. With an adequate wage floor, the programs might not face many changes. As previously mentioned, changes in the tax system could eliminate the equivalent of 3.3 million full time jobs. It would likely take several years for the market to adjust to the change. Educational institutions would have to alter their course material in the fields of business and accounting with regard to income tax courses. If the tax system were to be simplified down to simple mathematical calculations with little tax education needed, tax preparation courses would not need to be taught in their present form, if at all. Uncertainty about tax collections could cause the federal government to be in upheaval, at least for a period of time. Budgets would need to change if the tax was not revenue neutral and the magnitude of the Internal Revenue Service would be decreased.

A possible remedy for the difficulty of changing over from the current progressive system to a flat tax is to give the taxpayer the option of which system to use, at least for

one tax year. Steve Forbes's perspectives for the flat income tax include a plan where "Taxpayers would have a choice" (Forbes, 2005). He wants taxpayers to be able to "opt for the new flat tax, or they could file under the old [progressive] system," and "this type of dual system is being used successfully in Hong Kong" (Forbes, 2005). "People would be able to see for themselves which system is better--the flat tax or the old system. Given the choice, most people would opt for a simpler system" (Forbes, 2005). The wealthy would likely alter their choice of tax systems immediately, as would the upper middle class and big businesses because they could save money in taxes and tax preparation. The middle and lower classes would likely stay with the old system if there were no wage floor because it would cause a lesser tax burden. However, they might eventually change because of the ease of filing. As the "Attitudes on Tax and Wealth Issues" survey on American tax attitudes states, 34 percent of those surveyed responded that "considering all government services on the one hand and taxes on the other...[they would choose to] decrease services and taxes" (Dalbec, 2005). Over half of the taxpayers surveyed also stated they would rather lose some of their tax breaks and benefits as long as it would make the system less complex. Therefore, Steve Forbes surmised, it is likely that once American taxpayers used a simpler system, most of them would probably prefer to file under the flat tax system.

As fiscal policy is used by every party in the political and social world to exercise social policy, a change in the system has numerous repercussions. The system would have to be orchestrated to be as simple as possible, protect the poor, widowed, helpless, and middle class, and still procure the revenue necessary to have an effectively functioning country, economy, and government. It would also have to protect those who

need assistance in life. The system also needs to be as fair as possible. In order to effectively run the country and the federal government's budget, its citizenry must pay their portion, whether it is ten dollars or ten million. However, someone will always be disgruntled with the government and its taxation policies. Among 59 percent of those surveyed in the "Attitudes on Tax and Wealth Issues," there is a belief that they, as individuals, pay "more in federal income taxes each year... [than] millionaire Donald Trump" (Dalbec, 2005). Again, the problem of fairness arises because many Americans believe the federal income tax system provides numerous loopholes to the wealthy and privileged in addition to affording opportunities for questionable or illegal tax shelters. In order to be effective and socially acceptable, the system would have to fulfill all of these aims.

Compliance Costs with the Flat Income Tax

Another result of the flat income tax would be a change in the accounting profession, removing a substantial portion from the economy. The accounting profession performs myriad duties within companies and the economy, such as bookkeeping, cost analysis, financial planning, payroll functions, auditing, and budget analysis. An important portion of the accounting profession is working with the federal government and the income tax code; and all businesses and institutions, whether for-profit or not-for-profit must report their revenues to the government. Many certified public accountants across the country earn their living through tax work by preparing income tax statements for corporate and individual clients and advising clients about "issues such as financial choices, how to best treat a merger or acquisition, deferral of taxes, when to expense items" (Accounting: Job Options). They perform much of their yearly work during tax

season completing tax returns for individuals and companies because they have the knowledge, education, skills, and financial qualifications to navigate the federal tax code and individual state tax codes. The tax portions of the accounting profession studies and makes preparations for the tax season all year with continuing professional education, tax updates, and extensive tax planning work for their clients. A large accounting firm may hire another tax professional as a consultant to hold tax update workshops for the firm's employees. In addition, the firm will often provide tax planning for its clients. The accountant may meet with the client several times during the year to discuss tax consequences for property acquisition and capital improvements, as well as to adequately plan for the payment of the year's income taxes. This is especially pertinent for retirees that earn income from investments which do not withhold payroll taxes. They will be required to pay estimated income taxes quarterly and calculate the exact amount due at year end. Tax accountants also work closely with financial managers and investment planners in order to provide advice to the client on the best management of their investment portfolio.

The \$194 billion spent on tax compliance in the year 2002 was income for many people. In addition, the CPAs and other tax preparing businesses, such as H & R Block and Jackson Hewitt would be forced to change their profession and would face an abrupt loss of clients once tax filing became as simple as sending in a simple postcard-sized form once a year to the government. Thousands of businesses would cease to exist in their current form, including the "9,000 tax offices and 98 Financial Centers in the United States" of H & R Block alone (About H&R Block: History, 2006). Consultants hired by tax preparers to educate themselves would no longer be needed because every taxpayer

could file his/her taxes without any additional assistance. Payroll personnel would also have their duties reduced because they would no longer have to spend as much time working with the tax schedules of payroll deductions. The payroll administrator could simply remove the required percentage of the flat tax and remit it to the federal and state governments as necessary if there were no wage floor. If the compliance costs for the current progressive tax system equates to 3.3 million full time jobs in the economy, once instituted, the flat tax would allow these individuals more time to perform other tasks. Though there would still be some compliance costs with the flat tax, the costs would be far less. The economy would respond in time to the hours put back into the workforce and private lives, but the fact remains that millions would need to alter their jobs or find new professions.

The Internal Revenue Service would also face substantial changes. For example, in fiscal year 2004, 99,000 full-time equivalent employees worked for the IRS and the agency's budget was \$10.185 billion" (IRS History and Structure). The Internal Revenue Service's mission is to "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all" (The Agency and its Mission). If America's taxpayers calculated a simple percentage of their income, the IRS would collect the percentage of taxes from taxpayers and manage the simple tax system. The IRS would not only fulfill its mission, but the agency would not need the current staff or budget to accomplish the necessary collection and enforcement of the tax laws. The federal government could funnel much of the \$10.185 billion dollars spent to manage and run the IRS into more socially redeeming

programs such as health and social welfare programs. Many of the 99,000 employees could be relocated in another agency to better the American populace in different ways.

Likelihood of the Institution of a Flat Income Tax

The possibility of a national flat income tax being instituted at this stage of America's development is unlikely, particularly because once privileged treatment for a group of people or economic activity is "inserted into the code, [the] preferential tax provisions become entrenched over time as various groups lobby for their protection and expansion" (Moody, 2000). Most, if not all, politicians, lobbyists, interest groups, and others possess "a strong interest in maintaining the tax preference because they have usually spent substantial resources obtaining it" (Moody, 2000), and therefore are likely to fight attempts to alter the system. Either political party in Congress could halt a flat income tax plan in the House of Representatives, the Senate, or the White House. Without the dominant political parties working together to institute a flat income tax, any proposal for a flat income tax could be stopped or slowed in a committee. It is also unlikely that the lawmakers in the United States will agree to institute the flat income tax because their constituents and campaign financiers are likely to exert pressure on the congressperson to fight a flat income tax proposal.

Conclusion

This thesis has discussed implication of both the flat income tax and the current progressive system. While almost everyone has an opinion on the matter, the people in the position to change the entire federal income tax system or increase its complexities are not necessarily economists, accountants, financiers, sociologists, or even

knowledgeable in federal law. These individuals are making the fiscal and social decisions for their constituents often for political purposes.

Both systems have their strengths and weaknesses. The progressive system is complicated and requires significant compliance costs. The flat tax requires little compliance costs, but may have serious social repercussions if it is not fair or does not protect the lower classes of society. Regardless of which system is in effect, a section of the American taxpaying public will be unhappy with the income tax system and seek to reduce their burden through lobbying, convincing their representatives to vote against changes, or electing new representatives. There are examples of both tax systems around the world, some successful and some not. The issue of a flat tax system warrants study in order to fully understand the current system along with other possibilities.

Schedule T-1 — Married Filing Jointly or Qualifying Widow(er)

Adjusted Income of each spouse	Total income	The Tax Is
\$0	\$0	0%
\$14,650	\$29,300	\$4,600 plus 15% of the amount over \$14,650
\$29,300	\$58,600	\$8,190 plus 25% of the amount over \$14,650
\$43,950	\$87,900	\$12,170 plus 28% of the amount over \$29,300
\$58,600	\$117,200	\$16,150 plus 30% of the amount over \$43,950
\$73,250	\$146,500	\$20,130 plus 33% of the amount over \$58,600

Source: Internal Revenue Service, 2004. (www.irs.gov)

2005 Basic Individual Income Tax Rates

2005 Tax Rate Schedules

Schedule X — Single

If taxable income is over--	But not over--	The tax is:
\$0	\$7,300	10% of the amount over \$0
\$7,300	\$29,700	\$730 plus 15% of the amount over 7,300
\$29,700	\$71,950	\$4,090.00 plus 25% of the amount over 29,700
\$71,950	\$150,150	\$14,652.50 plus 28% of the amount over 71,950
\$150,150	\$326,450	\$36,548.50 plus 33% of the amount over 150,150
\$326,450	no limit	\$94,727.50 plus 35% of the amount over 326,450

Schedule Y-1 — Married Filing Jointly or Qualifying Widow(er)

If taxable income is over--	But not over--	The tax is:
\$0	\$14,600	10% of the amount over \$0
\$14,600	\$59,400	\$1,460.00 plus 15% of the amount over 14,600
\$59,400	\$119,950	\$8,180 plus 25% of the amount over 59,400
\$119,950	\$182,800	\$23,317.50 plus 28% of the amount over 119,950
\$182,800	\$326,450	\$40,915.50 plus 33% of the amount over 182,800
\$326,450	no limit	\$88,320.00 plus 35% of the amount over 326,450

Poverty Thresholds 2003

Poverty Thresholds for 2003 by Size of Family and Number of Related Children Under 18 Years (Dollars)

Size of family unit	Weighted average thresholds	Related children under 18 years								
		None	One	Two	Three	Four	Five	Six	Seven	Eight +
One person (unrelated individual)	9,393									
Under 65 years.....	9,573	9,573								
65 years and over.....	8,825	8,825								
Two persons.....	12,015									
Householder under 65 years.....	12,384	12,321	12,682							
Householder 65 years and over...	11,133	11,122	12,634							
Three persons.....	14,680	14,393	14,810	14,824						
Four persons.....	18,810	18,979	19,289	18,660	18,725					
Five persons.....	22,245	22,887	23,220	22,509	21,959	21,623				
Six persons.....	25,122	26,324	26,429	25,884	25,362	24,586	24,126			
Seven persons.....	28,544	30,289	30,479	29,827	29,372	28,526	27,538	26,454		
Eight persons.....	31,589	33,876	34,175	33,560	33,021	32,256	31,286	30,275	30,019	
Nine persons or more.....	37,656	40,751	40,948	40,404	39,947	39,196	38,163	37,229	36,998	35,572

Source: U.S. Census Bureau, Current Population Survey 2004 Annual Social and Economic Supplement.

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