CATO HANDBOOK FOR CONGRESS

Policy Recommendations for the 108th Congress

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24. Tax Reform

Congress should

- make permanent and accelerate the phase-in of tax cuts enacted in 2001, including rate reductions, estate tax repeal, and pension liberalization;
- repeal the individual and corporate alternative minimum taxes;
- reduce the taxation of capital by lowering personal taxes on capital gains and dividends, which are currently taxed at both the corporate and individual levels;
- expand Roth individual retirement accounts by greatly increasing contribution and income limits and repealing withdrawal restrictions to create a large all-purpose savings account available to every American;
- index individual income tax brackets to nominal income growth rather than inflation to prevent hidden tax increases caused by ''real bracket creep'';
- make permanent the 30 percent expensing provision for capital investment enacted in 2002, and expand it to ultimately allow 100 percent expensing;
- ensure that all tax cuts are consistent with replacing the income tax with a low-rate consumption-based tax, such as a Hall-Rabushka flat tax, a savings-exempt income tax, or a national retail sales tax; and generally
- make all federal taxes lower, flatter, and simpler.

Introduction

At the beginning of the 20th century, federal taxes accounted for just 3 percent of the nation's gross domestic product, and the tax code and

related regulations filled just a few hundred pages. Today, federal taxes account for more than 18 percent of GDP (after peaking at about 21 percent in 2000), and federal tax rules span 45,662 pages.

The annual extraction of $2 trillion in federal taxes from families and businesses comes at an enormous cost. The most obvious cost is that Americans are left with less money to meet their needs for food, clothing, housing, and other items, and businesses are left with fewer funds to reinvest to build the economy. Today's huge tax burden exacerbates every problem of the federal tax code, including the bias against saving and investment, complexity, unequal treatment, and wasteful tax avoidance and evasion.

Reducing the overall tax burden should be the top priority for Congress (Chapter 23 provides federal budget reduction ideas). The tax system can be redesigned to greatly reduce its high costs. That is particularly true of the income tax on individuals and corporations. The current high-rate income tax is excessively complex, discourages saving and investment, and creates large inefficiency costs that stunt economic growth. Any of those problems alone should give Congress a strong motive for major reforms. Taken together, they make major tax reform a necessity.

This chapter looks first at problems inherent in the current income tax that would be greatly reduced by a low-rate consumption-based tax. Short-term reform options are then proposed to make the tax code simpler and less burdensome. Finally, long-term consumption-based tax reforms are discussed.

Excessive Complexity

In 1976, president-to-be Jimmy Carter called for ''a complete overhaul of our income tax system. I feel it's a disgrace to the human race.'' Since Carter's attack, the number of pages of federal tax rules has more than doubled. And now, Treasury Secretary Paul O'Neill calls the tax system an ''abomination.'' Clearly, reform is long overdue.

The income tax's complexity creates a huge compliance burden, requires high enforcement costs, causes high error rates, impedes economic decisionmaking, leads to inequitable treatment of citizens, and promotes tax avoidance and evasion.

Compliance Burden

Estimates reported by the Office of Management and Budget show that Americans spend more than 6 billion hours each year filling out tax forms,

keeping records, and learning tax rules. The complexity of the tax system has spawned a huge public and private ''tax industry'' to perform administrative, planning, and enforcement activities. Those activities represent a pure loss to the economy since they consume resources and human effort that could otherwise be used to create useful goods and services. The costs of complying with federal income taxes are estimated to be roughly $200 billion per year. That huge burden falls on individuals both directly and indirectly through the burdens imposed on businesses. For example, a large corporate tax filing with related paperwork can run more than 10,000 pages. All Americans would gain if businesses spent less time on such paperwork and tax avoidance strategies and more time creating better products.

Enforcement Costs

In addition to the basic compliance costs of filing returns and tax planning, taxpayers incur large costs responding to IRS audits, notices, liens, levies, and seizures. The IRS assesses about 30 million penalties each year, thus imposing more costs on taxpayers. Because of the complexity of the tax system, many penalties are erroneous and thus a waste of effort all around.

Errors

Tax complexity causes taxpayers, the IRS, and tax experts to make frequent and costly errors. The IRS routinely gets up to half the answers to taxpayer phone inquiries wrong. *Money* magazine's annual test of tax experts, who are asked to compute taxes for a hypothetical family, consistently shows wide variations in experts' answers as a result of tax law complexity.

Economic Decisionmaking

Tax complexity impedes efficient decisionmaking by families and businesses. For example, the growing number of saving vehicles under the income tax, including 401(k)s and individual retirement accounts (IRAs), greatly confuses family financial planning. The wrong saving choice could result in lower returns, less liquidity, and payment of withdrawal penalties. Today's complex savings choices would be vastly simplified under a low-rate consumption-based tax.

The continual change in tax rules injects great uncertainty into long-term economic decisions, such as planning for business investment or

retirement. The 2001 tax cut law alone had 85 major provisions and created 441 separate changes to the tax code. Each change in the law sets off changes in tax regulations, requests for IRS guidance, changes to tax forms, and higher error rates. Income tax complexity also creates taxpayer confusion about the effects of current laws, let alone future changes. With regard to disagreements on business tax items, audits, appeals, and litigation with the IRS can drag on for years with no clear answer as to the correct tax payment amount.

Inequity and Unfairness

The many complex features of the income tax create unfairness because similar families end up paying different tax amounts. As Congress has larded up the income tax code with special preferences, inequities have increased. Tax incentives for education, home ownership, and savings plans reward some families but not others. Polls have found that most Americans believe that the income tax is ''unfair.'' No doubt such feelings have been fueled by the many special preferences carved into the tax code. A consumption-based tax would be simpler and fairer.

Avoidance and Evasion

Tax complexity leads to noncompliance with the tax system caused by both confusion and a desire to evade taxes. Complexity fosters multiple interpretations of the law and aggressive tax planning. Taxpayers take risks on their tax returns in the hope that complexity will hide their strategies from the IRS. The economy would be better off if tax rules were simple and transparent so that businesses could spend their energies on their operations, not playing cat-and-mouse games with the IRS.

Bias against Saving

The income tax system distorts the crucial economic tradeoff between consumption and saving. Saving is a primary source of economic growth because it provides businesses with the investment funds they need to expand and modernize the nation's capital stock. It is widely recognized that the income tax system is biased against saving because the returns to saving can face high tax rates, whereas current consumption does not.

That income tax bias has contributed to much of the interest in fundamental tax reform in recent years. Nearly all recent tax reform proposals would adopt a consumption base in order to eliminate saving and investment disincentives and to boost capital formation and growth. Also, a

consumption tax base would increase economic efficiency by equalizing the treatment of all types of capital income. By contrast, the current tax system distorts corporate financing. For example, interest payments are deductible at the corporate level, but dividend payments are not. Many experts believe that this disparate treatment has led American companies to take on too much debt relative to equity. That causes greater numbers of bankruptcies and exacerbates economic instability.

At the individual level, removing tax barriers to all types of saving would allow families to gain greater financial security. With larger pools of savings, families could better plan for their future and guard against unforeseen financial problems. Consumption-based tax plans would treat personal saving under rules similar to those that govern either regular IRAs or Roth IRAs. In the first case, saving is initially deducted but withdrawals are later taxed. In the second case, no deduction is given for saving initially but qualified withdrawals are not taxed. The Hall-Rabushka flat tax adopts savings treatment similar to that of the Roth IRA by taxing initial wage earnings but exempting dividends, interest, and capital gains from taxation at the individual level. If made universal for all types of savings and for all families, that treatment would greatly increase saving incentives and remove large paperwork headaches that taxpayers face under the current plethora of different savings vehicles, each with unique rules and limitations.

Economic Inefficiency

A $1 million government spending program does not cost taxpayers just $1 million. It costs them much more. That is because taxes cause large distortions in the efficient functioning of the market economy by changing prices and altering behavior. Those distortions are called ''deadweight losses.'' For example, consider a woman with a wage job who is considering launching a small business on the side to earn more income. If the government hikes marginal tax rates and dissuades her from those entrepreneurial plans, the nation loses the additional production and the innovative ideas that she could have added to the economy.

High marginal tax rates greatly increase the economic damage or deadweight losses of income taxes. That is because deadweight losses increase more than proportionally to increases in tax rates. In particular, deadweight losses rise by the square of the increased tax wedge between pre- and posttax income for income taxes. For example, a doubling of the tax wedge causes deadweight losses to quadruple. As a consequence, a flatter

tax rate structure would be much more efficient than today's highly graduated tax rate structure.

Economic research indicates that deadweight losses represent at least 25 percent of each additional dollar of federal income tax revenue. Indeed, the Office of Management and Budget incorporates a 25 percent deadweight loss measure into federal cost/benefit analyses. That means that for new government spending projects to even begin making economic sense, they must generate benefits at least 25 percent greater than their explicit tax costs because of the extra 25 cents on the dollar damage created by raising taxes.

Conversely, tax rate reductions benefit taxpayers by substantially more than the amount by which taxpayers' explicit liabilities are reduced. For example, an estimate of President Bush's original tax cut plan by Harvard professors Martin Feldstein and Daniel Feenberg in 2001 found that it would reduce deadweight losses by 38 percent of the value of the $1.6 trillion tax reduction, or about $600 billion over 10 years.

Tax rate cuts reduce deadweight losses by increasing rewards for work, savings, entrepreneurial activity, and business investment and by shifting economic activity into more productive areas. For example, a series of statistical studies by tax economists Robert Carroll, Douglas Holtz-Eakin, Mark Rider, and Harvey Rosen has found that personal income tax rate cuts, such as occurred in 1986, have a substantial positive effect on small business hiring, investment, and growth.

Short-Term Reforms

In 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act based on the outline of President Bush's tax reduction plan. The 2001 tax law took a number of very positive steps, including reducing individual statutory tax rates, liberalizing the tax rules on retirement savings, and repealing the estate tax. However, all those provisions are set to expire on December 31, 2010, which would impose a massive tax hike on Americans at that time. The tax law also included absurdly extended phase-in periods for tax reductions such that taxpayers will experience the benefits of some tax cuts for just a year or two before having them snatched away at the end of 2010. The first priority of the 108th Congress should be to fix the severe shortcomings of the 2001 tax law.

Make 2001 Tax Cuts Permanent and Effective Immediately

Under the 2001 tax law, individual tax rate cuts are not fully phased in until 2006, the estate tax is fully repealed for only one year in 2010, and

IRA liberalization is not fully phased in until 2008. Most other provisions in the law also have delayed effective dates. Congress should make all provisions in the 2001 tax law effective immediately. After all, the law's provisions help to solve long-standing problems with the tax code and help to spur economic growth. It makes sense to provide taxpayers with those promised future benefits today.

Expand and Make Permanent New Capital Expensing Rules

In 2002, Congress enacted a tax cut designed to stimulate the economy by allowing companies a 30 percent first-year tax write-off (''expensing'') for investment in qualified business equipment. That provision is effective for only three years. Yet expensing has long been proposed as a permanent tax code fix to spur investment and long-term economic growth. The expensing provision should be made permanent and ultimately expanded to allow 100 percent expensing. Full expensing would be the treatment received by capital investment under most major tax reform plans, such as the Hall-Rabushka (or Dick Armey) flat tax and the USA tax plan of Rep. Phil English (R-Pa.). Such treatment would not only boost economic growth; it would also greatly simplify the tax code by ridding it of all the complex depreciation rules.

Greatly Liberalize the Roth IRA

Individual-level taxes on capital income need to be reduced all around. One promising approach to that end would be to liberalize the Roth IRA. The Roth IRA, created in 1997, has become a popular way to save; 12 million U.S. households now hold accounts, according to the Investment Company Institute. Contributions to Roth IRAs are from after-tax earnings, but investment returns and qualified withdrawals are tax-free. But Roth IRAs have strict limitations that should be greatly liberalized so that families can build up larger pools of savings to achieve more financial security.

Roth IRAs have income limits, low caps on annual contributions, and restrictions on withdrawals before retirement age. Under the 2001 Bush tax cut, the annual contribution limit for Roth IRAs rises from $3,000 in 2002 to $5,000 by 2008. That limit should be raised to at least $20,000 immediately. Another key problem is that because a 10 percent penalty is placed on most withdrawals prior to retirement, the liquidity of these savings vehicles is greatly reduced. The result is that individuals save much less because they fear that they may need their money before the

government permits them penalty-free access. Thus, Roth IRAs should be liberalized and turned into universal-purpose savings accounts allowing withdrawals for any reason, not just for purposes specified by the government.

As currently designed, Roth IRAs are aimed at encouraging retirement savings. But tax code barriers to all types of savings, not just retirement savings, should be removed. Not only would that stimulate economic growth, it would encourage individuals to build up larger financial pools that could be used for any family contingency, such as medical expenses, home buying, unemployment, college, or unexpected crises. All individual savings are beneficial to long-term economic growth, and all savings contribute to individual financial stability.

Congress should create a universal savings account by removing income limits, contribution limits, and withdrawal restrictions on Roth IRAs. There would be no tax on dividends, interest, and capital gains earned within these new accounts because initial contributions would come from after-tax earnings. The revenue loss to the government in the short term would be small. Such a plan would greatly simplify the individual tax code by steering much of future individual savings into these simple accounts, and away from all the current complex and special-purpose savings plans.

Fix Real Bracket Creep

During economic expansions, individual taxes are steadily and stealthily increased by the phenomenon of ''real bracket creep.'' Much of the individual income tax code is indexed for inflation but not for real economic growth. As a consequence, increasing shares of Americans' incomes are moved into higher tax brackets each year as the economy expands. That occurs because of the steeply graduated rate structure of the income tax and provisions such as the standard deduction that are also not indexed for real economic growth.

A substantial share of the benefits from the 2001 tax cut may be eaten away by real bracket creep. Congress should index individual income tax brackets and other tax code provisions to nominal income growth, rather than inflation, to prevent real bracket creep. Implementing a low flat-rate tax would also eliminate the problem.

Reduce Taxation of Dividends and Capital Gains

Congress should follow a general policy of steadily reducing the excessive taxation of capital income. Top tax cut priorities include reducing

the corporate income tax rate and reducing individual taxes on dividends and capital gains. The United States is out of step with many of its major trading partners who have reduced capital income taxation in recent years. In fact, the United States has the fourth highest corporate income tax rate among the 30 major nations of the Organization for Economic Cooperation and Development. The average rate across the 30 OECD countries fell from 37.6 percent in 1996 to 31.4 percent in 2002 (including national and subnational taxes).

Regarding dividends, the United States has the fourth highest corporate plus individual tax burden on earnings distributed as dividends among OECD countries. About two-thirds of OECD countries—but not the United States—partially or fully relieve the double taxation of dividends, typically by providing shareholders with a tax reduction on dividends received.

The United States also lags behind on capital gains taxation. For example, Austria, Belgium, the Czech Republic, Germany, Greece, Hong Kong, Mexico, the Netherlands, New Zealand, Poland, and Switzerland all have a tax rate of zero on individual capital gains (holding periods or other conditions apply in some cases).

Enact Simplification Measures

Congress has taken a few very small steps to deal with the tax complexity problem. In April 2001, the Joint Committee on Taxation released a 1,300-page report on the topic. The study cataloged the excessive complexity of federal taxes and proposed more than 100 specific reforms. There is no reason why Congress should not move forward with these reforms, most of which are not controversial.

Congress should also move forward on tax reforms for international businesses. Many good reforms were proposed by House Ways and Means Committee chairman Bill Thomas (R-Calif.) in the 107th Congress. The U.S. tax rules on multinational corporations are perhaps the most complex in the world. The complexity of the rules causes U.S. companies to spend far too much time and energy on tax planning activities rather than more productive pursuits. Glenn Hubbard, chairman of the Council of Economic Advisers, and James Hines have in the past concluded that "the present U.S. system of taxing multinationals' income may be raising little U.S. tax revenue, while stimulating a host of tax-motivated financial transactions." It is time to move ahead on both business and individual tax simplification reforms.

Reform U.S. International Business Taxation

Not only are U.S. tax rules on international businesses complex, many experts agree that they put U.S.-based companies at a competitive disadvantage in world markets. Consumption-based taxes, including the flat tax, would eliminate most international tax rules because they are ''territorial'' taxes, which do not tax the foreign operations of U.S. businesses. About half of OECD countries have territorial business tax systems. Moving to a territorial system would allow U.S. companies to compete on a level playing field in foreign markets with corporations headquartered in other countries.

Repeal the Alternative Minimum Tax

The corporate and individual alternative minimum taxes (AMTs) are complex income tax systems that operate parallel to the ordinary income tax systems. There is broad agreement that the ill-conceived AMTs should be repealed. For example, AMT repeal has been recommended by the Joint Committee on Taxation and the American Bar Association. Former IRS national taxpayer advocate Val Oveson called the AMT ''absolutely, asininely stupid'' in a speech in 2000. Under JCT projections, 36 million taxpayers will be subject to the ''asinine'' individual AMT by 2010 unless Congress acts to repeal it.

Reform the Tax Policy Process

When Congress is considering raising or cutting taxes, expected changes in revenues are officially estimated by the JCT. The Treasury's Office of Tax Analysis performs a similar function for the administration. Those estimates are very important in policy debates about the desirability of tax changes, yet they are often erroneous and incomplete. Unfortunately, tax reforms that are desirable because they would raise Americans' incomes are often held up because of faulty estimates of the federal budgetary impact and because broad economic benefits are not taken into account. The current tax policy process in Washington stacks the deck against pro-growth tax reforms.

Revenue estimates by the JCT and OTA generally assume that tax changes will not affect the overall economy; thus they are termed ''static'' estimates. Yet major reductions in marginal tax rates, for example, would substantially boost economic activity and individual incomes, thus generating an offsetting increase in federal revenues. Revenue estimates that include such economic feedbacks are called ''dynamic'' estimates. Con-

gress should introduce procedures to present dynamic revenue estimates alongside current static estimates for major tax bills.

Other aspects of the tax policy process also need reform. The current process is closed to public scrutiny and is resistant to change. Information provided to policymakers is based on particular economic and tax theories that should be more open to peer review. In addition, the presentation of tax information to policymakers and the general public needs to be overhauled. For example, politically important presentations on the ''distributional'' effects of proposed tax changes (effects presented by income groups) can be very misleading. Congress should reexamine the way such information on tax changes is presented to ensure fairness and accuracy.

Long-Term Reforms

Raising the bulk of federal revenue from broad-based individual and corporate income taxes was a historic mistake. It has led to excessive complexity, a powerful bias against saving and investment, economic inefficiency, and a reduction in U.S. economic growth. To correct those problems, nearly all major tax reform proposals of recent years would replace the individual and corporate income taxes with a low-rate consumption-based tax.

Current System Has Complex and Damaging Tax Base

The key economic differences between income and consumption-based taxes regard the treatment of saving and investment. The federal income tax is loosely based on a very broad measure of income called Haig-Simons income. That basis results in heavy taxation of saving and investment. For example, a full Haig-Simons-based tax would tax all capital gains accrued on paper every year, whether or not those gains were actually received. It would also tax items that individuals would not normally think of as income, such as the implicit rent received from owning one's home and the buildup of wealth in life insurance policies.

Many tax policy experts traditionally supported taxing an expansive Haig-Simons income base. Yet there is no good economic argument for such a tax base. For example, the accrual taxation of capital gains would result in double taxation of investment. (A rise in an asset's projected future return would lead to an immediate taxable capital gain. Then, the return would be taxed again as the asset generated revenues in future years.) The attraction of a Haig-Simons income tax base seems to stem

mainly from the egalitarian impulse to impose a heavy load of taxation on those with high incomes.

Taxing a broad income base is very impractical and complex. As a result, the current income tax has fallen back on an array of ad hoc and inconsistent rules for defining individual and business income. Some income is exempt from tax, some income is taxed once, and other income is taxed multiple times. There is no consistent standard under present tax policy for what constitutes income or when it should be taxed.

In addition, inflation wreaks havoc with broad-based income taxes, making items such as capital gains and depreciation very difficult to measure properly. The many jury-rigged fixes under the income tax create decisionmaking difficulties and paperwork burdens for individuals and businesses. For example, the current income tax treats capital gains on a realization basis, which adds a great deal of planning difficulties for investors who must try to optimally time asset sales and offset gains with losses.

There is a growing realization among economists, tax experts, and taxpayers that the current income-based system cannot be made simple. What is needed is a fundamental overhaul that would create a simple and transparent consumption-based tax, in place of the complex and uncompetitive federal income tax.

Reforming Taxation with a Low-Rate Consumption-Based Tax

Congress should begin replacing the individual and corporate income taxes with a low-rate consumption-based tax. That goal can be reached gradually by following the short-term reforms listed above, or it can be implemented by an immediate replacement combined with various transition rules. Leading consumption-based tax proposals have included the Hall-Rabushka flat tax, a national retail sales tax, and variants of a consumed-income tax. The flat tax was originally proposed by Robert Hall and Alvin Rabushka of the Hoover Institution and was most recently championed by former house majority leader Dick Armey. Leading retail sales tax proposals have included a plan by Rep. Billy Tauzin (R-La.) to replace income taxes and the estate tax with a 15 percent retail sales tax; Rep. John Linder's (R-Ga.) plan would replace those taxes plus federal payroll taxes with a 23 percent sales tax called the ''FairTax.'' Rep. Phil English (R-Pa.) has introduced a plan based on the consumed-income tax approach.

Those plans are similar in economic thrust as they all would reduce the taxation of saving and investment. They would, however, differ in

Table 24.1
Advantages of a Low-Rate Consumption-Based Tax

Economic and simplification advantages
of a Hall-Rabushka-style tax compared with the current income tax

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Advantages for Individuals

Low tax rate: Increased incentives for working, saving, and entrepreneurial activities. With lower rates, more than 20 million small businesses and the self-employed who file under the personal tax system would have added incentives to hire and invest.

Personal savings: No taxation of interest, dividends, and capital gains. That would greatly enhance financial privacy and increase the ability and incentive for families to save for their own retirement and other future expenses. No need for half a billion 1099s and other IRS forms.

Capital gains: Eliminating capital gains taxation would get rid of multiple tax rates and holding periods and complexities such as the timing of realizations, matching gains with losses, and calculating basis. Great boon for entrepreneurial growth companies, which rely on investors who earn returns through capital gains.

Interest: Interest income and interest expense complications and distortions eliminated, such as the municipal bond preference.

Savings vehicles: Current plethora of savings vehicles, including 401(k)s and IRAs, would be phased out as tax hurdles were removed for all types of savings. Families would save for reasons of their own choosing, would withdraw funds without penalties, and would not have to sort through pages of rules to make savings decisions. Saving would become individually based instead of being tied to the risks of company pension plans.

Social engineering: Fairness would be increased as items that specially favor some taxpayers were eliminated, such as the five different current education tax preferences related to savings and interest.

Advantages for Businesses

Low tax rate: Increased incentives for all businesses to hire and invest. Greater attraction of foreign investment would help build the U.S. economy. Reduced efforts put into wasteful tax avoidance, evasion, compliance, and enforcement activities.

Capital income: All types of capital income would receive the same neutral treatment and be taxed only once. Distortions that change business and financial structure, such as the current corporate bias in favor of debt financing, would be eliminated.

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Table 24.1
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Depreciation: Complex and distortionary tax rules for capital purchases eliminated. Business investment would receive a huge boost, which would spur long-term economic growth.

Capitalization issues: Aside from depreciation, other tax rules that relate to the timing of income and deductions would be eliminated, such as the complex rules for business inventory.

Capital gains: Elimination of corporate capital gains would reduce complexities of business reorganizations and investment activities.

Inflation: Distortions caused by inflation under the income tax for such items as for depreciation, inventory, and capital gains would be eliminated under a consumption-based tax.

International tax rules: Businesses would be taxed on a territorial basis under a consumption-based tax, thus eliminating many complex tax provisions, such as the foreign tax credit.

Business structure: Uniform business taxation would replace C and S corporations, LLCs, sole proprietorships, and partnerships. Business and financial planning would be greatly simplified, as would be the tax treatment of mergers and acquisitions.

their mechanics and pose trade-offs with regard to administration, simplicity, and civil liberties. Nonetheless, they would all represent major improvements on the current federal income tax mess.

Table 24.1 summarizes the dramatic economic and simplification gains that could be achieved under a structure like the Hall-Rabushka flat tax, which would incorporate simple and low-rate business and individual-level taxes. Similar gains may be achieved under other low-rate consumption-based tax plans.

Conclusion

Consumption-based tax proposals have gained widespread support because they would reduce the tax burden on saving and investment and spur greater economic growth. In addition, replacing the current income tax with a consumption-based tax promises vast simplification of the complicated federal tax code.

Given the nine-decade reign of the income tax, it is surprising what a weak case there is for it compared with a consumption-based tax. In congressional testimony a few years ago, the current chairman of the Council of Economic Advisers, Glenn Hubbard, called the income tax ''fundamentally flawed'' because of its inefficiency, complexity, and unfairness. It is time to replace the flawed income tax with a lower, flatter, simpler alternative.

As discussed, there are many good short-term reforms that Congress should pursue, such as reducing overall marginal tax rates, eliminating the AMT, and cutting taxes on dividends and capital gains. All changes should aim for the ultimate goal of enacting a low-rate consumption-based system in place of the fundamentally flawed income tax.

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