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How the Tax Code Discriminates Against the Traditional Family

By David A. Hartman & Allan C. Carlson

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The Roadmap to Tax Reform™ Series

Executive Summary

Discriminatory taxation of the married-couple family is neither equitable nor economically efficient, and comes at an enormous social cost. Married-couple families bear a disproportionate share of the tax burden, resulting in stagnation of their incomes. Reform of the marriage tax penalty is not enough. A neutral consumption tax would correct all of the discriminatory measures against the family and would support higher real incomes for all Americans.

This report offers an analysis of current taxation of married-couple families. In brief, taxation of the married-couple family is neither equitable nor economically efficient. Furthermore, discriminatory taxation of families comes at an enormous social welfare cost. What is needed to end the numerous marriage tax penalties is nothing less than fundamental tax reform.

Between the years 1965 and 1995, the total cost of government as a percentage of median married-couple family (MMF) compensation rose from 37.5 to 46.7 percent. On the other hand, in 1995, the total cost of government as a percentage of total compensation was 39.4 percent. *Married-couple families paid 7 percent more in taxes than the average taxpayer.*

The disturbing flipside of this financial burden is that the income taken from married-couple families has increasingly gone to fund unproductive government programs that support costly dependents. In 1960, a 7.1 percent share of total personal incomes represented welfare spending on low-income families. By 1995, the cost of welfare spending had grown to 17.7 percent of total personal incomes.

As a result, the well-being of married couples, as reflected in their income, has stagnated. MMF income has remained practically unchanged (in real dollars) for over 25 years. This despite the fact that workforce participation of married women and mothers has dramatically increased over the same period of time.

Analysis of actual tax incidence on families shows a far-reaching, negative impact on United States capital formation. Because the family has less incentive to rear children, our human capital is diminished, and the gap left by decreased fertility is being filled by immigration. Furthermore, American families have little incentive (or opportunity, as the case may be) to save and invest. High marginal tax rates deplete the amount available for investment, and capital gains taxes discourage investment.

The pyramiding of taxes as a culmination of a lifetime of taxation can be extraordinary. Income after a maximum income tax at 39.6 percent saved for investment produces corporate income that is also taxed at 38 percent, and then taxed again at 39.6 percent on dividends or at 20 percent as capital gains. The decedent's death results in a final 55 percent, with the effect that his or her heirs receive only 16.5 to 19 cents out of the original dollar saved.

The government burden of taxes and fees in total—federal, state, and local—is estimated to have reached 46.4 percent of MMF total compensations as of 1995. Since married families with working adults receive little direct benefit from government subsidies, the effect of taxation is equivalent to supporting two families.

Token reform of the marriage tax penalty is not enough. Fundamental tax reform requires replacing virtually all federal taxes with one or two simple taxes. A single flat tax on consumption would correct all of the discriminatory measures against the family. What would result is a far more efficient, equitable, and pro-growth tax system, one that supports higher real after-tax incomes for all Americans, married-couple families or otherwise.

Direct all inquiries to:

Institute for Policy Innovation
250 South Stemmons, Suite 215
Lewisville, TX 75067

(972) 874-5139 [voice] Email: **ipi@ipi.org**
(972) 874-5144 [fax] Website: **www.ipi.org**

The Road Map to Tax Reform™

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How the Tax Code Discriminates Against the Traditional Family

By David A. Hartman & Allan C. Carlson

Introduction

The purpose of this inquiry is to examine taxation of the married-couple family in America, and how it has affected family incomes and consequently social equity and efficiency. It will be shown that taxation of the married-couple family is neither equitable nor economically efficient, and that an enormous social welfare cost is its consequence.

The focus of taxation for the purposes of this study took due note of the total tax burden on the married-couple family at the federal, state, and local level. However, the primary focus was on federal taxation that comprises more than two-thirds of total taxation and accounts for the principle discriminatory taxation versus the married-couple family.

Fundamental federal tax reform can eliminate all of the elements of the federal tax code that discriminate against the married-couple family.

The study is comprised of four parts. The first details the historical taxation of the married-couple family and how discriminatory taxation arose.

The second part examines the economics of the family as the basis for social welfare. This is compared to the alternative lifestyles that the married-couple family is required to subsidize through the discriminatory sharing of an excessive portion of an excessive total burden of government.

In the third part, the current income tax code is examined in order to determine how it selectively discriminates against the married-couple family, and how it diminishes the overall growth of incomes, including married-couple family incomes.

The final section demonstrates how fundamental federal tax reform can eliminate all of the elements of the federal tax code that discriminate against the married-couple family. It also demonstrates how fundamental tax reform would increase real incomes of *all* Americans, including married families, and would contribute to a general improvement in the well-being of all citizens.

The History Of Taxing The Family

At the initiation of federal income taxation in 1913, its focus was entirely upon "equitable" taxation of what was widely perceived to be excessive income and wealth of the super-rich. It was not until the onset of World War II that the average American family felt the impact of the federal income tax.

When the federal income tax was broadened in 1941 to include taxation of ordinary families, there followed a tax rebellion unparalleled in American history. To impose the yoke of income tax on American families, the Internal Revenue Service ended up giving an income tax amnesty for unpaid 1941 income taxes in exchange for individual agreements to allow income tax withholding commencing in 1942.

Discriminatory Taxation Of The Family

The fist step towards discriminatory taxation against the family took place in 1952, with the advent of the "head of household" schedule ("widows' tax relief"), a more favorable tax schedule that allowed special marital deductions for unwed mothers. This favored tax status was later enlarged under the "Great

Society" when the "earned income tax credit" (EITC) was granted a head of household schedule that was more generous to unwed mothers than to married households with dependent children.

The next overtly anti-married-couple family change to the federal tax code came in 1969 when married-couple tax brackets were lowered from double the brackets of single taxpayers (taxing married income at higher rates). As a result of this change to the IRS Code, the family became the only legal partnership not allowed income splitting or its tax equivalent. Income splitting allows typically lower marginal rates of taxation, due to lower brackets applicable to each taxpayer than for the two incomes combined. The IRS rationale for allowing this is that only the partners know who contributes in what proportion to the income earned.

The object of this discrimination was the then prevalent single-income, married-couple family, which was thought to be privileged with an unfair tax break compared to a single-income earner of equal income. Ignored was the obvious and fundamental division of labor within a legal partnership of two persons, one engaged in the commercial economy and the other engaged in the home economy. The only valid comparison is the taxation of the combined income of *two* single individuals with two incomes. Any other comparison is a statistical figment of the imagination. An unmarried pairing in which one has a career and the other solely provides domestic support seldom, if ever, occurs outside of marriage.

The family became the only legal partnership not allowed income splitting or its tax equivalent.

Over the course of the Great Society in the 1970s and tax legislation to the present, the federal tax code has become relentlessly more anti-family. The decrease of marriage deductions and dependent deductions as incomes rise was introduced in 1986, and credits for commercial child care (but not home care) were added in 1976.

Federal income taxes and the total tax burden on median married-couple family compensation (MMF) have been draconian, as shown in Table 1, which covers the period 1965 through 1995. Federal income tax (FIT) on median married income rose from 8.22 percent of income in 1965 after the Kennedy tax cuts to 14.69 percent by 1981—a 79 percent increase. Although FIT decreased to 9.73 percent of MMF income by 1995, growth of seen and unseen payroll taxes counteracted this relief, the tax burden amounting to 20.46 percent of total MMF compensation.

The *total* burden of the government on the family is also shown in Table 1, determined as total government receipts appropriated from MMF total compensation. The composite cost of federal state and local government rose from 37.5 percent of total MMF compensation in 1965 to 46.9 percent by 1981 and remained at 46.4 percent as of 1995. For the whole U.S. economy in 1995, the total cost of government as a percentage of total compensation was 39.4 percent. *A median married-couple family paid 7 percent more in taxes than the average taxpayer.*

Table 1 Measures of Median Married-Couple Family Income & Taxation, 1965–1995

Year	Median Married Family Income (B.T., 96 $)	MMF FIT Rate	MMF Total Comp. (B.T., 96 $)	MMF FIT & Payroll Rate	MMF Total Tax Burden	MMF Total '96 Comp. After All Taxes
1965	$36,187	8.22%	$39,778	14.07%	37.54%	$24,847
1973	$46,036	10.72%	$52,828	19.54%	42.97%	$30,128
1981	$43,264	14.88%	$52,107	23.24%	46.86%	$27,792
1989	$46,774	9.88%	$59,165	20.51%	44.98%	$32,552
1995	$48,452	9.73%	$59,249	20.48%	46.44%	$31,734

Source: Statistical Abstract of the United States 1998, U.S. Census Bureau, p. 308, Table 500, and prior series

Discriminatory Allocations of Government Spending

From 1960 to 1995, defense spending as a percentage of personal income declined 7.8 percent, from 13.1 percent to 5.3 percent. However, MMF total tax burden *grew* 7.9 percent. What was the increased tax burden funding? In 1995, a 17.7 percent share of total personal incomes represented welfare spending on low-income families, principally unwed mothers, their children and the aged. This represented an increase of 10.6 percent of personal income from 7.1 percent in1960. Little or none of this spending benefitted the median married-couple family with children.

In sum, virtually all of the increase in productivity and workforce participation of married families from 1973 to 1995 went to others, primarily to government employees and their welfare beneficiaries.

It is difficult to overstate the duress of married families with children since 1960. Increase of the total tax incidence was but the tip of the iceberg. The growth of MMF compensation before and after total tax burden is shown in Table 1. MMF total compensation after all taxes stagnated in 1973 at $30,128 in 1996 dollars and by 1995 had only increased 5.3 percent to $31,734.

From 1973 to 1995, the real output per paid hour rose 35 percent in the private sector of the United States, and the work place participation of married women rose from 42.8 percent to 61.0 percent. The increased contribution of married women to total output underscores the extent of the economic burden on the married-couple family. The workforce participation of married women with children increased from 30.5 percent in 1960 to 70.2 percent by 1995.

Much of national economic growth can evidently be attributed to the work of married couples. Yet family incomes have seen little improvement—despite even the contributions of married women, who were likely forced to work to offset burdensome taxes. *In sum, virtually all of the increase in productivity and workforce participation of married families from 1973 to 1995 went to others, primarily to government employees and their welfare beneficiaries.*

By 1995, the government was distributing money to unwed mothers at a rate of $20,000 per child in poverty and to the aged at an average of $20,000 per person 65 years or older, regardless of means. The primary source of this largesse was married-couple family incomes, with median compensation of typically two workers totaling only $31,734 income and benefits after all taxes, direct or imputed.

Effect on Married Family Demographics

After growing throughout the post World War II era, the marriage rate per 100 women 15 years and over peaked in the early 1970s and then dropped sharply. The United States' marriage rate has declined slowly ever since. The peak marriage rate corresponds to the 1973 peaking and stagnation of MMF compensation.

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The divorce rate rose sharply in the 1960s as no-fault divorce legislation swept the United States and then dropped in the 1980s as family income grew. Commencing in the 1970s, divorce rates soared to unprecedented levels in response to the trend of married-couple family income.

Fertility in the United States declined in the 1960s in response to birth control pills. The married fertility rate plummeted in the 1970s and then stabilized in the 1980s, but it is still slowly declining. As a result of government incentives to unwed motherhood, out-of-wedlock births soared from 5.37 percent of total births in 1960 to 30.1 percent by 1992.

In summary, although other social factors played a major role, the stagnation of married-couple family incomes due to increased taxation and the redistribution of their incomes to unmarried parenting have had an adverse effect on preferences for marriage and married parenting from the early seventies to the present.

The Economics Of Marriage And The Public Welfare

Government paid little heed to the distress of the family that resulted from the redistributionist goals of the Great Society. The transfer of "wealth" from families of middle class or higher means to lower-income families was considered a necessary condition of social justice. In practice, the transfer of wealth proved elusive.

The first problem to become apparent was that you get more of what you subsidize and less of what you tax. Soaring numbers of unwed mothers and rising divorce rates resulted from the growth and range of generosity of welfare programs. The aged, when qualified for entitlement to generous Social Security income plus Medicare and Medicaid healthcare in excess of their actual contributions, saved less and retired earlier. Indigent parents no longer lived at home. They began to live in nursing homes paid for by Medicaid welfare.

The resulting tax-and-spend on welfare continues unabated, and the burden primarily falls on the married-couple family. As the trend away from marriage continues, other socio-economic problems become evident. Children from single-parent homes show social disabilities in educational performance and greater propensity towards psychological problems, substance abuse, and criminality. They are also more exposed to violence. All of this results in the demand for expanded government welfare programs and still greater burdens on married taxpayers.

To increase the growth rate of family incomes and lessen the tax burden…will require fundamental income tax reform.

Rather than being a relative value preference, or a state of bondage for women as claimed by social critics, marriage has been clearly demonstrated to be a superior basis for economic efficiency and social well-being. By burdening the productive family and officially maintaining unproductive, socially damaging "lifestyles," the welfare state has enlarged, rather than reduced, the problems of poverty.

The breakdown of the married-couple family, the loss of community and charitable involvement because of the dual-earner claims on time, the diminished nurture of children in married families, and the institutionalized care for the aged are the bitter fruits that follow additional tax burdens on traditional married families.

These cultural and economic consequences call for more family-friendly government policies and a reversal of the descent into an all-encompassing welfare state. It is necessary to stop the increasing diversion of resources from socially functional and productive families to socially dysfunctional and unproductive individuals. It is particularly necessary to re-establish a reasonable tax burden to marriage and married parenthood so that we might encourage higher fertility, more nurture of children, and more educated workers to offset the graying of America.

Assurance of the accelerated growth of savings and investment is necessary to increase the growth rate of family incomes and lessen the tax burden. This will require fundamental income tax reform.

The Anti-Family Federal Tax Code

The current federal tax code is both directly and indirectly biased against the traditional family. It is directly biased against marriage, married child rearing, and the intergenerational family. It is indirectly biased in that the excessive scale of government taxation lessens resources available to generate growth and prosperity and redistributes income from the traditional family to dysfunctional dependents upon government.

Direct Anti-Family Elements of Federal Taxation

The Marriage Tax Penalty

One of the most visible forms of the anti-family bias in the federal tax code is the "marriage tax penalty." This penalty results from the fact that the married-couple family is the only legal partnership not allowed by the IRS to split incomes. Consequently, two singles of the same total income as a married-couple family face lower total income taxes. The singles are privileged to both better rate schedules for separate incomes and higher standard combined deductions.

The Congressional Budget Office (CBO) has sought to derail efforts to eliminate the marriage tax penalty. Its study, released in 1997, claimed there are as many marriage tax bonuses as penalties. In order to arrive at that conclusion, the CBO compared single-income married families to nonexistent, single-income unmarried households. A valid pairing of actual unmarried adults as the demographic equivalents of single-income marriages would confirm that the marriage tax penalty is prevalent for *both* single- and dual-income married families.

> ***The marriage tax penalty is prevalent for both single- and dual-income married families.***

Tragically, this flawed CBO study (which used the same contorted logic that resulted in revoking income splitting in 1969) has led to proposals to eliminate the marriage tax penalty *only* for dual-income families, thus excluding single-income married families. Legislators are also discussing proposals to remove the marriage tax penalty only from those families with incomes below $50,000. The question remains: why should tax equity be only applicable to dual-income families of lower incomes?

The *phase-out of deductions and exemptions* at higher incomes, particularly exemptions for children, strikes directly at families.

The Married Parenthood Penalty

The head of household tax status for unwed mothers provides a more favorable tax schedule, higher deductions, and a better EITC schedule than for married families. This equates to a "married parenthood penalty." The privileged tax status for single mothers who work, coupled with generous welfare benefits for lower- or non-income cases, acts as incentive toward unwed motherhood. It is essentially a subsidy for the single biggest source of children living in poverty.

To eliminate the "married parenthood penalty" requires one of two alternatives. Either the "head of household" tax status must be eliminated, or it must be made applicable to married families. The latter could be easily accomplished if income splitting is restored, ending the primary source of the marriage tax penalty, and one of the two income splitters is taxed as the "head of household."

The combination of allowing married couples to split income, combined with the ability for one spouse to use the head-of-household schedule when there are dependent children, would effectively eliminate both the marriage penalty and the married parenthood penalty. The combination makes a good political tax reform package, since the marriage tax penalty has more effect percentage-wise on upper incomes, while the married parenthood penalty takes a greater toll on lower incomes.

> ***The head of household tax status for unwed mothers provides a more favorable tax schedule, higher deductions, and a better EITC schedule than for married families.***

Childcare Credits

Few Americans question that the best child care, particularly for children below six years of age, is home care by mothers. Despite that preference, for economic reasons, 71 percent of married women with children less than six years old now work compared to 12 percent in 1950. However, a majority of these parents arrange for *family* care with a grandmother, sister, sister-in-law, or other relative.

There is now provision for tax deductions allowed for family child care—but usually only for paid commercial care. A mother's home care or unpaid family care for pre-school children is not tax deductible unless the relative operates as a "registered daycare provider." Here again, families who provide home care subsidize through their taxes married or unmarried mothers who work and do not provide family care for their children.

To provide tax equity, mothers or family members who provide home care for children should be allowed the maximum childcare credit.

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The Inheritance Tax (The Death Tax)

Upon the passing of a generation, the assets left in the estate of the deceased over and above $600,000 (rising annually since 1996 to $1,000,000 by 2006) are subject to "the death tax." The rates on this tax start at 18 percent and rise to 55 percent for the $3,000,000 taxable estate. When it is necessary to sell appreciated assets to meet estate tax obligations, capital gains taxes are paid in addition to the estate tax.

The pyramiding of taxes in culmination of a lifetime of taxation can be extraordinary. Income after a maximum income tax at 39.6 percent saved for investment produces corporate income that is also taxed at 38 percent, and then taxed again at 39.6 percent on dividends, or at 20 percent as capital gains. The decedent's death results in a final 55 percent death tax. The composite effect of all this taxation is that heirs receive only 16.5 to 19 cents out of the original dollar saved.

The federal government's confiscation of family capital by estate taxes results not only in massive tax avoidance planning, but also the sale or dissolution of productive family farms and businesses. Losses of investment capital, job continuity, and family ownership are of incalculable value.

It is estimated that the wealth attributable to the cohort that died in 1995 exceeded $1 trillion, yet only $15 billion was collected as estate taxes. The long-term wealthy were scarcely touched after a lifetime of tax avoidance planning. Those who made their fortune during a working lifetime were the principal source of estate tax revenue.

The estate tax, a purely confiscatory tax levied whether or not the heirs cash-in the assets, reduces productive capital and jobs. Other than catering to social jealousy, it serves no real purpose.

Indirect Anti-Family Taxation

The total government burden of taxes and fees—federal, state, and local—is estimated to have reached 46.4 percent of MMF total compensation as of 1995. Since married families with working adults received little direct benefit from government programs, their tax burden was the equivalent of supporting a second family. We have already considered some of the indirect social consequences of government redistribution. Now we will consider how costly these programs and taxes can be in their indirect economic consequences.

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Capital Formation

Taxation at high marginal rates and exorbitant combined levels has seriously limited United States domestic saving and corporate investment in support of more productive, higher paying jobs. High marginal progressive tax rates and double taxation of corporate income confiscate existing capital, while taxation of capital gains and inheritances prevents saving and investment.

The result has been to lower family incomes, creating the need for the earnings of two workers per household. Ironically, the social scientists who championed the 40-hour week early in the 20th Century now champion the 80-hour family week in support of the welfare state, with all of its socially dysfunctional consequences.

Inadequate capital formation has shipped jobs abroad. Foreign investment in the United States has not been a substitute because it is money made from the sale of imports that displace American jobs. Government that taxes too much and spends too much is the root cause, and married families carry the bulk of the burden and sustain the impact of losing higher-paying jobs.

Border Adjustability of Taxation

The federal tax system puts American workers and investors, particularly those in manufacturing, at a serious disadvantage. Foreign governments typically levy "value-added taxes," which are added to imports at the border and stripped from exports at the border. The United States' federal taxes are primarily income taxes that do not qualify for such treatment.

The result is that the federal tax code creates a tax preference for foreign goods, which takes away from American families higher-income manufacturing jobs. As manufacturing jobs disappear, the problem is exacerbated because of a narrowing base of high-paying jobs that pay a higher proportion of the tax burden.

If the tax code is to show any preferences, it should be for child rearing within marriage, the primary basis for creating human capital.

Reform of the tax code is needed to enable border adjustability of a sufficient portion of the federal tax burden to level the playing field for American manufacturing jobs and investments.

Human Capital

Today, the countries of the developed world have forgotten a prime goal of any healthy and forward-looking country: a growing or at least stable population of indigenous citizens. These citizens are integral to the productive fabric of a nation and provide the fundamental source of its human capital.

A government can tax married families so heavily that its youth do not marry, stay married, or rear children within marriage. This kind of taxation is dissipating the human capital of this nation. The evidence is clearly found in the accelerating growth of retirees and others dependent upon government. As typified in the "social security crisis," this population of dependents is becoming unsustainable in relation to the shrinking working population that is liable for supporting them. The rate of immigration of unskilled and uneducated workers has outstripped the rate of social and productive assimilation. This is not a satisfactory alternative to child rearing within families. Alongside immigration, we are seeing an unconscionable "brain drain," the loss of United States intellectual capital to lower-income countries for their own development.

If the tax code is to show any preferences, it should be for child rearing within marriage, the primary basis for creating human capital.

Expenditures on education, the modern cornucopia of intellectual capital from which social and economic progress flow, should be given broad exemption from taxation. The last bastion of inefficient socialism—our public education system—should be returned to communities and classical liberal foundations. The result would be an education at once more efficient, more effective and more supportive of the family. The goal of maximizing the potential of all American youth, our human capital, could be realized.

In maximizing our human capital, we could also find solutions to the crisis of the aging, the dependency of the poor, and the oppressive burden of government on the family.

Tax Incidence

The objectives behind the taxation of Americans have no logical relationship to the actual incentives and consequences of taxation.

When one takes a practical view of the incidence of progressive income taxation and multi-layered capital taxation, a paradox is obvious. The purpose of these progressive "tax policies," including redistribution of a portion of the receipts, is to shift the tax burden to those of higher incomes, relieving those of lower incomes. However, when the tax incidence is examined, those of middle to lower incomes bear most of the burden (even of corporate taxes), since the incidence materializes in the price of consumption expenditures.

The ultimate incidence of taxation on financial capital can be shown to fall disproportionately on workers' incomes and human capital (concentrated in upper-income professions). This means that the excessive taxation of income and capital only serves the interests of government. Progressive taxation may hit upper-income taxpayers, but it hurts lower incomes more.

The American family would be far better-off with smaller government at all levels.

Visibility of Taxation

At present, the myth that workers and families escape the bulk of taxes through a system of progressive taxation is believed because more than 40 percent of the taxes they pay are hidden. This makes government appear to offer low- or no-cost services, rather than high-cost, inefficient services of dubious value.

One cannot seize prosperity by taking a larger share of a shrinking pie. When you confiscate the incomes and capital of professionals vital to the productive process, you get less of what you tax—financial and human capital—and more of what you subsidize—the unproductive sector of government and its dependents.

Ultimately, all taxes are paid at the level of consumption expenditures that provide the means to pay the inputs of capital and labor. Taxes just add to the burden and diminish incentives. Wages or jobs are hurt by a tax wedge that results in higher prices, lower wages, or lost jobs. Every additional dollar of net import bears witness.

The American family would be far better-off with smaller government at all levels. Families could then use the bulk of their income to support themselves and their communities. They would also have less work time and more time for child rearing, community and "the pursuit of happiness."

Family Friendly Tax Reform

What is the road to fundamental reform of a tax system that works against the best interests of the traditional married-couple family, the bedrock of productivity and responsibility in American society?

Step-by-Step Reform

One could trust in a long-range process of reforming the tax code item-by-item following focused attention to the particular problems and much debate over the remedies. However, the government and public officials believe that the incomes of the citizens are theirs to redistribute equitably, so they fight tenaciously to ensure their increasing access to citizens' pocketbooks. Although *abolishing* the death tax has majority approval of taxpayers, the citizenry was recently offered a paltry 5 percent cut per year, with abolition of the tax remaining a distant promise. The marriage and married parenthood penalties were given only token changes, and the reforms only applied to dual-income married families with a family income below $50,000 income.

At that rate, tax reform will be a process like trying to contain an octopus by cutting tentacles that grow faster than one can prune them.

The real root of the problem lies in the fact that elected officials gain most of their political power by bestowing government appropriations of other people's money on their constituents. This power is principally derived from taxation. Thus, taxing a few "Peters" to redistribute to the more numerous "Pauls" becomes a sure source of political power and funding. Likewise, subsequently abating the levy on *selective* "Peters" can be a truly lucrative political franchise.

Definition of Fundamental Tax Reform

Fundamental federal tax reform requires replacing virtually all federal taxes with one or two simple taxes.

The federal tax code comprises 70 percent of the United States' tax burden on families and gives the impetus to most of the remaining 30 percent of state and local taxes through mandated entitlements. The first priority of tax reform must focus on federal taxation in total.

The problems with federal taxation are legion. The tax code is too complex and blatantly unfair. High marginal rates and double taxation prevent capital formation. Tax incidence intended to "soak the rich" has its ultimate effect on the incomes and purchasing power of ordinary Americans. The process, in summation, causes inefficiencies, lowers all Americans' incomes, and shifts jobs abroad.

Fundamental federal tax reform requires replacing virtually all federal taxes with one or two simple taxes. These new taxes should meet the criteria specified in the following proposal for a constitutional amendment to replace the Sixteenth Amendment:

"Any tax levied by government shall have only one rate, which shall be equally levied upon all citizens, and any deductions, credits, or exemptions granted to any citizen shall be equally granted to all citizens."

In practice, this would mean an end to progressive taxation and selective favoritisms in the tax code. It would, however, allow generous family allowances for a rebate of taxes on necessities, but these rebates would be given to *all* families and would be based upon family size alone.

Fundamental tax reform proposals center upon condensing all federal taxation into a single-rate consumption tax (a national sales tax) or a consumed income tax, with generous family allowances provided to prevent regressive tax burdens on lower-income families.

Family-Friendly Taxation Via Tax Reform

Fundamental federal tax reform would remedy the anti-family bias of the tax code to provide "family friendly" taxation.

It is truly remarkable to observe how effectively fundamental federal tax reform would remedy the anti-family bias of the tax code to provide "family friendly" taxation—a single-rate consumption-based tax with generous family allowances. It is important to note that none of the effects would discriminate against unmarried families, so that the result would be "value neutral." What would result is the elimination of all of the *anti-family* provisions of the present tax code and the enactment of a far more efficient, equitable, and pro-growth tax system, one that supports higher real after-tax incomes for *all* Americans, married-couple families or otherwise.

Reviewing the list of prejudices in the present tax code, it is easy to see how simple, fundamental flat tax reform brings about remediation simply and efficiently.

- **The Marriage Tax Penalty:** One flat (single rate) tax instead of progressive tax schedules entirely eliminates this penalty.

- **The Married Parenthood Penalty:** Legal requirement that any family allowances would apply equally to all families eliminates the "head of household" preferences for unwed parenting.
- **Child Care Credits:** These would be incorporated in family tax credits equally enjoyed by all families and, if educational, would also be further deductible as investment in human capital.
- **Inheritance Tax:** Since no capital or capital income would be taxed until consumed, the inheritance tax would be eliminated.
- **Border Adjustability:** Under present international agreements, the flat consumption tax (retail sales tax) is the most straightforward basis for border adjustability. Other bases for border adjustability (a consumed income tax, for example) are more problematical but potentially feasible.
- **Human Capital**: A more family-friendly tax code would once again encourage and support marriage and married child rearing. Allowing deductions for any and all educational expenditures as investment in human capital would augment this process of human capital formation.
- **Tax Incidence:** High marginal rates of taxation on human and financial capital in the form of progressive personal income taxation and multiple layers of taxation on capital would be replaced with a far lower single tax rate.
- **Visibility of Taxation:** A single flat rate consumption tax, whether levied upon consumption expenditures or consumed income, would be highly visible for all taxpayers. No longer would government be able to offer apparently free benefits to the many with funds extorted from the incomes of a few.

In total, all Americans, married or not, would be increasingly better-off with a well-crafted fundamental reform of federal taxation. The only losers would be government officials and bureaucrats—primarily in their loss of the power to subject the electorate to increasingly inefficient socialist programs designed to do what American families and communities can better do for themselves.

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Estimated Value of the Tax Reform Dividend

In order to get a specific estimation of the "tax reform dividend," Gary Robbins of Fiscal Associates has provided a 10-year projection that compares married-couple family income after federal income tax under the current tax code, with family income after reformed federal taxation. This projection is reported in Table 2.

The basic measure employed for constructing these projections was a replacement of all federal taxes other than social security taxes with:

- A 20 percent flat-rate consumption tax levied on either consumed income (income less savings) or on national sales.
- A tax credit for every family determined as 20 percent of the poverty level income applicable to that size of family.

A typical married-couple family with one child and average income was used as the basis for evaluation.

The projections show that the average family income would be 9.4 percent higher before federal income tax under tax reform compared to the current tax code. After-tax income would be 8.3 percent higher based upon standard deductions and 12.6 percent higher based upon typical itemized deductions.

It must be emphasized that the bounty of this greater real prosperity is not just financial. Perhaps more important than the financial benefits is the prospect for reduced working hours per family, with the balance of time available for improving the quality of life. The tax reform dividend can be invested in richer family life, more education, or in serving the community. Such goals make the objectives of social and fiscal conservatives one and the same.

Conclusion

The multiple elements of the tax code that discriminate against families cannot be fixed with token reform. The conditions for true reform are thankfully straightforward and simple. The federal income tax, with all of its complexities and penalties against marriage, saving, and investment, needs to be replaced by a single-rate tax. It is time for a pro-growth tax system, one that supports higher real after-tax incomes for *all* Americans, including married-couple families.

Table 2 **Projection of the Married-Couple Family Income Tax Reform Dividend**

Profile of Average Married Tax Return	Current Law				Under Reform		
(Selected Years)	1997	2001	2006	2011	2001	2006	2011
Adjusted gross income less deficit	$67,776	$81,790	$100,118	$121,436	$81,790	$102,535	$132,857
Salaries and wages	$57,671	$68,733	$83,199	$100,026	$68,733	$85,040	$108,607
Income from investments	$10,429	$13,448	$17,396	$21,989	$13,448	$17,984	$24,884
Taxable interest	$1,485	$1,914	$2,477	$3,130	$1,914	$2,560	$3,542
Dividends	$1,056	$1,362	$1,762	$2,227	$1,362	$1,822	$2,520
Sales of capital assets	$3,682	$4,747	$6,141	$7,762	$4,747	$6,349	$8,784
Business or profession	$4,206	$5,424	$7,017	$8,869	$5,424	$7,254	$10,037
Other income less loss	$175	$212	$259	$314	$212	$265	$344
Total statutory adjustments	$499	$602	$737	$894	$602	$755	$978
Average number of exemptions	3.2	3.2	3.2	3.2	3.2	3.2	3.2
% with itemized deductions	64.8%	64.8%	64.8%	64.8%	64.8%		
Average itemized deductions	$15,160	$18,295	$22,394	$27,162	$18,295	0	0
Taxable income for itemizers	$44,046	$54,926	$69,154	$85,703	$54,926	$85,040	$108,607
Tax before credits	$6,977	$9,484	$12,714	$16,632	$9,484	$17,008	$21,721
Child Credit	$500	$500	$500	$500	$500	$3,297	$3,650
After-tax income	$61,299	$72,807	$87,904	$105,303	$72,807	$88,824	$114,785
Change in after-tax income	—	—	—	—	—	$919	$9,482
Percent change in after-tax income	—	—	—	—	—	1.0%	8.3%
Standard deduction	$6,900	$7,600	$8,600	$9,500	$7,600	0	0
Taxable income for standards	$52,306	$65,620	$82,948	$103,366	$65,620	$85,040	$108,607
Tax before credits	$9,290	$12,478	$16,576	$21,578	$12,478	$17,008	$21,721
Child Credit	$500	$500	$500	$500	$500	$3,297	$3,650
After-tax income	$58,986	$69,812	$84,042	$100,358	$69,812	$88,824	$114,785
Change in after-tax income	—	—	—	—	—	$4,782	$14,428
Percent change in after-tax income	—	—	—	—	—	5.4%	12.6%
Average after-tax income	$60,486	$71,754	$86,547	$103,565	$71,754	$88,824	$114,785
Change in after-tax income	—	—	—	—	—	$2,277	$11,221
Percent change in after-tax income	—	—	—	—	—	2.6%	9.8%

Assumes:

CBO 2001 Baseline Forecast

Reform yields 5% real growth in 5 years

Reform yields 15% real growth in 10 years

Exemption credit is $3,000 in 2002 and indexed for inflation

About the Authors

David A. Hartman is the Chairman of The Lone Star Foundation of Austin, Texas. The Foundation conducts state policy studies and publishes The Lone Star Report. Federal fiscal policy studies are conducted through the Foundations Institute for Budget and Tax Limitation. Mr. Hartman has published numerous studies on federal and state welfare, taxation and finance. He is currently serving the Institute for Policy Innovation as the Editor for The Road Map to Tax Reform™ Series and as a contributing author.

Allan Carlson is founder and president of the Howard Center for Family, Religion & Society, and has written a number of books on social policy, including *Family Questions: Reflections on the American Social Crisis*. He received his B.A. degree, magna cum laude, from Augustana College in 1971, and his Ph.D. in Modern European History from Ohio University in 1978.

Carlson's writings have appeared in *The Journal of Social Issues, New Oxford Review, Policy Review, The Weekly Standard, The Human Life Review, The Public Interest, National Review, Caelum Et Terra*, and many other periodicals. He has been interviewed for the PBS News Hour, ABC, CBS and NBC News, CNN, eight special PBS productions on family and children's issues, and over 400 regional radio and television outlets. Carlson has testified before numerous Congressional committees including the U.S. Senate Subcommittee on Family and Human Services, the U.S. Attorney General's Taskforce on Family Violence, and in Federal Court.

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The Road Map to Tax Reform™ is a series of studies published by the Institute for Policy Innovation (IPI) and produced in cooperation with participating organizations. The purpose of this project is not to promote a particular tax reform plan or proposal, but to provide research, analysis and argument in service of fundamental tax reform toward a neutral federal tax system, and to work with all proponents of such reform. The series consists of topical investigations by leading experts, with the goal of creating a corpus of research that makes a truly comprehensive case for a neutral, transparent, and simple tax code.

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