Statement of National Taxpayers Union

Prepared for the Senate Finance Committee
Bipartisan Tax Reform Working Groups

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On behalf of the members of National Taxpayers (NTU), I am pleased and honored to submit comments regarding options to increase the transparency, simplicity, and fairness of America's current tax laws.

As you know, few other citizen groups in Washington can match NTU's more than 45 years of taxpayer advocacy and participation in the vital debate over restructuring our nation's tax system. Our leaders and membership worked with Treasury officials during the 1980s in exploring some of the first flat-rate income tax proposals. Later, NTU served as a collective voice for average Americans during Congressional debate over the Tax Reform Act of 1986. NTU was the leading advocate for overhauling the agency administering the tax system, culminating in the IRS Restructuring and Reform Act of 1998 – a law whose basic tenets were the product of a federal commission on which NTU's then-Executive Vice President served. In more recent years, NTU has actively championed reductions and simplification in many federal taxes, including the 2001, 2002, and 2003 personal income and small business tax relief laws.

The Finance Committee is now faced with a major challenge – overhauling the Tax Code to make it simpler and fairer while simultaneously stimulating economic growth and job creation. We applaud the Committee for tackling this enormous challenge and hope the following recommendations will be helpful to your efforts.

We believe the Committee might find NTU's research into the area of Tax Code complexity of particular interest. This phenomenon can be quantified thanks to "A Complex Problem: The Compliance Burdens of the Tax Code" a study NTU has conducted annually since 1999 that focuses on how changes in the law affect the typical tax filer. A full copy of the study is included as an appendix to this submission.

A few of the key findings were:

- The time burden imposed by Treasury Department paperwork – almost all of it attributable to tax compliance – totals an astounding **6.1 billion hours** for the most recent year available.
- Individuals spend a combined **$31.7 billion** a year on tax software and other out-of-pocket costs.

- When calculated at the average hourly wage, the value of the labor involved in the 6.1 billion hours is a jaw-dropping **$202.1 billion.**
- The most recently published Tax Code has roughly **four million words**. This is **seven times** the length of Leo Tolstoy's *War and Peace*. Or, more than **two times** the length of the King James Bible and the entire works of Shakespeare **combined** (3,345,402 words).

Clearly the act of *filing* taxes has become a separate and distinct burden from the act of *paying* taxes. The most straightforward way to minimize Tax Code complexity and encourage economic growth would be scrapping the current system entirely and replacing it with a flat tax or national sales tax. Both approaches, which are consistently introduced in every Congress, would provide the stability, accountability, and productivity-enhancing potential that the present tax structure lacks. Either would offer the additional advantage of eliminating defects in the laws such as the death tax, whose deadweight losses will continue to plague our economy with no relief from the fiscal cliff package Congress enacted earlier this year. Ultimately, a constitutional amendment repealing the 16th Amendment's authorization of progressive income taxes, or establishing a "supermajority" vote requirement to raise taxes in the future, would be vital protections against tinkering with the simplified system.

Of course, such reforms would also be very difficult given the vast number of special interests that will fight to preserve favored tax credits and deductions. Short of starting from scratch, we offer the following recommendations on tax policy reform:

- Reduce tax rates and burdens so as to allow citizens to keep more of the money they've earned.
- Simplify the tax system to make administrability of the law transparent and less difficult for those who must comply with it.
- Minimize economic distortion by replacing punitive taxes on individuals or businesses that have been singled out for political convenience with a tax structure that treats everyone the same.
- Protect taxpayer rights with procedural safeguards against the tendency of tax law administrators to abuse citizens, as well as the tendency of elected officials to tinker constantly with the tax system.

With these principles in mind, we present the following recommendations.

1) Streamline and Simplify Taxes on Savings and Investments

The Committee should consolidate the several types of current-law Individual Retirement Accounts (IRAs) into a single account called a Retirement Savings Account (RSAs). After-tax annual contributions of $7,500 per person or more could be allowed with no restrictions on income. Earnings in these accounts would grow tax-free and distributions after age 58 would also be tax-free. Required Minimum Distributions, which can have a terrible tax impact on seniors and depress the accumulation of savings for heirs, should be abolished. Creation of RSAs would be another healthy step toward the removal of the bias against savings that is currently embedded in our Tax Code, and would complement any effort to reform the Social Security system.

The Committee should simplify reporting and tax rules for mutual fund distributions. Prior to the popularization of Roth IRAs and other tax-advantaged saving vehicles, millions of Americans purchased taxable mutual funds for their retirements. These funds remain a nightmare in recordkeeping, where longer-term shareholders must keep page after page of cost-basis calculations for reinvested returns. Although efforts have been made to streamline this type of reporting – for instance, requiring mutual fund companies rather than shareholders to calculate cost-basis for shares acquired on January 1, 2012 or beyond—more can be done. At the same time, annual capital gain distributions, even if reinvested, must be reported as taxable income, while just a few dollars of unrecaptured gain attributable to Section 1250 of the Internal Revenue Code can trigger new paperwork filing requirements that add more compliance burdens on small investors. Provisions such as these should be reexamined, perhaps instituting in their place exemptions for reporting or keeping track of *de minimis* amounts.

2) End the Alternative Minimum Tax (AMT)

The American Taxpayer Relief Act of 2012 provided permanent AMT relief for many Americans by increasing the exemption amount to $50,600 for single filers and $78,750 for joint filers and indexing these amounts for inflation. This is good news for taxpayers and a significant improvement over the numerous temporary "patches" Congress has passed, which have provided merely short-term relief. Still, the only true way to "fix" the AMT is to repeal this morally unfair tax entirely.

The AMT is designed not to stamp out illegal tax evasion, but rather legal tax avoidance. Why should anyone be penalized with a second set of laws merely because, in Washington's political judgment, an individual has benefited "too much" from existing laws? Imagine if a Police Officer pulled over a driver traveling within the 55-mile-per-hour speed limit, and said, "I don't like your choice of your car, so for you the limit is 50. Pay up." This is precisely the absurd situation that AMT payers face today.

Even with a "patch" in place, an estimated 4.2 million tax filers reported AMT liabilities on their Tax Year 2014 returns according to the Tax Policy Center. This does not include many other filers who had to complete worksheets and other paperwork to determine whether they owed AMT in the first place.

Congress should get rid of the AMT altogether, a remedy repeatedly recommended by the IRS National Taxpayer Advocate. In a recent report, the Advocate wrote that the AMT "corrodes both the tax system and the democratic process."

3) Overhaul the Corporate Tax Code and Shift to Territorial Taxation

The United States now has the highest corporate tax rate the industrialized world. A study by economists at Ernst & Young shows that our high tax rate is exacerbating the nation's economic woes by causing a lower quality of living, reduced economic output and a decline in wages. Meanwhile, other countries are lowering their tax rates and attracting business and capital. As other nations move forward on corporate-tax reform by dropping their rates from an average of 45.4 percent to 29.6 percent, the United States stands still and thus falls behind.

Congress and the President must work to bring down the corporate tax rate. Eliminating all corporate-tax deductions and credits would produce enough revenue to lower the rate to 28 percent without adding to the deficit. But to encourage more economic growth, the Committee should work to lower it further. According to research by the Tax Foundation, reducing the rate to 25 percent would stimulate the economy, thus increasing gross domestic product by 2.2 percent and raising federal tax revenue by 0.8 percent.

Equally painful is the federal government's tax treatment of business income earned abroad. The United States is among the small minority of nations that heavily tax business income earned outside national borders. This policy of "worldwide taxation" is inconsistent with fundamental tax reform and exacts a heavy compliance toll on U.S.-based corporations. Territorial taxation – the common-sense notion of taxing only income earned inside national borders – would enable U.S. companies in foreign markets to compete on a level playing field.

4) Reduce Discriminatory Non-income Taxes

Some of the worst federal tax burdens have nothing to do with 1040 forms. Rather, they are embedded in the prices of goods and services.

For example, federal tax policy toward air travel has been wreaking havoc on the economic vitality of the commercial aviation sector. A plethora of excise taxes, passenger facility charges, inspection fees, security fees, and other mandatory charges can push the tax load on an airline ticket past 20 percent (even higher for bargain-priced international tickets). This means most middle-class travelers are paying a higher marginal tax rate on airline tickets than they do on their 1040 tax returns.

In 2009, Congress and the White House approved a massive tax hike on middle and lower income Americans by raising the federal tax on cigarettes by 62 cents per pack to finance an expansion of the State Children's Health Insurance Program. Now, the President is once again attempting to raise tobacco taxes – this time calling for a 94 cent-per-pack increase to pay for an expansion of early childhood education programs.

Tobacco taxes are highly regressive and disproportionately harm working-class Americans. According to Congress's own Joint Committee on Taxation, more than 2/3 of all federal tobacco taxes come from those earning less than $40,000 per year.

If Congress is looking for a stable revenue stream to finance new programs, peddling a higher tobacco tax doesn't make sense because higher taxes reduce consumption. In fact, the 2009 tax hike reduced cigarette sales by more than 8 percent in just a single year, which resulted in declining tax revenues. Unless Congress is willing to cut future spending, it will need to raise taxes elsewhere or increase our already out-of-control deficits. This leads many taxpayers to wonder what politically out-of-favor activity will be targeted next.

One of the more egregious instances of unfair federal tax policy concerns a segment of our economy long recognized for its importance to productivity and convenience: telecommunications. Layer upon layer of taxation is levied upon telecommunications services, including a portion of the 3 percent telephone excise tax and "Universal Service Fund" surcharges. Worse, governments at all levels have slapped wireless customers with an average combined tax and fee rate of more than 17 percent.

Another example concerns proposals to strip away a deduction for foreign affiliate reinsurance activities, which would penalize a common practice that has diversified financial resources against mega - disasters and helped to keep insurance rates reasonable for consumers

5) What Not to Do

Aside from these recommendations for positive change, we would urge the Committee avoid several negative proposals that have no doubt been proffered.

The Committee should reject, for instance, a new dual-component tax system consisting of a simplified income tax and a consumption tax (possibly in the form of a Value-Added Tax, or VAT). From NTU's perspective, this scheme would rank among the worst of all possible alternatives. VATs have proven to be administratively complex and notoriously conducive to expanding government's share of the private economy's output. Allowing the proliferation of major federal taxes would only provide elected officials with a larger field on which to play the game of political favor-trading, all while gradually ratcheting up the burdens on taxpayers.

Some have suggested that tax administration could be greatly simplified by allowing the IRS to compute liabilities and send "returns" to millions of taxpayers for their signatures. This truly appalling idea would turn tax reform on its head. Taxpayers would be discouraged from maximizing the savings that the laws may allow them under individual circumstances; and to the convenience of politicians, taxpayers would be disconnected from yet another process that reminds them of the high price they pay for government.

The Committee should also reject any proposals to use the mantle of tax reform as an opportunity to raise taxes through the closure of so-called "loopholes." Such efforts are, in reality, thinly veiled attempts to single out unpopular businesses for tax hikes. A case in point is the patently unfair suggestion that the Section 199 deduction for domestic manufacturers and producers should be denied to oil and gas companies. Public officials should recognize that when they begin punishing some firms while rewarding others through tax policies, principles such as rule of law and a level playing field for all Americans become trivialized. In turn, the entire tax system itself is jeopardized.

I hope these recommendations are helpful and that the Finance Committee will call upon National Taxpayers Union for additional perspectives or analyses as necessary. I am extremely grateful for the opportunity to share our views.

Sincerely,

Brandon Arnold
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