

# The Simple Tax

## A Proposal for U.S. Tax Simplification

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### Introduction

This document proposes a new way of thinking for funding at the Federal level. It takes the status quo as its starting point – that is to say, it assumes that the entire current Federal budget (not including recent stimuli and relief programs) is necessary. This five-page document is an abridged version of the slightly more detailed original of 9 pages, available upon request.

### The Proposal

I propose that the entire outlays of the U.S. Government can be funded with a single tax that is well within the bounds of the current U.S. Constitution – a gross receipts tax on business.

First, let's look at income and taxes from individuals.

Individual Tax Returns	2000	2001	2002	2003	2004	2005	2006
Number of returns.....	129,373,500	130,255,237	130,076,443	130,423,626	132,226,042	134,372,678	138,394,754
Adjusted Gross Income..	\$6,365,377	\$6,170,604	\$6,033,586	\$6,207,109	\$6,788,805	\$7,422,496	\$8,030,843
Total Taxes Paid.....	\$1,017,471	\$925,435	\$834,915	\$787,584	\$874,010	\$980,259	\$1,071,873
Tax to AGI Ratio.....	16.0%	15.0%	13.8%	12.7%	12.9%	13.2%	13.3%

Figure 1 - Individual Income Tax Data (2000-2006) from IRS.gov (dollars in millions)

As you can see, 130-140 million tax returns are filed each year, representing between 6 and 8 trillion dollars. Since our current system taxes gross income, less certain allowed deductions, Americans are paying an average of 13 – 16% of their gross income in taxes to support the operations of the Federal government. As you probably know, this system is heavily progressive, resulting in 33% of these filers having no tax liability at all (again from IRS.gov). There are also a fair number of individuals who make so little money that they don't even file a return. So somewhere less than 2/3 of us are actually funding the government.

Of course, this picture is not complete for individuals. The vast majority of the income represented above is paid as wages, which results in payroll taxes. Each worker has 7.65% of his gross pay deducted to fund the Social Security and Medicare programs. An equal amount is paid by their employer for the same purposes. So another 15.3% of a large portion of the gross figures in the table above are also collected to fund the Federal government. (It's not exactly that, since there is a cap on the Social Security tax for high wage earners, but let's just keep it simple for now).

So in reality, 20 – 32% of wages (depending on how you count the employer's half of payroll taxes) are being taken from individuals to fund the federal government. (As an aside, add on what you pay in state taxes, local taxes, sales taxes, gas taxes, road tolls, etc. and the total can be sobering!)

Now as I mentioned already, some of the problems in our current system are philosophical. Here's my first example:  
**Individuals are taxed on their gross income. Businesses are not.**

As the CEO of a small company, I fully understand that there are many expenses involved in running a business. Consider your own situation, however. You have expenses as well. You wouldn't be able to live where you do and earn the income you do without paying certain expenses, most of which are not tax deductible in our current system.

Wouldn't you like to be taxed only on the money you save each year? If you were, would you save less and spend more? As I mentioned, this is a philosophical problem, and I intend to revisit it a little later. For now, let's get back to the data.

Here's the similar data from the IRS website for business income and taxes.

<b>Business Tax Returns</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Number of businesses.....	25,007,504	25,605,898	26,434,293	27,486,690	28,695,533	29,902,448	30,862,868
Total receipts.....	\$23,845,405	\$23,752,254	\$23,361,178	\$24,461,951	\$26,873,071	\$30,281,259	\$32,593,139
Total Taxes Paid.....	\$435,168	\$441,299	\$447,890	\$471,012	<b>\$477,373</b>	<b>\$488,785</b>	<b>\$500,197</b>
Tax to Receipts Ratio.....	1.8%	1.9%	1.9%	1.9%	1.8%	1.6%	1.5%

Figure 2 - Business Income Tax Data (2000-2006) from IRS.gov (dollars in millions; figures in red are estimated)

The above information was taken from a consolidated report from IRS.gov which didn't contain quite all the data I needed for these purposes. I've estimated the missing data rather than going through the multiple reports that make up the totals and attempting to add them up myself. At some point, I'll do that so that I can extend the numbers beyond 2006 as well as have more precise data. For now, however, the estimates are close enough for an initial evaluation.

In this table we see that 25-30 million businesses are reporting gross revenues of 24 – 33 trillion dollars. Since businesses are only taxed on profits, the ratio of taxes paid to gross income is much smaller than it is for individuals – a meager 1.5 – 2%. When you consider that the business tax rate is around 40%, you find that businesses, on average are only 4 - 5% profitable.

There is an old expression that says, "If you tax something, you will get less of it." I believe we are seeing that principle in action in our tax system. ***We tax profit, so we get less profit.***

In every other area, businesses accept certain expenses as necessary costs to being in business. They reduce costs wherever they can. Since taxes are a cost that can be reduced, complex accounting games are played to ensure that taxes are minimized. In fact, individuals often start multiple businesses for exactly this reason. They can't easily get out of personal income taxes, so they divide their income across multiple entities, playing the game to get everything taxed at the lowest rate possible.

## The Philosophical Problem

Here now is the primary contradiction in our system that I think we should all consider. People who own businesses have the ability to manipulate their tax situation. People who simply earn wages do not.

If you divide all of us into "Haves" and "Have Nots," guess which of these groups corresponds to business owners and wage earners. Now of course, there are counter-examples in both directions, but primarily, business owners are more in the "Have" camp and wage-earners are more in the "Have Not" camp.

Of course, as I already pointed out, many of the "Have Nots" end up with no income tax liability, and at the lowest end of the spectrum, some people even receive money from the government rather than simply pay no taxes. This concept is called "refundable tax credits." In years gone by, this was called "welfare."

So I'm not trying to say that all the "Have Nots" are supporting the government with their taxes. Clearly most of the personal income taxes come from the highest wage-earners. But all individuals who earn wages are paying payroll taxes. And let's face it, if employers did not have to pay the matching payroll taxes, eventually some of that money would make it into the hands of the workers, at least in times when employers are competing for workers.

I'm not simply saying that business owners are rich and we should soak the rich for taxes. I would say, however, that our current tax system levies taxes at very different levels in many complex ways, creating lots of loopholes for the savvy to exploit.

What if we cut through all the loopholes and changed the philosophical underpinning of our tax system? What if we implemented a system that ensured taxes were paid by those who get the most benefit from the system?

The amount of money flowing around in our economy is tremendous. Only a small fraction of that ends up as individual wages, yet it is individual wages that are taxed the most heavily. The personal income tax is the single largest source of income to the Federal government. The next is Social Security taxes.

Why not levy a tax at the point where adjustments can and will be made to equalize its impact?

## The Plan

The Simple Tax plan calls for abolishing many taxes and replacing it with a single gross receipts tax on all businesses. Consider the following data taken from GPOAccess.gov and IRS.gov.

Historical Outlays	2000	2001	2002	2003	2004	2005	2006
Federal Outlays.....	1,789,067	1,863,033	2,010,972	2,159,917	2,292,215	2,479,404	2,567,617
Surplus/Deficit.....	\$236,151	\$128,161	(\$157,799)	(\$377,575)	(\$412,144)	(\$426,559)	(\$390,067)

Figure 3 - Federal Government Outlays and Deficit (GPOAccess.gov) (dollars in millions)

The federal budget increased from 1.8 trillion to 2.5 trillion over this time period. Due to the fact that the current tax system is inadequate to fund this budget, we had a deficit during most of these years. In fact, as most readers will know, we almost never have a surplus. Just during this time period, the accumulated debt caused by this budget deficit was 1.4 trillion dollars.

As you can see in the next table, a gross receipts tax of 7.5 – 8.8% would have been sufficient to cover the entire federal budget during these years without any borrowing.

The Simple Tax Plan	2000	2001	2002	2003	2004	2005	2006
Federal Outlays.....	\$1,789,067	\$1,863,033	\$2,010,972	\$2,159,917	\$2,292,215	\$2,479,404	\$2,567,617
Gross Receipts - All Businesses...	\$23,845,405	\$23,752,254	\$23,361,178	\$24,461,951	\$26,873,071	\$30,281,259	\$32,593,139
Gross Receipts Tax Rate.....	7.5%	7.8%	8.6%	8.8%	8.5%	8.2%	7.9%
Surplus/Deficit.....	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Figure 4 - Gross Receipts Tax Required to Match Federal Outlays

***If this gross receipts tax funded everything, what did we not need?***

Here's a starter list:

- Personal Income Taxes
- Social Security Taxes (employer and employee parts)
- Medicare Taxes paid (employer and employee parts)
- Gift Taxes
- Inheritance Taxes
- Import Taxes
- Excise Taxes
- Future Taxes (aka, additional debt)
- Complicated tax codes
- National Consumption Tax (or, VAT) (proposed recently)

I'll admit that there are some pros and cons. Some re-balancing would be required in certain industries. Some prices would increase, others would decrease. There would be indirect impacts to some areas (no more individual tax software required; sorry Turbo Tax). The IRS could be much smaller and focused on business revenue, rather than endless deductions, rules, and exceptions. Businesses could focus on increasing revenue and profits without concern that their tax situation would change dramatically simply because they had a good year.

Businesses and individuals would no longer have the federal government prying into their compensation or their company's profitability. If the tax comes off the top, then the buck literally stops there! Tax-sheltered retirement plans would no longer be government controlled or even sheltered – since personal income would not be taxed, neither would retirement savings.

In short, adjustments would be made. But this is what businesses do every day – they adjust to the economic situation in order to make their business successful. They evaluate costs and revenue.

In many businesses, the gross receipts tax would be more than covered by the combination of corporate taxes and employer and employee payroll taxes. If businesses reduced salaries by 7.65% (the payroll taxes) but workers had no income tax to pay, many workers take-home pays would actually increase, freeing up more money for investments, savings, and spending. All of these activities fuel our economy even further.

## A National Surplus?

Consider the consequences of fixing the Simple Tax at 9% for some years. Historically, this is what would have happened.

<b>The Simple Tax Plan @ 9%</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Federal Outlays.....	\$1,789,067	\$1,863,033	\$2,010,972	\$2,159,917	\$2,292,215	\$2,479,404	\$2,567,617
Gross Receipts - All Businesses	\$23,845,405	\$23,752,254	\$23,361,178	\$24,461,951	\$26,873,071	\$30,281,259	\$32,593,139
Gross Receipts Tax Revenue.....	\$2,146,086	\$2,137,703	\$2,102,506	\$2,201,576	\$2,418,576	\$2,725,313	\$2,933,382
Surplus/Deficit.....	\$357,019	\$274,670	\$91,534	\$41,659	\$126,361	\$245,909	\$365,765
Cumulative Surplus/Deficit	\$357,019	\$631,689	\$723,223	\$764,882	\$891,243	\$1,137,153	\$1,502,918

Figure 5 - 9% Simple Tax Generates \$1.5 Trillion Surplus (dollars in millions)

At 9%, The Simple Tax plan would have generated a surplus in every year from 2000 to 2006. The resulting cumulative surplus over that time period is 1.5 trillion dollars! Or, enough to fund TARP and the first Obama Stimulus plan out of cash on hand!

At 8.5%, the surplus would still be ½ a trillion dollars. If surpluses were used to pay down the national debt, the cost of government would actually begin to decrease rather than increase, due to decreasing interest payments.

## Impact to Various Business Models

Not all businesses are the same when it comes to what comprises their expenses.

The following table compares paying payroll taxes and taxes on profits compared to a simple gross receipts tax.

	<b>How Different Business would be Affected</b>			
	<u>75% Labor Cost</u>	<u>50% Labor cost</u>	<u>25% Labor cost</u>	<u>10% Labor Cost</u>
<b>Gross Receipts</b>	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
<b>Direct Labor</b>	\$750,000	\$500,000	\$250,000	\$100,000
<b>SS+MC Employee</b>	\$57,375	\$38,250	\$19,125	\$7,650
<b>SS+MC Employer</b>	\$57,375	\$38,250	\$19,125	\$7,650
<b>Net Profit (15%)</b>	\$150,000	\$150,000	\$150,000	\$150,000
<b>40% Tax</b>	\$60,000	\$60,000	\$60,000	\$60,000
<b>Total Taxes</b>	\$174,750	\$136,500	\$98,250	\$75,300
<b>Total Tax %</b>	17.48%	13.65%	9.83%	7.53%
<b>Gross Receipts Tax %</b>	8.5%	8.5%	8.5%	8.5%
<b>Gross Receipts Tax</b>	\$85,000	\$85,000	\$85,000	\$85,000
<b>Difference</b>	\$89,750 9.0%	\$51,500 5.2%	\$13,250 1.3%	(\$9,700) -1.0%

Figure 6 - Paying the Simple Tax vs. Payroll and Profit Taxes

In all of these examples, the tax on a reasonable profit combined with payroll taxes either more than pays an 8.5% gross receipts tax, or comes within 1% of doing so. What this means is that businesses with very low labor costs (possibly high material costs) may end up worse off than before and would have to resort to increasing product prices or reducing wages slightly to make up the difference.

The manufacturing sector may be affected the most in this way. If that is the case, then it's possible some consideration for variability in the rate may have to be made to equalize the burden fairly.

## The Hardest Question

***So if we tax gross receipts, will we get less of it?*** Excellent question.

I think in this case, the answer is mostly, no. I already mentioned above the problem of companies trying to move revenue off shore. A good solution to this problem would have to be found. But in every other respect, I believe The Simple Tax system would be a motivation to increase revenue, rather than decrease it.

Not taxing gains on investments, means more people investing more money in businesses, resulting in more revenue and more tax receipts. Businesses that want to make up for the tax burden could do so by expanding their business, resulting in more revenue, more profit potential, and more tax revenue. I believe many would happily abandon the game of maximizing revenue and compensation while minimizing profit in exchange for a pure business game – maximize everything (revenue, compensation, profits).

I believe this plan would create a business and personal environment that would be the envy of the world, resulting in more people wanting to move here and participate (thus more revenue and more tax receipts). The Simple Tax plan is more fitting with the traditional American Dream than anything existing today – work as hard as you can and reap the rewards.