BACKGROUND – THE FAIR FLAT TAX ACT OF 2005

American taxpayers deserve the best features of a flat tax – the simplicity that boosts compliance and improves administrative efficiency – without its inequities and costs. Combining simplification with progressivity will change the tax code – currently a 1.4 million-word, 10,000-section behemoth that takes the average taxpayer 31 hours to navigate each year – into an understandable, equitable system that provides real tax relief to the middle class, treats work and wealth equally and begins to reduce the deficit by calling on corporations and the most affluent Americans to pay their fair share.

Why a progressive system instead of a straight flat tax? There is no denying a flat tax is attractive for its simplicity and administrative efficiency, but these strengths are overshadowed by its serious shortcomings. A plain flat tax would raise tax rates for most Americans. This increased tax burden would fall squarely on consumers' shoulders and disproportionately harm the poor and elderly. Among other losers under a flat tax would be state and local governments, homeowners and non-profit groups, and the millions of Americans who get their health coverage, insurance and pension contributions from their employers. A flat tax would also drive up the country's deficit. A decade ago, the Treasury Department estimated a 17% flat tax would cut tax revenues by more than $138 billion a year.

The Fair Flat Tax Act of 2005 adapts the flat tax idea to provide a major middle-class tax break while helping to reduce the deficit through fewer exclusions, exemptions, deductions, deferrals, credits and special rates for certain individuals, businesses and activities, and through the setting of a single, flat corporate rate of 35 percent. On the individual side, it ends favoritism for itemizers while improving deductions across the board: the standard deduction would be tripled for single filers from $5,000 to $15,000 and raised from $10,000 to $30,000 for married couples. The number of forms would be slashed drastically, and every individual would use a dramatically shortened, one-page 1040. Six individual rates would be collapsed into three progressive rates of 15 percent, 25 percent and 35 percent, and income from all sources would be taxed the same. Several deductions used most frequently by individuals - including those for home mortgage interest and charitable contributions, and the credits for children, education and earned income - are retained. No one would have to calculate their taxes twice: this proposal eliminates the individual Alternative Minimum Tax (AMT), which could snare as many as 21 million American taxpayers in 2006.

This proposal would eliminate tens of billions of dollars each year in special breaks for corporations, and direct the Treasury Secretary to identify and report to Congress an additional $10 billion in savings from tax expenditures that subsidize inefficiencies in the health care system. Eliminating these breaks will allow the code to sustain current benefits for our men and women in uniform, our veterans and the elderly and disabled – as well as breaks that promote savings and help families pay for health care.

What makes the Fair Flat Tax Act truly unique is that it corrects one of the most glaring inequities in the current tax system: regressive state and local taxes. Low and middle income taxpayers are often hit with a double whammy: compared to wealthy Americans, they pay more of their income in state and local taxes. Poor families pay more than 11 percent and middle income families pay about 10 percent of their income in state and local taxes, while wealthier taxpayers only pay five percent. Because many low and middle income taxpayers don't itemize, they get no credit on their Federal form for paying state and local taxes. In fact, two-thirds of the Federal deduction for state and local taxes goes to those with incomes above $100,000. Under the Fair Flat Tax Act, for the first time the Federal code would look at the entire picture, at an individual's combined federal, state and local tax burden, and give credit to low and middle income individuals to correct for regressive state and local taxes.

The reforms of the Fair Flat Tax Act will more than pay for themselves. According to the Congressional Research Service (CRS), the changes the legislation makes to the Tax Code will achieve an estimated $100 billion in deficit reduction over five years compared to current law. This CRS estimate takes into account the additional revenue raised by changes in rates and brackets and by eliminating many individual and corporate tax breaks, as well as the costs of increasing the standard deduction, creating a new State and local tax credit and repealing the AMT for individuals.