

Candidates for Tax Simplification Reform

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Document date: July 12, 1999
Released online: July 12, 1999

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Continuing to tilt a bit at the windmill, I remain convinced that a tax simplification package could be put together and pass Congress sometime in the near future. In fact, I view the moderate-sized tax bill that Congress and President Clinton are eyeing as a perfect opportunity. I have little doubt that a simplification package would serve the public far better than what we otherwise could get: some hodge-podge collection of unrelated wants from administration and congressional laundry lists.

The simplification efforts of some members of the House Ways and Means Oversight Subcommittee—Chair Amo Houghton, R-N.Y. and Reps. Richard E. Neal, D-Mass., and William J. Coyne, D-Pa., have been noted here before and could provide a base. (See Tax Notes, [June 28, 1999](#), p. 1939.) The legislative trick is to be ready with a well-crafted bill that can be pulled out when the opportunity arises.

Here are a few of my candidates for what should be included in such a bill:

The individual alternative minimum tax is catching too many people. Worse yet, the items that go into the AMT tax base are not the types of shelter items that were meant to be attacked by the tax. Dependent exemptions, for example, are not "preferences." The primary source of the AMT tax is the deduction for state and local taxes. Although one could argue that state and local taxes finance some form of benefit, and, therefore, deductions should be limited, there are equally valid arguments that the person paying the tax is seldom the beneficiary of extra services when he or she pays higher-than-average state and local taxes. In any case, the AMT is not the right mechanism for seeing to it that people with these large deductions pay their fair share of taxes.

The capital gains "tax" now includes at least seven different rates. It requires taxpayers to fill out pages of tax forms even when they have only a few dollars of capital gains. Unlike AMT changes, any reforms here can easily be made revenue neutral.

A major source of complexity is phase-out after phase-out of such allowances as itemized deductions, personal exemptions, the earned income tax credit, eligibility for IRAs, eligibility for other saving incentives, and eligibility for educational tax breaks. Each of these phase-outs operates like a separate tax system, with a rate schedule and sometimes a tax base all to itself. While Congress may not be willing to simply get rid of all of the phase-outs because of the potential impact on progressivity, an equally progressive tax system can be derived by eliminating them, then adjusting direct tax rates enough in each bracket to create the same net tax liability for each income class.

Pension and saving incentives are almost endless in number. Each one operates with its own rules on withdrawals, penalties, social security tax treatment, allowable amounts of exclusion or deduction, and much else. A good deal of this could be cleaned up and simplified, again with little effect on revenues. Quite honestly, I have some personal interest here in getting a law that would make it easy to combine multiple accounts deriving from different retirement vehicles.

The current tax treatment of dependent children still causes millions of unnecessary tax returns to be filed. Admittedly, with no restrictions a parent could avoid substantial tax by shifting money to children. But if the amount is small, it just doesn't matter that much. A simple reform here would be to restore some of the old law: allow a child to take a personal exemption against all capital income. Then let her take a standard deduction, along with remains of the personal exemption, against wage income earned. That way Grandma doesn't generate a bunch of extra tax returns by donating a few thousand dollars to the grandchild.

The tax system now has multiple educational tax breaks. They are poorly coordinated with one another and with direct government expenditures on education as well. They require duplicate administration and create needless complexity for parents, educators, and the IRS. A little spadework here could come up with a

simpler, combined subsidy, and would probably be more equitable as well.

The complicated rules for charitable deductions and for charitable organizations could themselves be simplified significantly. The multiple limits on giving as a percent of income could be combined. The current excise tax on foundations operates perversely and actually discourages charitable giving. It could be modified both to eliminate those strange incentives, as well as simplified greatly.

The new child credit and the dependent exemption could easily be folded into one. Even while the child credit is phased out at higher incomes, the dependent exemption is worth more in higher tax brackets. A level credit would not be a bad substitute, but at a minimum both are not needed.

Estimated tax rules have been designed to accelerate very slightly the payment of revenues to the government. Enacted in days when every dollar of revenue helped meet some short-term budget target, they never made a lot of sense and make even less in an era of surplus. Taxpayers should again be given simple rules that lead to penalties only occasionally. The safe harbor of no penalty if total taxes paid are at least equal to last year's tax liability could easily be restored, if not for all taxpayers, then at least for all but the richest of taxpayers.

This list could be expanded significantly if the Treasury staff or the Joint Committee on Taxation staff were put to the task. Simplification is possible: failure to achieve it is not due to will searching for way, but rather way looking for leaders with will.

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