Q. What is a broad-based income tax?

A. One that minimizes tax preferences with the goal of increasing revenue at a given rate of taxation.

Expanding the definition of taxable income by removing or restructuring tax preferences could significantly increase revenue. In fact, the President's Advisory Panel on Federal Tax Reform estimated that converting the current preference-riddled tax to a comprehensive income tax system would nearly double the tax base.

In truth, virtually all tax analysts reach similar conclusions. Holding other factors constant, a broader tax base means that a lower tax rate will raise the same revenue. Hence, base broadening can offset the revenue effects of lowering the tax rate.

The National Commission on Fiscal Responsibility and Reform (Bowles-Simpson, for short) aimed to broaden the tax base by eliminating up to $1.1 trillion worth of tax expenditures, with the revenue gains used to reduce both tax rates and the budget deficit. The Domenici-Rivlin tax reform proposal also features base broadening and would reduce the deficit with a mix of eliminating, reducing, and simplifying various tax expenditures.

Further Reading

Domenici-Rivlin Debt Reduction Task Force. 2010. "Domenici-Rivlin Debt Reduction Task Force Plan 2.0." Washington, DC: Bipartisan Policy Center.

National Commission on Fiscal Responsibility and Reform. 2010. "The Moment of Truth." Washington, DC: National Commission on Fiscal Responsibility and Reform.

President's Advisory Panel on Federal Tax Reform. 2005. *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*. Washington, DC: President's Advisory Panel on Federal Tax Reform.

Q. What would and would not be taxed under a broad-based income tax?

A. Generally, all forms of income, but there are as many options as there are proposals.

Base broadening could include all forms of income, such as wages and "anything that allows you to spend more, either now or in the future" (President's Advisory Panel 2005, 20). These sources include retirement account income, capital gains, dividends, rental income, employer-provided health insurance, unrealized increases in the value of real estate, and securities.

The President's Advisory Panel looked closely at a somewhat less comprehensive broad-based income tax that would eliminate credits, "above the line" deductions, and itemized deductions. The individual alternative minimum tax would go; tax filers would get to keep the standard deduction and personal exemptions.

The Bowles-Simpson Commission's "zero-base budgeting" plan would modify the income tax to lower rates and deficits by cutting tax expenditures. This tax would eliminate all tax expenditures (an estimated $1.1 trillion per year) but would not modify the payroll tax base.

The Domenici-Rivlin plan, for its part, eliminates the standard deduction and personal exemption, taxes capital gains and dividends as ordinary income, simplifies the earned income tax credit, shortens the list of itemized deductions, and caps deductions for medical expenses.

Further Reading

Domenici-Rivlin Debt Reduction Task Force. 2010. "Domenici-Rivlin Debt Reduction Task Force Plan 2.0." Washington, DC: Bipartisan Policy Center.

National Commission on Fiscal Responsibility and Reform. 2010. "The Moment of Truth." Washington, DC: National Commission on Fiscal Responsibility and Reform.

President's Advisory Panel on Federal Tax Reform. 2005. *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*. Washington, DC: President's Advisory Panel on Federal Tax Reform.

Q. What would the tax rate be under a broad-based income tax?

A. That depends on what exclusions, credits, and deductions are left in and whether revenue neutrality is a must.

The President's Advisory Panel on Federal Tax Reform estimated how much marginal tax rates could be reduced under a broad-based income tax that generated the same revenue as the current system. As table 1 shows, the switch would permit across-the-board cuts of about one-third. This sort of reform would not be an easy political pill to swallow, however. The panel's version, for example, would preserve only the standard deduction and personal exemptions, and would eliminate credits, "above-the-line" deductions, and itemized deductions. On the plus side, a broad-based tax would eliminate the much-despised individual alternative minimum tax.

TABLE 1

Marginal Tax Rates for Married, Filing Jointly Households

Under current law and a broad-based system, 2006

Tax bracket	Current law system	Broad-based system
$15,050 and under	10.0%	6.6%
$15,051 – $61,100	15.0%	9.9%
$61,101 – $123,250	25.0%	16.4%
$123,251 – $187,800	28.0%	18.4%
$187,801 – $335,400	33.0%	21.7%
$335,401 and over	35.0%	23.0%

Source: President's Advisory Panel (2005).

The Bowles-Simpson alternative provides similar estimates but argues that its zero-base budgeting methodology would allow the system to reduce rates and the deficit simultaneously (table 2).

TABLE 2

Marginal Tax Rates in 2011 under Current Law and Broad-based Systems

Bowles-Simpson plan

	Current law system	Broad-based system	Illustrative plan[a]
Bottom rate	15.0%	8.0%	12.0%
Middle rate	28.0 – 31.0%	14.0%	22.0%
Top rate	36.0 – 39.6%	23.0%	28.0%

Source: National Commission (2010).

(a) The illustrative plan eliminates all tax expenditures except for the Child Tax Credit and Earned Income Tax Credit. It also taxes capital gains and dividends as ordinary income.

Further Reading

Domenici-Rivlin Debt Reduction Task Force. 2010. "Domenici-Rivlin Debt Reduction Task Force Plan 2.0." Washington, DC: Bipartisan Policy Center.

National Commission on Fiscal Responsibility and Reform. 2010. "The Moment of Truth." Washington, DC: National Commission on Fiscal Responsibility and Reform.

President's Advisory Panel on Federal Tax Reform. 2005. *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*. Washington, DC: President's Advisory Panel on Federal Tax Reform.