Citizens for Tax Justice

February 19, 2010
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Senator Specter's "Flat Tax" Cuts Taxes for the Richest 5% and Raises Taxes for Everyone Else

Since 1995, Senator Arlen Specter of Pennsylvania has introduced legislation to create a federal "flat tax" in every session of Congress, including this session. [1] This single-rate tax would replace the existing progressive personal income tax, as well as the corporate income tax and estate tax.

The Specter plan is based on the "Flat Tax" first proposed in a 1983 book by Robert Hall and Alvin Rabushka. The Flat-Tax authors wrote that it "will be a tremendous boon to the economic elite"[2] and also admitted that "it is an obvious mathematical law that lower taxes on the successful will have to be made up by higher taxes on average people."[3]

Impact of Specter "Flat Tax" in 2010

Income Group	Average Income	Average Tax Change
Lowest 20%	$ 12,400	$ +1,485
Second 20%	24,900	+2,299
Middle 20%	40,100	+2,678
Fourth 20%	65,500	+3,576
Next 10%	99,600	+5,182
Next 5%	140,100	+4,323
Next 4%	243,900	–5,834
Top 1%	1,327,700	–209,562
Bottom 95%	$ 48,000	+2,887

Source: ITEP Microsimulation Model, February 2010

Our analysis of the Specter plan confirms this is true. We find that Senator Specter's flat tax will result in:

- **Enormous tax cuts for the richest five percent of taxpayers**, including an average tax cut of $209,562 for the richest one percent in 2010.
- **Tax hikes for all other income groups.** The bottom 95 percent of taxpayers would pay an average of $2,887 more in federal taxes in 2010.
- **Low-income Americans would lose the refundable credits that they receive under the current income tax.** These credits are necessary to offset the regressive impacts of payroll taxes and state and local taxes, which eat up a larger percentage of income for low-income families than for well-off families.
- **The form of income that mostly flows to the wealthy — investment income — would be exempt from the personal income component of the flat tax, while all compensation for work, including wages and even employer-provided health care benefits, would be taxed.**
- **There would be little simplification in taxes for the majority of Americans.** Most middle-class taxpayers take the standard deduction and have fewer complications to deal with than wealthy

[1] S. 741.

[2] Robert Hall and Alvin Rabushka, *Low Tax, Simple Tax, Flat Tax*, 1983, p. 67.

[3] Hall and Rabushka, p. 58.

taxpayers, who pay others to do their taxes for them. (Some complications that middle-income people do face, like income from multiple jobs, would not be eased at all by Senator Specter's proposal.)

Ever since its adoption by a constitutional amendment in 1913, the federal income tax has had progressive rates, meaning wealthier people pay a larger share of their taxable income than people with lower incomes (at least in theory). Since the wealthiest people seem to benefit the most from many of the services government provides (like the protection of property and the infrastructure that makes commerce possible) it seemed fitting to past generations that they be expected to pay a greater share of their income in taxes.

A flat tax is a direct repudiation of this idea. Senator Specter would replace the current income tax, which has effective rates below zero for the poor and marginal rates as high as 35 percent for the very rich, with a flat 20 percent tax. In addition, capital gains and other investment income — the primary income of the rich — would be exempt from tax. This obviously means huge tax cuts for the wealthy and as the authors of the Flat Tax point out, higher taxes on everyone else.

It is true that Specter's flat tax includes large standard deductions.[4] But for low- and middle-income people, the loss of credits like the Earned Income Tax Credit and Child Tax Credit, the taxation of previously untaxed employer-provided health insurance and other fringe benefits (which would be taxed with no deductions), and a higher marginal tax rate for most people would far outweigh the benefits of the higher standard deductions.

The Flat Tax is often portrayed by its proponents as a way to simplify the tax system. But replacing progressive tax rates with a single rate has nothing to do with simplicity, because progressive rates are not what makes the current system complicated. Most taxpayers, once they have calculated taxable income, can simply look to a table to see what they owe in taxes (before any credits are applied).

What actually makes the tax system complicated are the various loopholes and special breaks that mostly benefit businesses and higher-income individuals. For example, capital gains income (which wealthy investors tend to have) is currently taxed at a lower rate than the wage and salary income that constitutes almost all income for most Americans. Many wealthy people therefore have an incentive to use various schemes to disguise what is really compensation for work as capital gains income. But instead of addressing this by taxing all income the same way, the Specter flat tax makes capital gains income entirely tax-free! So Senator Specter's flat tax is not so much about eliminating loopholes as it is about *consolidating loopholes for the rich*.

The term "flat tax" is therefore a misnomer. Specter's tax has two rates, zero percent for the investment income that mostly flows to the rich, and 20 percent for the compensation that most Americans receive for the work they do. It's no wonder the people who thought up this proposal called it "a tremendous boon to the economic elite" and a tax increase for "average people."

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[4]Senator Specter's flat tax includes a standard deduction of $12,500 for singles, $25,000 for married couples, and $18,750 for heads of households. It also includes an additional standard deduction of $6,250 for each dependent. He also would allow up to $3,125 a year in charitable donations and up to about $8,000 a year in mortgage interest to be deducted

Details on the Specter Flat Tax

Tax Rate: 20%

Tax Base:

1. Taxed on individual tax returns: Earned income only (mostly wages).

Large standard deductions would be allowed ($12,500 for singles, $25,000 for married couples, $18,750 for heads of households, and an additional $6,250 for each dependent). Mortgage interest and charitable contributions would remain deductible to a limited extent. Capital gains, dividends, interest and other investment income would not be taxable.

2. Taxed at the business level: Generally, most gross receipts less most business expenses, with very significant additions and subtractions. These include:

- Capital investments in equipment, buildings, land, etc. would be immediately written off, rather than "depreciated" over time (or not deducted at all in the case of land). This is intended to produce a zero tax rate on income from such investments.
- Investment income (interest, dividends, capital gains, etc.) would not be included in gross receipts and interest payments would not be deductible.
- The cost of employer-sponsored health insurance would not be deductible, nor would the cost of employer paid Social Security and Medicare taxes. This treatment of fringe benefits is intended to make them taxable at the 20 percent flat-tax rate, with no deductions. It is universally believed that the burden of the tax would fall on workers. (In fact, all other flat tax proposals include an excise tax at the same rate at the flat tax on fringe benefits paid by non-profit and governmental employers, so that their employees will be treated the same as workers for profit-making businesses. Although the Specter bill does not specify such an excise tax, we have assumed it in our analysis, since otherwise the plan would hugely favor government and non-profit employees over private employees.)
- Although the poorly drafted Specter bill fails to spell out many important details of its business-level tax, it does specify that it would double the current 50 percent business meals deduction and greatly expand the deduction for business entertainment.