

## 25 Ways to Make the Tax Code Simpler, Fairer, and More Efficient

By Alan D. Viard

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I propose 25 changes intended to improve the simplicity, efficiency, and fairness of the income tax system. The proposals would have various revenue and distributional effects, which could be offset, if desired, through changes in tax brackets. Many of these ideas are taken from the national taxpayer advocate's annual reports and the Joint Committee on Taxation's March 2001 and January 2005 reports. The task force should also draw heavily from the many other valuable proposals in those reports.

I have excluded larger reforms that could be considered as part of a sweeping overhaul. Those might include reducing tax preferences for employer-provided health insurance and owner-occupied housing, changing the state and local tax deduction, repealing the alternative minimum tax, moving to a dividend-exemption corporate tax system, repealing the corporate tax, and replacing the income tax with a consumption tax.

### Changes to Personal Income Taxation

1. Simplify section 1(h) by excluding a uniform percentage of long-term capital gains and qualified dividends from taxable income in all brackets and eliminating the special treatment of gains on collectibles and depreciable property.

2. Repeal the section 22 credit for the elderly and disabled and the section 63(c)(3) additional standard deduction for elderly (nonblind) taxpayers. These provisions are unnecessary in view of the size and growth of transfer payments to the elderly.

3. Simplify section 23 by changing the child-care credit to an above-the-line deduction, which is an appropriate treatment for a work-related expense.

4. Amend sections 24, 32, 36A, 63, and 151 to consolidate the child tax credit, the earned income tax credit, the Making Work Pay credit (if permanently extended), the standard deduction, and the personal exemption into a few simplified and coordinated provisions, such as the family and work credits proposed in 2005 by the President's Advisory Panel on Federal Tax Reform.

5. Reduce complexity and inefficiency by eliminating income-based phaseouts, including the section 68 itemized deduction limitation and the section 151(d)(3) personal exemption phaseout. The only remaining phaseouts should be in the family and work credits described above. Any other tax preferences, such as those for saving and education, should be available at all income levels or at none.

6. Repeal personal energy credits, such as those provided by sections 25C, 25D, 30B, 30C, and 30D, which are inefficient substitutes for direct taxes on energy and pollution.

7. Simplify tax calculation for nonitemizers by repealing the section 63(c)(7) above-the-line deduction for a limited amount of real property taxes.

8. Simplify section 86 by making a uniform percentage of Social Security benefits taxable at all income levels. If desired, the taxable percentage could be set to rise over time. In view of the size and growth of transfer payments to the elderly, it would be appropriate for that percentage to reach a relatively high level relatively soon.

9. Amend section 162 or reg. section 1.162-5 to resolve the uncertainty, manifested in recent Tax Court decisions, about whether and when MBA tuition is a deductible employee business expense. Also, consolidate current education incentives into two or three simplified provisions.

10. Amend section 165(d) to make all gambling losses nondeductible and amend the code to exclude gambling winnings from taxable income. The taxation of winnings and losses gives rise to complexity and noncompliance and is unnecessary because income tax already applies to workers and capital providers in the gambling industry.

11. Amend section 170(e) to reduce or eliminate the preferential treatment of taxpayers who donate property to charitable organizations relative to the treatment of taxpayers who sell property and donate the sale proceeds.

12. Consolidate current tax-preferred savings accounts and plans into a few simple and coordinated provisions, along the lines suggested by the presidential panel in 2005.

13. Dramatically expand the availability of section 904(k), allowing more mutual fund and other investors to avoid the complex computation of the foreign tax credit limitation.

14. Repeal the complex and distortionary section 1202 exclusion for capital gains on small-company stock.

15. Amend section 1211(b) to increase the \$3,000 capital loss deduction limit, which has been unchanged since 1978, index it for inflation, and authorize the Treasury secretary to increase it during stock market downturns. This change would reduce the tax penalty on risky portfolio investments.

16. Add provisions to more effectively prevent and prosecute the evasion of tax on offshore interest income, along the lines proposed in President Obama's fiscal 2010 budget proposal.

### **Changes to Business Income Taxation**

17. Amend section 41 to provide a single flat research tax credit, avoiding the complexity and inefficiency of the current incremental and alternative credits.

18. Repeal business energy tax credits, such as those provided by sections 43, 45, 45H through 45M, 48, 48A, and 48B, which have the same defects as the personal energy credits described above.

19. Amend sections 167(h), 291(b), and 613A to provide neutral tax rules for all oil producers, ending the current discrimination against large producers.

20. Amend section 172 to authorize the Treasury secretary to extend the net operating loss carryback period during recessions. This change would reduce the tax penalty on risky business investments.

21. Repeal section 179 expensing, which provides little marginal incentive and discriminates against large firms. For simplicity, allow all firms to expense a small specified volume of investment.

22. Repeal the section 199 domestic production deduction, which provides a complex and inefficient incentive to produce goods rather than services.

23. Amend section 243 to eliminate the tax on intercorporate dividends, a third tax layered on top of the double tax on corporate income.

24. Repeal the section 472(c) last-in, first-out conformity rule. Given that book conformity is not required for accelerated depreciation on equipment and structures, it should not be required for LIFO, which levels the playing field by providing comparable tax treatment for inventories. This change would be essential if the SEC adopts international financial reporting standards, which do not allow the use of LIFO.

25. Terminate the inefficient export subsidies provided by the domestic international sales corporation provisions in sections 991 through 997. ■