

Jonathan Gruber

Public Finance and Public Policy

First Edition

Chapter 25: Fundamental Tax Reform

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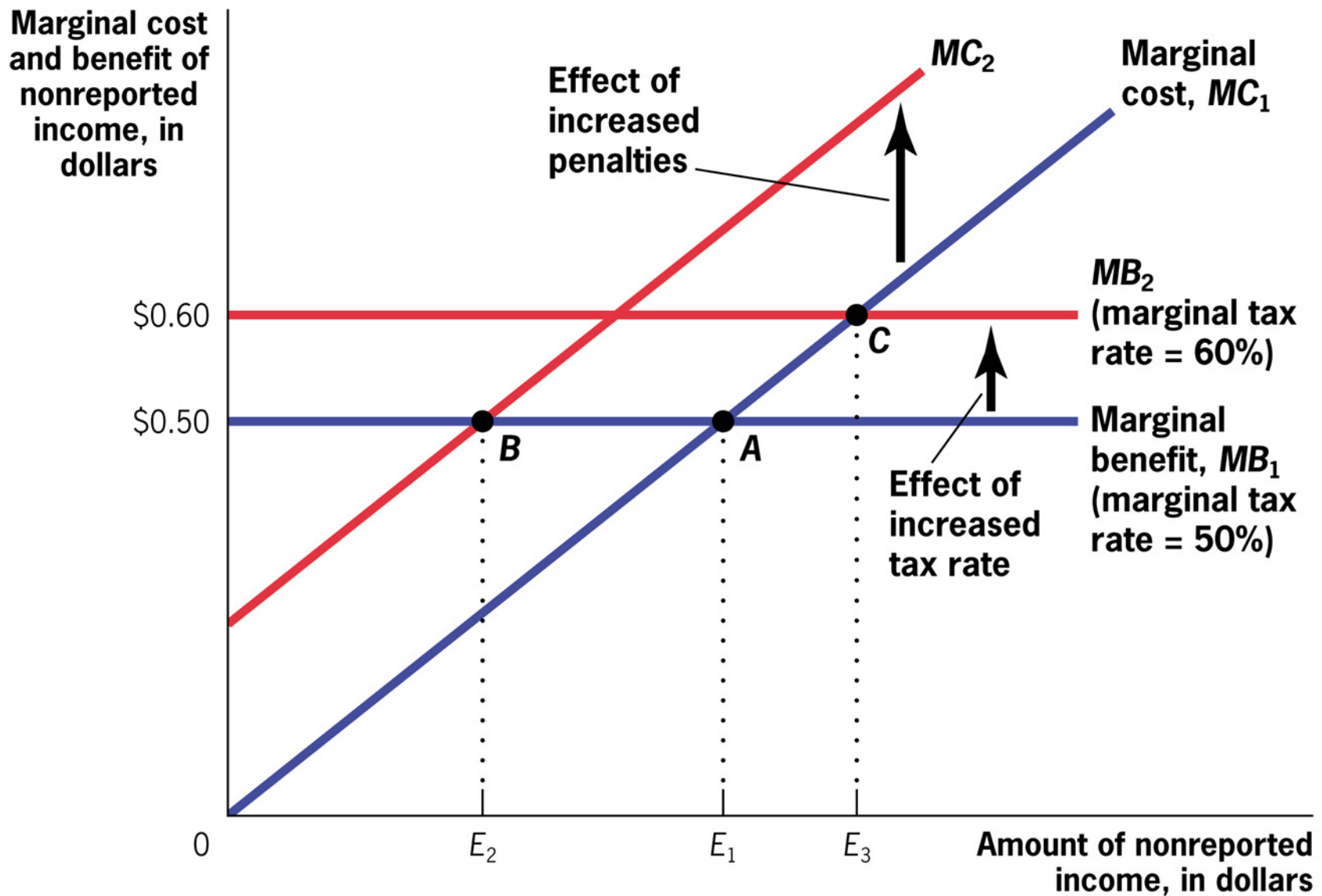


Figure 25.1 Optimal Tax Evasion
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■ **TABLE 25-1**

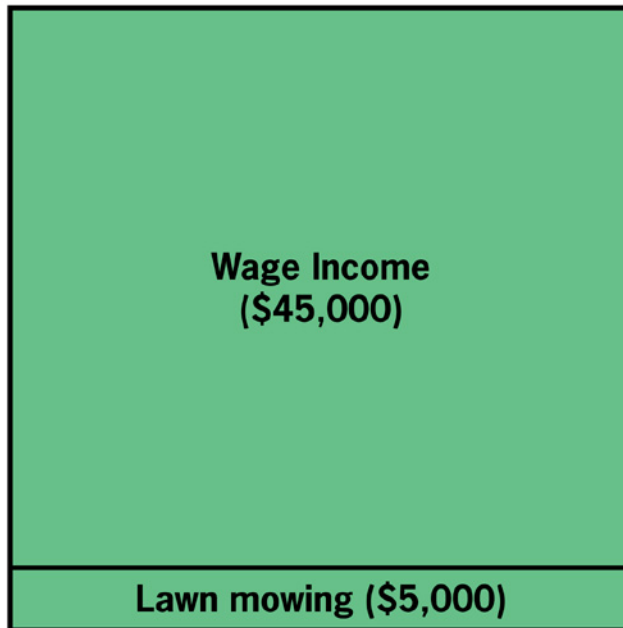
Simplicity Advantages of a Flat Tax

Current tax system	Forbes's flat tax
Gross income (wages, interest, etc.) – Deductions	Wage income – Exemptions
= Adjusted gross income (AGI) – Exemptions – Itemized (or standard) deduction	= Taxable income
= Taxable income <div>Use income tax schedule (Figure 18-3)</div>	<div>Multiply by 20%</div>
= Taxes owed – Credits	
= Total tax payment – Withholding	
= Final payment (refund) due	= Total tax payment

Table 25.1

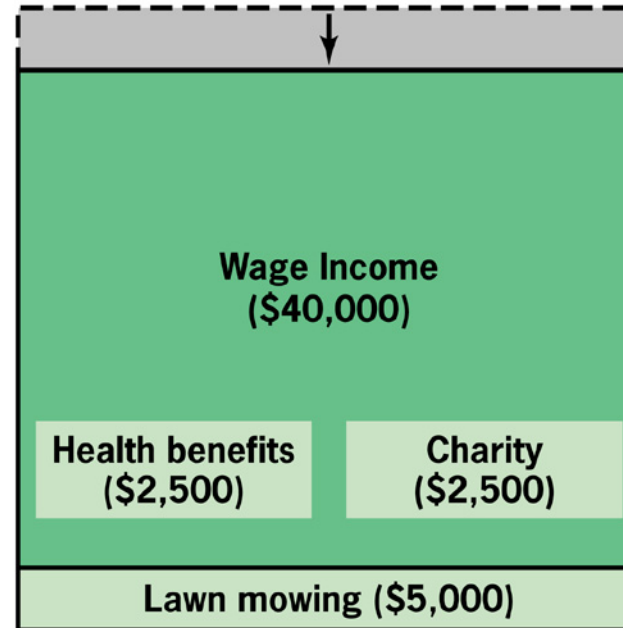
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Before tax increase,
taxable income = \$50,000
(tax rate = 10% flat rate)



Revenue = 10%(\$50,000) = \$5,000

After tax increase,
taxable income = \$35,000
(tax rate = 20% flat rate)



Revenue = 20%(\$35,000) = \$7,000

- = income included in tax base
- = income not included in tax base
- = tax revenue
- = decrease in wage earnings

Figure 25.2 Changes in the Tax Base as Tax Rates Rise
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■ TABLE 25-2

Tax Shelters

Action	Result
Invest \$100,000 in oil venture	
Sell oil venture for \$90,000	Lose \$10,000 in value
Deduct \$60,000 from this year's income	Save \$30,000 on taxes
Deduct \$10,000 loss from next year's income	Save \$5,000 on taxes
Net effect	Make \$25,000

Table 25.2

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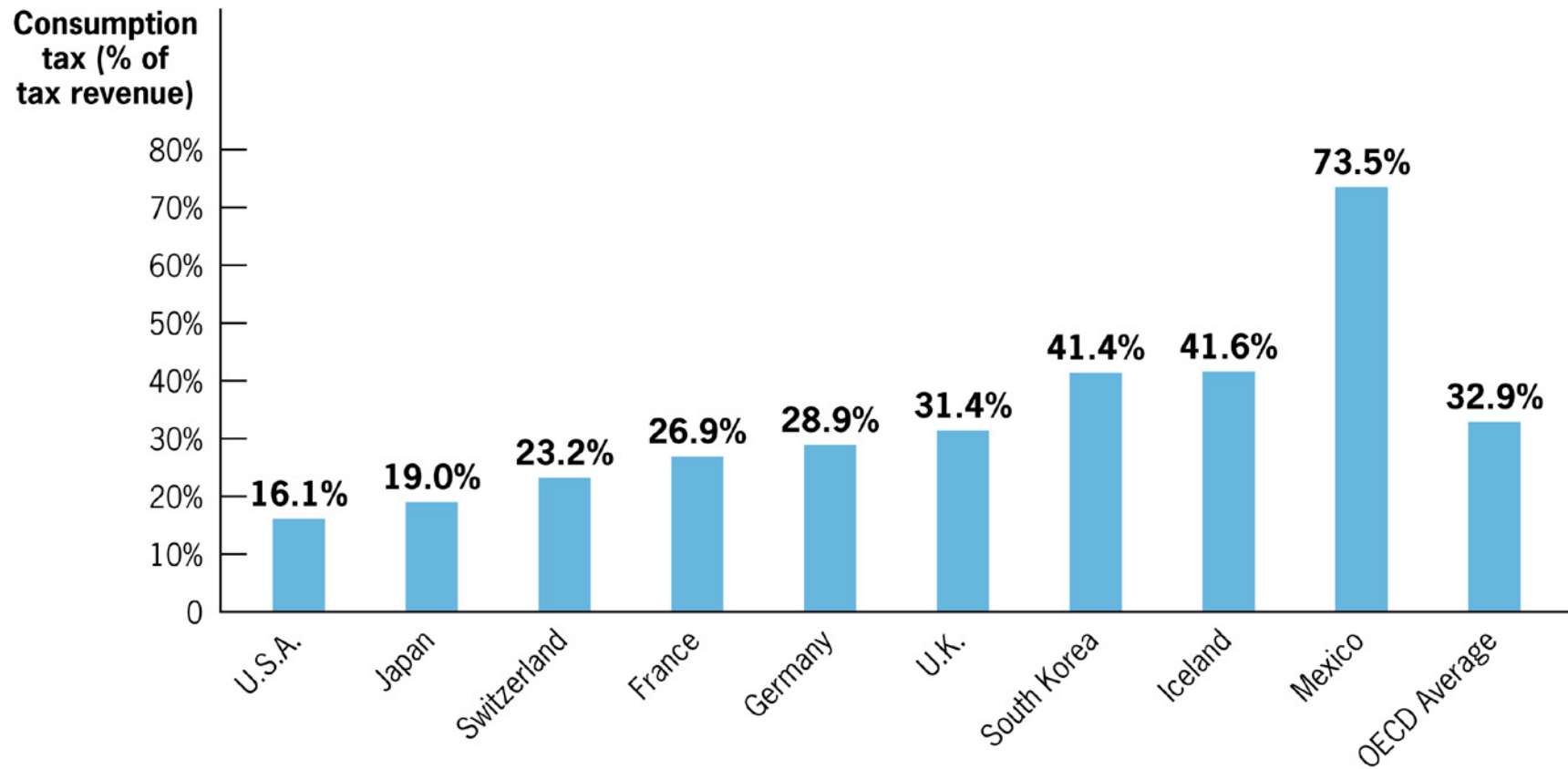


Figure 25.3 Consumption Taxation in OECD Nations
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■ TABLE 25-3

Income Versus Consumption Taxation and the Treatment of Savers

	Homer	Ned
Income tax		
Income in period 1	\$100	\$100
Taxes in period 1	\$50	\$50
Consumption in period 1	\$50	\$25.61
Savings in period 1	\$0	\$24.39
Interest earnings in period 2	\$0	\$2.44
Taxes in period 2	\$0	\$1.22
Consumption in period 2	\$0	\$25.61
PDV of taxes	\$50	\$51.10
Consumption tax		
Income in period 1	\$100	\$100
Taxes in period 1	\$50	\$25
Consumption in period 1	\$50	\$25
Savings in period 1	\$0	\$50
Interest earnings in period 2	\$0	\$5
Taxes in period 2	\$0	\$27.50
Consumption in period 2	\$0	\$27.50
PDV of taxes	\$50	\$50

Table 25.3

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■ **TABLE 25-4**

Value-Added Tax in Practice

Agent	Purchase price	Sale price	Value added	Tax paid (VAT = 20%)
Logger	\$0	\$25	\$25	\$5
Manufacturer	\$25	\$75	\$50	\$10
Retailer	\$75	\$100	\$25	\$5

Total tax paid: \$20

Table 25.4

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■ **TABLE 25-5**

Distributional Implications of the Flat Tax

	Household income (married couple with two children)				
	\$25,000	\$50,000	\$100,000	\$300,000	\$1,000,000
Current tax code (2004)	1.2%	6.9%	13.0%	24.2%	31.7%
Hall-Rabushka flat tax	0%	9.5%	14.3%	17.4%	18.5%

Table 25.5

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