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A Good Tax System: An Analytical Approach of United States Taxation

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A Good Tax System: An Analytical Approach of United States Taxation

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Abstract

This paper is an attempt to look at the American tax code in a different way. Rather than analyzing the tax on economic impacts, or how it effects the rich or poor, it sets a definition of "good tax" and constantly puts the American tax code under the microscope to determine if it is a good tax or not. For simplicity the paper only looks at personal taxes on the federal level which includes: estate, excise, gift, income, and payroll tax. After a summery and analysis of each tax is completed on an individual level, this paper looks at the entirety of the US tax code, again only the personal federal level, and compares the overall tax code to the definition of a good tax. Because the US tax code fails to meet the burden of a good tax, several third-party solutions are brought forth, and those are also put under the definition of a good tax. While no tax system or proposal fit the definition of a good tax, the point of this paper is to educate readers on the tax system that affects them as well as begins the thinking process in readers on how to change the system in order to achieve a better tax for all Americans.

Definitions

Bad Taxes – A tax that, regardless of popularity, fails to meet more than two of the criteria under "Good tax."

Consequences – Events or outcomes that are good or bad in nature that have transpired because of an action that a person, group, or entity has taken.

Estate Tax – A tax on your right to transfer property upon your death.

Excise Tax – A specific type of tax used to attempt and persuade buyers to either buy less or not buy a particular product. This tax is typically applied to the corporation or company and passed down to consumers.

Gift Tax - A tax on the transfer of property by one individual to another while receiving nothing, or less than full value, in return. The tax applies whether or not the donor intends the transfer to be a gift.

"Good tax" – Regardless of popularity, it is a tax that must meet many different requirements, but at least is: *Simple* (in compliance, administration, and enforcement), *Transparent* (in terms of what gets paid when, how clearly defined the tax is, and how consistent/predictable the tax code is), *Neutral* (in that it neither encourages nor discourages personal/business purchase decisions), *Fair* (both vertically and horizontally), and *Adequacy* (where the government collects enough revenue to support social welfare spending and on the basic needs of society).

[This definition comes from looking at around a dozen websites and what characteristics they believe a good tax is and counting how often similar words came up.

The chosen descriptors are words or phrases that appeared most often across all websites.]

Horizontal Equity (Tax) – People in similar economic positions pay similar amounts in tax.

Income Tax – A tax levied on the taxable income of an individual

Mediocre Tax – A tax that, regardless of popularity, fails to meet one or two criteria listed under "Good Tax."

Payroll Tax - Taxes that employees and employers must pay based on wages and tips earned and salaries paid to employees. The employee pays part of these taxes through a payroll deduction, and the employer pays the rest directly to the IRS. The four main types of payroll tax are federal income, Social Security, Medicare, and federal unemployment.

Personal Federal Tax – A tax that targets one person, or two if filing jointly, that comes from the national government.

Sales Tax – Tax paid based on the sale of goods or services.

Taxable Income – Wages, interest, and other items subtracted by the standard deduction.

Vertical Equity (Tax) – A vertical equitable tax is where the more affluent pay at least the same proportionally as the poor.

Introduction

Can a tax be "good"? If it can, what are the qualities? It seems that more and more people are asking these questions, and similar ones, as the word "tax" does not seem to remove itself from the list of common household names. Some people claim the rich do not pay enough, others say that we should remove the income tax altogether, and even more suggest that we should add more taxes to pay for societal services. In this paper, I will take an analytical approach to taxes. I will define what a good tax entails, what is required for it to be called a good tax, and other qualities that good taxes have.

A question I will delve into in this paper is, is our current tax system in the United States good? If it is not, I will compare and contrast other proposed methods of taxation to each other and the definition of a good tax. Suppose one of these alternatives is a viable option for America, I will propose it as the tax that the United States should use moving forward; if not, I will provide my own opinion of what tax the United States should adopt, why, and compare my tax code against the definition of a good tax. Suppose any option meets the burden of a good tax. In that case, I will advocate for it and show under every metric why it should be what we, as Americans, should have for our personal tax code, but we should not settle for just any tax system, especially if that system is not "good."

Before I explain any tax code or proposed tax code, a baseline for what is a "good tax" needs to be established. Whenever I refer to a tax as being good, I say the tax must have the qualities of simplicity, transparency, neutrality, fairness, and adequacy. There are other qualities that can make a tax good, but if more than one of these five qualities are missing, the tax automatically fails to meet the criterion of a good tax. If the tax is fair in proportionality and people in similar situations, neutral in the sense that it makes no attempt to influence economic decisions, and adequate in the sense that it does not hamper the government's ability to provide basic societal needs, but the tax code is incredibly complex, and the government actively makes understanding the tax code nearly impossible, then that would naturally call into question the true "goodness" of every other category. If you take any two away in a thought experiment, it becomes clear why missing more than one causes a tax to fail meeting the good criteria.

In the next section, I will go over each type of tax, in alphabetical order, give its definition, how the United States currently implements it on a personal level and whether or not it meets the criteria of a "good tax." Adequacy will not be evaluated for each individual tax because it looks at the entire tax code rather than an individual tax. Adequacy will be assessed at the end when the entire US tax code is put under the microscope of a "good tax."

Part 1: Current United States Taxing Methods

Estate Tax

The estate tax is a tax levied on the net value of a deceased person's estate before it is distributed to the heirs. Because of its nature, it has been deemed the "death tax" by those who oppose this tax. The estate tax brought in 0.5% of the total tax revenue that the United States Government received in 2019 and has remained in that area for the past few years (Policy Basics). The tax is progressive in nature, but there are exemptions. An individual does not have to pay estate taxes on the first $12.06 million of their estate, and this doubles for a married couple (Mengle). The table below shows the total taxable rate and base tax after exemptions and deducting the $12.06 million (Probasco). This amount is higher than recent decades because of The Tax Cuts and Jobs Act that raised the exemption level by $5 million adjusted for inflation yearly. Still, this increase is only available through 2025 (How Do the Estate…).

Taxable Amount	**Estate Tax Rate**	**What Your Estate Would Pay**
$0 - $10,000	18%	–$0 base tax –18% on taxable amount
$10,001 - $20,000	20%	–$1,800 base tax –20% on taxable amount
$20,001 - $40,000	22%	–$3,800 base tax –%22% on taxable amount
$40,001 - $60,000	24%	–$8,200 base tax –24% on taxable amount
$60,001 - $80,000	26%	–$13,000 base tax –26% on taxable amount
$80,001 - $100,000	28%	–$18,200 base tax –28% on taxable amount
$100,001 - $150,000	30%	–$23,800 base tax –30% on taxable amount
$150,001 - $250,000	32%	–$38,800 base tax –32% on taxable amount
$250,001- $500,000	34%	–$70,800 base tax –34% on taxable amount
$500,001 - $750,000	37%	–$155,800 base tax –37% on taxable amount
$750,001 - $1,000,000	39%	–$248,300 base tax –39% on taxable amount
$1,000,000+	40%	–$345,800 base tax –40% on taxable amount

With the basics of the estate tax laid bare, does it fit the criteria of a good tax? Transparency on this one is significant. Everything was easy to find, information on this particular tax was readily available and was the same across multiple sources. This tax is fairly simple as far as progressive taxes go. All someone has to do is ask, is my net worth above or below this specific number? If no, then there are no worries; if yes, then subtract net worth by exemption and take what remains and see where on the table you fall to pay the appropriate taxes.

This tax does not generally affect the people's decision to buy or sell things to a great degree. In fact, the only time they would would be to either not be taxed or fall to the tier below the one they would be in if no actions are taken. This claim is substantiated by the fact that in 2017 only 2 out of every 1000 estates were subject to the estate tax (Huang). Because only about .2% of Americans are subject to this tax, we can say that it is a reasonably neutral tax. For those that it does affect, the most common ways that people mitigate the amount of taxes paid is either by giving gifts, through charitable donations, or by reaping the benefits of life insurance purchased early in life (Ashoo and Snyder).

I was not able to find the operational cost of collecting estate taxes however, the Center on Budget and Policy Priorities tells us that the income generated from estate taxes alone is enough to fully fund the FDA, CDC, and EPA while still having money left over, so we can safely assume that this tax pays for itself, but is the tax fair? Horizontally, we can tell from the table that people in the same general net worth range will pay the same base tax and rate, meaning the tax has horizontal equity. This tax is also vertically equitable. Because the more affluent, those with a higher net worth than the average citizen, pay at least the same proportionally as the poor, then this is a fair tax.

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Excise Tax

Excise taxes generate about 0.5% of the US total budget and have stayed in this range since the mid-2000's (What Are the Major Federal…). Out of the various items taxed that fit this category, there are five main categories of excise taxes: highway, airway, alcohol, healthcare and tobacco.

The following numbers and percentages on highway excise taxes all come from Tax Policy Center's "What Are the Major Federal Excise Taxes, and How Much Money Do They Raise?" Most of the revenue from excise taxes comes from the highway category, 44.4% as of 2019, equating to $40.5 billion. This total is mostly made up from gasoline and diesel excise taxes; in fact, the taxes on gasoline and diesel, which are 18.4 and 24.4 cents per gallon, respectively, make up 90% of all of the federal taxes collected in the highway category. The remaining 10% comes from sources like taxes on trucks, tires, trailers, and other types of fuels.

The next 38.6% of the pie comes from aviation fees (16.1%), alcohol (12.5%), and tobacco (10%). Every plane ticket that is purchased tacks on a little tax. Due to COVID, that section earned less revenue in 2020 and moving forward, but it is something that should come back in the future when the US is comfortable flying with a mass amount of people again.

Alcohol and tobacco are what most people are familiar with when people mention the excise tax and is represented in about a $1 tax per pack of 20 for cigarettes, but generally varies for tobacco. Alcohol is harder to pin down because it varies depending on if it's wine, bourbon, beer, or any other different type of alcohol with varying alcohol content, but generally, the more alcohol that is in an alcoholic beverage, the more costly the tax (What Are the Major Federal…).

Because these percentages were taken in 2019, healthcare made up 9% of the federal excise taxes as well. That percentage could have risen post-2022 as the Cadillac tax would have taken effect had Trump not repealed it in 2019. Because of this, we can see the healthcare section staying stagnant for the foreseeable future.

When determining if the excise tax is a good tax or not, we can already tell that it is simple and transparent. Even in the example of alcohol, where there are different taxes depending on the alcohol content, excise taxes are flat taxes and are relatively simple to find online regardless of who you are. We can even assume that the tax is effective in this day and age where purchasing airline tickets, gasoline, and even alcohol and tobacco, to an extent, are done online or electronically, which makes collection cost very low. The issue comes in neutrality and fairness.

A neutral tax is not supposed to regulate or incentivize behavior, but this tax's entire purpose is to suppress consumption of certain items, but this is not effective. As discussed earlier, a fair tax should include the rich paying proportionately the same as the poor (vertical) and those in relatively similar economic situations pay close to the same (horizontal). If we assume those in similar economic situations have similar purchasing patterns, then excise taxes are horizontally fair because of the flat tax aspect, but for the same reason are not vertically fair. In the example of gasoline, even though Purdue University found that low-income people drive fewer miles than those with more money in 1995 and again in 2002 (Fricker), this is only how many miles people drive. What I mean by this is the taxes that the affluent pay is proportionately less than what the poor pay. This is applicable to every single kind of excise tax, meaning that it is not a good tax because it is neither fair nor neutral.

A solution that would make this tax a better tax would be to only have excise taxes on items that people must buy, like gasoline. While this does not remove the issue of fairness, any tax on the sale of goods will be inherently unfair. With this, we must make one of two choices, either reject every instance of a sales tax and remove excise taxes completely, or remedy the issue of neutrality and acknowledge that while excise taxes are not good taxes, it serves its purpose in the federal budget, so we should make it as "good" as possible.

Gift Tax

The gift tax is an interesting patchwork of exemptions and deductions. A vast majority of Americans may never worry about the gift tax, but those that do face a tax ranging from 18-40%. The gift tax works mainly in two ways. First, the yearly limit is $16,000 per person per recipient in 2022. This means is that I could give a friend $16,000, and give a different friend another $16,000 without having to pay a gift tax. On top of this, someone that I gave a gift to can receive gifts from other people as well because the gift tax only taxes the donor. This is important to note because taxing the donor rather than the receiver is not common in the United States. The second way the gift tax works is by providing a lifetime limit of $12.06 million in 2022 (Orem). So, if I were to gift a friend $50,000 the first $16,000 is untaxable for that year, but the remaining $34,000 would not be taxed, it would be subtracted from my lifetime gift limit.

The gift tax works slightly differently for family members, but the next example serves to demonstrate how the lifetime exemption works. When I die and give my estate to my family, that would be a gift because I receive nothing in return. What this means is, if you do not gift anything to anyone over the yearly limit your entire life, you have the lifetime limit to go against your estate. As an example of the other side, if I have gifted a lot of people a lot of money to the point where my lifetime exclusion is down to $5 million, and my estate is worth $7 million, of which I gift all of it away, then the last $2 million can be taxed under the gift tax. Because of this, it is theoretically possible for people with estates over $30 million to be taxed twice. The first would be the estate tax, where the first $12 million is tax-free, and then the gift tax, where the lifetime exclusion is $12 million at best.

Earlier I talked about how the gift tax ranges from 18-40%; the exact tax rate scales based on how far past the limit the individual has surpassed (Jackson), meaning it's a progressive tax. Because it's progressive, that means that the tax is vertically fair. However, the horizontal fairness is questionable. People who give similar amounts pay similarly, but that does not mean that those people are in a relatively similar economic situation. To be fair, any individual who can give more than $12 million in their lifetime is will be in a very good financial status, and it would not matter very much if we were to compare multi-millionaires to billionaires in this category.

The gift tax does not attempt to sway any individual's decision to purchase anything, so the gift tax is neutral. We can say this by relating back to the exemption levels of $16,000 per year and $12.06 million for a lifetime. That would lead to even median income Americans feeling comfortable purchasing and gifting big ticket prices without worry of feeling the gift tax. The gift tax is relatively simple at face value considering most people will never have to deal with it, but for those that do, it is a fairly complex system that intertwines with the estate tax making it even more complicated. While a lot of the information on the gift tax is readily available, the exact percentage of what you owe based on how far over the limit you've gone is extremely hard to find. There definitely is some transparency here, but making one of the most important areas near impossible to find is a little bit of a red flag.

What is interesting about the gift tax is that it only clearly meets one of the five criteria for a good tax. On the same foot, the gift tax does not clearly fail any of the five areas. Because of this, I cannot say that the gift tax is either good or bad, just decent. The gift tax certainly has aspects that are desirable, and aspects that can be improved, but overall, it is neither a good or bad tax.

Income Tax

Beardsley Ruml is a man who the general public knows nothing about today, and knew little about back in the 1940s when he made one of the most important suggestions in tax history. The United States had been taxing income for a while, but the citizens would pay one lump sum on Tax Day. With World War Two demanding as much money as possible, and millions of Americans not filing their taxes, Ruml had an idea that changed the entire fundamentals of how the government looked at taxes; instead of having everyone pay everything at once, let the government take a little bit of money from each paycheck, so you can, “pay as you go” (Shales).

That is the true story of how the government collects our income taxes today. Even Milton Freedman was dismayed over the economic short-sightedness of that plan because the short-term war effort turned into the primary way for the government to collect your taxes, reaching into your wallet before you can see how much is in it. When the actual merits of income tax are analyzed, how the government treats it will become clear as to why it’s important in determining if it’s a good tax or not.

Unsurprisingly, the income tax is the biggest revenue collector for the US in terms of taxes, in fact, it made up 50% of all tax revenues in 2019 (What Are the Sources)! This makes sense with over 150 million people in the workforce, and most of them being in a taxable bracket. It takes no small amount of imagination to understand why the income tax is the breadbasket of taxes, but the question that is at the back of so many Americans minds is, how does it actually work?

Part 1: The Tax Bracket

First, the simplest thing to explain is the progressive tax bracket. Below is the progressive tax bracket for 2022 as listed on the IRS website. As a matter of clarification, every rate for income tax seen below is what the government takes before exemptions and deductions are calculated. Every number used to explain the tax bracket is based on yearly income.

"For tax year 2022, the top tax rate remains 37% for individual single taxpayers with incomes greater than $539,900 ($647,850 for married couples filing jointly).
The other rates are:
35%, for incomes over $215,950 ($431,900 for married couples filing jointly);
32% for incomes over $170,050 ($340,100 for married couples filing jointly);
24% for incomes over $89,075 ($178,150 for married couples filing jointly);
22% for incomes over $41,775 ($83,550 for married couples filing jointly);
12% for incomes over $10,275 ($20,550 for married couples filing jointly).
The lowest rate is 10% for incomes of single individuals with incomes of $10,275 or less ($20,550 for married couples filing jointly)." (IRS).

Before moving onto deductions, I would like to point out a marriage penalty in the income tax. The top tax rate taxes two individuals who make over $325,000 each at a rate meant for those who make more than $200,000 per year rather than keeping the normal joint rate of 2x the single rate.

Part 2: Deductions and Credits

Before summarizing the different types of deductions and credits, understanding the difference between the two is critical. A credit has the ability to reduce the amount of taxes that you owe, it can increase your tax refund, and there are a few credits that give you a refund without you owing any taxes. On the other hand, a deduction reduces the amount of income before calculating taxable income.

Section a: Credits

There are five main categories of credits that people can claim, and each one practically self-describes what credits fit under that category. For example, the Family and Dependent Credits is the broad category that has credits like the adoption credit or credit for the elderly or disabled. The other four categories are Income and Savings Credits, Homeowner Credits, Healthcare Credits, and Education Credits (Credits and Deductions).

While there are five categories that credits cover, there are also three different types of credits. The first type is a nonrefundable credit, these types of credits help get the amount of taxes you owe down to $0, but any amount that would lead to a refund does not apply, thus the name. The second type are refundable credits which are always paid in full. If that means the taxes you owe go negative, then the government issues you a refund. The final type of credit is partially refundable credits where only a portion of the credit is allowed to be turned into a refund. An example of this is the American

Opportunity Tax Credit, whereupon no longer owing taxes, you then take 40% of the remaining amount from the original $2,500 or $1,000, whichever is smaller (Segal).

Section b: Deductions

While there are five categories of deductions listed on the IRS website, a vast majority of people will only ever use one of two methods of deduction, itemized or standard. The standard deduction is a simple flat amount to deduct from the taxes that any individual owes. For those filing as single or married but filing separately, it is $12,950, and exactly double that for married filing jointly. If you are the head of household then your standard deduction is $19,400 (Berry-Johnson).

There are certain people who are not eligible to receive the standard deduction, like a married person filing separately whose spouse itemized deductions. A person who was a nonresident alien is also not eligible, however there are some exceptions to this rule. If, due to a change in an individual's accounting period, they decide to file more than once in a 12-month period, then they are ineligible as well. Finally, a partnership, estate, trust, or common trust fund cannot receive the standard deduction (Topic No. 551).

Itemized Deductions as a definition are fairly simple, they are expenses that can be written off and subtracted to your income to reduce your total tax bill. An individual cannot use both itemized and standard deductions, but they can choose the one that will remove the most amount of taxes. When choosing to decide, it is important to know what expenses can or cannot be itemized. The most common itemized deductions are charitable donations, medical/dental expenses, mortgage interest, and state/local taxes

(Lu). You can also itemize legal fees and tuition, but these would be more on a case-by-case basis. Before Trump's tax cut, about 30% of people itemized their taxes, but after the tax cut, it is estimated that only 13% will itemize deductions (Eastman).

Part 3: Alternative Minimum Tax (AMT)

The Alternative Minimum Tax places a "floor" on the percentage of taxes that someone must pay regardless of how many deductions and credits they claim. What this does is ensure that certain taxpayers pay taxes on a minimum amount (Probasco). The AMT intentionally does not want to tax low- or middle-income earners, so it has a deduction of $75,900 for everyone and only starts to decline when yearly income surpasses $539,900 (IRS).

Part 4: Capital Gains Taxes

Capital gains taxes are split into three main categories, long-term, short-term, and dividends. Short term is acquiring an asset and selling it after waiting for a year or less, while long term is acquiring and selling an asset after waiting for any time period as long as it exceeds one year. Dividends are cash or stock distributions that companies can give you for owning any amount of their stock. There are exceptions to this rule, like gifts or property acquired from a decedent, but as a general guideline short term, long term, and qualified dividends is how capital gains taxes work (IRS).

Taxing short-term capital gains are fairly simple, it is taxed based on the normal income tax bracket. Short-term capital gains and what someone makes from their job as income are not considered the same income and are taxed separately. This means it is not impossible for short-term capital gains to be taxed at a higher rate than income.

Taxing long-term capital gains is not inherently complicated, but it is not based on what income tax bracket you are in. When being taxed by long-term capital gains, first determine if you are single, head of household, married filing jointly, or married filing separately, this should be the same as what you use to figure out your regular income tax. As seen below, the main difference between long-term, short term, and regular income tax is the reduced number of tax brackets. The below table shows the rates for 2022 (Boyte-White).

Tax Rates for Long-Term Capital Gains 2022

Filing Status	0% rate	15% rate	20% rate
Single	Up to $41,675	$41,676 to $459,750	Over $459,750
Head of household	Up to $55,800	$55,801 to $488,500	Over $488,500
Married filing jointly	Up to $83,350	$83,351 to $517,200	Over $517,200
Married filing separately	Up to $41,675	$41,676 to $258,600	Over $258,600

Dividends are split into qualified and ordinary dividends for tax purposes. The difference between the two is that qualified dividends have to meet certain requirements set forth by the IRS. The most important requirement for a dividend to be qualified is holding it for longer than 60 days during each 121-day period between dividends. The benefit of receiving qualified dividends is that they are taxed at a lower rate than ordinary dividends. Qualified dividends are taxed at the same rate as long-term capital gains, and ordinary dividends are taxed at the same rate as the normal tax bracket (Maverick).

Part 5: Analysis

The income tax is very complex, and simplicity is out of the window, but is there anything gained from the loss of simplicity? In terms of fairness, this incredibly complex system allows those who are poor to pay either nothing or next to nothing in taxes while setting a minimum threshold for the rich and having the highest tax bracket be semi-punishing even if it is on the lower end, by comparison. On top of this, people who earn around the same amount pay about the same percentage-wise. This general rule gets muddy very quickly because of deductions and credits, so we cannot confirm horizontal fairness, but vertical fairness is prevalent.

Despite the vertical fairness of the income tax, the sheer complexity makes income tax not very transparent in any sense. There are a lot of resources online that can help, but for an individual that knows little to nothing about taxes, it would take weeks for them to find the correct resources and understand them in a sense that allows for meaningful application.

In the entire process of research, I never found anything that implied or showed the income tax attempting to sway purchases one way or another. One potential area is credits, it rewards people for making certain choices, but those things are children and education, along with other areas of life that happen naturally in the United States. Income Tax is vastly neutral, but I do see the possibility for it to not be.

In sum, I cannot call the income tax a good tax; there is little transparency, questionable horizontal fairness, and no simplicity at all. With that said, it is not without its merits. For a tax system that has been in place since the mid-1940's, it is very expansive, elastic, and attempting to be as fair as possible. I understand there are arguments that the rich should pay more, or pay their fair share, but what most people do not understand is that the "rich," people who make $218,000 or more per year, paid 60% of all income taxes collected by the government in 2018. On top of this, the top 1%, people who make more than $540,000 per year, paid 40% of all collected income taxes in 2018 (Michel). In a system as big as the one we have, there will be loopholes, but understanding the numbers helps put into perspective who pays what slice of the pie.

Payroll Taxes

The two parts of payroll tax are some of the most well-known government programs in history, Social Security and Medicare. While the tax works the same as far as collection goes, there are differences in how each program works. Because these taxes only fund the program they are designed for, when analyzing fairness and transparency, an analysis of the actual program itself is necessary as well. Despite funding separate programs, they are collected together, and any reference to Federal Insurance Contributions Act, or FICA, taxes in this paper is in direct reference to the collection of both Social Security and Medicare simultaneously.

While FICA taxes are split between employer and employee, the rules change slightly when people are self-employed. Rather than splitting the total percentage, the self-employed person will pay the entire payroll tax themselves, and there will be a few examples of this later. While rates will be discussed in detail depending on the type of tax being talked about, all FICA taxes are applied at a flat tax rate. With all the basics of FICA taxes explained, an analysis of the specific taxes can be understood and expounded upon.

Part 1: Social Security Taxes

The government collects social security taxes very similar to that of income tax, it is taken from your paycheck before you see it, however that is where similarities end.

Because income tax is progressive, the government typically takes more than necessary, and most people are entitled to a tax return. Social Security is a 12.4% tax that the employer splits with the employee, meaning it is a 6.2% tax on every paycheck (Flynn). While the tax rate is 6.2%, it only is applicable on the first $147,000, adjusted for inflation yearly, meaning the most someone can pay in Social Security taxes in 2022 is $9,114 ("Retirement Benefits"). $9,114 is the most an employee will have to pay, but remember the rate for self-employed people is 12.4% on Social Security alone, meaning that what they pay in taxes would be double because they are paying both sides of Social Security.

Section a: Social Security as a Program

Every penny collected from Social Security goes into a pool that is redistributed to retirees, people with a disability that have enough work credits, or other eligible people. In 2022, the average benefit an individual can receive is $1,657 per month, and the maximum an individual can receive is $3,345 (Brandon). The rate for married couples is 1.5x that of individuals effectively creating a marriage penalty for people collecting Social Security benefits (AARP). The official reason given for this disparity is because the government believes that two people can live more economically than one person, and therefore do not need as much money.

There are multiple aspects to Social Security other than the widely known retirement benefits like: disability, survivor, and supplementary income benefits. For disability benefits, a person must meet work requirements each year they are healthy. For people who meet the requirements, disability payments are made to people who cannot work for a year or longer (Fay). Survivor benefits pay qualified widows, widowers, divorced spouses, and the payment allotted is based on a variety of factors like: age of death, salary, and relationship to the deceased. Supplementary income benefits are paid to people over the age of 65 and adults or children with a disability that don't make enough money on their own (Fay).

Section b: Social Security as an Issue

People are paid the aforementioned benefits from a trust fund. Every social security tax collected goes into this trust fund, but it is not inexhaustible. This causes several issues with Social Security outside of the marriage penalty, first is that it functions optimally only as long as there are more people entering the workforce than people retiring, which is the entire reason why the trust fund is depleting, even the Social Security Administration shows that the trust fund will be completely empty by the year 2033 (SSA).

The second issue is the 5-year gap in life expectancy between males and females in the United States. Women's average life span is around 80 years, and men's is about 75 (Ahmad, Farida, et al.). When most Americans retire at the age of 62, this makes Social Security's benefit allocation not equitably fair in the sense that some people will receive tens of thousands of dollars more just based on gender. If the roles were reversed and men were the ones on the benefitting side of this, there is no doubt in my mind that activists would be pushing to rectify the issue in one way or another.

The third issue is the low interest rates. While this is good for most individuals, for Social Security, it adds to why the fund is running out. Back in the 1980s when Treasury bonds were over 11%, the money pooling into Social Security from these special trust funds led to high investment income, exponentially increasing the money being added to the Social Security trust fund. In 2018 the interest rates were 2.8%, and these low interest rates mean the money in the trust fund goes dryer faster (Boyd et al.).

The fourth and final issue is that Congress will not try to fix Social Security anytime soon. The first reason is that the largest voter base is the beneficiary of Social Security, and modifying it in a way that reduces benefits can cause the voters to be angry, so in a word, fear keeps Congress from acting. A second reason is still fear, but from the rest of the voter base. The main option is to keep the current benefits even after the 2033 timeline is to increase Social Security revenue, and the only way to do that is to significantly increase the payroll tax (Goss). Both options come from blowbacks from massive voter pools meaning that anyone who relies on voters is hesitant to touch this issue.

Section c: Analysis of Social Security and How to Fix It

Social Security as a tax and as a program are both simple and transparent. A flat tax is the simplest to orchestrate, and the Social Security Administration makes it a point to be transparent. Social Security also does not influence any particular purchasing decision, even if it does penalize people for being married, meaning that it is a neutral tax. However, this tax is very unfair in both categories. Even though all people pay 6.2% which would denote at least horizontal fairness, but when about 16 million workers are self-employed and have to pay double the tax as others in their tax bracket, then it is not fair. Secondly, this is a regressive tax meaning the rich do not pay proportionately the same as the poor, because Social Security stops taxing income after $147,000 anything made after that is not taxable. While the tax itself is not a bad form of taxation based on the criteria, the program that it feeds into is riddled with issues that do not seem to be fixed any time soon.

As it currently stands, 39.63%, or $2.81 trillion, of the total federal budget (Federal Spending), and in 2021 the US Department of the Treasury estimated that payroll taxes made up 31% of the US budget, or $1.25 trillion (Josephson). Social Security operating at a deficit inherently negatively impacts the federal budget, which affects the adequacy of the entire tax system. When one program is threatening an entire system, the program must either be fixed or replaced, and because of the issues presented in the previous section Social Security will not be fixed. So, if Social Security cannot be fixed, then it must be replaced by something that aims to achieve the same goals, but does not cause such a profound impact on the government's ability to fund the nation's basic needs.

The replacement I propose is the US Railroad Retirement Board. Currently, only people who are railroad employees, but I will be taking everything that they do and applying it as if it were applicable to everyone. The Railroad Retirement Board, referred to as the RRB, has two different tiers, each is different in benefits and taxation, but I will only be focusing on Tier 1 for simplicity.

As far as taxation goes, the RRB is almost identical to Social Security, sitting at 7.65% for the employer and employee. This is split into 6.2% for Social Security and 1.45 % for Medicare, and they only tax up to $142,800 of a person's annual earnings (Jayne, Thomas R, et al.). This model was created solely for railroad workers, but when we add close to 100 million Americans and look at the issues of Social Security now, something needs to change. I will change the tax to where it affects every penny of a person's annual earnings. By removing the exemption ceiling, it makes this tax more vertically fair.

So, if everything is taxed the same, what is the difference? Maximum benefits of the RRB include $4,426 for retirees if you're single or $6,180 to an employee and spouse ("Railroad Retirement and Survivor Benefits"). This is a substantial increase from Social Securities' $3,345 along with having similar ways of distributing benefits to survivors, those with a disability, and a lump-sum death benefit. Two main differences between how the two systems work is that RRB requires you to work for 30 years compared to a predetermined retirement age and RRB uniquely offers unemployment insurance and sickness benefits.

Removing the tax ceiling will add money going into the pot, but since everything operates the same, at least financially, it is reasonable to assume that the same problems will plague this system if we switch over to it. While this argument is understandable, it is also incorrect. While Social Security relies on Treasury interest rates, the RRB trust fund gets invested in the National Railroad Retirement Investment Trust (NRRIT). This trust is separate from the government, run by a board of trustees, and in 2007 had a net return of 16.38%, compared to Social Securities' 5.3% in the same year (Whitman). This means that even if we enter a time of greater cash outflow it will happen a lot slower, and in times of cash inflow, the fund will build up quicker.

While not all of Social Security's problems can be solved with the RRB, it is a better long-term option that offers more in every category and operates the same way. Under this system, Social Security becomes a fairer tax and more equitable in its long-term distribution of assets while maintaining its simplicity and transparency.

Part 2: Medicare Payroll Tax

The Medicare payroll tax works the exact same way as Social Security, where the tax rate is split among employer and employee unless you are self-employed, in which case you pay the whole amount yourself. Another similarity is where those who are eligible for Medicare, a vast majority are over the age of 65, but someone can receive benefits under the age of 65 if they have a disability. The Medicare rate is 2.9% or 1.45% when split. When people make more than $200,000 in a year, or $250,000 for a married couple, they pay an extra .9% in Medicare taxes. Unlike Social Security, there is no cap limit, meaning that every penny that a person makes within a year is subject to Medicare tax (*Understanding*).

Medicare is split into a few major categories, the first being Part A, which covers inpatient hospital coverage. While Medicare does not cover all charges, it acts as a federal insurance provider. To receive Medicare under Part A, you have to be formally admitted into a hospital or psychiatric ward by a licensed doctor. Part A also covers partial payment for people admitted into nursing facilities, at-home health care, and hospice (Medicare Part A).

Part B Medicare covers provider services, limited ambulance services, preventative services, therapy services, X-rays, chiropractic, and some prescription drugs. This is not a full list, but some of the more common uses of Part B, and similar to Part A, only part of the cost is covered (Medicare Part B). Part C Medicare is essentially a premium version of Medicare called Medicare Advantage Plan, or the MA Plan for short. Part C allows you to keep all benefits from Part A and B along with some added benefits such as dental and vison. Part D is a subsidiary of Part B in the sense that it covers a list of prescription drugs, and if the drug you need is not on their list, then you file an appeal or pay out of pocket. Part D can either be a stand-alone plan offered by private companies, part of the regular Medicare plan, or part of the MA Plan, but if you delay registration for Part D coverage, some penalties might apply (Medicare Part D).

Section a: Analyzing Medicare

Medicare is the same type of tax as Social Security, a flat regressive tax. This inherently makes it simple yet vertically unfair. There is some redemption in fairness, because there is no cap, and those making over $200,000 pay extra, which makes it more vertically fair than a typical flat tax. Horizontal fairness is still an issue because the self-employed population still pay double the tax as a standard employee. As the United States' main federal health care provider, Medicare should be transparent, and there is a lot of information available, but there are some things that are confusing. For example, the difference between the four parts: which ones you need and which ones you do not.

<u>Overall Analysis of the United States Tax System</u>

Section A: Estate Taxes

As a reminder, the current estate tax is the only tax in the status quo that fits the definition of a good tax. There are no changes needed, but the recommendation to lower the exemption level dramatically could be applied. The only issue I see with that recommendation is that it might stifle the growth of mid-level income earners from building generational growth. This issue is easily solved with the progressive tax system of the status quo, allowing the recommendation to pass without issue. The estate tax stays with minor modifications.

Section B: Excise Taxes

There were no recommendations for excise taxes, but it does need reform. The tax is not neutral or fair, meaning it is not a good tax. One way to fix this is by removing the excise tax on products that are not necessary, like alcohol and tobacco. An argument can be made that it is for the public good and to increase public health, but a counterargument is that when the government generally has power, it will test the limits of that power. An example of this is Obamacare, at its founding the government tried telling people to purchase Obamacare or face a penalty tax. On top of this, people who want to drink or smoke, will drink and smoke regardless of the tax, meaning the positive effect on public health is mitigated. In an effort to value freedom over an attempt to improve public health, the estate tax remains but does not tax as much.

Section C: Gift Taxes

The gift tax has an exemption level so high that most people will never have to deal with this tax. This fact allows the gift tax to be decent and not good. The gift tax stays with no change.

Section D: Income Tax

While simplicity can never describe the current American tax system, it can become more transparent and fairer. For example, many people want to close the loopholes in the system by removing deductions and credits. This forces everyone to pay more taxes, but if all that is removed is deductions, then only the rich would pay more because the poor tend to use credits to lower their taxes, not deductions. The removal of deductions would also improve the horizontal fairness of the income tax. Transparency is harder with something so complex, but an easy solution, in the age of technology, is to have one government-owned website be organized to have all the information easily accessible and user-friendly. The income tax stays, but deductions go.

Section E: Payroll Tax

The Social Security tax has multiple issues, and the general belief is that, "I paid into it, so I should reap the benefits too." This belief stifles the American economy by taking up about 25% of the budget, which could be used to benefit the public good in a variety of different ways. Medicare is better because it does not function on the assumption that the workforce will be exponentially increasing. The tax rates are low enough that, even if you are self-employed, the impact is marginal. Social Security is repealed and replaced by a federal clause in all work contracts that 6.2% of each paycheck is to be invested, and the employer must match the contributions made this way. Medicare stays as it is, thus keeping the payroll tax, but in a much smaller fashion.

Section F: Adequacy

The US tax system is not good. After looking at all of the areas and the many ways it can improve, a better tax system must be found. However, it must be stated that the US tax system is adequate. The amount collected covers Social Security, health, defense, Medicare, social safety net programs, and interest on the debt (Herron). Despite all of the downfalls of the American tax system, the revenue collected does fulfill at least the basic needs of Americans, but a better tax system would hopefully do that and provide funds for social projects that are outside basic needs.

Part 2: Analysis and Search for a Good Tax System

While nobody enjoys paying taxes, it is understood to be necessary, but it is also understood that there are good taxes, bad taxes, and mediocre taxes. Citizens of any country should not be content to live with mediocre taxes and should actively strive for change if bad taxes are being levied. The goal for every nation is to have a tax system that is at least fair, transparent, neutral, adequate, and at least moderately simple. After analyzing the United States tax system for individuals, it can be reasoned that the United States has a slightly below mediocre tax system. There are some decent taxes, some good areas, along with some interesting choices and bad taxes, but all brought together creates a system that is not simple, semi-transparent, partially neutral, is decently adequate and only half-fair on both accounts.

Multiple interest groups have proposed different methods of taxation, and each should be analyzed against the definition of a good tax and the current system to see whether there is a better option for Americans, or if what the government has patched together is the lesser of all evils. In the analysis of each decision, only the reforms or proposals dealing with the individual will be assessed. It is understood that corporate tax is a large part of the tax code, but that is not the focus of this paper.

Section a: Cato Institute

The Cato Institute's plan is less of a reform and more of an overhaul of the entire system. The goal of their plan is to make a simple and transparent system that fosters economic growth, but those three criteria are not all a good tax should consist of. There will not be any argument for or against the proposal, just an analysis of the plan against what a good tax should be.

The plan consists of a multi-faceted approach to generally lower taxes while simultaneously increasing the tax base. The first method to reach this goal is to replace all current income tax rates with rates of 15 and 25% (Edwards). (There was no delineation on where the split will occur, so I will assume the 25% affects the top 10% of earners in the US, or those making more than $158,000 in a year.) This general lowering of the tax rate comes with the proposal to remove virtually all deductions and credits. The second method that the Edwards' article proposes is to remove the income tax completely and replace it with a consumption-based flat tax, otherwise known as a sales tax.

The issue with both methods is that the poor are extremely disadvantaged regardless of which option is selected. The first method is to be preferred however, the reason being is because tax credits are mostly used by low and middle earning citizens, so if this is re-instituted, then the first method would be a lot fairer while keeping the simplicity and transparency.

Other portions of the proposed plan exist regardless of which above method is chosen. First, cutting the top dividend and capital gain tax rates to 15%, which would only benefit the rich, while not really affecting anyone else. Second, the government would create a universal saving account for each family, meaning that all families can build up wealth without the fear of double taxation. Third, a complete repeal of individual alternative minimum taxes, and finally, a repeal of the estate tax (Edwards).

A universal savings account is not really a tax but is really similar to the idea to remove Social Security, so I feel like it is worth mentioning. A complete repeal of the alternative minimum tax sounds like it would benefit the rich due to there being no tax floor, but in relation to removing virtually all deductions, then the alternative minimum tax would not matter very much anyway. Considering the other factors repealing the estate tax does not make much sense when, put under strict analysis, the estate tax is good.

Section b: Brookings

Brookings has two main proposals for taxation, and both are tweaks to the current system we have. Both can exist simultaneously as the first addresses the estate and gift tax while the second addresses the income tax. Brookings' main goal is to increase fairness in the tax system that allows for generational growth and to increase revenue for the United States at the same time. An important disclaimer before analyzing either proposal is that no tax rates are given, but an expected increase in revenue is, so that will be provided in lieu of tax rates.

The first proposal is to remove the estate and gift taxes and replace it with a similar tax aimed at increasing the tax base. The estate tax would be replaced by taxing the estate as income once it is in the inheritor's hands. This proposal includes a lifetime exemption that could range from $500,000 to $2.5 million per heir. The gift tax would be replaced by taxing only assets that are gifted and result in capital gain, this also has an exception range above a certain point. The estimated gain of this proposal over ten years if the exemption rate was $500,000 is $1.4 Trillion, and $340 Billion if the exemption rate was $2.5 million.

This proposal is interesting because it claims to only tax those above the high exemption rate and increase tax revenue at the same time. It greatly reduces the current exemption rates for estate and gift taxes, allowing more people to be taxed. Brookings' argument is that it allows for a more equitable tax system, but it also has the potential to stifle growth for upper-middle-class families with the new exemption rates.

The second proposal is to deter illegal tax evasion and reduce tax avoidance by closing loopholes and increasing the tax base. The plan to deter illegal tax evasion is to increase IRS funding in order to increase the frequency of audits centered around high-income earners. The plan to close loopholes centers around closing tax shelters that allow individuals to not pay either income or payroll taxes, and the plan to increase the tax base is mainly through taxing capital gains like income tax.

While there are some good changes and ideas in both proposals, it is not enough of a change to the United States tax system to call it good. That being said, implementing at least the second proposal would make the tax system fairer and a better system overall than the one we currently have (Edelberg).

Section c: Tax Policy Center

The Tax Policy Center focuses solely on the income tax, but offers multiple options for either reform or new systems to take its place. The first option seems relatively simple, broaden the tax base by removing deductions, credits, and exclusions. However, as discussed earlier, deductions and credits are used by different people, so by removing all of them, sure, the rich pay more, but so do the poor. The second option is a sales tax, which is a regressive tax and very proportionally unfair for the poor. The third option is a flat tax, in which households above a certain exemption level would pay a predetermined rate. This is still regressive, but preferable to a sales tax because the people who might need that taxable income keep it. The final option is a consumed income tax. This is similar to a sales tax in the sense that it would only tax those when an item is purchased, but this system allows for education credits, charitable deduction, payroll tax credits, and other methods to make this tax more progressive (Tax Policy Center).

Most of these proposals center on simplicity while increasing revenue, but do not really try that hard to think about the Americans that are affected most by taxes. The best option provided at face value would be the flat tax, but, when it is compared to Brookings and the Cato Institute's plans, none of these are closer to the definition of a good tax.

Section d: Comparative Analysis

In the pursuit of a good tax, much of the current system and some alternatives have been covered and compared against the definition of a good tax. No individual system or recommendation fit the definition, but there have been areas that a good tax could be seen.

Conclusion

Finding an entire system to fit the definition of a good tax is nearly impossible, and may never happen in the future, but that does not mean that we stop striving for the best tax possible. While it is fairly obvious the United States tax system is not good, it is not bad either. There are redeeming aspects, especially the areas that do not require extensive modification. The only exception to that is the payroll tax, and by changing how it works, we allow America to exponentially increase its generational wealth across all income levels.

This discussion over taxes, and the best way to do it, will never end. That being said, this paper does not seek to put an end to the discussion, but rather to educate the reader about the system that we live in and give my opinions on what would make it better. Each American should have the ability to be educated on the tax system that affects them. If a tax is not transparent, or simple, or fair, or neutral, or adequate, then it puts Americans at risk by drastically lowering the possibility of understanding that tax. As such, this research serves as the bridge for every American that feels like they cannot possibly understand how our tax code operates to gain a base understanding and form their own opinions on what tax reform would be best.

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