Federal Tax Problems and Simple Solution

Our federal income tax system has several tax problems such as federal IRA contribution cliff, income tax complexity, child tax credit cliff, student loan interest deduction cliff, federal-state tax deduction cycle, corporate tax, and other tax problems.

Federal IRA contribution cliff is one of our tax problems. Maximum tax deductable IRA contribution is $7,000 for age 50 or older or $6,000 for age under 50 with earned income (EI) less than $123,000 for Married Filing Jointly (MJ)/Qualifying Widow(er) or less than $74,000 for all Others (2019). **There are two cliff problems (age and multiple-step EI), which are unfair.** One age cliff problem can be resolved by one simple formula of $((Age-45) \div 10) \times 1,000$ from 0% to 100% gradually for age such as from 45 to 55. EI problem can be resolved by one formula of $(1-(EI \div S-70,000) \div 10,000) \times 6,000$ from 100% to 0% gradually for EI from $70,000 \times S$ to $80,000 \times S$. The two formulas can be combined together to have up to $6,000, $1,000, $6,000-$7,000 or 0 (A). Tax revenue may have little or no change.

Existing federal tax system has 7 tax brackets, 224 (7×4×8) formulas, 21-page Withholding Tables, 28 taxable income ranges, and 12-page Tax Table. These formulas, tables, and rates are often changed, which are very complex. During the past 150 years, we have struggled about tax systems with different tax brackets (1-56), formulas (224), and tables (B). There are two income tax calculation systems. One is for employers to estimate withholding taxes (C). Another is for people to do tax returns (D). Taxable income ranges, marginal and effective tax rates, and tax numbers in the 21-page Withholding Tables and 12-page Tax Table are often changed. If businesses do not need to use the complex Withholding Tables and 224 formulas, then they can save related costs. The tax simplification also helps our IRS to reduce processing cost.

Federal tax simplification has been researched by Robert Kao and John Lee. They have more than 12 publications at https://taxsimplecenter.net/publication.html (tax simplification research). The 7, 10 or 56 tax brackets can be matched and reduced to 3. The 21-page Withholding Tables and 224 formulas can be eliminated to simplify our federal tax system with two simple linear formulas and one existing formula by 98% (1-3/224) deduction. Detail explanation is available by a research paper (E: Benefits and Values of the LG Tax Simplification for Federal Governments, Companies, and Taxpayers).

Simple visual comparisons of the existing tax rates and proposed tax simplification are shown by the Figure 1 (E) with very comparable results. When 2 tax rates are set such as 10% for bottom tax rate and 18.1% for taxable income $100,000, a linear line between them to have one formula $(YTI \div 1,234,568 \div S+0.1) \times TI$ is the most simple, fair, and effective. S is 1, 2 or 1.5. With the simplified 3 brackets and formulas, businesses can simplify and replace existing withholding taxes, 224 formulas, payrolls, and reports to reduce related costs. Tax revenue to the federal government is neutral.

Comparing existing 7 brackets, 21-page Withholding Tables, and 224 (7×4×8) formulas with the simplified 3 simple brackets/formulas, businesses may save $4,030 million from 1x26x155 million if businesses may save $1 on each biweekly period per employee. Federal employees are about 155 million. The $1 covers about 8 areas (E). There are about 15 direct and non-direct benefits. Their saving values from the 15 tax simplification benefits for federal government, businesses, and people may be billions of dollars per year (E: Table 7), which may need to be evaluated by the IRS.

Existing federal child tax credit is $2,000 for under age 17 if meeting all eligibility factors and annual income is not more than $400,000 for married filing joint return (or $200,000 for all other filing

statuses) (F). **There is a 20-cliff tax problem, which is unfair.** This cliff problem can be resolved with one simple formula. The federal child tax credit shall be reduced from $2,000 to 0 gradually by such as (1–(AGI÷S-150,000)÷100,000)×2,000 for AGI from $150,000×S to $250,000×S (A). Tax revenue may have little or no change.

Federal corporate tax system had 8 tax brackets (15-35%) before reforming to a flat tax rate at 21% in 2018. A flat tax rate is too simple, which can not cover different taxable incomes and small and large companies reasonably. A nice business tax plan is to have a relatively low bottom tax rate, which can encourage more people to start businesses. Small businesses hire many employees to meet social and economical needs for people and social development. Then mid and large businesses are more stable and pay relatively higher tax rates. Two brackets/formulas for federal corporate tax calculation system are suggested with two tax rate ranges such as gradual 15%-20%-25% or 15%-21%-28% (E).

Federal student loan interest deduction is up to $2,500, which depends on modified adjustable gross income (MAGI) and tax status (S). When MAGI is more than $170,000 for Married Filing Jointly (MJ) or Qualifying Widow(er) or $85,000 for all Others (2019), there is no student loan interest deduction allowed. Smooth rates between 100% to 0 are needed. When MAGI is increased from $80,000×S to $90,000×S, the rates shall be from 1 (100%) to 0 gradually by (1-(MAGI÷S-80,000)÷10,000)×2,500. Status (S) is 2 for Married Filing Jointly/Qualifying Widow(er) or 1 for all others.

Existing seniors' tax returns are complex, which cause some problems for seniors and need to be simplified (G). Federal and state tax deduction cycle is another problem. When state income tax can be deducted from the federal income tax and federal income tax (all or partial) can be deducted from state income tax, they are deducted each other with many deduction cycles without their end. State tax deduction is suggested to be removed from the federal income tax returns to avoid the cycle problem. We also have other tax problems (A).

There are two political trends for income tax systems. One is to increase tax revenue with complex income tax systems. Another one is to reduce tax revenue with a flat tax rate, which will not resolve related problems of tax revenue, basic living cost, income tax, fairness, and others. We do need tax simplification to save related costs and time for the IRS, lawmakers, companies, and people. Budget balance needs to be considered at first. Also our national debt is a serious problem, which means each American has about $100,000 debt. This serious debt problem needs to be resolved over time. Proper and simple tax system can be used to resolve our tax problems with one simple linear formula as a simple and effective solution (A and E).

If you have questions and comments, please contact John Lee at johnlee@taxsimplecenter.net (email).

A. https://taxsimplecenter.net/uploads/8/3/3/9/83395216/wtaxproblem_solutionf10.pdf
B. https://taxsimplecenter.net/uploads/8/3/3/9/83395216/wf_tax_bill_draft11.pdf
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