

110TH CONGRESS
1ST SESSION

S. 1040

To repeal the current Internal Revenue Code and replace it with a flat tax, thereby guaranteeing economic growth and greater fairness for all Americans.

IN THE SENATE OF THE UNITED STATES

MARCH 29, 2007

Mr. SHELBY introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To repeal the current Internal Revenue Code and replace it with a flat tax, thereby guaranteeing economic growth and greater fairness for all Americans.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Tax Simplification Act of 2007”.

6 (b) TABLE OF CONTENTS.—

Sec. 1. Short title; table of contents.

TITLE I—TAX REDUCTION AND SIMPLIFICATION

Sec. 101. Individual income tax.

Sec. 102. Tax on business activities.

Sec. 103. Simplification of rules relating to qualified retirement plans.

Sec. 104. Repeal of alternative minimum tax.

Sec. 105. Repeal of credits.

Sec. 106. Repeal of estate and gift taxes and obsolete income tax provisions.

Sec. 107. Effective date.

TITLE II—SUPERMAJORITY REQUIRED FOR TAX CHANGES

Sec. 201. Supermajority required.

1 **TITLE I—TAX REDUCTION AND**
 2 **SIMPLIFICATION**

3 **SEC. 101. INDIVIDUAL INCOME TAX.**

4 (a) IN GENERAL.—Section 1 of the Internal Revenue
 5 Code of 1986 is amended to read as follows:

6 **“SECTION 1. TAX IMPOSED.**

7 “There is hereby imposed on the taxable income of
 8 every individual a tax equal to 19 percent (17 percent in
 9 the case of taxable years beginning after December 31,
 10 2009) of the taxable income of such individual for such
 11 taxable year.”.

12 (b) TAXABLE INCOME.—Section 63 of such Code is
 13 amended to read as follows:

14 **“SEC. 63. TAXABLE INCOME.**

15 “(a) IN GENERAL.—For purposes of this subtitle, the
 16 term ‘taxable income’ means the excess of—

17 “(1) the sum of—

18 “(A) wages (as defined in section 3121(a)
 19 without regard to paragraph (1) thereof) which
 20 are paid in cash and which are received during
 21 the taxable year for services performed in the
 22 United States,

1 “(B) retirement distributions which are in-
2 cludible in gross income for such taxable year,
3 plus

4 “(C) amounts received under any law of
5 the United States or of any State which is in
6 the nature of unemployment compensation, over
7 “(2) the standard deduction.

8 “(b) STANDARD DEDUCTION.—

9 “(1) IN GENERAL.—For purposes of this sub-
10 title, the term ‘standard deduction’ means the sum
11 of—

12 “(A) the basic standard deduction, plus

13 “(B) the additional standard deduction.

14 “(2) BASIC STANDARD DEDUCTION.—For pur-
15 poses of paragraph (1), the basic standard deduction
16 is—

17 “(A) \$25,580 in the case of—

18 “(i) a joint return, or

19 “(ii) a surviving spouse (as defined in
20 section 2(a)),

21 “(B) \$16,330 in the case of a head of
22 household (as defined in section 2(b)), and

23 “(C) \$12,790 in the case of an indi-
24 vidual—

1 “(i) who is not married and who is
2 not a surviving spouse or head of house-
3 hold, or

4 “(ii) who is a married individual filing
5 a separate return.

6 “(3) ADDITIONAL STANDARD DEDUCTION.—For
7 purposes of paragraph (1), the additional standard
8 deduction is \$5,510 for each dependent (as defined
9 in section 152) who is described in section 151(c)
10 for the taxable year and who is not required to file
11 a return for such taxable year.

12 “(c) RETIREMENT DISTRIBUTIONS.—For purposes of
13 subsection (a), the term ‘retirement distribution’ means
14 any distribution from—

15 “(1) a plan described in section 401(a) which
16 includes a trust exempt from tax under section
17 501(a),

18 “(2) an annuity plan described in section
19 403(a),

20 “(3) an annuity contract described in section
21 403(b),

22 “(4) an individual retirement account described
23 in section 408(a),

24 “(5) an individual retirement annuity described
25 in section 408(b),

1 “(6) an eligible deferred compensation plan (as
2 defined in section 457),

3 “(7) a governmental plan (as defined in section
4 414(d)), or

5 “(8) a trust described in section 501(c)(18).

6 Such term includes any plan, contract, account, annuity,
7 or trust which, at any time, has been determined by the
8 Secretary to be such a plan, contract, account, annuity,
9 or trust.

10 “(d) INCOME OF CERTAIN CHILDREN.—For purposes
11 of this subtitle—

12 “(1) an individual’s taxable income shall include
13 the taxable income of each dependent child of such
14 individual who has not attained age 14 as of the
15 close of such taxable year, and

16 “(2) such dependent child shall have no liability
17 for tax imposed by section 1 with respect to such in-
18 come and shall not be required to file a return for
19 such taxable year.

20 “(e) INFLATION ADJUSTMENT.—

21 “(1) IN GENERAL.—In the case of any taxable
22 year beginning in a calendar year after 2008, each
23 dollar amount contained in subsection (b) shall be
24 increased by an amount determined by the Secretary
25 to be equal to—

1 “(A) such dollar amount, multiplied by

2 “(B) the cost-of-living adjustment for such
3 calendar year.

4 “(2) COST-OF-LIVING ADJUSTMENT.—For pur-
5 poses of paragraph (1), the cost-of-living adjustment
6 for any calendar year is the percentage (if any) by
7 which—

8 “(A) the CPI for the preceding calendar
9 year, exceeds

10 “(B) the CPI for the calendar year 2007.

11 “(3) CPI FOR ANY CALENDAR YEAR.—For pur-
12 poses of paragraph (2), the CPI for any calendar
13 year is the average of the Consumer Price Index as
14 of the close of the 12-month period ending on Au-
15 gust 31 of such calendar year.

16 “(4) CONSUMER PRICE INDEX.—For purposes
17 of paragraph (3), the term ‘Consumer Price Index’
18 means the last Consumer Price Index for all-urban
19 consumers published by the Department of Labor.
20 For purposes of the preceding sentence, the revision
21 of the Consumer Price Index which is most con-
22 sistent with the Consumer Price Index for calendar
23 year 1986 shall be used.

24 “(5) ROUNDING.—If any increase determined
25 under paragraph (1) is not a multiple of \$10, such

1 increase shall be rounded to the next highest mul-
2 tiple of \$10.

3 “(f) MARITAL STATUS.—For purposes of this section,
4 marital status shall be determined under section 7703.”.

5 **SEC. 102. TAX ON BUSINESS ACTIVITIES.**

6 (a) IN GENERAL.—Section 11 of the Internal Rev-
7 enue Code of 1986 (relating to tax imposed on corpora-
8 tions) is amended to read as follows:

9 **“SEC. 11. TAX IMPOSED ON BUSINESS ACTIVITIES.**

10 “(a) TAX IMPOSED.—There is hereby imposed on
11 every person engaged in a business activity a tax equal
12 to 19 percent (17 percent in the case of taxable years be-
13 ginning after December 31, 2009) of the business taxable
14 income of such person.

15 “(b) LIABILITY FOR TAX.—The tax imposed by this
16 section shall be paid by the person engaged in the business
17 activity, whether such person is an individual, partnership,
18 corporation, or otherwise.

19 “(c) BUSINESS TAXABLE INCOME.—For purposes of
20 this section—

21 “(1) IN GENERAL.—The term ‘business taxable
22 income’ means gross active income reduced by the
23 deductions specified in subsection (d).

24 “(2) GROSS ACTIVE INCOME.—

1 “(A) IN GENERAL.—For purposes of para-
2 graph (1), the term ‘gross active income’ means
3 gross receipts from—

4 “(i) the sale or exchange of property
5 or services in the United States by any
6 person in connection with a business activ-
7 ity, and

8 “(ii) the export of property or services
9 from the United States in connection with
10 a business activity.

11 “(B) EXCHANGES.—For purposes of this
12 section, the amount treated as gross receipts
13 from the exchange of property or services is the
14 fair market value of the property or services re-
15 ceived, plus any money received.

16 “(C) COORDINATION WITH SPECIAL RULES
17 FOR FINANCIAL SERVICES, ETC.—Except as
18 provided in subsection (e)—

19 “(i) the term ‘property’ does not in-
20 clude money or any financial instrument,
21 and

22 “(ii) the term ‘services’ does not in-
23 clude financial services.

24 “(3) EXEMPTION FROM TAX FOR ACTIVITIES OF
25 GOVERNMENTAL ENTITIES AND TAX-EXEMPT ORGA-

1 NIZATIONS.—For purposes of this section, the term
2 ‘business activity’ does not include any activity of a
3 governmental entity or of any other organization
4 which is exempt from tax under this chapter.

5 “(d) DEDUCTIONS.—

6 “(1) IN GENERAL.—The deductions specified in
7 this subsection are—

8 “(A) the cost of business inputs for the
9 business activity,

10 “(B) wages (as defined in section 3121(a)
11 without regard to paragraph (1) thereof) which
12 are paid in cash for services performed in the
13 United States as an employee, and

14 “(C) retirement contributions to or under
15 any plan or arrangement which makes retire-
16 ment distributions (as defined in section 63(e))
17 for the benefit of such employees to the extent
18 such contributions are allowed as a deduction
19 under section 404.

20 “(2) BUSINESS INPUTS.—

21 “(A) IN GENERAL.—For purposes of para-
22 graph (1), the term ‘cost of business inputs’
23 means—

1 “(i) the amount paid for property sold
2 or used in connection with a business ac-
3 tivity,

4 “(ii) the amount paid for services
5 (other than for the services of employees,
6 including fringe benefits paid by reason of
7 such services) in connection with a busi-
8 ness activity, and

9 “(iii) any excise tax, sales tax, cus-
10 toms duty, or other separately stated levy
11 imposed by a Federal, State, or local gov-
12 ernment on the purchase of property or
13 services which are for use in connection
14 with a business activity.

15 Such term shall not include any tax imposed by
16 chapter 2 or 21.

17 “(B) EXCEPTIONS.—Such term shall not
18 include—

19 “(i) items described in subparagraphs
20 (B) and (C) of paragraph (1), and

21 “(ii) items for personal use not in
22 connection with any business activity.

23 “(C) EXCHANGES.—For purposes of this
24 section, the amount treated as paid in connec-
25 tion with the exchange of property or services

1 is the fair market value of the property or serv-
2 ices exchanged, plus any money paid.

3 “(e) SPECIAL RULES FOR FINANCIAL INTERMEDI-
4 ATION SERVICE ACTIVITIES.—In the case of the business
5 activity of providing financial intermediation services, the
6 taxable income from such activity shall be equal to the
7 value of the intermediation services provided in such activ-
8 ity.

9 “(f) EXCEPTION FOR SERVICES PERFORMED AS EM-
10 PLOYEE.—For purposes of this section, the term ‘business
11 activity’ does not include the performance of services by
12 an employee for the employee’s employer.

13 “(g) CARRYOVER OF CREDIT-EQUIVALENT OF EX-
14 CESS DEDUCTIONS.—

15 “(1) IN GENERAL.—If the aggregate deductions
16 for any taxable year exceed the gross active income
17 for such taxable year, the credit-equivalent of such
18 excess shall be allowed as a credit against the tax
19 imposed by this section for the following taxable
20 year.

21 “(2) CREDIT-EQUIVALENT OF EXCESS DEDUC-
22 TIONS.—For purposes of paragraph (1), the credit-
23 equivalent of the excess described in paragraph (1)
24 for any taxable year is an amount equal to—

25 “(A) the sum of—

1 “(i) such excess, plus

2 “(ii) the product of such excess and
3 the 3-month Treasury rate for the last
4 month of such taxable year, multiplied by

5 “(B) the rate of the tax imposed by sub-
6 section (a) for such taxable year.

7 “(3) CARRYOVER OF UNUSED CREDIT.—If the
8 credit allowable for any taxable year by reason of
9 this subsection exceeds the tax imposed by this sec-
10 tion for such year, then (in lieu of treating such ex-
11 cess as an overpayment) the sum of—

12 “(A) such excess, plus

13 “(B) the product of such excess and the 3-
14 month Treasury rate for the last month of such
15 taxable year, shall be allowed as a credit
16 against the tax imposed by this section for the
17 following taxable year.

18 “(4) 3-MONTH TREASURY RATE.—For purposes
19 of this subsection, the 3-month Treasury rate is the
20 rate determined by the Secretary based on the aver-
21 age market yield (during any 1-month period se-
22 lected by the Secretary and ending in the calendar
23 month in which the determination is made) on out-
24 standing marketable obligations of the United States

1 with remaining periods to maturity of 3 months or
2 less.”.

3 (b) TAX ON TAX-EXEMPT ENTITIES PROVIDING
4 NONCASH COMPENSATION TO EMPLOYEES.—Section
5 4977 of such Code is amended to read as follows:

6 **“SEC. 4977. TAX ON NONCASH COMPENSATION PROVIDED**
7 **TO EMPLOYEES NOT ENGAGED IN BUSINESS**
8 **ACTIVITY.**

9 “(a) IMPOSITION OF TAX.—There is hereby imposed
10 a tax equal to 19 percent (17 percent in the case of cal-
11 endar years beginning after December 31, 2009) of the
12 value of excludable compensation provided during the cal-
13 endar year by an employer for the benefit of employees
14 to whom this section applies.

15 “(b) LIABILITY FOR TAX.—The tax imposed by this
16 section shall be paid by the employer.

17 “(c) EXCLUDABLE COMPENSATION.—For purposes
18 of subsection (a), the term ‘excludable compensation’
19 means any remuneration for services performed as an em-
20 ployee other than—

21 “(1) wages (as defined in section 3121(a) with-
22 out regard to paragraph (1) thereof) which are paid
23 in cash,

24 “(2) remuneration for services performed out-
25 side the United States, and

1 “(3) retirement contributions to or under any
2 plan or arrangement which makes retirement dis-
3 tributions (as defined in section 63(c)).

4 “(d) EMPLOYEES TO WHOM SECTION APPLIES.—
5 This section shall apply to an employee who is employed
6 in any activity by—

7 “(1) any organization which is exempt from
8 taxation under this chapter, or

9 “(2) any agency or instrumentality of the
10 United States, any State or political subdivision of
11 a State, or the District of Columbia.”.

12 **SEC. 103. SIMPLIFICATION OF RULES RELATING TO QUALI-**
13 **FIED RETIREMENT PLANS.**

14 (a) IN GENERAL.—The following provisions of the In-
15 ternal Revenue Code of 1986 are hereby repealed:

16 (1) NONDISCRIMINATION RULES.—

17 (A) Paragraphs (4) and (5) of section
18 401(a) (relating to nondiscrimination require-
19 ments).

20 (B) Sections 401(a)(10)(B) and 416 (re-
21 lating to top heavy plans).

22 (C) Section 401(a)(17) (relating to com-
23 pensation limit).

1 (D) Sections 401(a)(26) and 410(b) (relat-
2 ing to minimum participation and coverage re-
3 quirements).

4 (E) Paragraphs (3), (8), (11), and (12) of
5 sections 401(k), and section 4979, (relating to
6 actual deferral percentage).

7 (F) Section 401(l) (relating to permitted
8 disparity in plan contributions or benefits).

9 (G) Section 401(m) (relating to non-
10 discrimination test for matching contributions
11 and employee contributions).

12 (H) Paragraphs (1)(D) and (12) of section
13 403(b) (relating to nondiscrimination require-
14 ments).

15 (I) Paragraph (3) of section 408(k) and
16 paragraph (6) (other than subparagraph (A)(i))
17 of such section (relating to simplified employee
18 pensions).

19 (2) CONTRIBUTION LIMITS.—

20 (A) Sections 401(a)(16), 403(b) (2) and
21 (3), and 415 (relating to limitations on benefits
22 and contributions under qualified plans).

23 (B) Sections 401(a)(30) and 402(g) (relat-
24 ing to limitation on exclusion for elective defer-
25 rals).

1 (C) Paragraphs (3) and (7) of section
2 404(a) (relating to percentage of compensation
3 limits).

4 (D) Section 404(l) (relating to limit on in-
5 cludible compensation).

6 (3) RESTRICTIONS ON DISTRIBUTIONS.—

7 (A) Section 72(t) (relating to 10-percent
8 additional tax on early distributions from quali-
9 fied retirement plans).

10 (B) Sections 401(a)(9), 403(b)(10), and
11 4974 (relating to minimum distribution rules).

12 (C) Section 402(e)(4) (relating to net un-
13 realized appreciation).

14 (4) SPECIAL REQUIREMENTS FOR PLAN BENE-
15 FITTING SELF-EMPLOYED INDIVIDUALS.—Subsections
16 (a)(10)(A) and (d) of section 401.

17 (5) PROHIBITION OF TAX-EXEMPT ORGANIZA-
18 TIONS AND GOVERNMENTS FROM HAVING QUALIFIED
19 CASH OR DEFERRED ARRANGEMENTS.—Section
20 401(k)(4)(B).

21 (b) EMPLOYER REVERSIONS OF EXCESS PENSION
22 ASSETS PERMITTED SUBJECT ONLY TO INCOME INCLU-
23 SION.—

1 (1) REPEAL OF TAX ON EMPLOYER REVER-
2 SIONS.—Section 4980 of such Code is hereby re-
3 pealed.

4 (2) EMPLOYER REVERSIONS PERMITTED WITH-
5 OUT PLAN TERMINATION.—Section 420 of such
6 Code is amended to read as follows:

7 **“SEC. 420. TRANSFERS OF EXCESS PENSION ASSETS.**

8 “(a) IN GENERAL.—If there is a qualified transfer
9 of any excess pension assets of a defined benefit plan
10 (other than a multiemployer plan) to an employer—

11 “(1) a trust which is part of such plan shall not
12 be treated as failing to meet the requirements of sec-
13 tion 401(a) or any other provision of law solely by
14 reason of such transfer (or any other action author-
15 ized under this section), and

16 “(2) such transfer shall not be treated as a pro-
17 hibited transaction for purposes of section 4975.

18 The gross income of the employer shall include the amount
19 of any qualified transfer made during the taxable year.

20 “(b) QUALIFIED TRANSFER.—For purposes of this
21 section—

22 “(1) IN GENERAL.—The term ‘qualified trans-
23 fer’ means a transfer—

24 “(A) of excess pension assets of a defined
25 benefit plan to the employer, and

1 “(B) with respect to which the vesting re-
2 quirements of subsection (c) are met in connec-
3 tion with the plan.

4 “(2) ONLY 1 TRANSFER PER YEAR.—No more
5 than 1 transfer with respect to any plan during a
6 taxable year may be treated as a qualified transfer
7 for purposes of this section.

8 “(c) VESTING REQUIREMENTS OF PLANS TRANSFER-
9 RING ASSETS.—The vesting requirements of this sub-
10 section are met if the plan provides that the accrued pen-
11 sion benefits of any participant or beneficiary under the
12 plan become nonforfeitable in the same manner which
13 would be required if the plan had terminated immediately
14 before the qualified transfer (or in the case of a partici-
15 pant who separated during the 1-year period ending on
16 the date of the transfer, immediately before such separa-
17 tion).

18 “(d) DEFINITION AND SPECIAL RULE.—For pur-
19 poses of this section—

20 “(1) EXCESS PENSION ASSETS.—The term ‘ex-
21 cess pension assets’ means the excess (if any) of—

22 “(A) the amount determined under section
23 412(c)(7)(A)(ii), over

24 “(B) the greater of—

1 “(i) the amount determined under
2 section 412(c)(7)(A)(i), or

3 “(ii) 125 percent of current liability
4 (as defined in section 412(c)(7)(B)).

5 The determination under this paragraph shall be
6 made as of the most recent valuation date of the
7 plan preceding the qualified transfer.

8 “(2) COORDINATION WITH SECTION 412.—In
9 the case of a qualified transfer—

10 “(A) any assets transferred in a plan year
11 on or before the valuation date for such year
12 (and any income allocable thereto) shall, for
13 purposes of section 412, be treated as assets in
14 the plan as of the valuation date for such year,
15 and

16 “(B) the plan shall be treated as having a
17 net experience loss under section
18 412(b)(2)(B)(iv) in an amount equal to the
19 amount of such transfer and for which amorti-
20 zation charges begin for the first plan year
21 after the plan year in which such transfer oc-
22 curs, except that such section shall be applied
23 to such amount by substituting ‘10 plan years’
24 for ‘5 plan years’.”.

1 **SEC. 104. REPEAL OF ALTERNATIVE MINIMUM TAX.**

2 Part VI of subchapter A of chapter 1 of the Internal
3 Revenue Code of 1986 is hereby repealed.

4 **SEC. 105. REPEAL OF CREDITS.**

5 Part IV of subchapter A of chapter 1 of the Internal
6 Revenue Code of 1986 is hereby repealed.

7 **SEC. 106. REPEAL OF ESTATE AND GIFT TAXES AND OBSO-**
8 **LETE INCOME TAX PROVISIONS.**

9 (a) REPEAL OF ESTATE AND GIFT TAXES.—

10 (1) IN GENERAL.—Subtitle B of the Internal
11 Revenue Code of 1986 is hereby repealed.

12 (2) EFFECTIVE DATE.—The repeal made by
13 paragraph (1) shall apply to the estates of decedents
14 dying, and gifts and generation-skipping transfers
15 made, after December 31, 2007.

16 (b) REPEAL OF OBSOLETE INCOME TAX PROVI-
17 SIONS.—

18 (1) IN GENERAL.—Except as provided in para-
19 graph (2), chapter 1 of the Internal Revenue Code
20 of 1986 is hereby repealed.

21 (2) EXCEPTIONS.—Paragraph (1) shall not
22 apply to—

23 (A) sections 1, 11, and 63 of such Code,
24 as amended by this Act,

1 (B) those provisions of chapter 1 of such
2 Code which are necessary for determining
3 whether or not—

4 (i) retirement distributions are includ-
5 ible in the gross income of employees, or

6 (ii) an organization is exempt from
7 tax under such chapter, and

8 (C) subchapter D of such chapter 1 (relat-
9 ing to deferred compensation).

10 **SEC. 107. EFFECTIVE DATE.**

11 Except as otherwise provided in this title, the amend-
12 ments made by this title shall apply to taxable years begin-
13 ning after December 31, 2007.

14 **TITLE II—SUPERMAJORITY**
15 **REQUIRED FOR TAX CHANGES**

16 **SEC. 201. SUPERMAJORITY REQUIRED.**

17 (a) IN GENERAL.—It shall not be in order in the
18 House of Representatives or the Senate to consider any
19 bill, joint resolution, amendment thereto, or conference re-
20 port thereon that includes any provision that—

21 (1) increases any Federal income tax rate,

22 (2) creates any additional Federal income tax
23 rate,

24 (3) reduces the standard deduction, or

1 (4) provides any exclusion, deduction, credit, or
2 other benefit which results in a reduction in Federal
3 revenues.

4 (b) WAIVER OR SUSPENSION.—This section may be
5 waived or suspended in the House of Representatives or
6 the Senate only by the affirmative vote of three-fifths of
7 the Members, duly chosen and sworn.

○