Response to request for comments by the Federal Tax Reform Panel on Feb. 16, 2005

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Individual Submission to Federal Tax Reform Panel

Dear Panel Members:

Thank you for allowing me the opportunity to comment on the President's initiative to reform the U.S Tax Code. I have framed my comments as follows according to the categories suggested on the panel's website:

Headaches, unnecessary complexity, and burdens that taxpayers - both individuals and businesses - face because of the existing system.

About the only thing a taxpayer can be sure of when he or she files his or her tax return is that the amount of tax shown on the return is not the right amount. The tax system is now so monstrously complex that it is beyond the ability of any one person to understand it. Understanding the system is certainly beyond the reach of most mere tax lawyers, accountants, and tax administrators. A system that is so complex must be administered in an arbitrary and unfair way. If no one really understands what the law is, it is impossible to administer it fairly and uniformly – and of course, it is not so administered. The present system makes potential criminals out of every taxpayer struggling to decipher the current code. Every wage earner, investor, retiree, and business is potentially liable for filing an incorrect tax return each year. The liability incurred can be anything from a simple penalty to a levy of property and even imprisonment.

The Code is so complex that according to the Tax Foundation, in 2002 individuals, businesses, and nonprofits spent an estimated 5.8 billion hours complying with it, at an estimated compliance cost of over $194 billion. This amounts to imposing a 20.4-cent tax compliance surcharge for every dollar the income tax system collects. I have spent over 12 hours preparing my 2004 Income Tax Return so far. Now I am waiting for my accountant to prepare several forms. When I receive those forms, I will likely spend several additional hours preparing the final product. This is time that I could better spend with my family.

To put the tax compliance burden into perspective, the more than $200 billion tax surcharge is greater than the combined revenue of Sears, Walt Disney, Microsoft, Rite Aid, and McDonald's. Put another way, the 5.8 billion hours per year represents a work force of over 2.5 million people, larger than the populations of Dallas and Detroit combined, and more people than work in the auto industry, the computer manufacturing industry, the airline manufacturing industry, and the steel industry combined. Or as a sad comparison, more than ten times that spent on the National Institutes of Health for disease research. This is also more people than would reside in four Congressional districts. It would be a safe assumption that under the present Code, compliance costs will only increase as the years go by.

As long as we insist upon the present tax system, the system needs to be complex and needs to be enforced with a heavy hand. The system needs to have all of the 28 million in civil penalties imposed each year. And, the system needs to be intrusive. This is the heavy price we have to pay for the present system.

Aspects of the tax system that are unfair.

Small changes to the Code written by lobbyists and passed by Congress shift tens of millions of dollars to particular taxpayers and are not as visible as direct appropriations. However, this is a useful tool for benefiting favored constituents. With each special exemption, credit, deferral, deduction or definition that results, the tax burden on everyone else must be increased to raise a given amount of tax revenue. It is the hide-and-disguise method of taxation. This practice is undemocratic, invisible to the average taxpayer and just wrong.

Members of a small family firm are not allowed the same tax-favored fringe benefits available to the executives of a Fortune 100 company, like an allowance for commuting expenses or cafeteria plans, which in the case of small firms are automatically considered discriminatory. A farmer can't see the U.S. taxes that are buried in the price of his produce when he sells that produce at prices established by international commodity markets. Families seeking to get ahead do not have control over their paychecks to determine when to pay tax and how much to pay, instead they must delegate assumptions over tax credits and other benefits to the most successful lobbyists. Those seeking to save for a home cannot save with pre-tax earnings or pay home mortgage interest with pre-payroll tax dollars. Just try to determine under which Code provision is the best way to save for your children's college education, and you'll end up throwing a dart at a board.

To improve one's material position, to move from one income level to another, one must typically make more money or save more money in a given period of time than others. But the present tax code zeroes in on those who try to improve their financial condition, not those who have already obtained wealth. To improve one's standard of living, to 'catch up' to a wealthier pool, it is self evident that – unless one wins the lottery, marries well, or is born with a silver spoon in their mouth – one must earn greater income in a shorter period of time or save more. However, through the application of steeply progressive rates and by taxing savings multiple times, our income tax system provides increased resistance when someone seeks to better his or her lot in life through higher wages or earnings. The present tax system does not really tax the ability to pay; instead, it taxes changes in wealth that occur generally from income and it favors consumption over savings that would help amass wealth. Therefore, the income tax literally taxes our vehicle of transport from one standard of living to another. The American people should be allowed to save and invest in their families' future without being punished by punitive taxation.

Under the present Code, there is a resistance to excel which is increased for the poorest Americans seeking to escape poverty. To see the fallacy of the progressive rate structure as a 'fair' tax system, look at the Earned Income Tax Credit. The EITC is supposed to entice families to stay in the working world at low income levels. But, if decisions are made at the margin, what is most disturbing is what happens to marginal rates under the income tax with the EITC. Marginal rates for those qualified under the EITC are perhaps the highest marginal rates applicable to almost any other income group. Under current law, marginal tax rates for single parents with incomes above $12,260 are 36 percent and for those over $14,350, 51.4 percent. These rates would be 29 and 44 percent, respectively, if only the employee share of the payroll tax is considered. Since, however, most economists believe that the employer's share is borne by employees as lower wages, it is appropriate to consider all payroll taxes. These marginal rates fall to 30.3 percent at $30,095.

The present tax code is particularly unfair to farmers and ranchers because it makes it difficult, if not impossible to keep family farms in the family because of punitive death taxes. The present code taxes 'phantom income' by taxing inflation in property values due to the capital gains tax, generates excessively high compliance costs, raises the costs of seed and other farming inputs by imposing hidden taxes upstream, targets hard work, savings and capital investment, hinders exports by making U.S. produced goods less competitive in international markets, is riddled with loopholes and exemptions that benefit special interests, lowers our standard of living and the income of families, is intrusive and leaves our children with less of a future.

There is no question that the current tax system drives the structure of the existing health care system, but there is also little question that this has been a key factor in increasing health care costs. The U.S. spends about 50 percent more than other industrialized countries on health care but has lower life expectancies and higher infant mortality than comparable countries. These are, admittedly, crude measures of the efficacy of a health care delivery system and in some respects the U.S. health care system is superior but it is a fact that the U.S. spends much more on health care than other industrialized countries and by at least two measures U.S. citizens fare worse.

A reasonable hypothesis is that the nature of the U.S. health care delivery system bears at least part of the responsibility for its relatively high costs. More than half of health care expenditures in the U.S. are funded by the private marketplace. But, in large measure due to the distortions introduced by the tax system, it is not a normal market. Insured persons do not bear directly the costs of the insurance, employers do. More importantly, for insured persons once relatively small deductibles are met, the marginal cost of consuming health care services is quite small, reaching almost zero once the typical 80/20 co-payment is exhausted (typically at $1,000 to 2,000 out of pocket). There is very, very little cost consciousness among insured consumers of health care services. If the marginal cost of consuming a good is low relative to other goods, consumers will consume relatively more of it. Moreover, a consumer gains little or nothing, financially speaking, by minimizing the consumption of health care services. The recent Medical Savings Account (MSA) legislation is an attempt to address this problem. The advent of health maintenance organizations (HMOs) and preferred provider organizations or networks (PPOs) has introduced more significant price competition to the marketplace. Neither, however, have had a sustained impact on the high rate of health care cost increases.

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Specific examples of how the tax code distorts important business or personal decisions.

The U.S. has a sizable negative trade balance in manufactured goods with every principal nation and region. The deficit on trade is approaching $600 billion per year, more than 5 percent of GDP, and the net amount of U.S. assets now owned by foreigners is currently estimated to total $3.5 trillion, roughly comparable in scale to the total privately owned portion of the U.S. federal debt. The National Association of Manufacturers warned earlier this year that "the country may be dropping below critical mass in manufacturing."

The deterioration of the U.S. manufacturing sector will diminish future progress and prosperity of the U.S. economy, and risk loss of a vital source of military security. Moreover, leading researchers and thinkers argue that the declining employment and earnings in U.S. manufacturing is a principal root cause for the declining share of U.S. income earned by blue collar workers. In 1980, the average individual manufacturing employee earned one-third more income than the median married family; by 2001 the median married U.S. family income was double the average income per manufacturing employee. The average factory wage per hour in real dollars declined 11.3 percent from 1978 to 2001, despite an increase of productivity by one-half in the business sector, and a doubling of productivity in manufacturing. The present tax system has caused this decline.

The principal problem which lies at the roots of the U.S. manufacturing crisis is the federal tax structure of the U.S. compared to its foreign competitors; most particularly the advantage provided foreign competitors by border-adjustable taxes in the form of value added taxation. The United States, as the dominant economic and military superpower of the "Free World" led the movement to dismantle trade barriers. According to the OECD, its members had average tariff rates of 40 percent at the end of WWII. The U.S. average import duty on goods is currently 1.7 percent. However, the decline of tariffs masked a trend which started in Europe toward the adoption of "border-adjustable taxation" in the form of Value Added Taxes (VAT). These taxes were purportedly adopted to "level the playing field" for cost of government welfare spending by destination taxation of consumption expenditures principally levied upon manufactured goods. However, because these VATs were determined to be "indirect taxation", the WTO enabled them to be rebated upon exports and levied upon imports. Today, the EU 15 has an average "standard" VAT of 19 percent. During the 1990s Mexico and Canada increased composite rates to 15 percent from 10 percent and 7 percent respectively, and China adopted a 17 percent VAT in 1994. At the same time foreign governments have increased VATs, they have been reducing effective corporate income taxes. U.S. taxation of resident corporations' foreign income is causing a flight of corporations' headquarters to countries which exempt taxation of overseas income not allowed by the U.S. federal tax code.

The U.S. is unnecessarily endangering its security and prosperity, and particularly the economic well-being of blue collar workers and their families, by failing to construct a level playing field for U.S. manufacturers and corporations with the present system.

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Goals that the Panel should try to achieve as it evaluates the existing tax system and recommends options for reform.

I suggest that the panel develop options for tax reform which would:

- Untax the poor.
- Allow all Americans to determine how to spend their money and when to pay taxes.
- End corporate taxes and compliance costs hidden in the retail cost of goods and services.
- Fully fund the federal government while fulfilling the promise of Social Security and Medicare.
- Make all amounts paid to fund the government totally visible to the average taxpayer.
- Allow every taxpayer to plan their personal and business activities with absolute certainty of the exact tax consequences.
- End the economic distortions perpetrated by our present tax system.
- Create more jobs, and keep our jobs here instead of encouraging the export of our work to foreign countries.
- Help retirement/pension funds see improved performance.
- Neither raise nor lower taxes so consumer costs remain stable.
- Tax criminals and not make criminals out of honest taxpayers.
- End the waste of resources spent complying with the present code.
- Restore the productivity and international competitiveness of American business.
- Ensure that all Americans as well as foreigners spending time in the United States pay their fair share to support our government.

Respectfully submitted,

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