

UNITED CALIFORNIANS FOR TAX REFORM

A PROPOSAL TO REDUCE THE TOP TAX RATE TO 20% BY ELIMINATING THE PERSONAL EXEMPTION AND THE DEDUCTION FOR STATE TAXES

SUMMARY

United Californians for Tax Reform (UCTR) respectfully submits the following proposal for reforming the tax code using the Federal income tax as a base for reform. This proposal reduces the top tax rate from 35% to 20% by eliminating the deduction for all State and local income, sales, and property taxes while retaining all of the other itemized deductions, including the deduction for home mortgage interest and charitable contributions.

THE PROPOSAL

The seven key points of our proposal are as follows:

- (1) Eliminate all deductions for State and local income, sales, and property taxes.
- (2) Retain all other deductions, including home mortgage interest and charitable contributions.
- (3) Eliminate all personal and dependent exemptions.
- (4) Increase the standard deduction to \$7950 for single tax filers and \$15,900 for joint tax filers.
- (5) Retain the maximum tax rate of 15% for income from qualified dividends and capital gains.
- (6) Establish the tax rates and bracket levels as follows:

Taxable Income	2004 Rate	Proposed Rate
\$0 - \$7,000	10%	10%
\$7,000 - \$29,050	15%	15%
\$29,050 - \$70,350	25%	20%
\$70,350 - \$146,750	28%	20%
\$146,750 - \$319,100	33%	20%
\$319,100 - and up	35%	20%

- (7) Retain all other tax code provisions, including adjustments to gross income (AGI), (such as

IRA contributions and alimony payments) and tax credits (including the child tax credit).

BENEFITS OF THE PROPOSAL

SIMPLIFICATION

Our proposal will simplify tax filing for over 90 percent of taxpayers. The increase in the standard deduction, together with the reduced value of the itemized deduction will serve to reduce the number of taxpayers who claim itemized deductions from the over 40 million today to under 10 million. The personal exemption has been eliminated and folded into the increased standard deduction.

FAIRNESS

Our plan maintains the progressive nature of the tax code but alters the rate and amount of progressiveness. We make no change in the income level at which the various tax rates are imposed and maintain the \$1000 child tax credit. We make no change in the tax burden for single taxpayers with incomes up to \$37,450 and married taxpayers with incomes up to \$74,900 who claim the standard deduction. Taxpayers with incomes above these levels who claim the standard deduction will see their tax burden rise more slowly as their income increases, than it would under the present tax code. Also, by incorporating the personal exemption into the standard deduction, the proposed plan reduces the value of itemized deductions. This will result in a significant reduction in the disparity of the tax burden between taxpayers at the same income level.

ADMINISTRATIVE EASE

Our plan will simplify tax withholding, record keeping, and tax filing for millions of our citizens. Retaining the deductions for home mortgage interest and charitable giving prevents us from

making a wholesale simplification of the tax code; however, simple instructions could be prepared for those who do not chose to claim itemized deductions. While tax collection will remain essentially unchanged, we expect significant reduction in tax compliance costs for both the government and the taxpayers because of the reduction in the number of complex tax returns.

PROMOTE ECONOMIC GROWTH

Many small business owners will see a reduction in their tax burden. This will promote economic growth, and the lower rates in the personal income tax will reduce the current disincentive to work. We make no specific recommendations regarding corporate taxes. While fairness in the tax code is seen quite differently by the various segments of our society, our plan reduces the disparity in tax burden between taxpayers at the same income level and reduces the tax burden on many of the most productive individuals in our society.

TRANSITION COSTS

The simple changes we have proposed are not expected to result in any significant transition costs by either taxpayer or the government.

REVENUE NEUTRAL

Our proposal remains revenue neutral while eliminating the three top tax rates. This is possible because these tax rates collect less than 6% of the total revenue from the personal income tax . Table 1 shows that nearly 95% of revenue is collected by the first three tax rates.

Table 1 Revenue in 2001 from each tax rate (Ref. 1 & 2)

Tax Rate	Rates & income	% Revenue
10% =	10% above \$0	52.4%
15% =	5% above \$7000	22.2%
25% =	10% above \$29050	20.1%
28% =	3% above \$70350	2.5%
33% =	5% above \$146750	2.5%
35% =	2% above \$319100	<u>0.3%</u>
	Total =	100.0%

Our analysis of tax data for the 2001 tax year, using 2004 tax rates and income brackets, shows that eliminating the deduction for all state and local income, sales, and property taxes would increase revenue by \$73 Billion from the first three tax brackets alone. This is nearly twice the revenue that was collected by the 28%, 33%, and 35% tax rates which makes it possible to drop them entirely and reduce the 25% tax rate to 21.4%. Further analysis indicates that by eliminating the \$3100 dependent exemption, and folding it into the standard deduction, this 21.4% rate can be reduced to 20%. Details of this analysis which is the basis of our assertion to be revenue neutral is available upon request.

CONCLUSION

In conclusion, our plan provides the economic benefit of a lower marginal tax rate by eliminating the personal exemption and the deduction for state and local income, sales, and property taxes. It retains the existing 10% and 15% tax rates and brackets but reduces the 25% tax rate

UNITED CALIFORNIANS FOR TAX REFORM

page 5

to 20%, while retaining the income level at which it is imposed. Our plan makes no change in the tax burden for those in the 10% or 15% tax brackets today who claim the standard deduction. We hope the panel finds this plan for a revenue neutral revision to our tax code worthy of further examination.

Respectfully submitted,

Roland Boucher, Chairman

References:

- 1 IRS Report #1304 "STATISTICS OF INCOME - INDIVIDUAL INCOME TAX RETURNS 2001"
- 2 IRS 1040 instruction booklet for 2004