PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM

2005 APR 21 A 10:57

CHARLES CLARKE
1280 HONAN DR.
SOUTH BEND, IN 46614

April 8, 2005

The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

RE: Public comments on tax reform by an INDIVIDUAL

Dear Sir or Madam,

I am a retired tax lawyer. Please consider my views on tax reform, stated on the following pages.

Yours truly,

Charles Clarke

A. Improving Tax Equity

1. Exclude from gross income the amount of FICA taxes withheld. The withheld sum is not income under any reasonable definition of "income." Tie this change to item #A2.

2. Tax the value of employer-paid medical insurance premiums and reimbursed medical expenses, including payments on behalf of former employees. Taxing compensation is much fairer than creating new loopholes for taxpayers now spending after-tax dollars on medical care and insurance. The current loophole gets larger over time. For political reasons, combine this change with item #A1, phase it in over time, and earmark revenue gain for the Hospitalization Insurance trust fund.

3. Repeal the regressive Gore tax on telephone service. A telephone is a necessity. Re "universal" access to the Internet, tax broadband connections, dial-up service and cellphones with such access.

4. Tax current earnings on life insurance policies, thereby ending "janitor's insurance" and subsidies for high income earners who have the most life insurance.

5. The deduction for mortgage interest isn't equitable, but it's a sacred cow. Ending it would devastate real estate values as did the 1986 Tax Reform Act. But consider a ceiling.

6. End Sec. 1031 tax-free exchanges for transactions exceeding a certain amount or involving more than 2 parties. Most private fortunes amassed since 1913 were made in real estate because of 1031.

7. End long-term capital gain treatment for 60% of regulated futures contracts (100% short-term). This Rostenkowski legacy is a tax windfall for currency speculators who wreak havoc on international trade.

8. Increase the $3,000 limit on capital losses. This limit is an anomaly and abomination. When rates are graduated, "income" includes decrements/negative items under any reasonable definition of the term. To protect the Treasury from selective recognition of losses but not gains, require those claiming losses

over $5,000 (or other, new threshold) to disclose all of their assets and all unrealized/ unrecognized capital gains, and limit losses if they have substantial, unrealized capital gains.

9. Paul O'Neill was right at least once: tax incentives don't affect investment decisions by big business. Executive pay is rarely tied to after-tax income; when it is, it is tied to book income which is unaffected by timing differences like accelerated depreciation. End phony depreciation for big business.

10. Depreciation of real estate, an asset that seldom depreciates, is poor tax policy. The economic depreciation of structures approximates that using reverse sum-of-the years digits method, and this is the only method which should be allowed for structures and building improvements.

11. Impose a windfall profits tax on punitive damages awards and lawyers' income from strike suits, contingent fee cases and lawsuits used as extortion. Put this money in the U.S. Treasury, not the treasury of 1 political party, and pave the way for tort reform. Exempt from its scope income from jurisdictions that include in allowable costs attorneys' fees and the economic costs of complying with discovery.

12. Transform personal exemptions into credits, as California did. But exemptions aren't tax loopholes, so don't phase them out as income rises, as California does.

13. Keep the alternative minimum tax, but adjust the exemptions for inflation since its enactment.

14. The justification for graduated tax rates is ability to pay, so apply them to each economic unit, not to individuals. *I.e.*, change the definition of a taxpayer from an individual to a household, *i.e.*, 1 or more individuals who share the same dwelling and that household's expenses of living there. Collect the same tax from 2 households with the same income regardless of how many in that household have income or whether they are related, married or cohabit. Examples follow.

Example A. X earns $40,000 and either lives alone or has a non-working spouse, W. Y and Z live together, either married or cohabitants. Suppose Y and Z earn $25,000 and $15,000 respectively. If Y and Z were taxed as a single unit, then they would pay the same tax as a single X or a married X + W (ignoring the number of exemptions, a valid basis for differentiation).

Example B. Junior goes to college/works but lives at home. Junior isn't a separate economic unit.

Example C. Junior lives in a dorm at college and has a summer job. Tax Junior's income separately. Whether Jr. is a dependent on someone else's return won't matter if item 12 is enacted.

Example D. 13 non-citizens from 3 different families share 1 apartment. 9 work. The food, rent, and utilities are split 3 ways, 1 per family. Result: 3 economic units, 3 income tax returns. If expenses were split 9 ways, then 9 taxpayers. If communal sharing of expenses, just 1 unit, 1 return.

Joint returns were allowed in 1948 after common-law states started amending their property laws so folks in Michigan, etc. could achieve the same tax results as in California, etc. Marital status has never been a rational basis for preferential or discriminatory tax treatment. The "marriage penalty" concept is wrong-headed and would disappear if the income tax applied to households, not individuals. When households had just 1 earner or rates were low, *i.e.*, 1913-1960, taxing individuals was okay. That's not okay when many households have unmarried persons who function together as a single economic unit.

B. Taxes on capital and its income (Capital gains, dividends and estate taxation)

1. Permanently increase the threshold for taxable estates to its level in 1913, adjusted for inflation. Abolishing the estate tax entirely would create a plutocracy in the U.S. Index the credit or whatever to inflation, with rounding. Related to item B3

2. Adjust basis for inflation. Change the law now when estimates of inflation and tax scoring are low.

Current tax policy on TIPS bonds is unreasonable for cash basis taxpayers.

3. Tax gains on appreciated assets at death but only for estates larger than $1 million in assets. Related to items B1 and B2. Why? To increase mobility of capital otherwise locked in until death. Defer taxes on a primary residence if occupied for 3+ years before death by a surviving spouse or a minor or disabled dependent. Permit heirs to estimate basis if the object's value is *de minimis* or basis can be estimated reasonably and can't be adduced from decedent's records after reasonable, due diligence.

4. Tax capital gains in full, after adjusting for inflation and, in the case of stocks, for the profits retained during the holding period, excluding fractional years.

5. Make the current (2005) tax treatment of dividends permanent.

C. Simplification

The biggest sources of complexity in the tax code are: (1) double taxation of corporate income; (2) rules thwarting the conversion of ordinary income into capital gain; and (3) asserting jurisdiction over the worldwide income of U.S. citizens (Subpart F rules, etc.). But there is scant political support for taxing corporations the same way partnerships are taxed or imposing no tax when profits of foreign subsidiaries are repatriated.

D. Administration

1. Require "dynamic scoring" when estimating the revenue effect of proposed changes.

2. Give non-itemizers an option until ~ March 15 to input their data without doing math. Then the IRS sends out a bill or a 1-page questionnaire.

3. Stop telling taxpayers "you are required to give us this information." (See the instructions for many tax forms.) We already know this and hate it.

C.C.