Proposal for Comprehensive Reform to the Federal Tax System
To Create an Ownership Society
Submitted on April 28, 2005 to President's Panel on Federal Tax Reform by

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Description:

Tax base: All cash or in-kind personal consumption incomes from all sources above poverty levels, with phase-out of payroll taxes. (Social Security, Medicare and welfare benefits paid from appropriations funded from general revenues.)

Exemptions, deductions, credits and exclusions: Few, specified in proposal, with corporate dividends deductible at corporate level and taxable at personal level. Tax deferrals on acquisition of full dividend, full voting shares and other income-yielding assets accumulated in tax-sheltered personal Capital Homestead Accounts (CHAs) established at local banks for every citizen from birth, up to a lifetime Capital Homestead exemption of $ 1 million of accumulated assets, plus deferral of all debt service payments on one's principal residence. The CHA Exemption would be integrated with assets accumulated in ESOPs and for profit Community Investment Corporations for local land, resource and infrastructural development.

Tax rate: Single rate on all consumption incomes from all sources above exemptions of household incomes below poverty line, with rate calculated to balance Federal budget and gradually pay off existing Federal debt.

Distribution of tax burden: No tax, including payroll taxes, on individuals and households below poverty levels; proportionate tax above poverty level.

Inheritance and Gift taxes: Avoided by taxing the recipient only to extent recipient has accumulated assets above the personal $1 million Capital Homestead exemption, thus encouraging the voluntary diffusion of large estates from one generation to the next.

Charitable Giving: Structured to encourage wealthy citizens to contribute to CHAs, ESOPs, CICs and other such asset-diffusion vehicles for the workers who helped create their fortunes, teachers, students, community workers, the handicapped, clergy and other people the donor wants to help become capital self-sufficient.

Treatment of Business: Integrate Personal and Corporate Taxation, as detailed.

broadest distribution of capital ownership. From this point, a whole new set of conclusions follow:

The bias in the present tax laws against property accumulations and property incomes should be removed. The bias in favor of redistribution, as a practical matter, must be more gradually phased out, as redistribution of income is supplanted with an effective program of redistributing future ownership opportunities. The tax system and federal laws generally should be restructured to encourage the creation, accumulation and the maintenance of property, its widespread distribution among all households, and the maximum generation of new wealth and improved technology within the free enterprise system.

Government should announce a target goal for the economy of a minimum floor of capital self-sufficiency for every household to achieve within the next thirty years. A national ownership plan, including new tax laws, would be launched to reach that goal, similar to the manner in which government assisted Americans in the building of our agricultural base through the Homestead Act of 1862.

The 160-acre ceiling made sense in distributing shares of our necessarily finite land frontier. The amounts that could be accumulated under the proposed Capital Homestead program, however, are limited only by our talent, our know-how, our technological potential, and our ability to mobilize all our resources in building a new and more productive industrial frontier during the next several decades. Hence, in today's world, a target floor is more appropriate than a ceiling as the focus of government initiatives under a national ownership program.

An effective tax system would offer incentives for the enterprise system itself, as the principal source of wealth production, to become a more direct and efficient distributor of mass purchasing power for all consumers in the economy.

As the need for income redistribution and governmental intervention within the private sector lessens to an irreducible minimum, the functions and costs of government should drop progressively, eventually to the tolerable levels projected by the founding fathers. Instead of constricting private initiatives and production, as under today's tax laws, government under a soundly conceived national ownership strategy, would become the catalyst for stimulating expanded production of a more competitive free enterprise system.

Since the wealth necessary to cover the costs of government are products of private labor and private capital, taxes should be viewed as charges to consumers for essential services not available through the private sector. Unlike other services, however, the buyer of public services is compelled to buy and the government will remain the sole seller, at least until these same services can be satisfactorily provided through the competitive enterprise system. This seemingly minor change in emphasis could open up some new ideas for privatizing (democratizing) government services and new opportunities for creative businessmen.

Direct or Indirect Taxation

Any tax blunts incentives, but a direct income tax on individuals is the least damaging, and, at the same time, places before the electorate the cost of government. User fees for government services, like camping fees and grazing fees, are also legitimate direct taxes.

expenditures each year, including welfare, defense, interest on the Federal debt, social security obligations, unemployment and all other current spending not covered by user fees. It could also cover the cost of health insurance premiums under universal minimum health care coverage, including health vouchers for the poor.

This will allow for the gradual or immediate elimination of regressive payroll taxes on workers and companies, making the economy more competitive. And it would help make government vastly more accountable and transparent to the electorate. If tied into a vigorous national growth and expanded ownership strategy, one could easily imagine future candidates for public office actually competing for votes on the basis of who could offer the best government services at the lowest flat rate. Each year's single direct tax rate could be adjusted up or down to provide sufficient revenues to avoid budget deficits and pay off government debt over time.

Under a progressive or graduated tax, on the other hand, political irresponsibility and waste is more easily tolerated. Many voters believe that the cost of increased government spending can be shifted to a tiny fraction of high-income individuals or fat cat corporations, and overlook the dangers of "printing press money" where there are sizable budget deficits. A flat tax would help raise the levels of economic sophistication of the taxpayers.

Another shortcoming of a progressive or graduated tax is that tax evasion and the search for tax loopholes by wealthy taxpayers increase as tax rates increase. And when inflation forces workers into higher tax brackets, pressures for additional pay increases add more fuel to the inflationary fires.

Resources tend to be misallocated under a progressive or graduated tax. Economic decisions become increasingly made, not on their economic merit, but on tax considerations. Thus, high tax brackets stifle growth and incentives to innovate and increase production, making all of society the poorer and less competitive.

Earned or Unearned Income

Under the Kelso-Adler theory of economic justice, the earnings from one's property in the means of production are morally indistinguishable from the earnings produced by one's skill or brainpower. Since they are both rewards directly related to their contributions to production, they should be taxed alike. And discrimination against property discourages investment and reduces society's overall productive capacity.

Karl Marx considered profits as income stolen from labor. Our tax laws that discriminate against property incomes reflect the same bias. But if capital is recognized as a producer of wealth, then capital incomes (whether distributed or undistributed) are legitimately earned by those who share property rights in that capital, the same as those paid for their skills and ingenuity.

The most serious problem with laws that discriminate against property incomes is that they hurt the poor more than they do the rich. Access to the full, undiluted stream of earnings from capital is a prerequisite for the financing on credit of broadened ownership opportunities and for more widespread distribution of profits as second incomes among today's nonowning citizens, including civil servants, many professionals, teachers, the military and the unemployable.

raising the standard of living for all citizens. Taxes on property slow down the capital creation and accumulation process. On the other hand, a direct tax on the incomes from already accumulated capital assets is simpler to understand, less harmful to investment and the care of property, and easier for tax authorities to administer.

Government Debt and Government Deficits

Since tax policy affects the size of the government's debt and government deficits in general, a few comments on the wisdom of debt and deficit spending policies are in order. Under the influence of Keynesian economic concepts, the objective of many tax decisions since the early part of the 20th Century has been to cure inflation and unemployment. Keynes assumed the continuance of historic patterns of extreme maldistribution of capital ownership, and sought merely to fine-tune that malstructured economy through the bureaucratic manipulation of government tax, spending, interest, and money-creation machinery. Structural reforms to our corporate ownership patterns were not part of Keynes' approach to the problems of unemployment and inflation.

In the Capital Homesteading strategy, however, the structural void left by Keynes is met head-on. Capital Homesteading would attack inflation and unemployment at the roots. The main thrust of this approach is to super-stimulate expanded rates of private sector capital investment, financed so as to broaden the base of equity owners in society.

The credit financing of corporate expansion must meet rigid standards of feasibility and must be repaid as a self-liquidating investment. New dollars flow directly into new productive capacity. In sharp contrast, government debt seldom, if ever, finances any production increases. Rather, it goes into nonproductive spending, war, and even into

waste of human talent and natural resources. Government debt is therefore inherently inflationary. Even worse, when government spending is not matched with current tax revenues, the inflationary impact worsens. Funds must either be borrowed (thus diverting those same funds from productive investment in the private sector) or simply issued as printing press money.

From a standpoint of economic justice, government deficits make no sense at all. They cause inflation and are therefore a pernicious form of hidden tax on the public, most painful to the poorest members of society. A just tax system would work toward the elimination of future inflationary budget deficits and to curb further increases in the already bloated government debt. Better yet, a concerted effort should be made to begin to repay this debt.

Inheritance Policy

Under a national ownership strategy, inheritance policy should be restructured to discourage excessive concentrations of wealth and, in order to promote individual initiative and capital self-sufficiency, to encourage the broadest possible distribution of income-producing assets. Gift and estate taxes therefore should not be imposed on the donor or his estate (including assets accumulated within proposed Capital Homestead vehicles). Rather, taxation should be based on the size of the recipient's total accumulations after receiving the gift or bequest. If the value of the recipient's asset accumulations remain below the floor of capital self-sufficiency described above, no tax would be imposed on the newly acquired assets. Above that floor, a reasonable generational asset transfer tax (or a flat rate tax on "excess" Capital Homestead accumulations) would be paid.

Capital gains from long-term holdings deserve different treatment, however, under a national strategy to broaden the base of capital ownership. As recommended above, to the extent that investments are accumulated within a tax-qualified vehicle, the gains should be permitted to increase tax-free or tax-deferred, until the individual affected reaches a targeted floor of capital self-sufficiency. Above that level capital gains would be subject to normal taxation after indexing for inflation.

If all of the proposals recommended here were adopted, the capital gains problem would gradually disappear. Much of the appreciation in the values of corporate common stock can be traced to the retention by management of earnings for meeting their capital requirements. As dividend payouts increase (encouraged by tax-deductibility of dividends at the corporate level) and as new sources of equity financing become readily available through the discount mechanism of the Federal Reserve System, the value of individual shares would tend to stabilize over time and be based on current and projected dividend yields per share. Hence, long-term capital gains would be less a source of future government revenues.

To some extent, long-term capital gains result, not from the increased productive value of the underling assets, but from a gradual debasement of the American currency. Inflation-inducing government economic policies can be blamed for these artificial increases in profits and capital values. Except where prices increase from natural shortages, government should assume total responsibility for inflationary increases in the value of investments. Therefore capital gains taxation should always be inflation indexed to see if any gains in value actually exist.

State and Local Tax Systems

Today, a heavy portion of local revenues come from the taxation of property, thus discouraging investment and improvement of industry and residential property in their areas. Sales taxes also increase price levels, encourage tax evasion by local merchants, discourage trade, and generally can cause one area to become less attractive than another. Since high production, high incomes, and a higher quality of life rests on the quality of the structures, industrial equipment and facilities, and technology available to the residents of an area, it should be obvious that taxes on local property are counter productive and should be gradually supplanted with a universal system of state and local taxation based upon the direct incomes of its residents from whatever sources.

Thus federal tax policy should create additional incentives for state and local taxing authorities to gradually shift to direct flat rate income taxes at the individual level, for the same reasons outlined above. To simplify tax collections, the state and local rates could be set at a percentage of the federal taxable incomes of residents of the area. Another advantage of this approach is that all areas of the country would become tax-neutral for investment purposes, thus increasing the nation's overall efficiency in the allocation of our manpower and other resources.

Tax Simplification

Although corporate income tax returns would still be important for disclosure purposes and for corporations unwilling to pay out their earnings fully to their stockholders, most of the tax revenues would flow from the expanded personal tax base. The personal income tax return and the tax system itself would, as result, be enormously simplified and

(d) tariffs on imported goods (except when used selectively to encourage just market competition);

(e) tax shelters for speculative and non-productive investment;

(f) all forms of indirect taxes not based on consumption incomes.

5. Allow the full deduction of the purchase price or the current mortgage payment (principal as well as interest) for the purchase of a taxpayer's principal home. However, to provide tax neutrality between renters and homeowners, add the "imputed rent" of each dwelling of a taxpayer to his annual taxable earnings.

6. Convert Individual Retirement Accounts (IRAs) into Capital Homestead Accounts (CHAs) as a mechanism for enabling all individuals to accumulate income-producing assets on a tax-deferred and/or exempt basis and permit CHAs, like employee stock ownership plans, to be used for acquiring corporate shares on credit secured and repaid with dividends deductible at the corporate level. Gifts or bequests to CHAs, ESOPs, and other ownership-expanding vehicles could be made tax-deductible for income and estate tax purposes, as they are today for tax-free foundations.

7. Tax all dividends and interest income at the personal level without exclusions to the extent the taxpayer's total income from all sources exceeds the exemption levels for the poor.

8. Only allow exemption of capital gains from taxable personal income, to the extent that:

(a) The taxpayer's spendable gains are equal to or less than the inflation-adjusted value of the assets during the period over which the assets were held before being sold; and

(b) The taxpayer's gains are reinvested within 60 days (or 18 months for a home) into income-generating investments held within an IRS-qualified capital accumulation mechanism (e.g. CHA, ESOP, etc.) but not exceeding the "Capital Homestead Exemption" listed in paragraph (12) below.

9. Avoid double and triple taxation by maintaining a tax on corporate net earnings but allowing corporations to avoid taxes on earnings they (a) pay out as dividends, cash productivity bonuses, ESOP and profit sharing contributions, purchases or debt service payments on replacement assets, patronage refunds, etc.; (b) retain for research and development or (c) apply for depreciation and operating reserves.

10. Allow ordinary business expenses, like wages, to remain deductible at the corporate level as under present laws, while encouraging ownership expansion by allowing:

(a) Full debt service deductions on credit to acquire replacement assets.

(b) Full dividend deductibility on all corporate shares, thus permitting stockholders to purchase newly issued corporate shares with profits deductible both from corporate as well as personal earnings. In the alternative, employees through ESOPs, and other shareholders through CHAs, CSOPs, CICs, etc., could use these tax-deductible dividends to repay loans for the acquisition of larger blocks of stock on a leveraged basis.(89)

(c) Increasing the ceiling on tax-deductible contributions to a leveraged ESOP for financing new equity issuances representing growth capital of the company. This would social security benefits can become stabilized and perhaps eventually reduced as they are replaced by Capital Homesteading incomes.

Endnotes

Reforming the Tax System

82 E.J. Dionne, Jr., "Low-Income Taxpayers: New Meat for the Right," The Washington Post, November 26, 2002, p. A29.

83 Under the current United States tax code, capital gains are given favorable treatment under the assumption that past savings are required to form new capital. Absent the speculative influence of the stock exchanges, capital gains are, in large measure, generated by corporations retaining earnings to finance new investment. This, in theory, increases the value per share which, when the shares are sold, generates a short- or long-term capital gain. This gain can then be used to finance additional new capital. To encourage new capital formation, and presumably create jobs for nonowning workers, capital gains are traditionally given favorable tax treatment, either a lower tax or no tax. Since the rich, by definition, control the vast majority of directly held corporate equity and thus the source of capital gains, favorable tax treatment of this source of income generates substantial tax breaks for the wealthy, thus exacerbating the wealth gap and the rigid stratification of society into a small minority of capital owners and a large majority of capital-less workers.

84 The serious reader will find the justification and tax philosophy behind these Capital Homesteading reforms described in detail in the article, "Beyond ESOP: Steps Toward Tax Justice," by Norman G. Kurland, published in the April and July 1976 issues of Tax Executive and updated in chapter 8 of Curing World Poverty: The New Role of Property, John H. Miller, ed., Social Justice Review, St. Louis, 1994.

85 Walter Blum and Harry Kalven, The Uneasy Case for Progressive Income Taxation, University of Chicago, 1953.

86 Louis Kelso and Mortimer Adler, The Capitalist Manifesto, Random House, 1958, chapter 5. Mr. Kelso, the architect of the ESOP, and this author met with Senator Russell B. Long on November 27, 1973, and the Senator agreed that he would champion legislation to encourage ESOPs, one component of Kelso's capital homesteading strategy. (See http://www.cesj.org/thirdway/history3rd/kelsomeetslong.htm)

87 In 1984, Congress allowed for an analogous tax-deferred rollover of ESOP assets into an Individual Retirement Account or other qualified deferred compensation plan which a participant received in one lump sum. This was liberalized in 1992 to include incremental distributions rolled over into another qualified plan.

88 Note the radical departure of this "poor man's flat tax proposal" from the flat tax proposals of Steve Forbes, Jack Kemp and others: Their "make the rich richer" flat tax would exempt from taxation capital gains, dividends, interest, inheritances, and gifts, and insulate the rich from contributing from their property incomes to the regressive, pay-as-you-go Social Security and Medicare systems. Under our flat tax, the poverty level worker and his employer would pay no Social Security or Medicare taxes, because all revenues to meet Social Security and Medicare promises would come from a flat tax.

89 The tax-favored payout of corporate dividends advocated here should not be labeled "tax subsidies," any more than deductible wage costs are "subsidies" to employers. Tax-deductible profit distributions under Capital Homesteading represent structural reform of the tax system. These tax deductions are designed to eliminate the unjust "double tax" penalty on corporate profits, by integrating the corporate income tax with the personal income tax, while exempting reasonable property accumulations to meet the Nation's income security goals.