The Presidents Advisory Panel on Federal Tax Reform

Dear Advisory Panel Members

It is time for the US Senate, the House of Representatives and the President to put the good of the general public ahead of the interests of special interest groups.

I was able to find the following is information online at www. bea.doc.gov.

In 2004: Corporate profits were about $1,700 Billion
Personal income about <u>$10,300 Billion</u> (passive and earned)
All Income is about $12,000 Billion

"Earned" income was $6,616 Billion and only $5,383 Billion of that was taxed for social insurances (Social Security and Medicare at 15.2%), that is about ½ of all personal income.

The Government collected about $1,036 B(billion) from personal income , $230 B from corporate income and $818 B from social insurance (SS & Med.) plus another $1,000 + Billion from other sources. Total personal and corporate tax paid is about $2,084 Billion or 18% of all income (social insurance 7% income tax 11%).

I believe it is important to consider the whole tax system at once rather than band aide parts of it, which is what has been done in the past. The sacred cows of charitable deductions and mortgage interest deductions, President Bush wants to protect, are like all other deductions in that they shift tax burden from one person to another The following is my proposal.

<u>SIMPILEFIED INCOME TAX PROPOSAL</u>

1.) No tax (income or social insurance) on the first $8,000 of income per person and $4,000 per dependent child family member being limited to a maximum of 4 total personal exemptions per family (2@$8,000 and 2@$4,000) = about $1,700 billion of tax exemption.
2.) An 8% social insurance tax on the remaining income of $10,300 B (corporate and personal) = $824 B tax about what is collected now.
3.) A 10% income tax on the first $150,000 of income about $5,000 B and 15% income tax on income over $150,000 equals about $5,3000 B of the total non exempt income of $10,300 B (corporate and personal income taxed the same) = $1,295 B tax about equal to what is now being collected from personal income tax and corporate income tax.
4.) This requires the elimination of ***ALL*** special interest deductions, tax credits and income type classifications. Income is income regardless of how you make it and regardless of what you spend it on. No capital gains, passive income or other income classification. Profit on the sale of property, interest and dividends are all income.
5.) Collection would be through the existing payroll withholdings and the current IRS system. The simplification of the system should result in a reduction of the systems size resulting in cost savings and compliance.
6.) All businesses and corporations would have all retained income taxed at the individuals levels excluding the individual exemption. All distributed corporate profits would not be taxed at the corporate level but would be taxed at the recipient level.
    a. Depreciations would be eliminated. Business would be able to deduct cost of equipment and improvements to real property at the time of the expense.
    b. Real property and its new or expanded improvements would be the only capital property and would have a book value of its cost and could be expensed against

its sale price when sold. No depreciation or recovery thereof. Current depreciated properties would have a capital property value of their current book value. All repair or improvements other than expansion would be expensed as an operating expense.

c. Retained earnings that are distributed at a later date would receive a tax credit for tax paid by the corporation against current or future retained income taxes.
d. All accounting for taxes and SEC reporting would be on a cash/cost basis. Notes could explain the benefit of expenses as a future growth benefit instead of using the accrual accounting method. This makes all accounting easy and simple to understand. Stock options to be reported as expense by corporations and income by the recipient when the option is executed.
e. Eliminate all special corporate classifications (s-corporations, 501 corporations etc.) for tax purposes. Non profit corporations, if they spend all of their donations and income for its intended purpose they would not be subject to tax because all income would be expensed. Non profits and all other corporations would only pay tax on funds they stock pile in cash or use for capital (real property) purchases the same as individuals are now and would be under this program.

IMPACT OF PROPOSAL RELATIVE TO CURRENT SYSTEM

1. **Simplicity**: All income in excess of personal exemption is taxed at 8% for social insurance and 10% or 15% for government cost. Most income is reported on W-2, 1099, 1098, etc. and 1040 schedule C and would continue to be. The elimination of complicated tax credits and deductions would make it a lot simpler for the IRS to track income and enforce compliance.

2. **Fairness**: The lowest income groups would get a tax break in that they would not have to pay 15.2% on first dollar earned. The only people that would be negatively affected are those with large current deductions and those who use current tax shelters. There is no reason that a person who buys a house should get a larger tax break than a renter should, nor should an investor pay a lower tax on profits than a worker should pay on wages, its all income. No one gets rich solely on their own efforts and all should contribute to the social welfare of those who helped them become well off. Even retired people, including myself, should contribute to social insurance and pay their fair share of taxes. This proposal would negatively affect very few people and would restore fairness in our system. It would positively affect the lowest income groups at the expense of the all other income groups, which would give the lowest income groups the ability to survive more independently and give them a chance to get into a higher income category so they could help contribute to our great society.

3. **Economic Growth and Competitiveness**: The elimination of tax or reduction of tax on corporations who retain earnings would give our companies incentive to stay here and do business in this country, definitely a growth and competitive stimulant. It would also encourage corporations to distribute their hordes of cash to share holders or invest it in productive ventures, this is would also be a major economic stimulant.

The eliminations of depreciations and allowing modernization and remodeling to be directly expensed would stimulate corporations to buy new equipment and improve existing facilities. This would also stimulate the revitalization of urban areas due to a direct right off of remodel expense. Corporations would update existing properties instead of selling an old building and building new. This may adversely affect new construction but it would help remodel construction keeping it all in the construction business.

4. **Compliance and administration**: No system is fool proof and is subject to the honesty and integrity of those being taxed and the entity imposing the tax. The simplification of this proposed system should reduce current cost substantially and would use the existing institutions (IRS) and reporting procedures (1099-98, W-2, 1040 tax forms etc) there by eliminating most transitional costs and reduce public confusion. Value added tax, sales tax and income tax all rely on the participants reporting and contributing honestly. No one method has a particularly advantage over the other in the compliance and administration arena.

5. **Transition, Tradeoffs and Special issues**:

Transition: The transition to this system, because it uses the existing IRS and the existing basic reporting forms should minimize transitional cost and public confusion. The elimination of double taxations of corporate profits will stimulate the economy and the eliminations of depreciation will help to revitalize our urban areas.

Tradeoffs: The elimination of all deductions is offset for most people with the personal exemption provided. Depreciation elimination and direct write off of improvement or replacement expense will be a total wash in the long run. The classification of earned income, passive income, interest and dividend income, capital gains and all other types of income all as one category is offset by a substantially lower tax rate for all income levels. What makes this work at the low rates is that all income is taxed instead of major income categories being exempt as they are now.

With this simplified income tax proposal we have three tax brackets 1.) For those with income less than $8,000 for singles and $16,000 for couples and $24,000 for families the tax would be 0% 2.) Total tax of 18% (8%social insurance SS $ Med. and 10% federal tax) for singles over $8,000, couples over $16,000 and families over $24,000 income and less than $150,000 income. 3.) Total tax of 23% (8% SS & Med. and 15% Federal) for all incomes of $150,000 or more. The exemption levels and the bracket should move up with the cost of living. Income for government operation will increase with the growth of the economy.

Special Issues: State and government employees who have their own retirement programs instead of Social Security would have to contribute to the national social insurances. Most of them are entitled to social security due to a spouse who has contributed to Social Security and therefore should contribute. My wife was a teacher with her own retirement program but is entitled to social security because of my contributions. With the reduced rate of 8% they would only have an increase of 5.5% (they currently pay about 2.5% to medicare) which is offset by the personal exemption and the overall lower tax rates.

In summary tax credits, income classifications and other manipulation that gives a group of people a tax break, shifts their tax burden to people who do not have income or expenses that qualify for the credits or special classification. These three pages could replace thousands of pages of tax code and would be easy to understand by people as well as being a lot fairer to all tax payers. The simplification alone would encourage more compliance.

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