

ROBERT BATINOVICH
400 South El Camino Real, Suite 1289
San Mateo, California 94402
(650) 343-5488

April 13, 2005

Jeffrey F. Kupfer
Executive Director
The President's Advisory Panel
on Federal Tax Reform
1440 New York Avenue NW, Suite 2100
Washington, DC 20220

PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM
2005 APR 21 A 10:55

Re: Tax Reform for a Stronger America

Dear Mr. Kupfer,

This is a brief follow-up letter to the documents I previously sent.

Let me highlight two points. First, the most regressive tax is the payroll tax. The substitute consumption tax in my proposal will be borne more fairly across the entire population. The equitable flat tax benefits everyone.

Second, given the importance that Congress attaches to the home mortgage deduction, I enclose the revised calculations which include this important deduction.

Thank you again.

Respectfully,



Robert Batinovich

Attachment

ALVIN RABUSHKA
879 ALLARDICE WAY
STANFORD, CALIFORNIA 94305

Tel: (650) 494 8528
Fax: (650) 858 1610
Email: rabushka@hoover.stanford.edu

April 13, 2005

Robert Batinovich
441 Roehampton Road
Hillsborough, CA 94010

By Fax: (650) 343 0957 (2 pages total)

Dear Bat,

Internal Revenue Service *Statistics of Income* data have been posted on the IRS web site for 2001 and 2002 Individual Income Tax Returns. In 2001, home mortgage interest (HMI) deductions totaled \$330.7 billion. In 2002, the amount was \$336.6 billion. Extrapolating to 2005 suggests a number in the neighborhood of \$350 billion.

Removing \$350 billion of HMI from the Equitable Flat Tax (EFT) base, multiplied by the 19% tax rate, reduces federal income tax receipts by \$66.5 billion. (The tax base of EFT is \$6,400 billion. Removing \$350 billion in HMI reduces the tax base to \$6,050 billion.) The 19% EFT presented in **Tax Reform for a Stronger America** yields revenue of \$1,216 billion. It would take a higher rate of 20.1% to generate the same \$1,216 billion from the EFT with HMI (20.1% times \$6,050 billion equals \$1,216 billion)

The 16.5% revenue neutral EFT calculated in **Tax Reform for a Stronger America** requires a higher rate of 17.4% for an EFT with HMI.

The data for 2002 show that returns with adjusted gross income of \$60,000 to \$100,000 received 31.7% of the total value of home mortgage interest (HMI) deductions. Those with AGI of \$100,000 to \$500,000 enjoyed 31.4%; those under \$60,000 received 34.1% of the total; and, the remaining 2.8% was taken by those with AGI over \$500,000.

Individuals who borrow against their homes and use the proceeds to purchase capital goods used in a small business receive a double benefit: first, full writeoff of investment; second, an interest deduction on borrowed funds used to purchase the capital goods. Regulations should be written to try to control the use of the HMI deduction as a subsidy for capital investment. One suggestion is to limit HMI to a primary residence only. (In any event, this problem should not be too large given that only \$1,000,000 of HMI is currently deductible, and any use of the deduction of the interest on

Page 1 of 2

this amount to buy capital goods, which could save as much as \$20,000 a year in federal taxes assuming a 5% interest rate, would likely be used by small, home-based businesses). Still, subsidizing capital works to the benefits of the owners of capital, not workers deriving their income solely from wages and salaries.

Sincerely,



Alvin Rabushka