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Re.: A Tax Reform Proposal

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

Dear Ladies and Gentlemen,

A proposed change the federal tax system is enclosed hereafter. The focus is on simplification, fairness through competition, administrative efficiency, and highlighting federal spending priorities. The main idea is for Congress to tax state governments instead of individuals and corporations.

I discovered your request near the deadline, so the ideas lack adequate detail. Should the panel request, I could provide more detail or ameliorate specific considerations.

I appreciate the opportunity to offer a new direction to the discussion.

Sincerely,

Gary McGrath

A Tax Reform Proposal

Gary G. McGrath

I. DESCRIPTION

The federal government should not tax individuals or corporations directly. Instead, the federal government should bill state governments at fiscal year end for booked spending. Direct collection of duties and tariffs should continue unchanged.

Congress should:

- continue to impose and collect tariffs and duties;
- repeal all other federal taxes on individuals and corporations;
- tax states for department of defense expenditures apportioned by land area;
- tax states for all other expenditures apportioned by population using the most recent census;
- transmit state tax bills within 30 days of the fiscal year end;
- finalize budgets before the fiscal year start as due notice to states;
and
- not regulate how state governments apportion state taxes.

II. IMPACT

The changes are revenue-neutral to the federal government and greatly simplify its administration. A large displacement of federal workers and eliminating taxing considerations from federal debate would be some of the larger impacts. State governments would see little change as well except for a large change in tax rates, revenues, and a new budget item.

Changes may be much greater for individuals or corporations depending on the tax laws of their state.

Four categories divide the impact of these changes.

i. Simplicity

The budget at the beginning of the fiscal year and the final bill at the end improve the transparency over current practices. State tax bills clarify the burden of federal spending state-by-state. State tax bills also serve to contrast booked spending against the budgeted amounts.

Taxes are simpler and clearer for individuals and corporations, as they would only deal directly with state governments. Individuals will focus on federal spending through one budget with the context of overall spending. Many conflicts, exemptions, and subsidies between the federal and state governments cease.

ii. Fairness

These changes provide for fairness through competition between state governments. States may raise revenues through a variety of taxes: income, capital gains, property, sales, estate, *etc.* Individuals and corporations can evaluate tradeoffs when choosing where to reside.

iii. Economic Growth and Competitiveness

This simpler and more direct tax system will encourage economic growth. Because of the increased tax competition between state governments, taxes become better tailored to their tax base. A more efficient overall tax system will lead to better growth.

iv. Compliance and Administration Costs

Compliance costs for individuals and corporations will go down with the elimination of direct federal taxation. Their compliance costs for state taxes remain the same, but their federal costs discontinue.

Compliance and administration costs for the federal government become minimal. The Social Security Administration already collects its revenues separately and maintains separate income and balance sheets. Risk mitigation costs for fiscal disasters within state governments will offset a minor part of those savings. However, those risk mitigation costs will be direct and visible. For example, the Department of Treasury may need to maintain a larger capital reserve.

While administration costs remain unchanged for state governments, their compliance costs will increase due to an increased incentive for state tax avoidance. It is difficult to estimate the size of that increase.

III. TRANSITION

Although the changes may appear large, the transition is not difficult because state governments already have all of the systems in place. Federal taxation would proceed until the cutover fiscal year start. State governments could plan the best course for changing their tax structure to meet the upcoming tax bill. With new tax structures in place, revenues would be collected all year leading up to the final tax bill from the federal government.

Individuals and corporations would have some time to adjust their practices to the new tax structure. While there may be a large impact on corporations in states where the additional tax burden is placed mostly thereon, such corporations would also find a new level of political influence depending upon their mobility.

U.S. code could remain largely unchanged. Ideally, most taxation code would be eliminated and the 16th amendment to the Constitution repealed. Additionally, repealing the 17th amendment would provide for more accountability to state governments and thereby their constituents.