The United States Senate Committee on Finance

Here are 10 suggested guidelines for improving federal taxes. Sometimes, following one guideline can conflict with another. In such cases, reasonable compromise is required. Some suggestions would be politically impossible by themselves, but combined they may be doable.

1) Do not tax anyone based on the first $20,000 of annual income.
2) Simplify the outrageously complicated tax rules, and strictly enforce the new rules.
3) Avoid taxing gains due to inflation (a significant portion of long term capital gains).
4) Stop tax class welfare and warfare - tax everyone on the same basis.
5) Mitigate tax change chaos.
6) Quit using the tax code to pick industry winners and losers.
7) Treat dividend payments just like interest expense for corporate tax purposes.
8) Tax dividend and interest income just like earned income.
9) Set corporate tax rates at rates competitive with the rest of the world.
10) Avoid taxing persons twice based on the same income.

Some specific recommended changes under those guidelines are:

1) (Guidelines 1, 2, 4 & 8) Start the employee Social Security and Medicare (SS&M) tax at $20,001 of income, but tax all types of income (earned income, dividends, interest, capital gains, social security, pensions, annuities, etc.) at 15.3%.

I prefer no employer portion of SS&M, but would require employers to increase employee's gross wages by 7.65% of the first $118,500. The current system just conceals the source of the cost, and employers should be indifferent to whether they pay the government or the employees 7.65% of the first $118,500. This could also be used to replace the earned income credit for low income taxpayers by giving them a 15.3% raise on the first $20,000. But this may be a chaotic and politically impossible change.

In any case, an employer would not start withholding and paying SS&M until an employee is paid a cumulative $20,000 in each year. Then withhold and pay at the flat SS&M rates. Payroll and accounting systems can easily handle this. Employers with seasonal temporary workers will like it, and so will the temporary workers. Increase the top limit for SS&M taxes from $118,500 to $300,000 of taxable income.

Start at $20,001 because it is: a) easy to remember; b) above an individual's poverty level; and c) avoids taxing retiree's living only on Social Security. End at $300,000 because that is where I would recommend starting the highest income tax rate thus avoiding a cost cliff or step up at that point. Providing SS&M Tax on an additional $181,500 and on all types of taxable income should replace the loss of revenue on everyone's first $20,000.

Leave the SS benefits at current levels. Don't try to give the persons earning over $118,500 a higher level of benefits. This is a compromise on guideline 4 causing the high earners to subsidize the low earners. But that's already happening in a less obvious manner. Individuals who worked a full 45+ years paying in the maximum for most of those years are not likely to live long enough to collect it all back with a reasonable 4% to 5% interest rate of return. However, if those individuals are married to a spouse that never worked, the couple will easily collect more than they paid with interest. Also individuals that earned an average income during their career should recover their SS payments with interest in less than ten years, just as they now do. The additional amounts will be paid from the higher earner's tax payments.

2) (Guidelines 1, 2 & 4) Eliminate personal exemptions and itemized deductions for Individual Income Taxes and increase the standard deductions to $20,000 ($40,000 for joint returns) for everyone.

This eliminates many complexities and detailed record keeping issues including: a) 2% floor on miscellaneous itemized deductions; b) 7.5% medical threshold; c) election of either state income or sales tax deduction; d) limitations on interest deductions; e) 30%/50% limitations on charitable contributions; f)

80% reduction of deductions; g) exemptions in divorces and unconventional families; and h) misguided or fraudulent deductions.

Each of the deductions had a reasonable justification when instituted, but the multitude of incremental changes over the years has created a counterproductive mess. We may have a once in a lifetime opportunity to correct it. Eliminating the mortgage interest deduction will create opposition from home owners, but recent lower interest rates and stagnant real estate markets should reduce that opposition. The mortgage interest deduction was a contributing factor to home owners over mortgaging their homes during the past 15 years. The increased standard deduction combined with the above changes to Social Security taxes reduces the impact for most homeowners.

Religions and charities will object to the elimination of deductions, but it will simplify their record keeping and reporting. Many taxpayers now spend hours documenting donations, then take a standard deduction anyway, and high income taxpayers do not currently receive the full benefit of charitable deductions due to the 80% reduction of deductions. If other deductions were eliminated, hardly anyone would qualify for this itemized deduction. The unlimited charitable deduction for estate taxes should be retained.

States and cities will object to eliminating individual deductions for state and local taxes. But, a person's federal income tax should not depend on where they live. All state and local taxes and fees contribute to their revenue, and help pay for their services. However, all are not currently equally deductible for federal taxes.

3) (Guidelines 2, 3, 4 and 8) Revise the individual income tax rate schedule. Exclude 50% of Social Security benefits and long term capital gains from taxable income based on the logic that they are about half return of capital and inflation. End the 3.8% Additional Tax on Net Investment Income and 0.9% Additional Medicare Rate on high income taxpayers and the Alternative Minimum Tax.

Suggested individual tax rates on taxable income (after $20,000 standard deduction and including all forms of income):

SS&M	Tax rate	Single filers			Married filing jointly		
15.3%	10%	$ -	to	$ 10,000	$ -	to	$ 20,000
15.3%	15%	$ 10,001	to	$ 30,000	$ 20,001	to	$ 60,000
15.3%	20%	$ 30,001	to	$ 55,000	$ 60,001	to	$ 100,000
15.3%	25%	$ 55,001	to	$ 90,000	$ 100,001	to	$ 150,000
15.3%	30%	$ 90,001	to	$ 150,000	$ 150,001	to	$ 250,000
15.3%	35%	$ 150,001	to	$ 300,000	$ 250,001	to	$ 425,000
2.9%	40%	$ 300,001	to	∞	$ 425,001	to	∞

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This should result in about the same tax revenue than the current system. But it would be more straightforward and simple to plan, estimate, report, collect and enforce.

4) (Guidelines 2, 5 & 6) Allow businesses and corporations to immediately write off (expense) capital additions of fixed assets other than land. Eliminate most of the business tax credits.

In a transition period, allow continued depreciation of existing assets with remaining lives of up to 10 years under current rules. For existing assets with more than 10 years of depreciation remaining, depreciate over 10 years straight line. Sale of a fixed asset will result in taxable income for the amount of the proceeds. Transfer of a fixed asset to a facility in another country will result in US taxable income for the fair value of the asset transferred.

This will encourage the return of manufacturing to the US a lot more than the 9% deduction for domestic production activities. It will promote US economic growth more than all the credits and special deductions that have been lobbied into the tax code. Businesses will like this, but will object to the loss of the many complex deductions and credits to be eliminated. We must do both together or we will just make matters worse.

Depreciation only causes a timing difference for taxes, but the IRS, businesses and their accountants spend millions of hours analyzing and arguing over depreciation rates and repair expenses. If the business paid for the asset, the cash was spent and I would allow them to deduct it as an expense like section 179 property. This would eliminate section 179 and many other sections of the tax code.

Suggested business deductions to eliminate include: a) domestic production activities; b) small refiners' deduction for upgrades to produce low sulfur fuels; and c) new refinery property deduction. Suggested business credits to eliminate include: a) investment tax credit; b) alcohol fuels credit; c) increased research expenditures credit; d) low income housing credit; e) renewable electricity production credit; f) railroad track maintenance credit; g) biodiesel fuels credit; h) advanced nuclear power facilities credit i) energy efficient appliance credit; and j) carbon dioxide capture credit.

These deductions and credits are to benefit specific industries or are totally replaced by the immediate expensing of fixed assets.

5) (Guidelines 7, 8 &10) Dividends paid from retained earnings of a corporation should be a business expense of the corporation for income tax purposes and ordinary income for the recipients. Dividends paid from paid in capital after retained earnings are exhausted are non- taxable return of capital and neither corporate expense or income to recipients.

Corporate debt and equity are very similar to the corporation from an economic standpoint. The current tax deductibility of interest has contributed to many corporations becoming highly leveraged which have resulted in liquidity bankruptcies for some companies.

6) (Guideline 9) Reduce the maximum corporate income tax rate from 35% to at least 30%.

Most other countries are only at 25% for corporate income taxes, but many of those countries also have a value added tax. Therefor the US does not necessarily have to match their 25% to be competitive, but 35% is not competitive and state income tax make it even less competitive. When corporations evaluate where to produce products this is a factor.

Our current policies are driving American jobs overseas. A lower US rate would also make it less irrational to repatriate foreign earnings to the US. Companies are currently redeploying foreign earnings overseas because they would pay a 10% penalty to use it in the US.

A competitive corporate tax rate would increase the US economy and mitigate the flow of jobs from the US to other countries.

Respectfully submitted,

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