TOEWS & MURPHY, INC.

March 12, 2015

Senate Finance Committee
Hon. Orrin Hatch
Hon. Ron Wyden

Re: Tax Reform

Dear Senators:

I am writing this as a tax lawyer with over 30 years' experience in advising clients on tax matters. I hold a specialty certificate in tax from the State Bar of California and am also a member of the New York Bar (inactive). The practice of my firm is devoted primarily to advising closely held businesses and on estate planning for business owners.

The Internal Revenue Code has become an embarrassment both because of its complexity and because of its unfairness, requiring in many cases individuals of modest means who earn their income to pay tax at higher rates than others with huge incomes (e.g., hedge fund managers). Here are some modest suggestions for reform:

1. The tax base should be broadened by eliminating all itemized deductions except perhaps for charitable contributions. The standard deduction or an exemption equivalent should be placed at a level where anyone who is at some modest multiple of the poverty line pays no tax.
2. The Code should also be cleansed of many other provisions (e.g., percentage depletion, clean energy bonds) that attempt to subsidize behavior that somebody in Washington thinks is beneficial. Fundamentally, the Code should be about collecting revenue, not choosing winners and losers.
3. Payroll taxes for Medicare and Social Security should be abolished because they are regressive and unfair, allowing taxpayers who do not need to work for a living to pay less tax than those who do. The same revenues should be built into the rate schedule for income tax. Among other things this would eliminate the need for tax planning designed to avoid payroll and self-employment taxes.[1]
4. The treatment of capital gains should be changed to both promote growth and restore fairness. The best approach would be to either exempt or apply a reduced rate to capital gains that are reinvested and treat any gains that are not reinvested in the same way as other income.[2] This approach would promote growth because it would allow investors to sell underperforming investments and put their money

[1] Such as, for example, labeling payments to owners as rents or royalties instead of salaries and using S corporations that pay low salaries to owners.
[2] This is allowed in a limited way under current law for assets owned through Individual Retirement Accounts, with the difference that current income on these accounts is tax deferred.

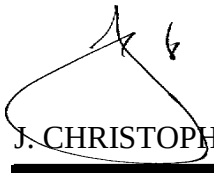
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in better ones with no or minimal tax burden.[3] At the same time, proceeds of capital transactions used to support a lifestyle would be taxed in the same way as ordinary income.

5. The income tax should not apply to U.S. citizens who are *bona fide* foreign residents.[4] As a former expatriate worker I personally saw companies recruit Canadians and Europeans for jobs that Americans should have gotten because they were cheaper – the employer did not have to reimburse these others for taxes, whereas tax reimbursement was part of the standard expat package for Americans.
6. The estate tax should be left where it is. Present exemptions are large enough to make it a non-problem for most taxpayers and the present rate is low enough so that it is not a serious problem even for the very wealthy.[5] You should be extremely skeptical of claims that this tax forces sales of family farms and businesses as in my entire practice I have never seen a single such case. Family businesses and farms are sold because the children of the founders either can't or won't run them or because of disputes between family members, not because of taxes.
7. All of the above changes should be structured in such a way as to be revenue neutral. The committee should explicitly disown the practice, advocated by Americans for Tax Reform and others, of using changes in the tax laws to force changes in government policy which they deem desirable. Government policies should be determined on their merits and should dictate revenue levels, not the other way around.

Sincerely,

TOEWS & MURPHY, INC.



J. CHRISTOPHER TOEWS
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[3] Under current law there are some limited provisions that allow investors to exchange some investments for others – e.g., section 1031. Also, capital gains may be avoided by other means, e.g., charitable remainder trusts or estate plan provisions that are designed to trigger inclusion of the assets in the taxable estate of the owner. The reform I suggest would eliminate the need for elaborate tax planning in this area.

[4] There is a limited exclusion for earned income under current law. However, this exclusion is insufficient to cover amounts paid even to middle management staff because of taxable benefits they receive, such as school tuition for children, housing and tax reimbursement.

[5] In fact, because the top rate of 40% is lower than the effective income tax rate in some states, planners are currently advising clients with very low-basis assets not to transfer them because paying the estate tax will be less expensive than paying capital gains tax on gifted assets.