Tax Reform: Is it Realistic?

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INTRODUCTION

The rhetoric which has surfaced during the most recent presidential process could wear down the most ardent follower of the process. The gridlock which has polarized the political scene is recent years has rarely been more apparent. Interestingly, there is one proposal, tax reform, which has surfaced on both sides of the political spectrum. Since it is politician's mantra to seek to address issues about which voters are most dissatisfied, the fact that all candidates are calling for tax reform during the last two election cycles strongly suggests that this is an area of general dissatisfaction. This paper will look at some of the proposals, provide a background for our present taxing system, and offer some opinions as to the feasibility of making significant change to the present system.

BACKGROUND

If the underlying cause for these proposals is economic stimulus and parity, then it should be specified whether the calls for reform address corporate or personal taxes or both. The United States corporate income tax rate, a combination of both federal and state, is one of the highest among members of the Organization for Economic Cooperation and Development (OECD), which comprises the world's industrialized nations. At the same time, however, US corporate tax revenue as a percentage of GDP is well below the OECD average, in part because our tax code is full of deductions, credits and exemptions. In addition, the United States is one of only a handful of countries that tries to tax multinational companies on their foreign earnings while allowing them to avoid these taxes by keeping these profits overseas. While the primary purpose of any country's tax code is to raise sufficient revenues to fund government expenditures, it would be assumed that this process should not be detrimental to the country's economic business model.

Personal tax reform is no less complex and confusing. Anyone filing more than a Form 1040EZ faces a plethora of forms, regulations and requirements so complex that most surrender and seek professional help. Options to address this complexity include using commercial electronic filing packages such as Turbotax or hiring other professionals tax preparers like H & R Block or accountants and tax lawyers specializing in tax return preparation. The Internal Revenue Code even allows a deduction for the cost of preparing a tax return by allowing it as a business expense for businesses and as an itemized deduction for individuals. Ignoring the inequity of the overall tax system, the Internal Revenue Code has become so complex that it can only be managed and interpreted by those who can afford to pay "experts" to chart their course through the tax maze. As outlined, it is relatively easy to make a case for tax reform at both the corporate and personal levels. Before looking at the myriad reform proposals, however, it is important to have some understanding of how the present tax structure arose.

U.S. TAX HISTORY

As Benjamin Franklin said in his letter to Jean-Baptiste Leroy back in 1789 "in this world nothing can be said to be certain, except death and taxes." Little did Benjamin Franklin contemplate that in spite of the absolute certainty of taxation, the actual methodology and goals of the taxation system are anything but certain.

Income taxes were first constitutionally protected by the addition of the Sixteenth amendment to the United States Constitution in 1913. Prior to this amendment direct taxation was permitted by Article I of the United States Constitution (in particular Sections 2, 8 and 9). The Constitution provided that any direct taxes had to be apportioned among the various states based on the census data gathered and must be uniformly applied. Thus, while the concept of taxation has been with us since the country's origins, the taxes assessed were either a direct tax on property or were a capitation tax, the most common of which was the poll tax.

Prior to 1913, Congress had only imposed a direct tax on income during the civil war[i] and again thirty years later in 1894 when Congress imposed a 2% tax on any income in excess of $4,000.[ii] The assessment of income taxes in 1894 was constitutionally challenged on the basis that direct taxation was not allowed. The United States Supreme Court agreed with the assertion and held in the landmark case of *Pollock v. Farmers' Loan & Trust Co*.[iii] that the taxes collected had to be apportioned according to the Constitution to the states based on the census. The Court concluded that as the taxes were collected on income on various property (including salary, dividends, interest, rents, etc.) that the income must be apportioned.

As stated in *Penn Mutual Indemnity Co. V. Commissioner*[iv], "[*Pollock*] only held that a tax on the income derived from real or personal property was so close to a tax on that property that it could not be imposed without apportionment." As this proved to be administratively unfeasible, the Supreme Court ruled, in a divided opinion, that this form of taxation was unconstitutional.

In the intervening years from *Pollock* until the passage of the Sixteenth Amendment, there were various attempts to continue some form of taxation by such means as revenue stamps,[v] a war revenue tax on tobacco,[vi] and an inheritance tax.[vii] An expansion of excise taxes and tariffs was used in an attempt to collect revenue from the nation's taxpayers. Congress decided to allow a direct form of taxation by passage of a constitutional amendment. The amendment was originally proposed by President William Howard Taft and was ratified by Congress on July 12, 1909. It was approved by a two-thirds vote of the states with Delaware pushing the amendment over the constitutional top on February 13, 1913.

The Sixteenth Amendment provides:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

With the passage of this amendment, the limitation of direct taxes and the required apportionment was over and the federal government was entitled to tax all income from all sources with only minor exceptions.[viii]

The tax code has evolved since that time where the United States Supreme Court stated, "Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax."[ix] This congressional authority has resulted in what is arguably one of the most complex tax systems in the world.

TAXING METHODS

As defined in Black's Law Dictionary, tax is "a pecuniary burden laid upon individuals or property to support the government."[x] Taxation comes in many forms such as the traditional income taxes on individuals and businesses. Taxation also incurs in many forms of add-on taxes such as excise taxes and sales taxes.

In 1913, the first constitutional income tax was assessed. The 1913 Revenue Act assessed all married taxpayers who made over $4,000 ($3,000 for a single individual) a normal one percent tax. In addition to this tax, there were six additional brackets with a maximum marginal tax rate of seven percent (1% normal rate plus an additional tax of up to 6% on all income over $500,000.)[xi] Other than the exemption of income, there were no other offsets or deductions allowed. Since 1913, the income tax brackets have been expanded and contracted on numerous occasions. From 1932 to 1935 there were 55 tax brackets and there have been more than 24 separate brackets for a total 49 years since 1913. At the opposite end of the spectrum, there were only two brackets from 1988 until 1991. The marginal income tax bracket has varied from a low of 7% from 1913-1916 (modern low was the 28% from 1988 to 1991) with the highest marginal rate being 94% in 1944 and 1945. The inclusion of these brackets and marginal rates have provided Congress with a constant source of adjustment and manipulation to allow the desired tax impact to be achieved.

ECONOMIC TAX THEORIES

There are three primary economic theories related to the impact of taxation on the individual taxpayer. The **progressive** tax system is based on taxing income at a higher marginal rate as the income of the taxpayer increases. Thus, the more income one makes the more their tax burden would be. This format is reflected in the tax tables used for calculation of individual and corporate taxation. As will be discussed later, while the tables represent a true progressive tax, the determination of net income prevents this system from being a true progressive tax.

The second theory is the **regressive** format of income taxation. In other words, the tax stays the same irrespective of the level of income. As a person generates more income, the tax rate represents a lesser burden. The most common demonstration of this is the sales tax. Whether a person earns $10,000 or $100,000, a $500 purchase with a 5% sales tax still results in a tax burden of $25 for each. However, this tax has a greater economic impact on the person making $10,000, since this tax represents a greater portion of his income, even though the tax is identical for both parties. Many states have attempted to reduce this regressive nature by exempting food, pharmaceuticals and other necessities from the burden of sales tax.

Adam Smith in Book Five of *The Wealth of Nations*[xii] described the impact of both the regressive nature of taxation as well as the need for a progressive form of taxation by stating:

> The necessaries of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be anything very unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion.

Smith highlights the primary thrust of regressive tax in that the poor spend a disproportionate share of their earnings on food, shelter and other necessities than the wealthier individuals. His general conclusion is that the rich should contribute a greater portion of their income to keep the government functional.

The third economic approach is the **proportional** tax. This tax rate is static but the amount to be taxed increases. In other words, the burden each taxpayer pays is calculated in the same ratio as their property bears to the total of property to be taxed. The higher your value, the higher your tax bill, but all taxpayers are taxed at an equal tax rate. Most excise taxes fit this description. For example tax on the use of diesel remains .244 per gallon for 2011 but this number is taxed by the number of gallons used.[xiii] So the tax is the same within its class, but as the volume of diesel increases so does the tax burden. Another example would be the assessment of real estate taxes. The mileage remains the same but as the value increases so does the tax amount.

THE UNITED STATES TAX SYSTEM

The United States tax system utilizes a hybrid format which applies various elements of the progressive, regressive and proportional approaches. In certain circumstances, the tax application may be a hybrid format on the same tax. For example, payroll taxes are assessed on the first $110,100 of earned income. The first wage earned has an assessment of 7.65% (currently 5.65% for the employee) and this continues in a regressive format until the upper limit is achieved. For an employee in the lower salary ranges the tax operates as a regressive tax in that this employee will have fewer dollars to consume while paying the same proportionate tax as the higher salaried employee.

When the $110,100 salary level is achieved, 4.2 percent (currently as compared to the traditional 6.2%) is no longer taxed and, for all amounts above this level, the employee retains the additional 4.2 percent. At that point, the assessment drops to 1.45 percent for all income thereafter. This tax is a proportional tax but, once the tax reaches the upper limit, it becomes a regressive tax. A person with a salary of $1,000,000 pays the same social security tax as is paid for a person making $110,100. So even though this regressive nature is at a higher rate, there is still a regressive nature to this tax.

The United States tax system professes to adopt a progressive taxation format as it pertains to the assessment of income taxes, estate taxes and gift taxation. All of these forms of taxation utilize a rate schedule with the tax rate increasing as the amount to be taxed increases. The facts suggest however that ours is not a true progressive tax system due to the existence of various tax incentives.

TAX INCENTIVES

Most tax incentives are designed to encourage taxpayers to undertake certain activities that they would not necessarily be normally inclined to do. (Sometimes the tax incentive is to encourage a taxpayer not to take some action.) By rewarding this behavior by either allowing a special deduction or an allowance of a tax credit, the federal government can encourage certain resulting investment and/or social behavior. The granting of tax incentives is not a revenue raising activity. Instead, such incentives redirect what would be normal government resources into other areas in which the government does not wish to have to directly fund. These incentives are a waiver of normal tax rules and allow the government to direct the types of activity to be accomplished.

Social Consideration – As noted, the Internal Revenue Code (IRC) provides tax incentives to encourage investment in areas that the government believes should be funded by the general public rather than by the government. Probably the best example of this lies in the area of charitable giving. From a purely economic view, there is no rational reason to exempt the taxation of charitable organizations.[xiv]

Almost all charities have the same goal as any for-profit organization; namely to accomplish their stated mission by maximizing revenue and minimizing expenses. Such charities may in fact be as well-organized and efficiently run as any Fortune 500 organization. The Internal Revenue Code[xv] specifies however that, if certain "charitable" goals (religious, charitable, scientific, testing for public safety, literary, or educational purposes, to foster national or international amateur sports competition, to promote the arts, or for the prevention of cruelty to children or animals) are achieved, then the entity will not be taxed on its gross receipts. There is an exception when the organization enters into direct competition with a for-profit organization.[xvi] The overall structure is such that charitable organizations pay no taxes on their primary fundraising activities. Therefore, the government does not receive any form of direct taxes from charitable organizations.

The government further compounds this loss of revenue by allowing individual taxpayers several advantageous tax deductions for making contributions to these charitable organizations. For example, Section 170 of the Internal Revenue Code allows a deduction for most contributions to a qualified Section 501(c)3 organization.

In addition to allowing this tax deduction for direct contributions, the government offers a further tax incentive if a donation of stock or tangible personal property (used by the charity for the two year period) is made to a charitable organization. The taxpayer receives a fair market value deduction rather than the original tax cost of the donor. As a result of this, the appreciation difference between the taxpayer's basis and the fair market value also escapes taxation. This form of donation has resulted in substantial tax benefits to both Ted Turner and Bill and Melinda Gates when they donated stocks in their respective organizations to charitable foundations.

The government does not tax the revenue and additionally allows a deduction for the same funding, thereby surrendering revenue on both sides of the transaction. If not for the social considerations, there would be no logic reason from a taxing standpoint to enact any of these tax provisions.

Economic Considerations - In the Economic Recovery Act of 1981, depreciation on all fixed assets was substantially modified by the adoption of the Accelerated Cost Recovery System (ACRS – the precursor for MACRS). This tax act changed depreciation from a useful life concept with a salvage life computation to a mid-year convention using a double declining methodology. Perhaps reflective of the times, depreciation on real property was decreased from a normal useful life of 35 to 45 years to a flat 15 years. The committee reports and the underlying congressional debates contained discussions indicating that the reason for the change was that the existing depreciation methods were not able to provide the investment stimuli essential for economic expansion.[xvii]

More recently, Congress adopted the Housing and Economic Recovery Act of 2008[xviii] which granted first-time homeowners a $7,500 interest free loan that could be paid back over fifteen years. In addition, this Act relaxed rules for mortgage lenders and increased the insurance on FHA loans. Less than seven months later, Congress adopted the American Recovery and Reinvestment Act of 2009[xix] (better known as the Stimulus Bill). A portion of this bill allowed first-time homeowners a non-refundable $8,000 credit for the purchase of a new home. While there may have been some slight social considerations (in so far as it was limited to first-time home buyers, the bill encouraged taxpayers that had not made a home purchase to make this purchase) the primary purpose as set out in the House and Senate comments on the Bill was to stimulate the housing market. Thus a tax benefit was granted for the sole reason of spurring the economy.

Once again, there was absolutely no pure tax logic to this transaction since it resulted in a diminution of federal resources.

There are various types of tax incentives including **tax credits and deductions**. The tax credit represents a dollar for dollar reduction of the taxpayer's income tax liability, with some limitations. The deduction is allowed as an offset against the taxpayer's revenue before the tax calculation is made. As stated previously, most of these factors include both social and economic factors so in discussing tax incentives, the distinction is not critical.

Special tax incentives available for businesses include several specialized accounting benefits such as LIFO (and its related cousins). Other business incentives include Section 179, the immediate deduction for research and development costs, specialized accounting in many industries such as the oil and gas business, international tax benefits (including outsourcing and offshore planning) and so on. For a simpler or more flat tax to be considered, every deduction for business would have to be re-evaluated.
Other examples of business tax incentives would include: (Form 3800 General Business Credit lists over 25 different business credits and even this list is not comprehensive):

> Low Income Housing credits (credits paid to encourage investment in low income housing).
> Qualified School Construction credits (helping schools rebuild and repair by the granting of a credit in lieu of interest).
> Work Opportunity credits (tax rebates for those who hire high unemployment groups).
> Renewable Energy credits (credits for investing in alternative energy sources).

This same logic also applies on the state and local tax levels when a government agency agrees to forego taxation (usually on real estate) in exchange for an organization agreeing to locate in their taxing district. These abatements bring in new industry which provides both an economic and social boost but at the cost of tax revenue.

There are numerous other tax incentives in the area of individual taxation including:

> the Earned Income Credit, the American Opportunity Tax Credit (as well as Lifetime Learning and Hope Credits), the Residential Energy Efficient Property Credit, the Alternative Motor Vehicle Credit, the Elderly and Disabled Credit, the Retirement Savings Credit, the Adoption Expenses Credit, the Child Care Credit, the Dependent Care Expense Credit, the First-Time Homebuyers Credit, the Charitable Contribution Deduction, the Mortgage Interest Deduction, Retirement Accounts (SEP, SIMPLE, IRA, ROTH IRA, 401(K), etc.) and the Student Loan Interest Deduction

Many of the credits afforded both businesses and individuals result not only a loss of revenue to the government but may also represent a negative cash flow as the credits may be refundable. The earned income credit for example not only has no taxation benefit, it refunds money to taxpayers that did not originally pay these funds to the government. This is not a waiver of tax but is actually a negative tax. Obviously, this is a form of social welfare because, while it rewards work effort, it is without the controls of food stamps or other forms of direct welfare. Like this credit, several of the other credits and deductions have a "Robin Hood" impact of reallocating resources. In all of these situations, the government's purpose in foregoing tax revenues by extending these tax advantages is to achieve social and/or economic goals that help implement public policy.

Another type of tax incentive is the **stealth tax**. These arise when any act creates an additional tax burden without being included in an actual tax law or, alternatively, tax change included in a Congressional bill that fails to note that it results in a tax increase only to a certain class of taxpayers.

The most obvious example under the current tax structure is the alternative minimum tax. Inflation has always created a form of stealth tax but as tax rates, deductions and other indices are now indexed, this form of stealth tax has been minimized (it has not been totally removed as the factors used for inflation adjustment do not always adjust to the actual inflation impact). As inflation caused an eroding of the amount of consumable funds, the tax rate remaining static caused taxpayers to suffer an effective tax increase even though their income remained the same. The alternative minimum tax rate has not been indexed and so many middle income taxpayers are now being taxed under the alternative minimum tax for the first time. They have been "stealthed".

Stealth taxes can also include movement of particular funds, such as gasoline taxes collected from a road and highway fund, to a general fund. Additional stealth taxes would include the fact that a married couple with two qualifying children can receive a tax credit equal to $2,000, whereas a married couple with no children receives no credit, resulting in a tax bill which is $2,000 higher.

The stealth tax is not limited to just the lower brackets. There are many situations where there is a phase out of a taxable deduction based on income limitations. Some of the phase-outs would include the child credit, excess itemized deductions, personal exemptions, IRA deductions, etc. that are phased out for higher earning individuals. These tax adjustments were not recognized as a tax increase.

Another form of tax incentives are **penalty taxes.** They exist to illicit certain behavior from businesses or individuals. Sometimes these taxes are assessed to curb consumption (such as limiting harmful emissions) or, alternatively, to help pay a social penalty for the potential harm that comes from certain types of behavior. Examples would include taxes on alcohol, tobacco, gasoline, and luxury items. These taxes garner an additional assessment over just a pure sales tax.

Traditionally, the thinking on this would be that the tax would be progressive in nature; however, quite often the actual application has a tendency to be more regressive. In addition, some of these taxes may miss their mark. If there is a luxury tax on a boat and the buyer will not buy because of the additional tax, the wealthy individual electing not to make the purchase does not suffer the loss of taxes, but the seller of the boat is the one suffering the loss of sale. So not only does the government not collect the revenue of the penalty tax, but the economy is negatively impacted as the sale did not occur.

CANDIDATES' APPROACH

As discussed, the United States tax system utilizes a hybrid format which applies various elements of the progressive, regressive and proportional approach to tax collection coupled with the many forms of tax incentives. That this system would be perceived as inequitable and extremely complex would appear obvious. In difficult economic times, it is also easy to see why those running for political office would see this as an area ripe for inciting the electorate and providing a cause behind which followers can rally.

What is significant in the discussion of any tax reform is how these incentives can be removed to accomplish a more fair application of the taxes or, as some candidates have proposed, a flat tax. A flat tax by definition would have to eliminate all special tax deductions and credits. As can be seen from the above listing of credits, the elimination of these special governmental entitlements may actually fiscally harm the taxpayers calling for the flat tax. Over the past two presidential elections, every candidate has proposed some form of tax reform. We will briefly discuss the primary candidates approach. While this is not intended to be an exhaustive study of the various candidates' tax policy platforms, it is interesting to see the varied approaches in light of the above discussion of existing tax policies.

2012 CANDIDATES

Barack Obama - Obama is the likely Democratic candidate for President and he offers a new proposal for reforming the tax laws. He has repeatedly called for higher taxes for the wealthy, saying:

> Do we want to keep these tax cuts for the wealthiest Americans? Or do we want to keep our investments in everything else – like education and medical research; a strong military and care for our veterans?[xx]
>
> If you make more than $1 million a year, you should not pay less than 30 per cent in taxes.[xxi]

President Obama's web page has very little in the form of information as to his reform plans but did offer the following:[xxii]

> "That's why President Obama proposed the Buffett Rule, asking millionaires and billionaires to pay their fair share of taxes. But if you're one of the 98 percent of American families that make under $250,000 a year, your taxes shouldn't go up."
>
> "The President has called for reforming our tax code and closing tax loopholes for millionaires and billionaires as well as hedge fund managers, private jet owners and oil companies."

Mitt Romney - Romney is a candidate for the Republican nomination for President, and had this to say about tax reform:

> "And that's why I put forward a plan to eliminate the tax on savings for middle income Americans. Anyone making under $200,000 a year, I would eliminate the tax on interest, dividends and capital gains. People need help to be able to save their money."[xxiii]
>
> "I`ll also bring the corporate tax rate down to 25 percent as quickly as possible and then begin a process of reshaping the entire tax code. It's far too complex, it's far too intrusive, it`s far too great."[xxiv]
>
> "I would like to lower the rates, broaden the base, akin to what we saw in the Bowles-Simpson plan, which, by the way, the president commissioned and then simply brushed aside. We need to go back to that, get our rates down, and get a pro-growth tax policy in this country."[xxv]

Romney's additional position on tax reform includes the following:[xxvi]

> "Tax policy shapes almost everything individuals and enterprises do as they participate in the economy. With bad design, tax policy can discourage economic activity. With good design, it can encourage it. Yet our current tax system is an accretion of decades of patchwork decisions that came into being with no systematic thought for their implications for job creation or economic growth. Every year, individual taxpayers are forced to confront a Rube Goldberg contraption of bewildering complexity that leads to a range of undesirable outcomes, including the fact that millions of Americans have to pay hundreds of dollars to have their tax returns prepared by a professional who understands the rules. Corporations, for their part, are subject to rules and regulations that all too often encourage tax gamesmanship while discouraging reinvestment in the American economy."
>
> "We need taxes to pay for the operations of government. But they should be collected by a system that is simple and fair, and that causes the least possible disruption to the productive economy

Rick Santorum - Santorum is a candidate for the Republican nomination for President, and said this at the Republican debate in Florida:

> "That`s why I proposed in my tax plan -- and I talk about five areas where I allow deductions -- well, one of them would be, be able to deduct losses from the sale of your home."[xxvii]

His other suggestions for tax reform a can be summarized as follows:[xxviii]

> •Cut and simplify personal income taxes by cutting the number of tax rates to just two - 10% and 28% and return to Reagan era pro-growth tax rate;
> •Simplify the tax code and reduce middle income taxes by eliminating the Alternative Minimum Tax (AMT);
> •Lower the Capital Gains and Dividend tax rates to 12% to spur economic growth and investment;
> •Reduce taxes for families by tripling the personal deduction for each child;
> •Reduce and simplify taxes for families by eliminating marriage tax penalties throughout the federal tax code;
> •Retain deductions for charitable giving, home mortgage interest, healthcare, retirement savings, and children;
> •Cut the corporate income tax rate in half to make our businesses competitive around the world, from 35% to 17.5%;
> •Eliminate the corporate income tax for manufacturers to spur middle income job creation in the United States and benefit from the job multiplier effect in manufacturing;
> •Increase the Research & Development Tax Credit from 14% to 20% and make it permanent to spur on innovation in America;
> •Eliminate the tax on repatriated taxable corporate income invested for manufacturers equipment investment, 5.25% corporate tax rate on other repatriated income invested in the USA, and 100% expensing for new business equipment;

Newt Gingrich - Gingrich is also a candidate for the Republican nomination for President, and has expressed his view on tax reform, as follows:

> "I have in my tax proposal an alternative flat tax on the Hong Kong model, where you get to choose what you want, and our rate`s 15 percent. So I`m prepared to describe my 15 percent flat tax as the Mitt Romney flat tax. I`d like to bring everybody else down to Mitt`s rate, not try to bring him up to some other rate."[xxix]
>
> "Well, if that -- and if you created enough jobs doing that -- it was Alan Greenspan who first said the best rate, if you want to create jobs for capital gains, is zero. My number-one goal is to create a maximum number of jobs

> to put the American people back to work. It`s a straightforward argument."[xxx]
>
> "So get the regulations out of the way, get the tax incentives right, and you can get back to creating an amazing number of jobs very fast."[xxxi]

He has additionally added the following to his tax reform proposals:[xxxii]

> "Stop the 2013 tax increases to promote stability in the economy. Job creation improved after Congress extended tax relief for two years in December. We should make the rates permanent."
>
> "Eliminating the capital gains tax to make American entrepreneurs more competitive against those in other countries; Dramatically reducing the corporate income tax (among highest in the world) to 12.5%; Allowing for 100% expensing of new equipment to spur innovation and American manufacturing; Ending the death tax permanently."

Ron Paul - Paul is a candidate for the Republican nomination for President, and while not making any comments about tax reform during the Republican debate in Florida,[xxxiii] has stated his tax reforms opinions as follows:[xxxiv]

> As President, Ron Paul will support a Liberty Amendment to the Constitution to abolish the income and death taxes. And he will be proud to be the one who finally turns off the lights at the IRS for good.
>
> Capital gains taxes, which punish you for success (and interfere with your efforts to hedge against inflation by purchasing gold and silver coins), should also be immediately repealed.
>
> Struggling college students and those working to support their families would be greatly benefited and receive an immediate pay raise by eliminating taxes on tips.
>
> While a Flat Tax or a Fair Tax would each be a better alternative to the income tax system, Congressman Paul believes we would have to guarantee the 16th Amendment is repealed to avoid having both the income tax and one of these systems as an additional tax.

TAX REFORM FEASIBILITY

While reforming of the tax code is conceptually a very difficult proposition, every politician running for a significant elected position has called for a restructuring of the Internal Revenue Code and more equality in the taxing system. From George H. Bush's famous "read my lips, no new taxes" to subsequent promises, the proposals have been numerous and varied. Given the complete lack of unanimity in any of the proposals, it is reasonable to question whether they are serious proposals or just an effort to appeal to a generally dissatisfied electorate. Is it possible that there are simply too many hidden factors in the Internal Revenue Code that have to be considered before any meaningful restructuring can occur? As discussed, the history of our tax system and the social and economic considerations must also be considered in formulating an approach to equality in taxation.

This task becomes all the more daunting when considering that even the underpinnings of the process have become blurred. The advent of the "refundable tax credit" has created a social welfare payment disguised as a tax refund. With the earned income credit, the American Opportunity credit, child care credit, and other credits, some taxpayers actually get money from the government that they did not pay in. This has helped to foster resentment throughout as the wealthy believe that the lower income taxpayers are not only not paying taxes but are being subsidized by the government with tax dollars from the wealthy. The lower income taxpayers who are struggling to maintain a job, mortgage payments and accelerated health care costs believe that the wealthy are not paying their fair share of taxes. Ironically, based on the regressive and progressive hybrid nature of the United States Internal Revenue Code, both sides have a point.

One study shows that 47 percent of those who file a federal tax return pay not one penny of federal tax (probably better said, they receive a full refund of all taxes paid). The concept of "horizontal equity," where those with similar incomes ought to pay roughly the same taxes, is gone. With the allowance of special deductions and credits, a married couple with exactly the same gross income can have a totally different tax result with offsets for children, charitable contributions, mortgage interest, capital gains, educational expenses, health insurance costs, retirement plan options (401(k) or IRA). Inequity abounds.

To illustrate the complexity of the tax return process, in 2011 the Internal Revenue Service estimated that the average taxpayer needed 23 hours to prepare his Form 1040. This number escalated to 32 hours if the return had a Schedule C or E. Additionally, it was estimated that taxpayers spent over 7.6 billion hours and more than 193 billion dollars to comply with the Internal Revenue Code. These costs represent the deadweight costs of not only compliance but also the necessary tax planning for the compliance.[xxxv] Further statistics from this article states that over 60 percent of all taxpayers now pay to have their return prepared. This could be caused by the 3,500 tax law modifications since 2000 and an Internal Revenue Code (now over 72,000 pages) that is now seven times wordier than the Bible.[xxxvi] [xxxvii]

In order to achieve a flat tax system or tax system with fewer options, the government must find alternative methods to encourage social or economic behavior. Only when the social and economic tax incentives are removed can meaningful tax policy be accomplished. Tax incentives have a tendency to either fall within social considerations or economic considerations. Sometimes the incentive can fit easily within both groups. Those seeking to bring about significant tax reform would have to evaluate whether their plan would take on every vested interest simultaneously. It would be a simple matter for those opposed to elimination of mortgage interest to join with those wishing to maintain charitable contributions that have also joined with those protecting retirement deductions to present a formidable block against any significant change.

CONCLUSION

Does our present tax system need to be revised? Do we want a tax code that encourages or discourages economic and social behavior; a system whereby it is possible for Mitt Romney to earn a total 20.9 million dollars in 2011 and pay an effective tax rate of 15.4%; a system that requires some level of understanding of an Internal Revenue Code that exceeds 72,000 pages (this does not count regulations and other interpretations); a system that requires billions of hours in preparation time and billions of dollars of deadweight costs; a system in which almost half of the individuals earning income pay no tax at all? The answer would appear to be obvious and, were the facts better understood, probably universally agreed upon. Unfortunately, identification of the inequities is the easy part. As we have shown, everyone has an idea and there is little if any unanimity of approach. It is the methodology of removing the special interest which distinguishes the various plans, however, nobody is suggesting that all special interests be eliminated. The 9-9-9 plan called for by Herman Caine, the former Republican presidential candidate, might have done this however the candidate, when pushed, backed off with regard to certain social tax incentives. If prior history is to be believed, any attempt to remove "favored deductions" results in all sorts of protests and gnashing of teeth, including a fair amount of correspondence to their various legislative bodies. For there to be meaningful tax reform, the entire structure must be revisited or the class warfare that the present system engenders is likely to expand.

For all the reasons enumerated including a host of obvious inequities, the case can be made for a flat tax or some sort of major tax reform which would eliminate the social tax incentives. Unfortunately, it is hard to envision a Congress that would remove all social and economic factors from the Internal Revenue Code to accomplish a logical format of taxation without all of the rules, regulations, and interpretations under any circumstances. In an election year, the odds of this happening become infinitesimal. For that matter, it is equally difficult to believe that the majority of the electorate would approve of such a drastic revision when faced with the loss of some favored tax treatment which practically everyone receives in some form. Thus, we conclude that significant tax reform, while desirable, is probably going to be relegated to the campaign rhetoric category.

[i] Ch.173, Sec. 116, 13 Stat. 223, 281 (1864)

[ii] Ch.349, Sec. 27, 28 Stat. 509, 553 (1894). Sometimes known as the Wilson-Gorman tariff

[iii] 157 U.S. 429 (1895); 158 U.S. 601 (1895) . (It should be noted that this case is the case that most tax protesters rely on to state that income taxes are unconstitutional.)

[iv] 277 F.2d 16, (3rd Cir. 1960)

[v] *Nicol v. Ames*, 173 US 509, 19 S. Ct. 522, 43 L. Ed. 786 (1899)

[vi] *Patton v. Brady*, 184 US 608, 22 S. Ct. 493, 46 L. Ed. 713 (1902)

[vii] *Knowlton V. Moore*, 178 US 41, 20 S. Ct. 747, 44 L. Ed. 969 (1900)

[viii] State municipal interest being one such exemption.

[ix] Helvering V. Independent Life Ins. Co., 292 U.S. 371, 381 (1934)

[x] Black's Law Dictionary, p. 1628 (4th ed. 1968).

[xi] Revenue Act of 1913, Section II, B., 38 Stat. 114, 167.

[xii] Adam Smith, An Inquiry into the Nature And Causes of the Wealth of Nations (1776). Book V, Chapter 2, Article I: Taxes upon the Rent of House.

[xiii] Form 720 – Quarterly Federal Excise Tax Return

[xiv] Please note this article is not about separation of church and state. The discussion is purely a tax discussion of a possible revenue source.

[xv] 26 U.S.C. § 501(c)3.

[xvi] 26 U.S.C. § 511 (unrelated business Income)

[xvii] Economic Recovery Act of 1981, Acts Section 201

[xviii] Public Law 110-289, enacted July 30, 2008

[xix] Public Law 111-5, enacted February 17, 2009

[xx] President Obama in the 2012 State of Union Address on January 24, 2012

[xxi] President Obama in the 2012 State of Union Address on January 24, 2012

[xxii] http://www.barackobama.com/record/taxes?source=issues-nav

[xxiii] Republican Debate held in Tampa Florida on January 23, 2012

[xxiv] Republican Debate held in Tampa Florida on January 23, 2012

[xxv] Republican Debate held in Tampa Florida on January 23, 2012

[xxvi] https://mittromney.com/issues/tax

[xxvii] Republican Debate held in Tampa Florida on January 23, 2012

[xxviii] http://www.ricksantorum.com/defender-taxpayer

[xxix] Republican Debate held in Tampa Florida on January 23, 2012

[xxx] Republican Debate held in Tampa Florida on January 23, 2012

[xxxi] Republican Debate held in Tampa Florida on January 23, 2012

[xxxii] http://www.newt.org/solutions/jobs-economy

[xxxiii] Republican Debate held in Tampa Florida on January 23, 2012

[xxxiv] http://www.ronpaul2012.com/the-issues/taxes/

[xxxv] Deadweight costs being costs that add no economic benefit. Obviously, the cost of tax return preparation and the resultant tax planning, while conferring economic benefit for the person having the work performed, does not confer any economic benefit to society as a whole.

[xxxvi] MSN Money article by Jeff Schnepper published on December 13, 2011

[xxxvii] CBS Money Watch article by Kathy Kristof on January 4, 2010.