

Submission on April 29, 2005

to the

President's Advisory Panel on Federal Tax Reform

by

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Individually

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THE SIMPLIFIED INCOME TAX

The **Simplified Income Tax** calls for the elimination of most tax credits and many deductions. Like the flat tax, it seeks to broaden the tax base. Unlike the flat tax, however, the **Simplified Income Tax** maintains the progressive tax system of the United States wherein people pay taxes based upon their ability. Congress will no longer be allowed to use smoke and mirrors to hide tax increases as it has done with the phase-outs of exemptions and credits. Taxation will be straight-forward and honest. The guidelines for a **Simplified Income Tax** are as follows:

1. **ELIMINATE ALL DOUBLE TAXATION**
2. **ELIMINATE THE ALTERNATIVE MINIMUM TAX**
3. **ELIMINATE ALL "SOCIAL ENGINEERING" CREDITS**
4. **ELIMINATE ALL PHASE-OUTS OF DEDUCTIONS/EXEMPTIONS**
5. **ELIMINATE UNNECESSARY COMPLEXITIES AND SPECIAL RULES**
6. **ALLOW ALL DEDUCTIONS RELATING TO PRODUCING INCOME**
7. **SIMPLIFY THE PENSION RULES**
8. **SIMPLIFY AND/OR ELIMINATE OTHER DEDUCTIONS**

Clarification of the eight points above can be found in my 1998 submission to the 1998 Congressional Small Business Summit, which can be found at the end of this text.

The Advisory Panel has requested the impact of my proposal on the eight areas set forth below. The impact, as I see it, is as follows:

1. The Tax Base:

Income would continue to be the tax base.

2. Exemptions, deductions, credits and exclusions

Credits would be reduced dramatically.

I have no opinion about the handling of exemptions, other than to eliminate the complexity of a phase-out. (A phase-out of an exemption is merely a higher tax rate on income earned throughout the phase-out range. I think Congress should be more honest about tax increases by merely setting the rate and not hiding tax rate increases through phase-outs).

As to deductions, all phase-outs regarding deductions should be eliminated. And, social engineering deductions (e.g. college tuition credits, deductions and savings plans) should be eliminated altogether. Rather, support for college should be provided by increasing direct aid, increasing loan availability, and rewarding those saving for college rather than penalize them (as is done now by the financial aid system). Many colleges reduced financial aid packages dollar for dollar when students and their families received the benefit of the tuition credits.

3. Tax Rates

The tax rate should continue to be progressive and should be set so that the number of "winners" and "losers" is minimized. Overall, the impact of the simplified income tax should lower the tax rates in order to raise the same amount of revenue. However, due to the elimination of phase-outs, the tax rate (although not the tax) will likely be higher for those with the highest income.

4. Distribution of the Tax Burden

See item #3. The tax burden should not change if the rates are properly set.

5. Treatment of Charitable Giving

The impact depends on whether the itemized deduction for charitable contributions is retained. I believe that it should be to a large extent. However, there is much abuse in this area that needs to be examined and considered.

6. Home ownership

Since the Simplified Income Tax calls for the retention of the mortgage interest deduction, we believe there would be a slight negative impact on home ownership due to the expectation of lower tax rates.

7. Collection Methods

Since the computation of income will be dramatically simpler, the collection of taxes should be easier.

8. Treatment of Business

Business will be treated more fairly in that all legitimate costs of doing business will be allowable as deductions. However, some businesses receiving targeted "social engineering" tax credits will realize increases in their tax liability. Note, that many "shelters" based on arcane credits will go out of business.

I believe that the impact of the proposal, relative to the current system will be that it is simpler, fairer, will reduce the cost of both compliance and administration, and will have a positive impact on growth and competitiveness.

PREPARED BY E. MARTIN DAVIDOFF

FOR CONSIDERATION BY THE

1998 CONGRESSIONAL SMALL BUSINESS SUMMIT

THE SIMPLIFIED INCOME TAX

The **Simplified Income Tax** calls for the elimination of most tax credits and many deductions. Like the flat tax, it seeks to broaden the tax base. Unlike the flat tax, however, the **Simplified Income Tax** maintains the progressive tax system of the United States wherein people pay taxes based upon their ability. Congress will no longer be allowed to use smoke and mirrors to hide tax increases as it has done with the phase-outs of exemptions and credits. Taxation will be straight-forward and honest. The guidelines for a **Simplified Income Tax** are as follows:

1. **ELIMINATE ALL DOUBLE TAXATION**

Effectively, this would eliminate the estate tax and taxes on dividends.

2. **ELIMINATE THE ALTERNATIVE MINIMUM TAX**

3. **ELIMINATE ALL "SOCIAL ENGINEERING" CREDITS**

4. **ELIMINATE ALL PHASE-OUTS OF DEDUCTIONS/EXEMPTIONS**

Such phase-outs are, in effect, hidden tax increases on those with income above the phase-out levels.

5. **ELIMINATE UNNECESSARY COMPLEXITIES AND SPECIAL RULES**

Through 1997, the safe harbor for high-income taxpayers was 110% of the prior year tax. The 1998 threshold was decreased to 100% and the threshold for the three years 1999 through 2001 was increased to 105%. In 2001 the threshold goes to 112% and in 2002 and all future years the threshold goes back to 110% ... unbelievable complexity for minor shifts in the timing of tax payments. The tax code is also filled with thousands of provisions that are intended to assist one specific taxpayer. Such legislation should be prohibited.

6. **ALLOW ALL DEDUCTIONS RELATING TO PRODUCING INCOME**

All deductions related to the production of income should be allowed. Accordingly, 100% of meals and entertainment should be allowed if such expenditures are appropriate for the conduct of the business. The 2% floor related to business expenses of individuals should be eliminated and medical insurance deductions should be allowed in full as business expenses (for both FICA and income tax purposes) to all those who conduct their business as self-employed individuals, partners, or as owners of S Corporations.

7. **SIMPLIFY THE PENSION RULES**

Existing legislation has a plethora of rules relating to pension and profit sharing plans. Large corporations put away hundreds of thousands of dollars per year for their corporate executives while many in America are limited to \$2,000 IRA deductions. The **Simplified Income Tax** will both eliminate this inequity and provide simplified rules with respect to pension deductions (or the elimination thereof).

8. **SIMPLIFY AND/OR ELIMINATE OTHER DEDUCTIONS**

Supporters of the **Simplified Income Tax** call for the retention of the mortgage interest deduction and the deduction for interest expenses incurred to produce income. However, we believe that other itemized deductions should be carefully examined to determine whether they can and should be simplified and/or eliminated. Once the initial structure is achieved and implemented into law, no new deductions should be added to the new tax code without a Congressional supermajority.

THE SIMPLIFIED INCOME TAX

In making the determination of what type of new tax system to support, keep in mind the following facts:

- approximately 9% of the population generates 39% of the nation's income* and pays 59% of the individual income taxes. Beneath this highest level, the next 19% of taxpayers earn 29% of the income and pay 24% of the taxes. It becomes clear that the biggest winners in the elimination of a progressive income tax system will be the 9% of the population that currently pays 59% of the taxes ... those best able to afford it. The **Simplified Income Tax** eliminates the current tax system's complexity while maintaining the benefits of a progressive tax system.

*based upon adjusted gross income reported to the Internal Revenue Service

THE PROBLEM WITH CONSUMPTION-BASED TAXES

Both the national sales tax and the purest form of a flat tax (which will not tax investment or savings) are consumption taxes. The impact is that those who consume the highest percentage of their income, bear the largest tax burden. It is clear that those in the middle class consume a higher percentage of their income than the very rich. Accordingly, those in the middle class will pay a higher percentage of their income in taxes than the very rich under the proposed consumption-based taxes. Not only is this not a progressive tax, it becomes a regressive tax ... those least able to pay, paying the highest percentage of their income in tax.

In addition to placing an unfair burden of taxation, consumption taxes threaten the strength of our economy. No one can fairly predict the drag on our economy of a 15% to 20% consumption tax. Frankly, the supporters of the **Simplified Income Tax** are not willing to put at risk our healthy economy in the name of tax simplicity. We support the alternative which eliminates the bulk of the current tax law's complexity while retaining a progressive tax system based upon one's ability to pay. Quoting a Wall Street Journal article of October 23, 1997 included in our materials:

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“in 20 of 21 developed countries that tried sales taxes, they didn’t work because people found ways to avoid paying them. In desperation, governments in those countries then turned to a value-added tax, which blackmails business into doing the collecting for the government. A combination of the VAT and the income tax ... has killed jobs in Europe.”

For further information about the **Simplified Income Tax**, contact:

Americans For “Tax Equity Now!”

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Most important, a SIMPLIFIED INCOME TAX will provide:

TAX EQUITY NOW!

For All Americans