

PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM

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April 25, 2005

The President's Advisory Panel
on Federal Tax Reform
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Dear Sirs:

I enclose for your consideration my proposal for the complete overhaul of the federal income tax which was published in 1995 in the tax periodical, "Tax Notes".

The individual income tax simplification proposal, set forth on pages 866 to 868, would provide for tax rates of five to fifteen percent, no tax on capital gains and, for those not engaged in an unincorporated business, no tax returns at all. For the years I examined, it produced tax revenues comparable to those under then existing tax law (see pp. 867-868).

Very truly yours,

David Sachs



VARIATIONS ON A THEME BY DICK ARMEY — A FRAMEWORK FOR REAL TAX SIMPLIFICATION

by David Sachs

I. Introduction

Pleas for simplification of the federal income tax laws have been prevalent for many years, even during times when tax laws were considerably less complex than they are now.¹ The annual massive "reforms" and revisions of the Internal Revenue Code over the past 20 years, interspersed with comparably intricate technical corrections, have resulted in a broad-based recognition, by government officials as well as tax practitioners and educators, of the need for simplification.² Nevertheless, tax legislation continues to generate greater complexity almost on an annual basis. Until 1994, serious suggestions for simplification of the income tax focused merely on identifying and improving the most acute problem areas, such as penalties³ and pensions.⁴ Simultaneously, much attention has been addressed to issues such as revision of Subchapter C (governing corporate reorganizations) and integration of corporate and personal income taxation. In both areas, current law, while far from perfect, is relatively well-known and adequate. There is little doubt that any revision of Subchapter C or integration will introduce

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In this article, Sachs reviews the flat tax proposal offered by Rep. Richard Arme, R-Texas, and presents his variation on that proposal. The two main concepts embodied in Sachs's proposal are (1) to tax corporations and other business interests on their book income, preferably without adjustment, and (2) to tax individuals mainly by a withholding system imposed on the principal classes of income. Sachs argues that his proposal merely expands the application of concepts that Congress has adopted in the past, and utilizes data and procedures that are well-established and readily available with relatively little modification.

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¹E.g., Paul, "Simplification of Federal Tax Laws," 29 *Cornell L. Q.* 285 (1944); Surrey, "Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail," 34 *Law & Contemp. Probs.* 673 (1969); Bittker, "Tax Reform and Tax Simplification," 29 *U. Miami L. Rev.* 1 (1974).

²For example, an invitational conference on "Reduction of Income Tax Complexity" ("simplification" was apparently viewed as an oxymoron), sponsored by the Section of Taxation of the ABA and the Tax Division of the AICPA on January 11 and 12, 1990, included as speakers a stellar roster of 38 current and former government officials, economists, tax practitioners, and tax educators and a participating audience of approximately 185 "conferees." See AICPA/ABA, *Proceedings of the Invitational Conference on Reduction of Income Tax Complexity* (hereinafter "Proceedings"), II-B-1 through II-B-3, II-C-1 through II-C-12 (1990). No tax law changes resulted from this conference.

³Title VII, Subtitle G (sections 7701-7743) of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. No. 101-239) revamped the complex and sometimes conflicting civil penalty provisions.

⁴N.Y. State Bar Ass'n, Special Comm. on Pension Simplification, "A Process Awry: A Call for Simplification and Rationalization of the Federal Pension Laws," 8 *Am. J. Tax Pol'y* 75 (1989).

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greater complexity, at least in the sense of requiring application of many new concepts.

At the risk of oversimplifying the causes of the seemingly inexorable trend toward complexity, it is suggested that this trend is attributable to a convenient synthesis of the pragmatic need for constantly increasing federal revenues with the theoretical doctrine that the purpose of the income tax is to tax "correct" economic income and the corollary notion that "correct" economic income is susceptible of statutory definition if one tries hard enough.⁵ As long as these two factors continue to control the structure of the income tax law, complexity will continue to be unavoidable, all good intentions to the contrary notwithstanding. And since there is no realistic possibility that the need for increasing revenue will dissipate, it is the concept that "correct" economic income must be taxed that must be modified to achieve real simplification. It is submitted that the purpose of the income tax today should not be to tax "correct" income, but rather to allocate in a relatively simple and reasonably fair manner part of the costs of government among the persons and entities that the government benefits. If one can accept this proposition, it follows that it should not matter whether all items of income are precisely determined and taxed, provided that the overall tax allocation is reasonable and as simple as practicable, though perhaps not perfect.

II. The Arme y Flat Tax Proposal

On June 16, 1994, Rep. Richard Arme y, R-Texas, introduced H R 4585,⁶ the "Freedom and Fairness Restoration Act of 1994." The bill provides for both income tax simplification and severe spending restraints on the federal government.

The tax portion of the bill is indeed simple.⁷ For individuals, it provides for taxation *only* of earned income (retaining the current exclusion of foreign earned income) at the rate of 20 percent for the first two years and 17 percent thereafter. There are standard deductions ranging from \$12,350 for separate filers to \$24,700 for joint returns. Dependents qualify for \$5,000 deductions. These deductions are indexed for inflation. Withholding taxes on wages are repealed. Arme y visualizes a postcard-sized individual income tax return.

For businesses (regardless of form of organization), there is imposed a tax on the business at the same 20-percent rate, reducing to 17 percent after two years. The tax base is gross income, excluding investment income, less three deductions: business inputs, com-

pensation of employees and costs of tangible personal and real property. Business inputs are defined as costs of goods, services, and materials determined on a cash accounting basis (disregarding inventories) and travel and entertainment expenses. If deductions exceed income, the excess, increased by an interest rate factor equal to the year-end three-month Treasury Bill rate, may be carried over to the succeeding year.

Since 1994 was a major congressional election year, the Arme y proposal, put forth by the chair of the House Republican Conference, inevitably became caught up in the intense pre-election political battles. Conservative commentators lauded the flat-tax proposal,⁸ Democrats condemned it, referring only to the individual income tax portion. The business tax proposal was virtually ignored, presumably because it was not of relevance to the average voter.

Supporters of the Arme y bill contended that it would promote saving, capital investment, and employment. The principal substantive criticisms of the individual income tax portion of the bill were that it would produce too great a reduction in revenue and too much benefit for higher-income individuals, especially the "coupon clippers." Putting partisan considerations aside, there is still some merit in these objections. They are addressed and remedied in the proposals presented below.

The principal vice of the Arme y business tax proposal is that it retains, though in a changed format, the current requirement that businesses compute taxable income under a different regime from what they use for normal accounting purposes. It exacerbates this problem by establishing a new set of taxable-income-determining definitions that, no doubt, will lead to years of litigation over their application to the myriad types of business enterprises. These difficulties are also addressed and remedied in the following proposals.

III. Variations on the Arme y Theme — Summary

In keeping with the foregoing precepts, it is proposed that the federal income tax be revised (1) to tax corporations and other business interests on their book income, preferably without adjustment, and (2) to tax individuals mainly by a withholding system imposed on the principal classes of income.

These proposals will be discussed in greater detail below. However, it is not the intention of this commentary to provide an all-inclusive plan for complete implementation of the suggested tax structure. Obviously, considerable further study will be necessary, particularly with respect to categories of persons that are now subject to special tax regimes, such as insurance companies, cooperatives, and tax-exempt entities. Procedural provisions will have to be carefully examined.

⁵For brief discussions of the impact on tax legislation of the so-called Haig-Simons economists' definition of income, see Hickman, Comment on "The Role of the Treasury Department in Reducing Tax Complexity," Proceedings, I-E-1, I-E-3; McLure, "The Budget Process and Tax Simplification/Complication," *id.* I-A-1, I-A-12 through I-A-13.

⁶103d Cong., 2d Sess. (1994).

⁷The tax portion of the bill occupies only about 6 of its 50 pages; the remaining 44 pages deal with the spending restraints. The latter provisions are outside the scope of this commentary.

⁸In New Jersey the Republican candidate for the Senate, Garabed Haytaian, running against incumbent Frank Lautenberg, included a slightly modified version of the Arme y proposal as a major plank in his platform. Haytaian lost the election.

to determine whether there should be additions, deletions, or modifications.

IV. Corporations

A. Significance of Book Income

The book income of corporations (as disclosed by their financial statements) is relied on by government regulators, shareholders, prospective investors, lenders, and other interested persons for virtually all purposes except taxation. Certified financial statements are generally considered adequate to meet the rigorous disclosure requirements of the securities laws. While not all financial statements are certified, they are accepted as valid bases for evaluating corporate performance, although they may not state economic income "correctly." They should also be acceptable as a means of allocating corporate income tax liabilities. For this purpose, book income does not need to be absolutely correct, but only reasonably comparable on a relative basis. In other words, is it not reasonable for a corporation with book income of \$10,000,000 to pay five times the tax of one with book income of \$2,000,000?

Is it not reasonable for a corporation with book income of \$10,000,000 to pay five times the tax of one with book income of \$2,000,000?

There is no inherent reason why this format would not be as fair as the current taxing system. For a short while (1987-89), book income (50 percent thereof) was utilized as one of the measures of corporate alternative minimum tax.⁹ Criticism of that element of the AMT centered on the additional complexity resulting from the addition of a third alternative basis for taxation¹⁰ and transitional problems.¹¹ My proposal, of course, does not involve any alternative bases but rather adopts the basic, existing financial records as the corporate tax base. Transitional issues are unlikely to arise because the new system, in not seeking to define "correct" income, can accommodate some short-run duplications or omissions.

B. Evaluation of the Proposal

It is unclear whether the aggregate tax base under the proposed corporate tax system would differ substantially from the current tax base. In 1994, the Internal Revenue Service reported aggregate corporate taxable income of \$366.4 billion in 1990, and \$350 billion in 1991.¹² For the same two years, the Bureau of Economic Analysis of the Department of Commerce (the

BEA) currently reported respective aggregate corporate profits before tax of \$304.7 billion¹³ and \$334.7 billion,¹⁴ before any adjustments could have been made by reference to tax return data. Thus, assuming that the BEA statistics more closely approximate aggregate book income than do the IRS data, deviation of book income from IRS taxable income (-17 percent in 1990 and -4 percent in 1991) does not appear to be sufficient to justify the retention of a separately defined, exceedingly complex system for calculating income only for tax purposes. Probably all that would be needed is a slight adjustment in the tax rate to compensate for any difference in the tax bases and the identical tax revenues could be produced. Since the major corporations report their book income quarterly, the government would have a more accurate and up-to-date basis for projecting corporate tax revenues than it now has.

It might be argued that financial accounting is biased in favor of balance sheet conservatism (that is, minimizing net assets). Even conceding that, it should not have a significant adverse effect on the relative amounts of reported income. More troublesome is the possibility that corporations will intentionally bias their accounting practices to minimize taxable book income. This problem now exists in the computation of taxable income under the Internal Revenue Code, and it will have to be met with similar deterrents, including IRS audits and penalties. To the extent that certified accounting statements are involved, there would be the added element (not now existing) of the independent review by the certifying accountants.¹⁵ Certification could be encouraged by giving certified financial statements the benefit of favorable presumptions, possibly together with penalties (like the current substantial authority and preparer penalties) for taxpayers and accountants who intentionally deviate from generally accepted accounting principles for the purpose of tax avoidance.

It is recognized that there are varying accounting principles that are viewed as generally acceptable, although the range of acceptable principles is being narrowed.¹⁶ This problem of selective use of favorable accounting principles could be largely ameliorated by imposing, from the outset, a mandatory conformity requirement that would preclude any change in prior accounting for any item without IRS approval. The IRS maintains that it currently has this authority,¹⁷ although there is some judicial precedent to the con-

¹³U.S. Dep't of Commerce, Bureau of Economic Analysis, *Surv. of Current Bus.*, V 71, No. 7, Table 1.14 at 7 (July 1991).

¹⁴U.S. Dep't of Commerce, Bureau of Economic Analysis, *Surv. of Current Bus.*, V 72, No. 7, Table 1.14 at 54 (July 1992).

¹⁵IRS data indicate that \$347.2 billion (94.8 percent) of the \$366.4 billion in taxable income reported in 1990 was earned by corporations with assets of \$1,000,000 or more. IRS, Pub 16, *Statistics of Income*, 1990 Corporation Income Tax Returns, Table 4 at 37 (1993). Such corporations should be able to bear the cost of certified financials.

¹⁶P. Delaney, J. Adler, B. Epstein and M. Foran, *GAAP, Interpretation and Application* 550 (1989).

¹⁷See Treas. reg. section 1.446-1(e)(2).

⁹IRC section 56(f) (1986).

¹⁰Anthony & Dilley, "The Tax Pressure on Financial Reporting," 66 *Taxes* 466, 472 (1988).

¹¹Brown, "Corporate Alternative Minimum Tax," 45 *NYU Ann. Inst. on Fed. Tax'n* 7-1, 7-29 (1987).

¹²IRS, Pub 1136, *SOI Bulletin*, Summer 1994, Fig. 1 at 22 (1994).

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trary.¹⁸ In addition, in the case of public corporations, there would be the countervailing incentive favoring the reporting of increased book income (to say nothing of securities law restraints) to offset any tendency to overutilize accounting principles that reduce income.¹⁹

IRS audit attention would have to be focused on nonpublicly owned corporations, particularly those that have no certified financial statements.

IRS audit attention would have to be focused on nonpublicly owned corporations, particularly those that have no certified financial statements, to confirm that book income is being fairly reported

C. Application of the Proposal

Under my proposal, corporations that are subject to tax at corporate rates²⁰ (i.e., C corporations) would be taxable based upon their income as determined for financial accounting purposes. This would simply be their "bottom-line" net income, adjusted only to eliminate the provision for federal income taxes. The financial statement fiscal year would be used as the taxable year

A number of consequences, mostly self-evident, would follow from this proposal. The income of all consolidated corporations, including foreign subsidiaries, would be taxable. Foreign income taxes would become deductions rather than credits. No other credits would be available. No income would be exempt from tax or subject to special treatment. In other words, dividends from unconsolidated corporations, municipal bond interest²¹ and capital gains would be fully taxable. Conversely, deductions would be available for accrual expenses and liabilities, and the much-debated *General Utilities* doctrine that no gain is taxable to a corporation upon distribution of appreciated property to shareholders would be reinstated. There would be no loss (or other) carryovers or carrybacks, though cumulative corrections of current book income, when appropriate under generally accepted accounting principles, would be taken into account. Consideration would have to be given to the treatment of items that are normally dealt with in footnotes to financial statements, though the presumption would favor disregarding them.

¹⁸E.g., *Gimbel Bros. v. United States*, 535 F.2d 14 (Ct. Cl. 1976); *Beacon Publishing Co. v. Commissioner*, 218 F.2d 697 (10th Cir. 1955).

¹⁹Corporations having assets of \$50 million or more, which are likely to be public corporations, reported 84.3 percent of aggregate corporate taxable income in 1990. See IRS, Pub. 16, *Statistics of Income*, supra note 15.

²⁰IRC section 11 (1986).

²¹The United States Supreme Court has made clear that there is no constitutional impediment to inclusion of municipal bond interest in the tax base. See *South Carolina v. Baker*, 485 U.S. 505, reh'g denied 486 U.S. 1062 (1988).

Corporate structural changes would be nontaxable when book income is not affected (e.g., where pooling is permitted). Amortization of goodwill and negative goodwill would be taken into account. Dividends would continue not to be deductible, thus preserving the distinction between debt and equity. However, recent financial developments suggest that the tendency toward overleveraging may no longer be a serious threat to the tax base. In any event, the book-income proposal would merely perpetuate and not exacerbate this problem.

Foreign corporations engaged in business in the United States would be taxable on the book income of their United States branch or facility, subject, of course, to any treaty restrictions. The treatment of S corporations would continue as at present, except that book income would be allocated to the individual shareholders.

No doubt the exceedingly varied nature of business corporations would in some instances result in what some would consider improper taxation. However, some aberrations of this sort should be deemed an acceptable price to pay for the substantial simplification involved. It would, of course, be possible to "adjust" book income (such as by the exclusion of municipal bond interest) to take care of perceived improprieties either in favor of or against the taxpayer, and the pressure to do so would be great if the system were adopted. But, once started, such adjustments would quickly become the rule, rather than the exception, and the benefit of utilizing book income would be lost. For this reason adjustments would have to be kept to a minimum, and preferably avoided entirely. The new system should be given a test period of at least three years with no or minimum adjustments.

V. Individuals and Passthrough Entities

A. Application of the Proposal

Individuals who are not engaged in business (other than the performance of personal services)²² would be subject to withholding taxes at fixed rates (which in some cases could be graduated) on the following categories of income:

- (1) Compensation, including pensions and compensatory annuities;
- (2) Interest, including original issue discount and the interest element of financial annuities but excluding municipal bond interest;
- (3) Dividends;
- (4) Rents and royalties;
- (5) Alimony; and
- (6) Casino and lottery winnings.

Pass-through entities (partnerships, trusts, and estates) that are not engaged in business would pass through the net balances of such classes of income after

²²Such individuals constituted approximately 80 percent of individual return filers in 1990 and 1991. IRS, Pub. 1304, *Statistics of Income*, 1991 Individual Income Tax Returns, Table A at 2 (1994).

withholding, either by the payer of the income to the pass-through entity or by the entity if, for some reason, the payer has not withheld. The basic concept would be that such pass-through entities would be subject to one level of withholding on the designated classes of income, so it would make no difference whether or not they distributed their income.

As mentioned, withholding on certain categories of income, such as compensation, could be at graduated tax rates. Governmental payments, such as unemployment compensation and Social Security benefits, could be exempted or taxed, as deemed appropriate. Withholding on original issue discount and financial annuities would be applicable to the amounts accruable by the payers as annual deductions for book purposes, whether or not distributed. This would require the payers to make advance payments of the withholding tax in cases where payment of the discount or annuity is deferred, but such advance payment requirement could be taken into account by the payer in establishing the interest rate and other terms of the obligation. Alimony withholding should be designed to pass through proportionately to the recipient the effect of taxes paid on the income of the payer. This could be accomplished by allowing credits on the withholding tax return to be filed by the payer for taxes paid with respect to the portion of the payer's income paid as alimony.

Foreign persons (including corporations) not engaged in business in the United States would likewise be subject to withholding tax on the same categories of income, much as they are under current law and taking treaties into account.

B. Business Income

Individuals, trusts, and estates engaged in business would, in addition to the withholding tax on the designated classes of income, be taxable on a tax return basis and at rates not exceeding corporate rates upon the net book income of the business, including their shares of business income earned through pass-through entities (e.g., partnerships, S corporations). The pass-through entities themselves would continue to be exempt from taxation on business income, but would be required to file information returns reflecting their book income and its allocation among owners, and to withhold on the categories of nonbusiness income subject to withholding if such withholding has not previously occurred. To avoid distortions of normal pass-through-entity business and investment activities, the classes of income subject to withholding (and related expenses) would be excluded from business income of pass-through entities.

Similar treatment would be applicable to foreign individuals and foreign pass-through entities engaged in business in the United States, subject to treaties.

C. General Effect of the Proposal

The effect of these proposals with respect to individuals and pass-through entities would be to eliminate all credits and all deductions not allowable in determining business book income. Capital gain included in business book income would be taxable. Nonbusiness capital gains would not be taxed. Except for possible withholding tax returns, no tax returns

would have to be filed by individuals and pass-through entities that have no business income.

Tax rates could, and probably would, differ with respect to the different classes of income, taking into account fairness and revenue requirements.²³ To the extent rates are graduated on a particular category of income, such as compensation, the effect of joint return or head-of-household rates could be provided.

D. Evaluation of the Proposal

The BEA recently published a reconciliation of its estimates of adjusted gross income compared with adjusted gross income reported by the IRS for the years 1990 and 1991.²⁴ Two significant facts may be gleaned from the BEA study. First, the initial five categories of income designated above for withholding taxation plus business income constituted at least the following percentages of aggregate adjusted gross personal income reported in the study:

	BEA Adj. Gross Income	IRS Adj. Gross Income
1990	95.6%	94.3%
1991	95.8%	94.5%

This indicates that very little income (about 5 percent) would be untaxed under my proposal. Second, the study indicated that there was a noncompliance gap of about 11.6 percent in both 1990 and 1991 between the adjusted gross income reported by the IRS and the reconciled adjusted gross income determined by the BEA. (This gap does not include unreported capital gains or illegal income.) If the gap could be closed by operation of the withholding and book income system, the already small diminution of the personal tax base by my proposal would be more than fully offset.

The following example shows how the proposal might apply to aggregate adjusted gross income, as determined by the BEA for 1991:

Category of Income	Amount of AGI (bill.)	Assumed Tax Rate	Tax (bill.)
Compensation	\$2,793.7	12% ²⁵	\$335.2
Bus. income	343.9	15%	51.6
Dividends	128.3	10%	12.8
Rent	28.2	5%	1.4
Interest	229.8	10%	23.0
Pensions and Annuities	241.4	10%	24.1
Total Tax			\$448.1

²³See example, in part V.D., *infra*.

²⁴U.S. Dep't of Commerce, Bureau of Economic Analysis, Relationship Between Personal Income and Adjusted Gross Income, 1990-91, *Surv. of Current Bus.*, V 73, No. 11 at 68-71 (Nov. 1993).

²⁵The 12-percent assumed tax rate on compensation is an average rate; lower-income individuals would be taxed at a lesser rate and higher-income individuals at a greater rate.

For purposes of comparison, the reported federal receipts from individual income taxes in 1991 was \$448.4 billion.²⁶ If higher or graduated rates were imposed on business income, other rates could be reduced or tax revenues increased, or both. The foregoing comparison, of course, ignores the very substantial reduction in costs to both taxpayers and the government from the proposed simplification.

E. Withholding From Dividends and Interest

It is recognized that there was an unsuccessful attempt in 1982 to impose a 10-percent withholding tax on dividends and interest.²⁷ This tax was repealed in 1983 before it came into effect,²⁸ as a result of an intensive lobbying campaign sponsored by financial institutions that did not wish to undertake the substantial bookkeeping burden (nor, perhaps, to discourage business from customers who may not have been reporting their interest or dividends). However, the publicly stated objection to withholding was the adverse effect withholding would have on the small investors (the "widows and orphans") who would have no ultimate tax liability. Ironically, the repeal was accompanied by elaborate information reporting requirements that were virtually as cumbersome to the financial community and almost as damaging to noncompliance as withholding would have been. Now that the reporting procedure is in place and fully operational, the additional requirement of withholding should not be a significant additional burden to the financial community.

In any event, current data processing systems of both the IRS and private business should be able to cope with the withholding, and should be able to provide an efficiently functioning system for not withholding on persons entitled to exemption by reason of having low income or otherwise. For example, the IRS could adapt its backup withholding procedures²⁹ to certify exemption claims by taxpayers. As a fail-safe, the IRS could also provide a "quickie" refund procedure for improperly withheld funds.

F. Possible Additional Variations

It would be possible to permit or require the filing of returns to provide for certain objectives deemed to be meritorious, such as the allowance of foreign tax credits (or other credits), the application of graduated tax rates to income other than compensation, or the taxation of classes of income not readily susceptible of withholding. The obvious problem with departures such as these from the basic withholding concept is that, like modifications to business book income, they are likely to proliferate to the point where they would defeat the simplification objective. If such proliferation could be avoided, one or two special exceptions (such as the graduated taxation of interest and dividends) could be accommodated.

²⁶IRS, Pub. 1304, *Statistics of Income*, supra note 22.

²⁷Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, sections 301-308 (repealed 1983).

²⁸Interest and Dividend Tax Compliance Act of 1983, Pub. L. No. 98-67, section 102 (1983).

²⁹See IRC section 3406 (1986).

VI. Conclusions

Some may have the instinctive reaction that the proposals presented above represent too fundamental a change in the system for taxing income. But this is not really the case. The proposals merely expand the application of concepts that, as previously noted, have been adopted by Congress in the past. More importantly, they utilize data and procedures (book income and withholding) that are well-established and readily available with relatively little modification. And most importantly, a change in the system is vital to assure continued effective functioning of the voluntary compliance concept.

Another possible approach for evaluating the proposals, commonly used in connection with proposed tax legislation, would be to calculate whether the evaluator is advantaged or disadvantaged by the contemplated change and to support or oppose it accordingly. It is hoped that this testing procedure will not be applied (though it may result in a majority of approvals). Rather, it is suggested that one should consider whether the business community and the general public would view the new system as a significant improvement over the old and at least as fair, if not more fair.

It is submitted that most people would view with approval the allocation of the business tax burden in the manner proposed.

It is submitted that most people would view with approval the allocation of the business tax burden in the manner proposed. Business people are accustomed to relying on financial statements and should be most pleased to have to produce only one income statement and to analyze only one set of financial data in making management decisions. And the general public would probably view book income as less artificial a measure than taxable income (as currently determined).

As for the exclusive reliance on withholding for non-business taxation, this would make it less feasible to graduate the rates of taxation. But if, as seems likely, an acceptable range of rates could be applied to compensation and other rates could be made low enough, the overall arrangement should meet with public endorsement, particularly since for most taxpayers the very costly (both in time and money) annual April 15 ritual would be eliminated. The de facto exemption of unconventional categories of income should not result in any serious distortions since all the principal types of income would be taxed.

The focus of this discussion has been on the simplification benefits to taxpayers. There would also be considerable benefits to the legislative and executive branches of government, in the elimination of periodic (sometimes annual) marathon sessions for tax "reforms" and the resulting need for ever increasing regulation projects, form changes and taxpayer education. Withholding would also reduce collection costs and collection failures. The audit function would have

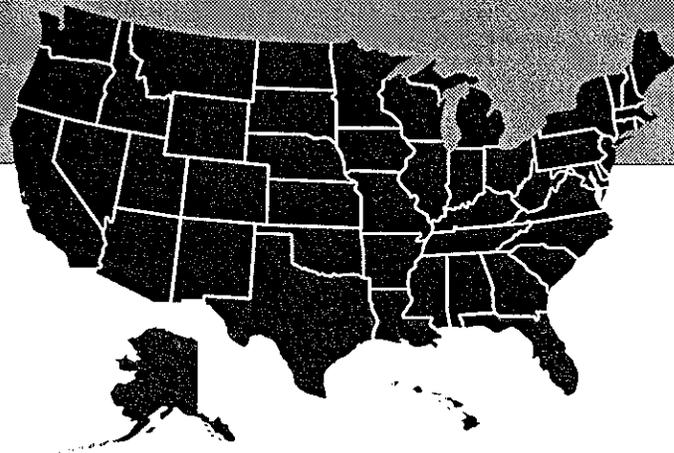
to continue in the business return and withholding compliance areas. The judicial branch of the government might also benefit from a reduced number of tax controversies.

The adoption of these proposals would, of course, also require a revision of the functions of the tax practitioner. Those who are not accountants would have to familiarize themselves with accounting principles (as tax accountants have been required to familiarize themselves with legal concepts). However, the inherent

complexity and variety of taxpayer activities would, no doubt, continue to generate issues requiring expert assistance. Experience has demonstrated that even seemingly elementary forms of taxation, such as stamp taxes and transfer taxes, raise challenging questions.

The principal benefit to be expected from the instant proposals would be the elimination of many (or most) unnecessary complexities that provide merely a marginal benefit or no benefit at all to the ultimate governmental objective of collecting revenue.

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