

his wife. Under current rules, Mr. B will have to include 85 percent of his \$12,000 annual Social Security benefits, or \$10,200, in his taxable income and will pay an additional \$2,784 in federal income taxes.

Mr. A and Mr. B both paid the same amount of Social Security taxes during their careers, but both are not being treated the same by the government when they receive benefits. Mr. A led a more carefree lifestyle and gets to receive his full benefits without owing any tax. Mr. B led a more conservative lifestyle and has to pay \$2,784 in federal taxes to receive the same benefits as Mr. A. Yes it is true that Mr. B has more income to spend in retirement than Mr. A, but why should Mr. B be penalized because he was more conservative with his money than Mr. A? Mr. A and Mr. B are in separate classes of Social Security recipients because of their respective lifestyles and for no other reason. This is not a fair system with respect to Mr. B. This is doubly unfair to Mr. B because he is paying additional taxes on his portfolio income and has paid taxes on his earnings over the past 40 plus years. Mr. B has paid a considerably higher amount of taxes than Mr. A and they earned the same income.

There are things Mr. B can do to reduce his tax burden, such as reinvesting his principal in tax-exempt securities. The same amount of Social Security benefits may be subject to tax because tax-exempt income is counted in the Social Security benefits tax test, but he may be able to reduce most of his tax burden by switching. However, it may not be in Mr. B's best interest to change his portfolio at this stage of his life.

We can see that the current tax system is unfair in the way it taxes different taxpayers on the same type of income based on lifestyle choices. Two individuals who pay the same Social Security taxes during their careers and earn the same amount of income throughout their careers should be treated the same way for tax purposes when they receive their benefits. Taxing them differently may make good politics for a country that has close to a \$5 trillion debt, but taxing Mr. B's Social Security benefits will not solve the budget crises in this country. My fear is that 20 years in the future, when the Social Security trust fund runs out of money, the government may have to resort to a needs test to determine which taxpayers will receive benefits. Under that possible scenario, Mr. A may receive Social Security benefits and Mr. B may not.

That prospect is even more unfair than taxing Mr. B and could contribute toward undermining the entire Social Security system.

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153-94

The U.S. Flat Tax: A Look Back at The First Year

by Richard B. Malamud

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The following was reported in the *Congressional Record*, January 5, 2000.

House Ways and Means Committee, Hearings on H.R. 1, The Technical Corrections Act of 2000, Amending H.R. 1999, The Flat Tax Tax Act of 1999.

The following are the comments made by taxpayers to the Committee:

The testimony of Father Smith of the 107th Street Congregation:

Father Smith: "I would like to thank the Committee for not repealing section 107. Lord knows, it would cost all taxpayers a lot of money if we of the cloth had to pay tax on our parsonage allowance, especially since parishioners can no longer deduct their contributions."

Representative Ginny Rich: "But Father, don't all other taxpayers have to pay tax if their employer provides them with a housing allowance?"

Father Smith: "I don't know. My tax advisor, *Preparation of Tax Returns by the Clergy* by So Low Taxes Press, states: 'As everyone knows, housing allowances are exempt from taxation.' I always thought everyone got the same deal."

The testimony of Mr. Arnie Cost, President, Divided Chest Charities:

Mr. Cost: "According to our economist, charitable giving should be reduced by over 20 percent with the repeal of section 170. Couldn't we have an above-the-line deduction for charitable deductions like we once did?"

Representative Charity B. Quest: "There is no longer a line. Just a simple post card for the flat tax. If we had to put a line on the card, we would have to go to an 8½ by 11 inch form. Do you realize the implications? Look at the additional paper that would be required. The environmental movement would be so upset. What about the envelope? Do you realize that every envelope the IRS has to open costs taxpayers an additional 5.375 cents?¹ Thus, the cost of 75,000,000 full-page tax returns would increase compliance costs by over \$4,000,000. Don't you want to help reduce the deficit?"

¹For purposes of this article, any costs or other estimates, such as the number of tax returns filed by mail, that are stated as facts, bear no relationship to actual costs. Any such relationship is purely accidental and a marvelous guess by the author. All amounts are quoted strictly for purposes of illustration (and hopefully comedy).

Mr. Cost: "Sure I do, but isn't there a happy medium? Maybe we could allow charitable contributions by way of a cafeteria plan or as an offset from a section 401(k) plan."

Committee Chair Richard Navey: "Point of information. The Commissioner of Internal Revenue, Denise Jones, is present. Ms. Jones, does the FTTA (Flat Tax Tax Act) contain a section 401(k)?"

Ms. Jones: "It does not. All of the old pension provisions have been repealed and pension plans frozen. Instead, the FTTA simplified the pension area by establishing the Super IRAs, or 'SIRs' as they are now called and the Monthly Advanced Donations for future Actuary Money, or 'MADAMs.' I think that is the closest thing to the old IRAs and cafeteria plans.

As the Committee is aware, a SIR is simply a money purchase pension plan whereas a MADAM is a defined benefit plan. I just don't see how a SIR or MADAM can help with charitable contributions. I hope that answers your question."

The Chair: "So do I. Thank you both for helping our committee deal with this serious and compelling issue."

The testimony of Postmaster General Walley Postage:

Mr. Postage: "Our budget committee has determined that the FTTA will result in a net loss of \$332,550,000 for the Postal Service. Please see Exhibit One on the board. Could you possibly add a \$1.50 surtax to each return and forward that amount to the USPS to offset our loss? How about a checkoff, just like the presidential election campaign contribution (now \$10) that has been retained?"

Exhibit One

90,000,000 ² federal corporate, partnership, and individual returns, average cost of mailing \$1.25 (\$112,000,000).	
65,000,000 state returns, averaging \$1.75 (113,750,000).	
Mailing of returns by CPAs to their clients, 40,000,000, average cost of \$2.95 (118,000,000).	
Less additional revenue. Post card revenue on 90,000,000 cards at \$0.30 each (\$2,700,000), plus letters sent by CPAs and tax attorneys inquiring about jobs, 10,000,000 letters, average cost of \$0.85 (\$8,500,000).	
Lost revenues:	
Federal returns	\$112,000,000
State returns	113,750,000
CPA mailing	118,000,000
Revenue increases:	
Post cards	(2,700,000)
Job applications	(8,500,000)
Total lost revenue	\$342,550,000

²Of course there probably aren't that many tax returns filed by mail. Many tax returns are filed by electronic transfer. Thus, the phone companies may also be the monetary victim of the flat tax.

Mr. Henry Frankley, a 102-year-old employee of the Frankley Corp.: "As you may be aware, I have lived in the 1800s, the 1900s, and now in the 21st century. When I was a young boy, there were no income taxes. Then the Sixteenth Amendment was passed. Beginning on March 1, 1914, my 1913 income was subject to tax at the then outrageous rates of 2 percent all the way up to 6 percent on taxable income over \$500,000. We thought those rates were high and we were told by our representatives that tax rates would never rise, but taxes kept rising. I remember during one of the wars, taxes reached 90 percent or more. Even as recently as 1980, the highest marginal tax rate was 70 percent on taxable income that exceeded \$108,300 for single and \$215,400 for joint returns. Luckily, by 1982 the maximum tax rate was reduced to 50 percent for taxable income that exceeded \$41,500 for single and \$85,600 for joint returns. Then in 1988, a revolution occurred. Rates were reduced to a maximum marginal tax rate of 28 percent for taxable income of \$89,560 for single and \$149,250 joint returns, if you don't take into consideration the 5-percent bubble and the exemption phase-out. Then, rates went back up to 39.6 percent on incomes of over \$260,000 for single and joint returns. Effective this week, Congress has passed a flat tax with a rate of 20 percent. I ask you, will that rate be changed in my lifetime and what guarantee will you give to my great-grandchildren that the 20-percent rate will not be increased during their lifetimes?"

Representative Hal F. Truth: "Sir, I am glad you asked that question. As you are aware, we hope to keep the tax rate at a flat 20 percent and even drop the rate in the future. I can guarantee you that during your actuarially calculated life expectancy (of 2.3 years) as determined under regulation section 1.72-9, there will be no increase in the tax rate. As for increasing the tax rate during your great-grandchildren's lifetime, unfortunately as the Chair of the Legislative Organization's Transportation Subcommittee of Building Urban Landfills ('LOTS of BUL'), I must leave this committee to chair that subcommittee. I hope one of my fellow representatives can answer your question."

Chair Richard Navey: "There being no representatives who wish to address the taxpayer's question, we will hear from the next witness."

Ms. Jane Kohn-Stern: "As a senior citizen, I feel that the present flat tax is unfair. What happened to my additional standard deduction for being 65? What happened to my over-55-years-of-age exclusion of \$125,000 on the sale of my principal residence, and why can't I write off the cost of my health insurance co-payments?"

Mr. Home Owner: "I wish to express similar concerns to those of Ms. Stern. This flat tax is very family unfriendly. Under prior law, I could deduct the property taxes and interest on my principal residence and on one vacation home. By eliminating the property tax deduction and eliminating the interest deduction on my two homes, my federal income tax will actually go up since my taxable income will increase substantially. Moreover, living in California my taxes will skyrocket under the new law since our state's income tax of almost 10 percent is no longer deductible. Neither is my

COMMENTARY / VIEWPOINT

property tax, state disability payments, or the license on my car and boat. Don't you realize what you are doing to my kids? I may have to sell our vacation home. That is definitively family unfriendly."

Representative Simp A. Thee: "As the witnesses are aware, there is no perfect system of taxation. Under the Internal Revenue Code of 1986, there was a marriage penalty for some taxpayers. Capital gains were often taxed at lower rates than the salaries of hard-working Americans and 85 percent of senior citizens' Social Security benefits was subject to tax at up to a 39.6-percent tax rate, an effective rate of 33.66 percent. Many of those problems have been cured. Sure, there are still some problems, but let me assure you, we never intended to penalize senior citizens or families."

Mr. B.N. Counter, representing the Organization of Tax Compliance Practitioners: "I have just finished editing our latest continuing education course, the 875-page book *The FTTA of 1999; Everything Accountants and Attorneys Need To Know*. I would like to verify several things with you prior to publication. Can taxpayers still deduct their union dues, the cost of preparing their tax returns, or the losses resulting from a casualty such as an earthquake or fire? Is it true that capital gains are no longer subject to income tax? If an employee receives a stock option subject to a substantial risk of forfeiture, if an election is made under section 81(a), formerly section 83(b), is the income realized at the time of sale exempt from taxation as capital gain income? As for ISO income, is that salary subject to tax or capital gain income exempt from tax? What about receipts from a pension plan, are they taxable? Finally, do taxpayers continue to receive deductions for section 1231 losses on the sale of depreciable property used in their trade or business and are they allowed to exclude from taxation the section 1231 gains since they are treated as long-term capital gains?"

Treasury Official Mr. Bill D. Bum: "In answer to your questions, no, no, no, yes, no, yes, and no depending on how long you held the ISO, yes, yes and maybe. The reason for the maybe is that as the Committee is aware, sections 1221-1222 were repealed. Thus, the reference in section 1231(a)(1) to long-term gains must be corrected in this technical correction. I hope that answers your extremely insightful questions."

Our final witness is Mr. John J. Johnson, of the Left-Right-Centrist Coalition: "I understand that under the flat tax law, if I make \$100,000 above the new section

63(h) standard exemption, zero bracket, filing status, family member dependent, age and sight impaired allowance amount, my federal income tax is \$20,000, or a 20-percent tax rate. If my neighbor earns \$1,000,000 over the SEZBFSFMDASI allowance, her tax is \$200,000, or 20 percent. That seems to be a very regressive tax. Why should I pay the same rate as a millionaire? I don't mind paying my share of taxes, but I should not pay the same rate as *those* citizens!"

Representative Thee: "Your point is understood by this member of the Committee. I am therefore proposing that we add several brackets to the flat tax rate, thus creating the Modified Flat Tax. The rates would be 15 percent for taxable income under \$25,000, 20 percent for those with incomes over \$25,000 but under \$75,000, and 25 percent for the rich."

Mr. Johnson: "That certainly would not be fair. Why should I be classified as one of the rich? I work hard, and with just over \$100,000 of flat tax income, I am just a humble, middle-income taxpayer. Maybe if you raise the 20-percent bracket to those with taxable incomes of over \$100,000, that would be fair."

The Meeting was adjourned at noon.

The following was reported in the *Congressional Record*, January 6, 2000.

House Ways and Means Committee, Hearings on H.R. 1, The Technical Corrections Act of 2000, Amending H.R. 1999, The Flat Tax Act of 1999. The meeting was called to order at 9:00 A.M.

Committee Chair Richard Navey: "Based on the evidence heard by this Committee, the following bill is proposed":

"H.R. 1, The Technical Corrections Act of 2000.

"Act Section 1: Repeal of H.R. 1999, The Flat Tax Act of 1999.

(a) The Flat Tax Act of 1999 is repealed retroactive to January 1, 2000,

(b) The Internal Revenue Code of 1986, as amended, is renamed The Flat Tax Substitute Revenue Code of 2000.

"All in favor, vote Aye.

"There appears to be unanimous agreement.

"Next Tuesday, this Committee will begin hearings on H.R. 2, the National Income Tax, Paid Involuntarily by Consumers (Nit Pic)."

The Meeting was adjourned at 9:01 A.M.

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156-94