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A SMART AND SIMPLE TAX

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A Smart and Simple Tax

by William John Cox

The burden of taxation in the United States has been shifted from those who most benefit from our government to those who work the hardest and earn the least. This shrugging of responsibility is not only unfair, it fails to accomplish public policy goals required to move the economy out of recession and the environment out of crisis.

Uncorrected, the heavy burden of taxation borne by workers and small businesses today for the benefit of corporations and the wealthy elite will certainly lead to chaos and violence tomorrow.

It is time to discard our stupid and complex system of taxation and replace it with a smart and simple tax that balances the burden of taxation with the benefits of government.

How It Happened

Commencing in 1817, Congress eliminated all internal taxes and funded the government by tariffs on imported goods. Tariffs increased the cost of goods imported from outside the country, and were primarily paid by the wealthy and larger businesses. Laborers, farmers, and small business owners paid little or no taxes because the goods they consumed were primarily manufactured in the U.S.

Enforced by a new Internal Revenue Service, Congress passed an income tax during the Civil War along with sales, excise and inheritance taxes. The income tax was progressive in that those who earned less than $10,000 only paid 3%, while those who earned more were taxed at a higher rate.

Congress eliminated the income tax in 1868, and although it later flirted with taxing income, the government mainly relied on tariffs and an internal tax on tobacco and liquor for support. The U.S. Supreme Court ruled in 1896 that taxes on income violated the Constitution, since they were not apportioned among the states.

The Sixteenth Amendment in 1913 allowed Congress to tax the incomes of both individuals and corporations. Taxes continued to increase over the years, and with the introduction of payroll withholding in 1943, most Americans were forced to pay a tax on their incomes.

Initially, the wealthy and corporations were taxed more heavily than individuals. When Eisenhower was president, corporations paid approximately a quarter of all federal taxes, the maximum tax rate on top earners was 92%, excise taxes brought in 19% of tax revenue, and most workers paid minimum Social Security payroll taxes.

Today, corporations pay about 12% of income taxes, the maximum rate is only 35% for all those who earn more than $372,950, even those who receive millions or billions each year, and excise taxes have dropped to 3% of revenue.

It gets even worse!

In August 2008, **the Government Accountability Office** reported that two-thirds of all U.S. corporations and 78% of foreign companies doing business in the United States paid no federal income taxes between 1998 and 2005, even though they booked trillions of dollars in receipts.

The Gross Domestic Product (GDP) of the United States was almost $14.2 trillion in 2008. The government took in $1.2 trillion in estimated receipts and sustained an estimated deficit of $390 billion. Approximately 45% of the revenues came from individual income taxes, 36% from Social Security and other payroll taxes, 12% from corporate income taxes, 3% from excise taxes, 1.2% from estate and gift taxes, 1.3% from customs duties, and 1.5% from other sources.

The Tax Policy Center calculates that individual income taxes and payroll taxes now account for four out of every five federal revenue dollars.

Current Proposals

It has been proposed that the progressive income tax be eliminated in favor of a single flat rate for everyone in hopes of shutting down the income tax industry and the IRS; however, the proposal has had little traction since it would further shift the tax burden from the wealthy to the working class.

A more popular proposal is known as the **Fair Tax.**. Essentially, the Fair Tax is a national sales tax designed to entirely eliminate the income tax and individual tax filings.

Proponents, including **the Cato Institute** , envision a tax of 18% to 23% on the final sales of all goods and services. There would be no tax on exports, intermediate business transactions, or security transactions.

To help counteract the inherently regressive effect of sales taxes on the poor, everyone, including the wealthy, would receive monthly rebates allowing the annual expenditure of an amount equal to the federal poverty level to be tax free.

Motivated by the collapse of the banking industry and the current recession, several commentators have proposed a tax on financial transactions to not only raise tax revenues, but to also restrain the insane trading that caused the crash.

Taking into consideration that, in 2008, the annual trading of over-the-counter derivatives amounted to $743 trillion globally, financial author **Ellen Hodgson Brown** has proposed the imposition of a .005% to 1% tax on the short-term speculation in currency transactions, commodities, stocks and derivatives.

Currently, these transactions are not taxed at all, allowing banks, such as Goldman Sachs, to pay an income tax of only 1%. This, even though Goldman Sachs is gambling with a $167 billion stake using sophisticated trading software that allows it to place high-speed bets that cheat ordinary investors.

Paul Krugman of The New York Times has also endorsed the idea of a financial transaction tax based on the 1972 proposal by James Tobin, a Yale professor who won the Nobel Prize for economics.

It was Tobin's view that the world economy was being disrupted by currency speculation in which money moved around the world as bets on the fluctuations in exchange rates. Tobin believed that the imposition of a small tax on every currency transaction would disrupt the currency gamblers, while imposing a trivial burden on those legitimately engaged in foreign trade or long-term investment.

Dean Baker of the Center for Economic and Policy Research believes a modest 0.25% "financial transactions tax" on the trade of stocks, futures, credit default swaps, and other financial instruments would produce more than $140 billion a year. He believes that it is only fair to have the financial sector bear the brunt of the tax, rather than workers, who would have to pay a national sales or value-added tax.

Adair Turner,, the Chairman of England's Financial Services Authority, has proposed a tax on all financial transactions to discourage "socially useless" activities. Prime Minister **Gordon Brown** endorsed the proposal, which he presented to the Group of 20 meeting in November.

Although U.S. Treasury Secretary **Timothy Geithner** disagreed with Brown, saying a "day-by-day" tax on speculation is "not something we're prepared to support," **President Obama** has signaled he might consider new fees on financial companies engaging in "far out transactions."

House Democratic leaders are currently considering a tax on financial transactions to fund a jobs bill, and) **Rep. Peter DeFazio (D-OR** actually introduced a bill to tax short-term speculation in some securities earlier this year.

An Even Smarter and Simpler Tax

Wouldn't it be more sensible and much fairer to simply tax the movement of all money in our economy? Not a sales tax, not a value-added tax, not a flat income tax, not a speculation tax, but rather a simple toll on every financial transaction that occurs within our economic system. Not just every time you buy a pack of chewing gum, but every time stocks and bonds are bought and sold, every time currencies are traded, and every time Haliburton invests in a new oil rig.

Since the working-, middle- and small-business-classes have far fewer and much smaller financial transactions, the wealthy and the multinational corporations, who always have to spend a lot of money to avoid having any "taxable income," would have to share proportionally in paying the toll for their traffic on our economic highway and their use of our courts and institutions to enforce their contracts and to facilitate their profits. Why should so many of our largest corporations completely escape the payment of any taxes?

It is likely that the federal government could operate on the revenues produced by a simple transaction tax of much less than 10% on the movement of money. In addition, the payment of taxes would shift to those who most benefit from the services of our government, from individuals to the corporations and from the laboring poor to the wealthy elite.

Envision the effect of a slight touch every time money moves, a tiny ka-ching in the U.S. Treasury's cash register, which in the aggregate would quickly add up to more than a trillion dollars each year. Think about the debate in Congress as to whether the tax rate should be 6.25% or 6.27% for the next year. The difference could produce billions.

Imagine that most of us might only have to pay an annual tax rate of perhaps 6.25% on our spending (income). The transaction tax would result in an increase in the overall cost of the goods and services we purchase; however, the toll would apply to all financial transactions, including the purchase of limousines and spas by the wealthy, who rely on every imaginable scheme to avoid having any "income" upon which to pay taxes.

Those who enjoy luxuries would pay more for them, and those who gamble in the money markets would have to pay for their visit to the economic casino.

A tax on all financial transactions would be far more equitable than a "flat" income tax, which would eliminate the progressive tax rates that require a greater contribution from those who most profit from our economy. A flat income tax would further shift the burden of taxation from corporations and the wealthy, who hide their money, to the rest of us who have our taxes withheld from our salaries.

There would, however, be a benefit for the wealthy in that a transaction tax would eliminate the progressive income tax rates to the extent they still exist. The rich would simply pay their fair share based on what they spend and upon their monetary manipulations.

A transaction tax would be similar in some respects to a value-added tax; however, it would apply to all financial transactions, including those intermediate sales involved in the production of all goods and services, not just in manufacturing, and it would be paid at every stage, not just at the end.

A transaction tax was believed to pose impossible accounting problems when first proposed by James Tobin 40 years ago; however, computer technology now allows for instantaneous posting of all financial transactions. Just as a worker's income tax contribution is withheld from his or her payroll check every week, it should be possible for the tax on financial transactions be paid every single day at the close of business.

Policy Issues

To encourage savings, money invested in Social Security, federally-insured savings accounts, 401(k)s, IRAs, and the earned interest should not be taxed until it is withdrawn and spent.

To encourage investment, capital gains should not be taxed until they are realized and spent, and investments should not be taxed until they are sold and the proceeds are spent.

To encourage giving, donors should not be taxed; however, the recipient should pay a tax when the gift is received or the money is spent.

A smart and simple tax would operate somewhat like the income tax in that individuals and corporations would have to prepare an annual tax report, rather than as a sales tax where the revenue is collected at the time of the transaction. For most individuals, businesses and corporations the preparation of tax returns would be greatly simplified.

Let's say a married couple earns $100,000 of joint income. Employers would still file 1099 and W2 forms, and the couple would file a return setting forth their "income." They would then deduct the amount paid for their own health insurance, including Medicare payments, and further reduce their transactions by the amount paid into social security, IRAs, 401k plans, and into federally insured savings accounts.
Tax payers could further reduce the amount earned by what they gave away.

When all the deductions are added up and credited against their income, the difference would be what they had actually "spent" for the year. That would be the amount taxed - at a very low rate.

There would also be great benefits to businesses and corporations. To the extent they are owned by U.S. citizens and that salaries are paid to citizens, businesses, corporations and other organizations should not have to pay a transaction tax on their payroll, as salaries would be directly passed through to their employees to spend (and to be taxed).

Thus, if 100% of a corporation's stock is owned by American citizens, or other businesses or corporations that are in turn owned entirely by American citizens, the corporation should not have to pay any taxes on the salaries paid to American workers. Or, if 50% is owned by citizens, the corporation should only have to pay half of the payroll transaction tax.

The transaction tax would be paid on payrolls to American workers by foreign owners as the price of their access to the services of our healthy and well-educated workers and to our free-market economy and system of justice.

Payrolls paid to foreign workers by American corporations would also be subject to the transaction tax, as the money would not pass through into our economy. Wouldn't this policy slow down the current trend of "outsourcing" American jobs offshore to other countries?

Inasmuch as there is a movement of money when foreign imports cross our borders, tariffs could be replaced by the up-front collection of the transaction tax when foreign corporations transfer their products to their American subsidiaries or when they sell to American businesses. The movement of goods into and out of the United States would represent a taxable transaction.

Foreign registration and ownership of U.S. patents, copyrights, and other legal protections should also carry a toll on all protected transactions, requiring non-citizens to share the cost of our courts to enforce their rights.
While a good case might be made for a few public policy tax deductions or exemptions, such as the interest on home mortgages and other state and local taxes, the final result should be a very broad-based, smart and simple tax that benefits everyone.

Last Word

We do not have to willing endure corrupt government and unfair taxation. We, who pay the taxes, must make the essential decisions about the methods of taxation and the level of payment. Otherwise, we live in slavery and our freedoms are illusionary.

William John Cox is a retired prosecutor and public interest lawyer, author and political activist. His 2004 book, You're Not Stupid! Get the Truth: A Brief on the Bush Presidency is reviewed at http://www.yourenotstupid.com, and he is currently working on a fact-based fictional political philosophy. His writings are collected at http://www.votersevolt.com, and he can be contacted at u2cox[at]msn.com.

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