A NEW FORM 1040:
TAX REFORM PROPOSALS FROM A TAX PROFESSIONAL

by Robert D Flach
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As a paid tax professional who has been preparing 1040s (and 1040As) since 1972 I am well aware that our current Tax Code has grown into a convoluted "mucking fess". The major reason for tax return errors, by both paid tax preparers and taxpayers who self-prepare, and for tax fraud is the excessive complexity of the Tax Code.

I strongly believe the Tax Code must be totally rewritten from scratch in the context of the following:

PRINCIPLES OF TAX REFORM

The one and only purpose of the Tax Code is to raise the money necessary to fund the government.

The Tax Code **must** –

(1) Be simple – easy for everyone to understand. Simplicity for simplicity's sake.

(2) Be fair and equitable - treat all taxpayers equally.

(3) Be consistent – treat specific conditions, situations, and activities, and maintain specific definitions and descriptions, the same in all instances.

(4) Encourage savings, investment, and growth.

(5) Index for inflation all allowable deductions and credits.

The Tax Code **must not** –

(1) Be used for social engineering, to redistribute income or wealth, or to deliver social welfare and other government benefits.

(2) Encourage or discourage certain economic decisions (other than savings, investment, and growth), or provide exclusive benefits for specific industries, business activities, or classes of taxpayers.

(3) Contain any refundable credits, or any phase-outs, exclusions or adjustments based on Adjusted Gross Income or Modified Adjusted Gross Income.

(4) Contain any "alternative" tax calculation systems (such as the current "Alternative Minimum Tax").

(5) Contain any temporary deductions, credits, benefits, or provisions

The TAX FOUNDATION has identified 6 components of a sound tax policy, which I support-

1. Simplicity: Administrative costs are a loss to society, and complicated taxation undermines voluntary compliance by creating incentives to shelter and disguise income.

2. Transparency: Tax legislation should be based on sound legislative procedures and careful analysis. A good tax system requires that taxpayers be informed and understand how tax assessment, collection, and compliance works. There should be open hearings, and revenue estimates should be fully explained and replicable.

3. Neutrality: Taxes should not encourage or discourage certain economic decisions. The purpose of taxes is to raise needed revenue, not to favor or punish specific industries, activities, and products.

4. Stability: When tax laws are in constant flux, long-range financial planning is difficult. Lawmakers should avoid enacting temporary tax laws, including tax holidays and amnesties.

5. No Retroactivity: As a corollary to the principle of stability, taxpayers should be able to rely with confidence on the law as it exists when contracts are signed and transactions are completed.

6. Broad Bases and Low Rates: As a corollary to the principle of neutrality, lawmakers should avoid enacting targeted deductions, credits, and exclusions. If tax preferences are kept to a minimum, substantial revenue can be raised with low tax rates. Broad-based taxes also produce relatively stable tax revenues from year to year.

Put simply, good tax policy promotes economic growth by focusing on raising revenue in the least distortive manner possible.

Why is a paid tax professional calling for tax simplification?

It is widely thought, within and without the industry, that continued complexity in the US Tax Code is good for my business. I remember that the Tax Reform Act of 1986 was referred to by many as "The Accountant's Full Employment Act".

Complexity is actually bad for business. While it may drive clients to use tax professionals, and certainly generates more billable hours, the real result is additional aggravation, agita and anxiety for tax professionals as well as the increased potential for error and preparer penalties. It creates more work – but more unnecessary and wasteful work.

I have said for years that I would make more money, experience less agita, make less errors, and substantially reduce the number of extensions needed each year if I did nothing but 1040As all day during the tax filing season.

I firmly believe my clients would not decide to do their own returns if the tax system was simplified; they would continue to come to me. Most taxpayers who use a tax professional simply don't want to be bothered with the task of preparing their tax return, and want to make sure they do not miss anything. And even with a more simplified tax system there would still be a need to complete Schedules C, D, E, F, SE and related forms.

Less complication also reduces my cost – for paper and ink and for CPE. The less complicated the tax return the less additional forms, schedules and worksheets it generates and the less continuing education I need to keep up-to-date and educated on the complexities.

Tax professionals should champion the cause of true tax simplification.

The new simpler Form 1040 that follows was not created from an economic point of view – how much tax is collected – but from the point of view of simplicity and fairness as per the above Principles of Tax Reform. The actual tax rates and rate brackets would be determined based on economics.

FORM 1040: US INDIVIDUAL INCOME TAX RETURN

TAXPAYER	SOCIAL SECURITY NUMBER
SPOUSE	SOCIAL SECURITY NUMBER

ADDRESS____

____

FILING STATUS:
____ SINGLE/JOINT FILER
____ MARRIED FILING SEPARATELY ON ONE RETURN
____ MARRIED FILING SEPARATELY

	COLUMN A SINGLE OR COMBINED	COLUMN B SPOUSE
INCOME:		
1 Wages, salaries, tips, etc (W-2)		
2 Interest (Schedule B)		
3 Dividends (Schedule B)		
4 Business Income (Schedule C or C-EZ)		
5a Capital Gain or Loss (Schedule D)		
5b Less 50% of long-term capital gains (from Schedule D)	( )	( )
6 Other Gains and Losses (Form 4797)		
7 IRA Distributions (a)__________ (b) Taxable		
8 Pensions and Annuities (a)__________ (b) Taxable		
9 Rental real estate, royalties, ptrshps, etc (Schedule E)		
10 Farm income or loss (Schedule F)		
11 Unemployment Compensation		
12 Social Security Benefits (a)_______ (b) Taxable_____		
13 Other income ____		
14 TOTAL INCOME		
DEDUCTIONS:		
15 Deductible part of self-employment tax (Schedule SE)		
16 USA deduction		
17 Gambling losses (to extent of winnings)		
18 Legal fees on settlements and awards		
19 Standard Deduction		
20 State and local _____ income or _____ sales tax		
21 Property tax on principle personal residence		
22 Mortgage interest on principle personal residence		
23 Charitable contributions (Schedule CC)		
24 Unreimbursed business expenses (Form 2106)		
25 Add lines 15-18 AND line 19 or lines 20-24		
26 TAXABLE INCOME (line 14 less line 25)		
27 If Column A = COMBINED total enter ½ of line 26	( )	
28 SEPARATE TAXABLE INCOME (combine line 26 and line 27)		
29 SEPARATE INCOME TAX (calculate on line 28)		
30 TOTAL INCOME TAX (combine Column A and Column B)	xxxxxxxxx	

Form 1040 Page 2

31 TOTAL INCOME TAX (Amount from line 30)	
32 Taxpayer credit (Enter 300 per taxpayer listed on return)	
33 Child credit (Enter 1,600 per qualifying child from Schedule A)	
34 Non-Child credit (Enter 300 per qualifying relative from Schedule A)	
35 TOTAL CREDITS (Add lines 32-34)	
36 Subtract line 35 from line 31	
OTHER TAXES:	
37 Self-employment tax (Schedule SE)	
38 Additional tax on qualified savings and retirement plans (Form 5329)	
39 Household employment taxes (Schedule D)	
40 TOTAL TAX	
PAYMENTS:	
41 Federal income tax withheld	
42 Estimated tax payments	
43 Amount paid with request for extension to file	
44 Excess social security and tier 1 RRTA tax withheld	
45 TOTAL PAYMENTS (Add lines 41-44)	
46 OVERPAYMENT	
47 AMOUNT YOU OWE	

SCHEDULE A – DEPENDENTS

Name	Relationship	Social Security Number	Qualified Child	Qualified Relative	Form 8332

TOTALS _______ _______

TAXPAYER SIGNATURE ____

SPOUSE SIGNATURE ____

TAX PREPARER SIGNATURE ____

TAX PREPARER PTIN ____________________

TAX PREPARER NAME ____

SCHEDULE CC – CHARITABLE CONTRIBUTIONS

Taxpayer(s) _______________________________ Social Security Number _______________

Gifts by cash or check (list donee if $250 or over):	
	__________
TOTAL	__________
Non-cash (You must attach Form 8283 if over $500)	__________
Volunteer expenses (list done if $250 or over):	
	__________
TOTAL	__________
Carryover from prior year	__________
TOTAL CHARITABLE CONTRIBUTIONS (Enter on Line 23 of Form 1040)	__________

COMMENTS:

There is only one (1) tax rate schedule for all taxpayers, regardless of filing status, and three (3) tax rates – perhaps 10%, 25% and 35%.

Married taxpayers can elect to file separately on one return or to file separately on separate returns.

Married taxpayers who elect to file a joint return on combined income would divide the total combined taxable income (Line 26) by 2, calculate the tax on this one-half of combined income, and multiply the calculated tax liability by 2 to come up with the total combined tax liability. This would do away with any "marriage tax penalty".

The filing status of "Head of Household" is gone.

On the corporate side, in lieu of reducing the corporate tax rate there would be a "dividends paid" deduction. Corporations could deduct from taxable income all dividends paid to shareholders out of accumulated "earnings and profits", and pay federal corporate income tax on this net amount. The dividends paid would be taxed to the recipient shareholders at normal "ordinary income" rates. There would no longer be a special lower tax rate on "qualified" dividends, as there would no longer be a "double-taxation" of corporate dividends.

Instead of claiming a credit for the foreign tax withheld from dividends paid the recipient taxpayer would report as taxable dividend income on Schedule B and Line 3 the net of ordinary dividends less foreign tax withheld.

There would be no special "capital gains" tax rate for long-term capital gain, investors would be taxed on 50% of net long-term capital gains from Schedule D.

No deduction would be allowed for the depreciation of real property on Schedule C, E, or F or any business entity form. See THE DEPRECIATION OF REAL PROPERTY later in this report.

All the special "loopholes" and separately reported items of income and deduction that are reported as "other income" and "other deductions" on the Form K-1s of limited partnership investments would be repealed. There would be only one item of net income or loss for general business activity (Box 1) and one item of net income or loss for rental real estate activity (Box 2) reported on the Form K-1 of a limited partnership investment that would "pass-through" to the limited partner's Form 1040 on Schedule E. Foreign taxes paid by the limited partnership entity would be included as a deductible expense in determining the amount reported as general business or rental income on the K-1 and not claimed as a credit.

Social Security and equivalent Railroad Retirement benefits would be taxed the same as regular employer pensions. Employee contributions would be recovered by amortizing them over the taxpayer's life using the, what else, "Simplified Method" to determine the taxable amount of the benefits received.

The current IRA, HSA, MSA, ESA, and Section 529 plans are replaced by one all-encompassing USA (Universal Savings Account). All taxpayers, without exception, could contribute up to $10,000 per year. There would be a "traditional" (fully deductible - no tax on earnings for qualitied withdrawals) and a ROTH (contributions non-deductible – qualified withdrawals totally tax free) option. Distributions made before age 62 for education and medical expenses or to purchase a first home (only one first home per lifetime) would be considered to be qualified withdrawals. There would be no penalty on non-qualified withdrawals after age 59½, but earnings would be taxed. All withdrawals after age 62 would be considered to be qualified.

Similarly, all employer and self-employed retirement plans would be replaced by an RSA (Retirement Savings Account). Employers can elect to contribute up to 25% of wages annually, and all employees can elect to contribute up to $20,000 of wages annually. No requirements for either to contribute. As with the USA, there would be “traditional” (employee contributions pre-tax) and ROTH options. Self-employed individuals could contribute up to 20% of their adjusted earnings from self-employment.

Contributions to an RSA by self-employed taxpayers and the deduction for health insurance premiums for the self-employed would no longer be deducted on Page 1 of the Form 1040. These would be deducted on Schedule C for a sole proprietor and Schedule E for a general partner, and would reduce the net earnings from self-employment subject to the self-employment tax – to provide more parity with the treatment of owner-employees of a closely-held corporation.

The Standard Deduction amount would be increased, perhaps to the same amounts as in the current Republican tax proposals. As with the GOP plan, no additional amount would be permitted for age or blindness.

The deductions for state and local income or sales tax and property tax and acquisition debt interest only (on up to $500,000 in principle) on a primary personal residence are maintained in an attempt to “geographically equalize” taxation. See PROVIDING GEOGRAPHIC EQUALITY later in this report. As with the current GOP proposals there would be no deduction for “home equity” debt interest.

“Points” on up to $500,000 of principle on a mortgage for the purchase of a primary personal residence would be amortized over the life of the mortgage. 1098 reporting would need to be revised to reflect the deduction limitation of $500,000 in principle for one primary personal residence.

No charitable deduction would be allowed for contributions to a church or religious organization for religious activity. Non-religious social and community action programs (soup kitchens, homeless and domestic violence victim shelters, youth centers, day care centers, etc) run by individual churches and religious groups would need to separately organize and request non-profit status to allow contributions to be deductible. Permitting a deduction for contributions to churches and religious organizations for religious activity results in the government in effect subsidizing religious activity, which, in my opinion, is a violation of the separation of Church and State.

Employee business expenses would be limited to the travel, transportation and promotional expenses of outside salesmen whose employers do not reimburse for employee business expenses under an accountable plan. See EMPLOYEE BUSINESS EXPENSES later in this report. The standard mileage allowance for business use of the taxpayer’s personal auto would not include a component for depreciation of the vehicle. This reduced standard mileage allowance for business travel would also apply to Schedules C, E and F and entity returns. See DEDUCTING BUSINESS USE OF A PERSONAL AUTO later in this report.

I have used the same child credit and “non-child” credit amount as the current Republican tax cut proposal as an example. Economic considerations would determine the actual amounts.

There would be no Earned Income Credit, or credit or deduction for qualified educational expenses, or Premium Tax Credit reconciliation on the new Form 1040. And none of the Child Credit would be refundable. These benefits would still be available to qualifying individuals, but through more “normal” channels and not as a tax credit or deduction. See DELIVERING SOCIAL WLEFARE PROGRAM BENEFITS

There would be no individual mandate or Obamacare surtaxes.

And, of course, there would be no dreaded Alternative Minimum Tax (AMT).

You will notice there is no “Adjusted Gross Income” line on the new Form 1040. No deduction or credit would be reduced or phased out based on a taxpayer’s level of income.

What follows is more details on some of the specific components of my proposed simpler and fairer Form 1040.

THE DEPRECIATION OF REAL PROPERTY

The Tax Code should not permit a deduction for the depreciation of real property, or capital improvements thereto, on Schedule C, Schedule E, or Schedule F of Form 1040, Form 1041, Form 1065, Form 1120, or Form 1120-S.

According to the IRS, depreciation is "*an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property*".

Let us look at depreciation from the point of view of the Income Statement of a business or rental activity. Basically, if you purchase an asset (i.e. equipment, a vehicle, or real estate) that will last more than one year you spread the cost of the asset over its "useful life". You purchase a new computer. You certainly do not purchase a new computer each year – you expect that it will continue to provide service for several years. So, you divide the cost of the computer over a period of years to reflect this fact, and to properly report the "economic reality" of the purchase.

If you deducted the full cost of the computer in the year of purchase this would distort the true cost of doing business. Since you generally purchase a new computer every five years, deducting the cost over a five year period "more better" represents the cost of operations. Thus, depreciation is used to "recover the cost or other basis of certain property".

Another way to look at depreciation is from the Balance Sheet perspective. When you purchase an asset that asset has value to you. You trade the asset of cash for the asset of a computer. If you sold your business the value of the computer would be included in the value of the business. As an asset ages its value drops. A two-year old computer does not have the same value in the market as a comparable brand-new computer. Depreciation is used to reflect the drop-in value of the asset. Thus, depreciation is used to reflect the "*wear and tear, deterioration, or obsolescence of the property*."

A building has a life of much more than the 27.5 or 39 years over which depreciation is currently allowed. The building I lived in several years ago was 100 years old at the time, and is still going strong. And, for the most part, the value of real estate does not drop in value over the years. If properly maintained its value will generally increase. My parents purchased their first home for $13,000 and sold it many years later for $75,000 (and they were robbed). Granted real estate values can go down due to market conditions. But this is the exception and not the rule.

So, for all intents and purposes, real estate does not "depreciate". You do not replace a building every few years because it no longer provides the same service or function. And the value of real estate as a component of the value of a business does not drop as it ages. So why should we allow a tax deduction for the depreciation of real estate?

Being a "phantom expense", the deduction for depreciation of real estate distorts the economic reality of the investment activity. An activity producing a positive cash profit becomes a deductible tax loss.

Real estate is an investment, just like stocks, bonds, mutual funds, etc. You invest in rental real estate because you expect the building to increase in value over time, often more so than stocks and mutual funds, and because it generates "dividends" in the form of net "in pocket" rental income. The deduction for depreciation of real estate is like allowing those who purchase stock to depreciate the purchase price of the stock as a deduction against the dividends paid out.

Doing away with the depreciation of real property means taxpayers no longer have to deal with depreciation "recapture" when the property is sold, which would greatly simplify the overall process.

PROVIDING GEOGRAPHIC EQUALITY

The Internal Revenue Code taxes Americans based on income measured in pure dollars. Yet, it is a fact that the "value" of one's level of income differs, sometimes greatly, based on one's geographical location. A family living in the northeast or California that has an income of $150,000 may be just getting by, while a similar family that resides in “middle America” lives like royalty on $150,000.

It costs an awful lot to live in states like California, Connecticut, Massachusetts, New Jersey and New York. State and local income and property taxes are the highest in the country in these states. The cost of real estate is also excessively high. As a result, one must earn a lot more money to be able to live in these states – and salaries are arbitrarily increased to reflect the increased cost of living. Yet $150,000 in income is taxed by the federal government at the same rate in New York City as it is in Hope, Arkansas. Many components of the Tax Code are indexed for inflation, but nothing is indexed for geography.

State and local income taxes, local property taxes, and the cost of a primary residence, and therefore also the amount of “acquisition debt” mortgage interest paid on the property, are higher in the Northeast, and California. Since we pay taxes on “net income” after deductions, allowing an itemized deduction for these items would help to somewhat geographically “equalize” the tax burden.

EMPLOYEE BUSINESS EXPENSES

Many employers have established an “accountable” plan for reimbursing employees for these expenses. If an employee incurs a legitimate job-related out-of-pocket expense he/she submits proof of payment to the employer and is reimbursed.

However, others, especially outside commission salesmen, are not reimbursed for the expenses incurred to generate sales. The employer pays the employee a draw and a commission based on sales volume. The employee is expected to “eat” his out of pocket expenses, which could be extensive in terms of business miles, meals and entertaining, and promotional expenses.

In the case of the reimbursed employee, his net salary is, in effect, all “in-pocket”. In the case of the unreimbursed employee his net “in pocket” is his net salary less his unreimbursed expenses. And the salary of the unreimbursed employee is usually higher due to the “unreimbursementness”. The unreimbursed employee is being more highly taxed than the reimbursed employee.

If the commission salesman was self-employed instead of an employee he/she would be able to deduct in full all related expenses, and pay tax, income and payroll, on the true “in pocket”.

DEDUCTING BUSINESS USE OF A PERSONAL AUTO

For the most part taxpayers who use their car for business, other than commuting, would own a car whether or not one was needed for business. The business use, however extensive, is basically secondary to personal use.

I’ve always owned a car. Although a large percentage of my driving is for business, I own the car primarily for personal reasons, and would own a car whether it was needed for business or not.

Currently the standard mileage rate for business is calculated using an annual study of fixed and variable costs of operating an automobile - including depreciation, insurance, repairs and maintenance, tires, and gas and oil. The rate for medical and moving purposes is based only on the base variable costs, like gas and oil.

Because the main reason for purchasing a car is personal and not business, depreciating the cost of purchasing the car, based on business use, is not really a true business expense. Only the business use percentage of actual operating expenses should be allowed as a deduction – because the more miles you drive the more you spend for gas, oil, repairs and maintenance, tires, and insurance.

The 2016 business standard mileage rate of 54 cents per mile, for example, includes 24 cents allocated to depreciation. Under my change if you use your car for business, either as an employee or a self-employed individual, the standard mileage allowance for business miles would not include a component for depreciation. So, using the 2016 rate as an example, business standard mileage allowance would be 30 cents per mile and not 54 cents.

Taxpayers using their car for business would continue to have the option of using the appropriate business use percentage or actual expenses, but without depreciation. Those who lease a car and use it for business could also use the standard mileage allowance or actual expenses, but this deduction would not include the monthly lease payment.

In the case of motor vehicles used 100% in a business – trucks, vans, limos, cars that are leased out to others (including one's corporation) or used exclusively by couriers or for deliveries – a deduction will be allowed for 100% of the actual costs of maintaining and operating the vehicle, including depreciation. The standard mileage allowance would not be allowed.

DELIVERING SOCIAL WLEFARE PROGRAM BENEFITS

One of the biggest problems with the current system, and a large source of its complexity, is the erroneous use of the tax return to deliver government benefits. The Internal Revenue Service, and the tax professional community, should not be required to act as Social Workers and administer and verify government program benefit payments. This practice is not only inappropriate, but it also invites and encourages tax fraud.

I am not saying the government shouldn't provide financial assistance to the working poor and college students, provide encouragements for purchasing health insurance, making energy-saving purchases and improvements and other 'worthy' actions. What I am saying is that such assistance and encouragements should not be distributed via the Form 1040.

The benefits provided by the Earned Income Tax Credit and the refundable Child Tax Credit should be distributed via existing federal welfare programs for Aid to Families with Dependent Children. The benefits provided by the education tax credits and deduction for tuition and fees should be distributed via existing federal programs for providing direct student financial aid. The benefits provided by the Premium Tax Credit, the energy credits, and other such personal and business credits should be distributed via direct discount payments to the appropriate vendors or direct rebate programs, similar to the successful Cash for Clunkers program of a few years ago, funded by the budget of the appropriate Cabinet departments.

Distributing the benefits in this manner is much better than the current method for many reasons:

1. It would be easier for the government to verify that the recipient of the subsidy, discount or rebate actually qualified for the money, greatly reducing fraud. And tax preparers, and the IRS, would no longer need to take on the added responsibility of having to verify that a person qualifies for government benefits.

2. The qualifying individuals would get the money at the "point of purchase," when it is really needed, and not have to go "out of pocket" up front and wait to be reimbursed when they file their tax return.

3. We would be able to calculate the true income tax burden of individuals. Many of the now infamous "47 percent" would still be receiving government benefits, but it would not be done through the income tax system, so they would actually be paying federal income tax.

4. We could measure the true cost of education, housing, health, energy and welfare programs in the federal budget because benefit payments would be properly allocated to the appropriate departments.

Your thoughts and comments on my new Form 1040 are welcomed. Email me at **rdftaxpro@yahoo.com** with "The New Form 1040" in the subject line.

ROBERT D FLACH – TAX EXPERT
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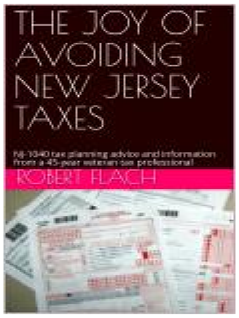

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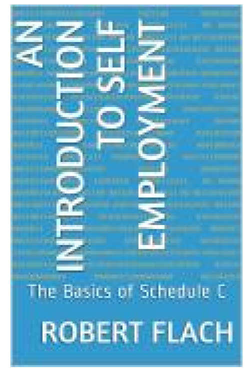

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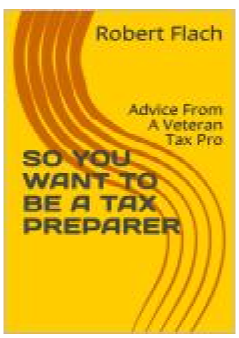

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