THE TAX CODE *MUST* BE DESTROYED!

TAX REFORM PROPOSALS FROM A TAX PROFESSIONAL

by Robert D Flach

INTRODUCTION

I have been preparing 1040s (and 1040As) for compensation since February of 1972. As a veteran tax professional I am well aware that the Internal Revenue Code had grown into a convoluted “mucking fess”.

The major source of tax return errors, by both paid tax preparers and taxpayers who self-prepare, and tax fraud is the excessive complexity of the Tax Code.

Congress has made its attempt at “reform” by passing the “Tax Cuts and Jobs Act”, but it does not properly do the job.

Like Frankenstein in the Hammer film, the Internal Revenue Code must be destroyed! The current US Tax Code, as revised by the recent tax legislation, must be totally shredded and rewritten from scratch.

The new Internal Revenue Code MUST acknowledge and confirm the fact that the one and only purpose of the federal income tax system 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.

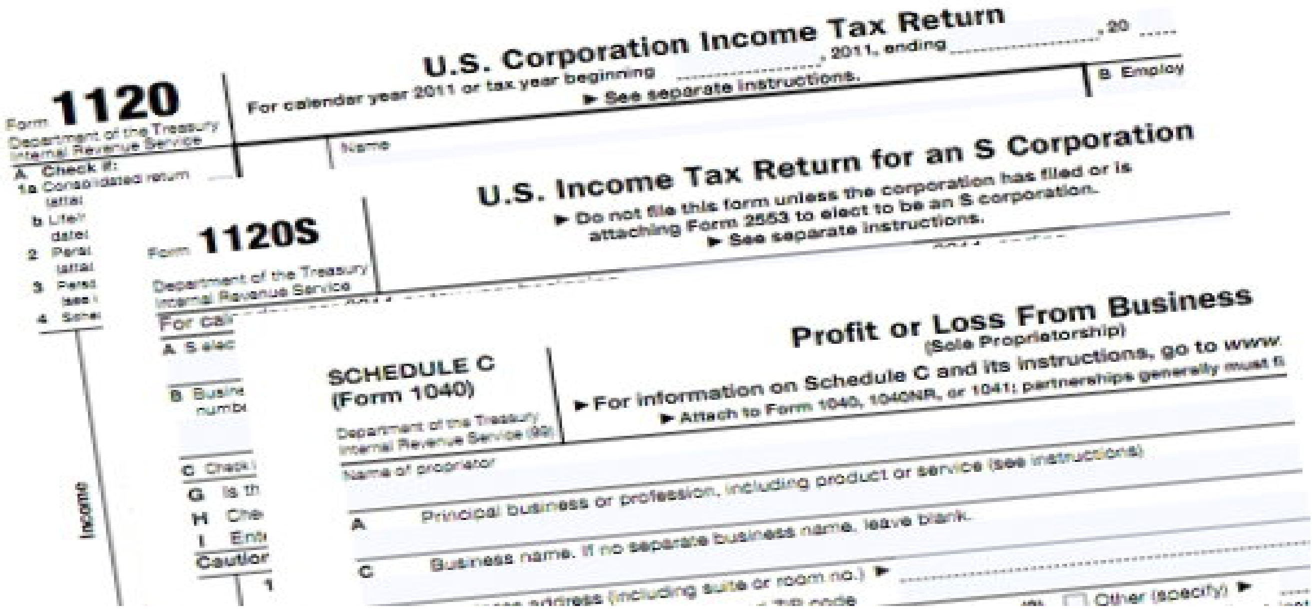
4. Stability: When tax laws are in constant flux, long-range financial planning is difficult. Lawmakers should avoid enacting temporary tax laws, including tax holidays and amnesties.

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.

In this book I present my personal tax reform proposals, within the context of the MUSTs and MUST NOTs listed above, to make the Internal Revenue Code simpler and fairer. My proposals are not initiated from an economic point of view – how much tax is collected and who pays how much tax – but solely from the point of view of simplicity and fairness.



BUSINESS

Let me begin with the taxation of business activity, as changes here will affect the taxation of individuals on Form 1040.

My rewritten Tax Code would do away with ALL industry-specific loopholes, deductions and credits, and with perhaps ALL general business tax credits as well, for ALL business activities, regardless of the chosen method of organization (sole proprietor, partnership or corporation).

I would basically tax ALL business activities on the net book income for the year's activity, again regardless of the type of entity. The only possible adjustment I would allow in going from book to tax return would be for "expensing" of a limited amount of equipment purchases. There is controversy as to whether or not this practice actually helps the economy. I would not permit unlimited expensing of purchases – perhaps keeping the current $500,000 limitation, not adjusted for inflation and without phase-out. I would treat this adjustment as "bonus depreciation", which would be an optional election to claim and not required with the election to "opt-out", and not under the current "Section 179" rules.

One exception to the repeal of business tax credits might be the Research and Development credit. My experience with corporations and business partnerships is limited to closely-held personal service and retail activities, and I have absolutely no knowledge of, training on, or experience with the R&D tax credit in either theory or application – so I cannot intelligently review its effectiveness.

I am not quite sure how I would treat foreign tax paid on business income. I expect I would replace the "foreign tax credit" with a tax deduction for the foreign tax paid, as per book accounting. I would most certainly replace the foreign tax credit on dividends by taxing the net amount of dividends received, after reducing this by the foreign tax withheld – see my discussion of "Individual" proposals that follows the "Business" discussions.

Instead of, or perhaps in addition to, 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. This would do away with the current “double-taxation” of corporate income, and I expect eliminate the need for the sub-S corporation status.

NO deduction would be allowed for the depreciation of real property, or capital improvements thereto, for ANY business activity – not on Form 1065, Form 1120, Form 1120S, Form 1041, or Form 1040 Schedules C, E, or F.

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.

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 apply to deductions on Form 1065, Form 1120, Form 1120S, Form 1041, or Form 1040 Schedules C, E, or F.

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

I have 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 the 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, included 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 here

All current employer and self-employed retirement plans – 401(k), 403(b), 457, SEP, SIMPLE, KEOGH, etc - would be replaced by an RSA (Retirement Savings Account). Employers could elect to contribute up to 25% of wages annually, up to a maximum of $25,000, and all employees could elect to contribute up to $25,000 of wages annually. There would be no requirements for either to contribute. There would be "traditional" (employee contributions "pre-tax") and ROTH options (employee contributions "after-tax", all qualified distributions totally tax free, and no RMD requirement). Self-employed individuals could contribute up to 20% of their adjusted earnings from self-employment, up to a maximum of $25,000.

All existing employer and self-employed retirement accounts would be automatically converted to an RSA by the Trustee. Taxpayers could roll-over any RSA to a Universal Savings Account (USA) – see my discussion of "Individual" proposals that follows the "Business" discussions.

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 either on Schedule C or Schedule E or on Schedule SE, 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.

Here is how this would play out on Schedule C. First a net gain or loss would be determined under "normal" circumstances. If there was a net gain the sole proprietor could claim a home office deduction, to the extent of the gain. If there was gain left a deduction would be allowed for the health insurance premiums for the proprietor and his/her family, to the extent of the remaining gain. If gain still remained, a deduction could be claimed for contributions to a self-employed RSA, up to a maximum of 20% of the still remaining gain. The result would be carried to Schedule SE, where 92.65% would be subject to the self-employment tax, within the limitations of the Social Security component of the SE tax.

For example – if the initial net gain is $100,000, the home office deduction is $5,000 and the health insurance premiums are $12,000, the maximum RSA contribution would be $16,600 ($100,000 - $5,000 - $12,000 = $83,000 x 20% = $16,600). The amount subject to self-employment tax would be $61,320 ($83,000 - $16,600 = $66,400 x .9235 = $61,320).

Required Minimum Distributions (RMD) would be required to begin from a "traditional" RSA at age 72, but based on only 50% of the account balance. And ALL beneficiaries could roll-over the entire amount of an inherited RSA into their own USA and NOT have to take any RMDs until age 72 themselves. With the ROTH option, all distributions after age 62 would be totally tax free, as contributions were "after-tax", and there would be no RMD requirement and no tax on any withdrawals by a beneficiary.

Prior to the introduction of the Republican tax reform proposals, the discussion of "pass-through" business income never included the income of a sole proprietor reported on Schedule C, or C-EZ. It had always been limited to business income from a partnership, sub-S corporation, estate, or trust "passed through" to the Form 1040 via a Form K-1. However, as the income of a sole proprietor is not taxed separately, but directly on the Form 1040, I suppose it, too, can be considered "pass-through" income.

The Tax Cuts and Jobs Act provides special treatment for some “pass-through” business income in the form of lower tax rates. Pass-through business income of a sole proprietor and general partner of a partnership is the equivalent of a combination of W-2 wage income and dividends, and pass-through business income of a sub-S corporation is the equivalent of dividends. With a pass-through entity, it is assumed that all income is distributed, whether or not it actually is. Under my new Tax Code, both W-2 income and dividends are taxed as “ordinary income”, and so is ALL pass-through business income. There is no different treatment of this type of income.

The issue, however, is not with income tax, but with the amount of net earnings from self-employment of a sole proprietorship filing a Schedule C or a general partner subject to the self-employment tax (the issue does not apply to pass through business income from a sub-S corporation, as the corporation already pays owner-employees a W-2 wage).

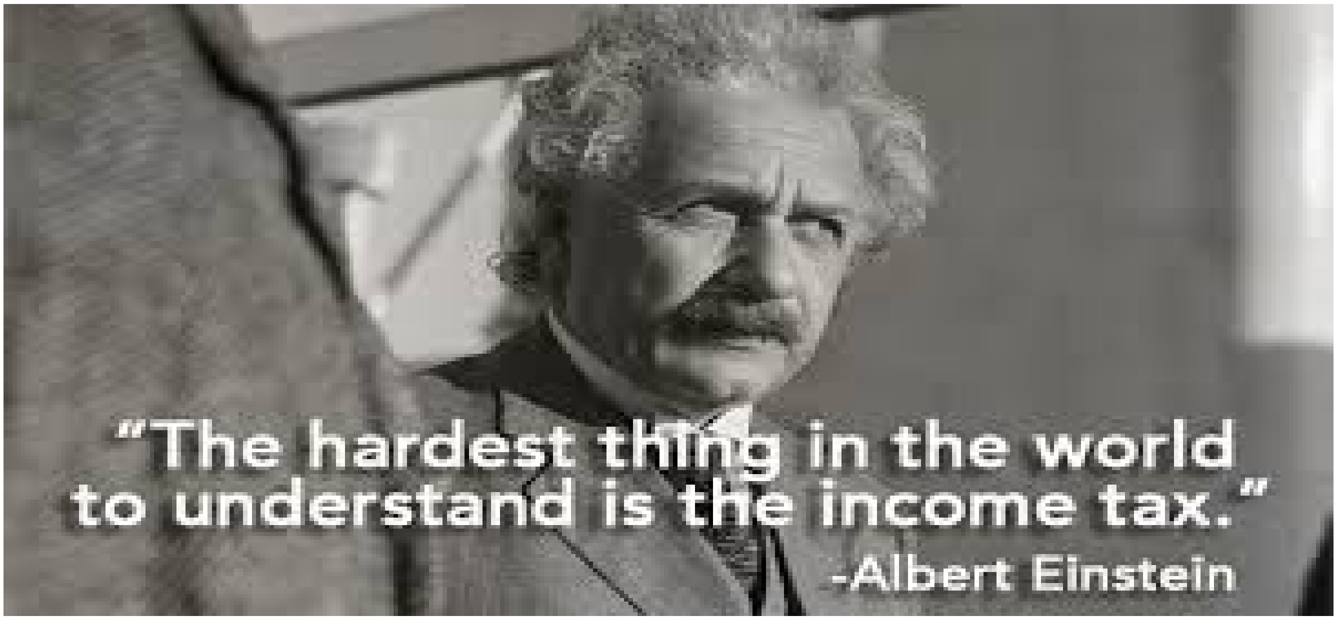
Before the Tax Cuts and Jobs Act, all of the net profit of the business activity, after an adjustment for half the tax rate to provide parity with the treatment of W-2 wages, was subject to the self-employment tax. It appears TCAJA will treat some business activities this way while others were permitted to claim an adjustment for “return on investment” using either a prescribed percentage or “facts and circumstances”.

In the case of a “personal service” business activity – the practice of an accountant, architect, attorney, consultant, or medical professional – with the one or few owners being the only working professional(s), the income of the activity is generated by the personal service of the owner(s). The investment here is the owner(s) time and talents. So, all of the net profit could be said to represent net earnings from self-employment.

But a retail or manufacturing activity generates income from the investment in inventory, so part of the net earnings could be said to represent a return on investment. And a personal service activity that has non-owner employee professionals generates some of its income from the investment in professional staff, so here, too, part of the net earnings could be said to represent a return on investment.

It is truly difficult to determine the appropriate allocation of net income to earnings and return on investment – wages and dividends. Perhaps using an arbitrary allocation, like 70% - 30%, is the simplest way to go. There would be no need to make any allocation to the business income from a sub-S corporation passed-through to the Form 1040 on Form K-1, as sub-S shareholders are paid a W-2 salary on which FICA tax is withheld.

As I said at the beginning, I would do away with ALL industry-specific loopholes, deductions and credits for ALL business activities, basically taxing business entities on net book profit. In terms of a limited partnership investment, this means there would no longer be a laundry list of obscure and confusing items of pass-through “other income” and “other deductions” on the Form K-1. There would be ONE net income item for “ordinary business income(loss)”, all pass-through “portfolio” income from all sources would be reported in the appropriate K-1 boxes (currently Box 5 through 10), and pass-through deductions will be limited to charitable contributions. I would no longer hate the K-1s of limited partnership investments.



INDIVIDUAL

EVERY taxpayer should be taxed exactly the same – regardless of marital status – under one tax rate schedule. There should be neither a marriage tax penalty nor a marriage tax benefit.

In my new rewritten Tax Code there are three filing categories – Single, Married Filing Joint, and Married Filing Separate. Married taxpayers can elect to file separately on one return or to file separately on separate returns. The Head of Household filing status is gone, as is Qualifying Widow(er). And there is only one tax rate schedule for ALL taxpayers, regardless of filing status.

The Form 1040 (and 1040A) would have two columns for entering amounts of income, deductions and tax calculation - Column A for the numbers of a Single filer, the combined numbers of a married couple filing jointly, or the numbers of the first spouse if filing separately on one return. Column B would be for the numbers of the second spouse. Married taxpayers who elect to file a joint return on combined income and deductions would divide the total combined net taxable income 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, against which credits for exemptions would be applied.

If, for example, the total combined reportable taxable income of John and Jane Q Taxpayer, after all allowable deductions, is $100,000, a tax liability would be determined on $50,000, half of the total, based on the one tax rate schedule. If the tax liability on $50,000 was, as an example only, $5,000, the couple's total tax liability would be $10,000. Credits for the taxpayers and dependents would reduce the $10,000 to come up with the total amount due before withholding and estimated payments are applied.

There would be only three tax rates – perhaps 10%, 25% and 35%. The actual rates and income brackets would be determined by the economic necessities of making the rewrite "revenue neutral".

The Standard Deduction amount would be at least the same as the new TCAJA amounts. As with current law, the Standard Deduction for a married couple filing a joint return on combined income would be twice that of a Single or separate filer. There would be no additional Standard Deduction amounts for age or blindness.

And, as with TCAJA, the deduction for personal exemptions for the taxpayer and spouse and dependents would be replaced with tax credits. The taxpayer and spouse would each get a "Taxpayer Credit" of $500. Each dependent child under age 19, or under age 24 if a full-time student, would get a "Child Credit" of perhaps the same as in TCAJA (economic considerations would determine the actual amount), and all other dependents, would get a "Dependent Credit" of $500 each.

There would no longer be a special lower tax rate on "qualified" dividends and long-term capital gain. ALL income would be taxed at "ordinary income" rates. With corporations being allowed to claim a "dividends paid" deduction there would no longer be a double-taxation of corporate income.

As for long-term capital gain, it would be "déjà vu all over again". Back when I first started out in "the business" in the early 1970s Schedule D allowed for a 50% deduction for net long-term capital gain – only half of such gains were included in taxable income reported on the Form 1040. If the combination of net short-term and net long-term capital gains on Schedule D showed a gain you would deduct 50% of the smaller of the total net gains or net long-term gain to come up with the amount to carryforward to the Form 1040. I would return to this policy and, instead of taxing net long-term gain at a lower rate, provide for a 50% deduction on Schedule D. So, if your tax rate was 10% the actual tax you would pay on net long-term capital gains would be 5%, or 12.5% if you were in the 25% bracket.

I have always had questions about limiting the current deduction for net capital losses to $3,000. Business losses are allowed a full current deduction, so why not investment losses. However, I expect I would keep this limitation in the new Tax Code, but I would index the $3,000 for inflation.

What I would do is allow for excess net capital losses to be carried back at least one and perhaps three years. Currently if you have $10,000 in net capital losses in 2017 you can deduct $3,000 against other income on the 2017 Form 1040 and carry forward the remaining $7,000 to apply against 2018 gains, again subject to the annual $3,000 limit. If the $7,000 is not all used up in 2018 the excess is carried forward to 2019, and so on. But the excess loss cannot be carried back. I would allow taxpayers the option to first carry back the $7,000 to 2016, or 2014, to apply against any net gains reported on the 2016, or 2014, Form 1040.

I first proposed this idea in a letter to George W Bush back in 2002 when the initial Bush tax cuts were being formulated. During the late 1990s and into 2000, when the stock market was flourishing, many taxpayers realized, and were taxed on, large capital gains, including excessive capital gain distributions from mutual funds. In most cases these capital gains were reinvested in the market and in additional mutual fund shares. In 2001 and 2002 the bear market provided these same investors with substantial capital losses. It seemed to me at the time only fair that they be allowed to carry back the losses to apply against the earlier gains of the bull market and get a refund of the taxes paid on these gains.

Back then I had 1040 clients, a married couple, who had $200,000+ in net capital gains, much of it short-term, in one calendar year, followed the next calendar year by $200,000+ in losses. So, in reality they did not have any net income. However, the $200,000 was taxed, most at ordinary income rates, when earned, but only $3,000 in losses was deducted per year in subsequent years. Unless the taxpayers had another huge gain in a subsequent year, it would take forever to fully use up the $200,000+ in net capital losses. The client is still carrying forward the remnants of this $200,000+ loss.

As an aside – here is the response I received to my letter to Dubya –

"*Dear Mr. Flach:*

On behalf of President Bush, I thank you for your letter. The President appreciates hearing your view and concerns.

President Bust remains confident in the faith and resolve of our Nation, and he is confronting our country's challenges with focus, clarity, and courage. As the President has said, this is a time of great consequence, and he is working for a prosperity that is broadly shared, strengthening domestic programs vital to our country, and answering every danger that threatens the American people.

To accomplish these goals, President Bush welcomes suggestions from all Americans. Thank you again for sharing your ideas.

Sincerely,
Desiree Thompson
Special Assistant to the President and Director of Presidential Correspondence"

Instead of claiming a credit for the foreign tax withheld from dividends paid, the recipient taxpayer would report as taxable dividend income the net of ordinary dividends less foreign tax withheld – the amount of dividends actually received by a taxpayer.

Social Security and equivalent Railroad Retirement benefits would be taxed the same as regular employer pensions are currently taxed. There would be no special calculation, and the taxable benefit would no longer be affected by increases or decreases in other items of income. Taxpayer 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.

I would replace the current IRA, HSA, MSA, ESA, and Section 529 plan tax-deferred savings accounts with one all-encompassing USA (Universal Savings Account). ALL taxpayers, without exception, could contribute up to $10,000 per year. Contributions would be fully deductible and there would be no tax on earnings for qualitied withdrawals.

Distributions made before age 62 for education costs, medical expenses or to purchase a first home (only one first home per lifetime) would be considered 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 qualified.

While there would be NO taxation of earnings on qualified distributions from the "traditional" USA, there would still be a required minimum distribution (RMD) beginning at age 72 - but on only 50% of the account balance. And ALL beneficiaries, not just spouses, could roll-over the entire amount of an inherited account into their own USA and NOT have to take any RMDs until age 72 themselves. With the ROTH option, all distributions after age 62 would be totally tax free, as contributions were not deductible, and there would be no RMD requirement and no tax on any withdrawals by a beneficiary.

All existing accounts – IRA, HSA, MSA, ESA, Section 529, etc. – would be automatically converted to a USA by the Trustee. Taxpayers could consolidate individual USA accounts from the same or different Trustees via rollover without any tax consequences.

The deduction for state and local income or sales tax, and deductions for property tax and acquisition debt interest only (on up to $500,000 in principle) on one primary personal residence would be maintained in an attempt to “geographically equalize” taxation.

Many components of the Tax Code are indexed for inflation, but nothing is indexed for geography. The current 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.

State and local income taxes, local property taxes, and the cost of a primary residence, and therefore the amount of “acquisition debt” incurred on its purchase, are higher, and salaries are higher to reflect the increased cost of living, in states like California, Connecticut, Massachusetts, New Jersey and New York. A family living in these states that has an annual income of $150,000 may be just getting by, while a similar family that resides in “middle America” lives like royalty on $150,000.

“Points” on up to $500,000 of principle on a mortgage for the purchase of a taxpayer’s 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, limited to the travel, transportation and promotional expenses of outside salesmen whose employers do not reimburse for these expenses under an accountable plan, would be allowed as an itemized deduction.

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 taxed more 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”.

There would be no other itemized deductions. Gambling losses, to the extent of reported winnings, and legal fees paid on or withheld from ALL taxable settlements and awards, regardless of the type of claim, would both be deductible in full by all applicable taxpayers, similar to an “adjustment to income”. The only other such deductions allowed, before claiming either the Standard Deduction or total itemized deductions, would be the 50% of self-employment tax from Schedule SE and contributions to a Universal Savings Account.

As stated in the introduction, the new Tax Code would NOT be used for social engineering, to redistribute income or wealth, or to deliver social welfare and other government benefits. 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. The government benefits provided by these tax credits would still be available to qualifying individuals, but through more “normal” channels and NOT as a tax credit or deduction.

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 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 would 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 would 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 would 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.

Finally, the legislation to create this new, simpler and more fair Tax Code MUST include the following provision –

“*Once passed, no changes, revisions, subtractions, or additions can be made to the provisions of the Act for a period of ten (10) years beginning with the date of enactment, except for temporary emergency measures in response to Presidentially-declared natural disasters, unless approved by two-thirds of both houses of Congress*.”

WHY IS A PAID TAX PREPARER CALLING FOR TAX SIMPLICIFATION?

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 actually reduces my costs – 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 LAST WORD.

To be perfectly honest, I do not believe I will ever see the current tax return replaced by my dream Form 1040.

I very much doubt that any of my tax proposals outlined herein will ever make it into tax law. Although I would truly be happy as a pig in reality tv if one or two of my ideas did.

The reason why there will probably never, at least in my lifetime, be true substantive tax reform is the fact that tax law is written by Congress, and, for the most part, the members of Congress have absolutely no real knowledge of or experience with the practicality of tax return preparation. I doubt very much that any member of the tax-writing committees has ever actually prepared his or her own Form 1040. Some wise person once suggested that all members of the House Ways and Means and Senate Finance Committees be required to manually prepare their own tax return every year.

The two Parties have different approaches to federal income taxes. Unfortunately, Democrats continue to erroneously believe that the answer to all our country's problems is to tax the rich, simply because they can afford it.

And, of course, there are the personal agendas of the individual Congresspersons, many of which are affected by the political contributions of lobbyists.

At the very least I hope that this report of mine will encourage a discussion of the purpose of federal taxation and the principles of sound tax policy.

Your thoughts and comments on my tax reform proposals are welcomed and solicited. Email me at **rdftaxpro@yahoo.com** with "Tax Reform Book" in the subject line.

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)		
5 Capital Gain or Loss (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 Dependent 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 ____

ABOUT THE AUTHOR - ROBERT D FLACH

Robert D Flach, a recent transplant from Jersey City NJ to rural Northeast PA, has been preparing 1040s for individuals in all walks of life since 1972. He is “winding down” his tax practice and no longer accepts new clients.

In 45 years of preparing individual income tax returns he has never used tax preparation software. One of the last of the dinosaurs, he prepares over 250 sets of returns each year manually.

He learned how to prepare 1040s the best way possible - by preparing 1040s.

“*On my first day at work for my uncle’s tax preparer, having never prepared a tax return before, my boss led me to a desk. He gave me a copy of a client’s prior year 1040 and a briefcase with the current year’s ‘stuff’ and told me to ‘jump in and swim!’*”

Robert has been writing the popular tax blog THE WANDERING TAX PRO (**http://wanderingtaxpro.blogspot.com**) since the summer of 2001, and also writes the blog THE TAX PROFESSIONAL (**http://thetaxprofessional.blogspot.com**). And he is the creator and author of the websites FIND A TAX PROFESSIONAL (**http://www.findataxprofessional.com**), A TAX PROFESSIONAL FOR TAX REFORM (**http://www.taxprosfortaxreform.com**), and THE TAX PROFESSIONAL (**http://thetaxprofessional.webs.com**).

He has been a member of the National Association of Tax Professionals for 30 years, and often writes for the Association's TAXPRO JOURNAL as well as the newsletter of the New Jersey state chapter. He has created several compilations of forms, schedules and worksheets and special books, reports and guides on tax planning and preparation. His Amazon.com author page is **http://amazon.com/author/robertflach**

Robert is available to write articles and columns for websites and portals and print or email newsletters, on general tax topics, or specifically for your individual audience. You can find samples of his writings at **http://robertdflach.blogspot.com**.

ROBERT D FLACH – TAX EXPERT
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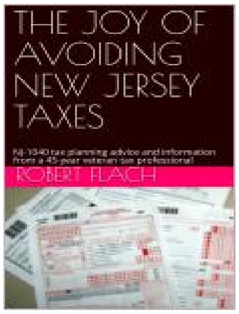
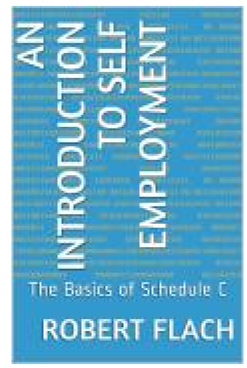


You can now purchase my book ***THE JOY OF AVOIDING NEW JERSEY TAXES*** from AMAZON.COM to read as an e-book on Kindle FOR $9.99.

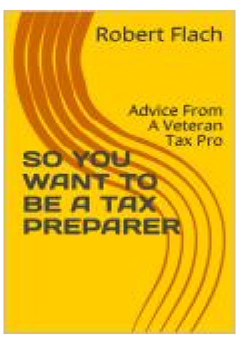
I share my knowledge and experience from 45 years as a professional tax preparer to help you to learn how to pay the absolute least amount of NJ Gross Income Tax possible.

This is the only book I know of that deals exclusively with tax planning for and preparation of NJ state income taxes

I also offer my book ***AN INTRODUCTION TO SELF-EMPLOYMENT: THE BASICS OF SCHEDULE C*** in e-book format, available from AMAZON.COM for $8.99.



Are you thinking about starting a business – either full-time or part-time? Or will you be starting a business in the near future? This book is an extensive "must-have" guide for the newly self-employed sole proprietor who will be reporting business income and expenses on Schedule C, and also a good source of information and advice for the already existing business. It covers a wide range of topics related to tax planning and preparation for Schedule C filers.



And finally, there is ***SO YOU WANT TO BE A TAX PREPARER***, available at AMAZON.COM for $5.99.

I love my profession, and share my advice and comments on the tax preparation business for those who are thinking about becoming a paid tax preparer. This book can also provide help to tax preparers who would like to expand their practice. The APPENDIX includes copies of a Code of Ethics, Standards of Professional Conduct, an Engagement Letter and the Tax Professional's Online Resource Guide.

The first two books each have a compilation of forms, schedules and worksheets that are not included in the Kindle e-book version. I will email the compilation to those who purchase this version. Email **rdftaxpro@yahoo.com**, with KINDLE EBOOK WORKSHEETS in the subject line, and proof or confirmation of purchase "attached", and I will send you the appropriate forms, schedules and worksheets compilation as a "word document" email attachment.

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