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A Radical New Income Tax Plan

Donald E. Twitchell*

Coleman Andrews, former Commissioner of Internal Revenue, has embarked upon a campaign to abolish the income tax. J. Bracken Lee, Governor of Utah, has refused to pay part of his income tax as a protest against foreign economic aid. A Constitutional Amendment to limit the income tax to 25% was seriously considered a short time ago.

Governor Lee's heroic gesture probably must be dismissed as a defiant skirmish in the perennial protests of isolationists. Though less spectacular, Andrews' views are much more significant because he will gain much sympathy from people who may never consider how they would fare under any alternative system of taxation. The point is, however, that these gestures are symptoms of a profound public dissatisfaction with our present income tax system.

The irony of the problem is that a solution is available, if we are bold enough to face it. The solution requires a radical shift in approach to the problem.

Suppose, in our new approach, that we seek to devise an income tax that will dispense with all other federal taxes!

Just suppose, for a starter, a new federal tax law that provided that:

1. All federal revenues would be raised solely by a graduated income tax which would have a top limit of 50%.
2. Estates and gifts would be taxed only as income to the beneficiaries.
3. Corporations and trusts would be taxed exactly the same as individuals but without personal exemptions.
4. Capital gains would be taxed like any other income, with losses fully deductible.
5. Most of the present deductions for contributions, interest, etc., would be eliminated, as well as most of the tax credits and extra exemptions now allowed.

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[Editor's Note: So radical are the suggestions proposed by the author that the editors hesitated to publish this article; but concluded that these proposals are provocative enough to warrant reading by members of the legal profession and of government.]
6. Social Security taxes would be computed as part of the income tax.

7. Income for the United Nations would be derived from the profits on atomic and nuclear production for peaceful use in all countries.

Simplicity would govern this entire plan. One tax law could be enacted, and thereafter it would merely need an adjustment each year to set the lowest or starting rate at a figure that would bring in the required revenue (e.g., 10% for the first, plus 1% for each additional $1000 of income). If starting at 10% produced inadequate revenue in a period of high government expenditures, the starting rate could be set at 14% or 18% or 25% as the need dictated. A person’s tax would be affected by the change in his highest bracket. For instance, the 50% rate would become applicable in the above three examples at an income level of $36,000, $32,000 or $25,000 respectively. However, with the following proposed adjustments even our present federal budget could be met with a tax starting at 10% or 12%. By the same token the lowest bracket might be adjusted to 8% or 4% if conditions warranted.

Taxing of estates and of gifts as income to the beneficiaries requires that we relinquish the feudal concept of inheritance insofar as the tax effects are concerned. Other than as an historical accident there is no need for viewing inheritances differently from other income. Yet it seems equitable to retain the present marital deduction, so as to halve the tax on property going from husband to wife, for we do recognize a husband and wife as virtually one taxing unit. However, children or other donees would be taxed as though they had earned the inheritance in the year paid.

In order to encourage family ties and individual enterprise (do you remember that?), the tax on inheritances and gifts would start with the smallest estate but would be limited by the 50% ceiling, as compared with the present federal tax scale reaching 77% on estates and 57 1/4% on gifts after large exemptions.

Under this wholesale revision it is contemplated that no taxpayer would be allowed any deduction for gifts to charitable organizations. There is little real advantage to the wage-earner or average man in the existing provision, and if the income tax is limited to 50% there will be no need to bribe the wealthy to donate to such institutions. Indeed, was there ever any justifica-
tion for the government to subsidize these gifts? Is a donor aiming for heaven or for tax benefits?

Whereas a considerable section of the Internal Revenue Code is now devoted to special provisions and rates for corporations, a complete overhaul of the tax structure would eliminate the necessity for anything beyond a few sections. Corporations generally would revert to their real status in law as "legal entities." Without any personal exemptions, a corporation's profits would be taxed on a graduated scale exactly as if it were a natural person. The income, however, would be computed after payment of dividends to stockholders.

Several significant effects emanate from this change. First, it encourages the new enterprise which starts with low earnings, by taxing it at a lower bracket (in our basic example above, it would have net earnings after dividends of $40,000 before reaching the 50% bracket). Secondly, it will stimulate more distribution of dividends, which will then become taxable as income to the stockholder, and avoid the double taxation before and after distribution that now exists. Thirdly, management will realize, perforce, that the corporation belongs to the shareholders. Fourthly, it will simplify conflicts over whether dividends are really salaries or vice versa, whether loan interest is really a dividend, and so on. Fifthly, the complaint against co-operatives, that patronage refunds are not taxed in the hands of the corporation, will also cease when dividends obtain the same treatment. Consequently, corporate profits will be taxed only to the extent that they are not distributed as dividends to stockholders.

The same would hold true for trusts. Only the net income remaining undisbursed would be taxed to the trustee. However, distribution of both trust income and principal would be taxed as income to the beneficiary. It might seem that large fortunes could escape high taxes by the use of trusts to distribute their largesse over long periods, but it is no secret that this device has long been used for that purpose. Furthermore, this is only postponing the tax. Today a gift or bequest is taxed when it goes into a trust. Under our theory it would be taxed when distributed from a trust to a beneficiary. Then the taxing process would be much simpler.

Little need be said about the proposed change in tax on capital gains. Income on an investment, held for under or over six months, is no different from a profit in business and should be taxed in full. A simplified tax law would permit losses to be
deducted up to the amount of taxable income after personal exemptions and then carried over to subsequent years, just as business men can do now with an operating loss.

Also, there is now a limit on the capital gains tax, which benefits only high incomes, so that this source of income is never taxed at a rate higher than 25% regardless of the bracket for other income. Witness Jack Benny’s transfer of his show from one radio network to another, under a legal scheme, to get the benefit of this lower rate. President Eisenhower did the same by holding his book for six months and then “selling” it to the publisher. Under our proposed change, these devices would not reduce their taxes, because their entire profits would be added to other income. The only concession here might be to allow spreading capital gains, as we now do large professional fees, over three years.

Taking up the deductions from income in the order in which they appear on the tax form, we have already discussed the recommendation for eliminating Contributions as a means of tax avoidance.

The next deduction, Interest, should also be eliminated. How can we justify the government’s subsidizing or encouraging improvidence? Even if we recognize that it is most often used for paying off a home mortgage, it also penalizes tenants. While interest on obligations is legitimate as a business expense, it can hardly be justified as a personal deduction from taxable income, nor as a device for evading corporate or other taxes.

The deductibility of other taxes is a bit more complex. The helplessness of the individual to control the amount of state taxes might justify deducting all other taxes from income. On the other hand, the federal government could create pressure for reform in state taxation by allowing deduction only for land taxes.

Considering that the local government has financial responsibilities closely parallel to the extent and use of its land area, why go beyond this source for revenues? Furthermore, since one effect of taxation is to stifle enterprise, why not confine state taxation to land, without penalizing the person who erects a building on his property? This is Henry George’s Single Tax theory, by which the state would collect a rental for the use of the land according to the value of the community activity.

Probably all tax enforcement agencies could be reduced to a fraction of their present personnel if the public had only an
income and a land tax to pay. Pending that millennium, we shall probably have to give an income deduction for all state taxes.

To continue on the deductions from gross income before computing the income tax, certainly casualty losses (such as flood, fire, etc.) are justifiable; but why should not medical expense be in the same category, without any limitations? Today we can deduct only the excess over three percent of our income when actually sickness or accident is a real catastrophe, especially with today's level of medical expenses.

While Social Security benefits are really the fruits of a mammoth insurance operation, nonetheless it is simplest and practical to include the charges for this as part of our exclusive tax on incomes. Thus the employer would neither deduct separate taxes from the employee nor pay any additional share for the F. I. C. A. Instead, let us say that 10%, or whatever is required, of the total income tax revenue is set off to the fund from which benefits are paid to those over age 65. In effect this would amount to collecting Social Security taxes on all income without regard to the $4200 salary maximum which now limits contributions. However, benefits could still be limited and computed as at present; and the employer's withholding tax records as well as the employee's income tax return would furnish the basis for ultimate payment. A taxpayer receiving old age benefits under Social Security should report them as income for taxation, although it seems most equitable to permit the aged to continue the double exemption after age 65. However, we should eliminate the Retirement Income Credit, for the double exemption is adequate in lieu of all three special provisions for the aged.

Unemployment insurance taxes could be handled the same as the Federal government collects only operational expenses. It might present another problem in the state tax systems, which give a tax credit to the stable employers. To this extent, despite the advantages of the Single Tax for the state, the insurance operations of the state for unemployment benefits might be classed the same as Workmen's Compensation for injuries, or any other insurance benefit carried by the employer. These two benefits commonly provided by state governments can hardly be classed as revenue-producing in the sense of general taxation; nor can they be compared to the old age benefits in which everybody ultimately benefits.

If the state and municipalities are to depend solely on a land tax, and the nation solely on an income tax, to what source will
we turn for the tax to support the United Nations as it inevitably assumes more governmental power to insure peace? Today each nation contributes on a voluntary basis, but soon we must face the need of the U. N. to stabilize its functions much as we faced the need for a constitutional republic.

As the member nations gradually delegate power to the U. N.—to have its own legislature, its own administrative functions, its own courts, and its own police force—all this will be impossible without the power to raise revenue in its own right. Since it is largely the development of nuclear energy which makes a stronger U. N. a compelling necessity, and also because the U. N. probably will be the safest repository for developments in this field, then the U. N. should collect fees and charges for licensing the use of this source of power to nations and to individuals. The U. N. certainly will have the ultimate right to inspect all areas of the world in order to insure the peaceful use of the material with which civilization can be destroyed.

How does all this affect the man in the street? The average man may complain about the loss of some deductions for interest, or he may object to paying an income tax on $5000 inherited from his father. Yet he probably will pay a smaller initial tax on his income, and he will be able to buy an automobile without paying some $400 in hidden excise taxes. He will know that the tax is so simple that it is very difficult for anybody to cheat. He will know that it is much less expensive to administer. He will know that it is fair to all. Finally, it will be so simple that he can make out his own tax return.

That last factor, in itself, would justify revamping of our entire tax system.