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Time To Take Another Look At The U.S. Income-Tax System

If you think discussions about taxes are boring, consider how much of your and your loved ones' paychecks gets siphoned off each year by various government agencies. Everyone, even people earning the minimum wage, pays over a thousand dollars a year under a system that is neither fair nor simple. In last month's article, I described how the U.S. personal income tax got started, to fund the Union's debt in fighting the war against succession, and noted that certain "consumption" taxes were used to lessen the burden on ordinary citizens.

This month's article looks at the core workings of our current, overly complex income tax system, where everyone pays to play but no one understands. In theory, people who make more money are supposed to pay in not only more money but at a higher percentage rate. In fact, with the availability of a myriad of tax deductions, business depletion, depreciation, travel and entertainment expenses, personal deductions and tax avoidance schemes, there are considerable numbers of very wealthy Americans who still pay less in tax than working people. This is just flat out wrong and it undermines our republic.

Every year, ideologues who profess to believe whole heartedly in "free" markets suggest that a "flat" tax is appropriate for America. For example, they suggest that everyone might pay 20% on all income. Under this scenario, lower income people would pay the same percentage as high income people. This would negate whatever measure of fairness exists in what we now have, which is a "progressive" tax tables. Higher income taxpayers do pay high rates on some of their inflows, the portion called "taxable income", up to 36.5%. Low income workers generally pay around 10 to 15%. This is one of the few redeeming characteristic of the current tax code.

Unfortunately, our current tax system promotes weird business and personal decisions. It actually discourages conservative types of savings by taxing interest at high levels and, as I have pointed out in many previous articles, it serves to promulgate America's high consumption patterns by giving many types of tax breaks for taking on debt. These are contributing factors in our nation's shameful international deficit, whereby we eventually will end up handing over some, if not much, of our future economic clout to other world powers.

If we can simplify the tax code and take it out of our lives as factors in our decision making, individuals and businesses will then look towards the future in a more rational, clear headed way. My basic proposition is for a "progressive flat" tax, where people can earn up to a certain amount of money and pay no tax at all. Consider what would happen if the first $20,000 in earned income per person, in every household, was totally exempt from taxation.

A family of four people would be able to earn up to $80,000 with no tax while a single person with $100,000 would start to pay tax on amounts over $20,000. While the $20,000 per person noted here is arbitrary and would need to be refined, the concept is to levy no tax on the amount needed to support a reasonable lifestyle in today's dollars, increasing that amount in the future with a realistic appraisal of inflation.

What ever the amount finally determined to be totally exempted from tax per individual, people earning over that amount, say, $80,000 for a family of four, would pay a moderate amount, perhaps 10% on all income above their base level, up to twice their base or $160,000. They might then pay 20% on all income from twice their base level to four times base level or from $160,000 to $320,000. To continue the analogy, a rate of 30% would be levied on income from four to eight times base, $320,000 to $640,000, and then above $640,000, the progressive flat tax could be set at a rate of 40%, to cover income up to sixteen times base. At that point, the rate would cap out at 50% on all income above $1,280,000. A family of one person would start to pay tax on lower amounts of income because their natural consumption level ought to be far lower than a family of four.

The important point here is that with some kind of progressive flat tax, and the numbers suggested above are just beginning points to start the discussion, there would be no need to tax any kind of long term capital gain. Our nation would clearly experience a boom in long term investment, including real estate, agriculture, as well as stocks and bonds, as investors learned to pay attention to real world opportunities and not just trying to tweak themselves around the tax laws. There would also be a boom in entrepreneurial activity if there was no tax on capital gains with a concurrent increase in employment opportunities.

In order to simplify the tax code, make up for lost revenue due to the extinction of the capital gains tax, and to insure that people not investing in the future but living off the fat of the land are paying their fair share of taxes, there would be no reason to allow for any deductions, be they depletion, depreciation, mortgage interest, entertainment, travel, professional expenses, medical expense, etc. This would mean that business ventures would have to make sense from a production of useful goods and services point of view, that politicians would have no need to pander to special interests, and ordinary people would then be able to see rewards for thinking of future generations.

All of these suggestions would vastly simplify our tax code, promote long term savings and remove the government's influence on our personal decisions. If those sound like worthwhile goals to you, stay tuned for more on this subject. In next month's article, due to be published July 12, I will outline some direct action we can take to affect these kinds of changes.

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