The GDP Tax Plan

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The tax system in the United States is broken and needs to be replaced. The costs to our society are enormous and threaten our economy. The complexity of the tax code is oppressive for taxpayers and leads to increased noncompliance. **The IRS cannot administer a broken system effectively and cannot fix a broken system administratively.**

- By 2015, taxpayers will spend over $480 billion annually in compliance costs to prepare and file their tax returns.
- The Tax Gap approximates $450 billion annually (the difference between what individuals and businesses owe the government and what they actually pay).
- 60% of all individual income tax filers are forced to hire professionals to help them prepare their tax returns.
- Tax preparation fees cost the poorest among us as much as 6% of their adjusted gross income.

Congress should focus on making our tax system efficient and simple which will free up nearly $1 trillion dollars annually which can go towards new tax revenue and cost savings to the American taxpayer. American taxpayers would probably be willing to pay more in taxes if they had more money in their pockets.

In designing a replacement, the new system should incorporate the following principles:

- **Simplicity** – easy for taxpayers to understand and minimal costs to comply.
- **Broad base** – allows tax rates to be as low as possible which encourages compliance.
- **Minimize tax burden** – the private sector is the source of all wealth and drives increases in the standard of living in our market-based economy so taxes should be minimized.
- **Equity and Fairness** – ensure the lowest-income citizens' limited resources are not depleted by taxation and ensure everyone else is paying to cover the cost of government.
- **Minimum Tax Gap** – structure the tax to minimize noncompliance which includes unreported revenue and over reported expenses.
- **Appropriate government revenue** – enable the government to determine how much tax revenue will likely be collected and when.
- **Stability** – tax changes should be permanent and should not change continuously or instability makes long-term planning difficult and increases uncertainty in the economy.
- **Certainty** – the tax laws should clearly specify when tax is to be paid, how paid, and how the tax amount was determined.

Current Revenue Source

Since World War II, tax receipts have averaged around 18.1% of GDP. However, due to the 2010 recession, tax receipts were about 15.1% of GDP. Most of the federal revenues come from individual taxpayers and represent the largest portion of the revenue. Social Security and Medicare payroll taxes are the second-largest source of revenue. Below is a CBO (Congressional Budget Office) estimate for 2012 of tax revenue ($2.3 trillion):

Federal Revenue by Source		
Type of Tax	**Amount (Billions)**	**Percentage**
Individual Taxes	$1,091.5	47.4%
Social Insurance (Payroll)	$ 818.8	35.6%
Corporate Taxes	$181.1	7.9%
Customs, Duties, Misc.	$131.3	5.7%
Excise Taxes	$72.4	3.1%
Estate and Gift Taxes	$7.4	0.3%
Total	$2,300.0	100.0%

Who Currently Pays Taxes

The current tax system is already highly progressive. The top 10 percent of income earners paid 71 percent of all federal income taxes in 2009 but only earned 43 percent of all income. The bottom 50 percent paid 2 percent of income taxes but earned 13 percent of total income. About half of tax filers paid no federal income tax.

Loopholes - Tax Expenditures

Tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers. Some people call these preferences tax expenditures because they consider them the equivalent of direct spending through the tax code. In 2011, there were over 180 tax expenditures exceeding over $1 trillion dollars in revenues. Below is a table of the major categories in billions:

Top Tax Expenditures FY 2011	
Major Categories	**Amount (in billions)**
Exclusion for Health Insurance	$173.7
Exclusion for Pensions/401(k)s	$135.4
Refundable Outlays (EITC etc.)	$108.2
Mortgage Interest Deduction	$88.7
Charitable Deduction - Individuals	$46.2
Total	$552.2

Who Are the Beneficiaries

In 2011, the top 20% of taxpayers received 67% of the $526 billion in tax expenditures considered "exclusions". These include exclusions of health insurance and tax-deferred retirement plans such as 401(k)'s. Also, the top 20% of taxpayers received 81.3% of the $147 billion in itemized deductions; including, home mortgage interest and charitable contributions. In addition, the top 20% received 96.1% of the $78 billion in dividends and capital gains taxed at lower rates than wages. The bottom 80% of taxpayers received 92.8% of the $122 billion in refundable credits like the earned income and child tax credits.

How Loopholes Harm Our Economy and Are Unfair

Most loopholes benefit the wealthy. They complicate the tax code and often distort the decisions of businesses and families. Many economists feel loopholes are "extremely regressive and perverse forms of subsidies." For example, our current tax system is subsidizing the rich to help them get an expensive home and in the process real estate prices are higher which makes it more difficult for others to qualify to buy a home. This loophole causes distortions in the housing market. Housing costs will go down if this loophole is eliminated.

Another example is health insurance. Katherine Baicker, Professor of Health Economics at Harvard School of Public Health, said

> "The highest tax subsidies go to people with the highest incomes and the most generous health plan coverage, at the expense of those with lower incomes and less generous – or no – insurance. Today, workers who get health insurance through their jobs still don't have to pay taxes on those benefits, but people buying insurance on their own do. They must use their after-tax earnings to shop for nongroup insurance or pay for care out-of-pocket without seeing any tax relief for these expenses. This is particularly regressive, since high-wage workers are more likely to get insurance through their jobs, more likely to have very expensive insurance packages, and are in the highest tax bracket (and consequently get the most benefit out of paying with pre-tax dollars). "

Donald B. Marron, an economist and director of the nonpartisan Urban-Brookings Tax Policy Center, explained what is wrong with the health insurance loophole in this way:

> "Another flaw is that the tax exclusion raises the cost of health insurance for everyone. Because the exclusion is essentially open-ended (i.e., whatever amount an employer spends on a worker's health insurance is excluded from that worker's taxable income), workers have an incentive to choose expensive, high-end insurance plans that cover as much health care as possible. Such plans will usually minimize cost-sharing provisions like co-payments (which consumers usually pay for with after-tax dollars) while offsetting the costs through high

premiums (which are paid for with pre-tax dollars). ***This system, in turn, drives up health-care costs overall — since the generous employer-provided coverage removes individual consumers' financial incentives to limit their use of health services.*** Absent this tax distortion, insurers would offer less expensive plans that relied more heavily on co-pays, co-insurance, and deductibles in order to both manage demand for health services and keep insurance costs low."

Introduction to the GDP Tax

Gross domestic product (GDP) is defined as the market value of all final goods and services produced domestically in a single year and is the single most important measure of macroeconomic performance. There are two ways of measuring GDP, the income approach and the expenditure approach.

The **income approach** adds up all the income earned by households and businesses in a single year. Therefore, by adding together **wage, profit, rent**, and interest income, one should get the same value of GDP as the expenditure approach.

The **expenditure approach** is to add up the market value of all domestic spending made for final goods and services in a single year. Final goods and services are goods and services that have been purchased for final use or goods and services that will not be resold or used in production within the year. Personal consumption expenditures on goods and services comprise the largest share of total expenditures. Consumption goods expenditures include purchases of **nondurable goods**, such as food and clothing, and purchases of **durable goods**, such as appliances and automobiles. Consumption service expenditures include purchases of all kinds of personal services, including those provided by barbers, doctors, lawyers, and mechanics.

The Bureau of Economic Analysis, an agency of the Department of Commerce, has GDP data as far back as 1929. This information reveals that the wage and profit components from the **income approach** have a history of consistency which should be considered as foundational building blocks in constructing a new tax system. Also, this data shows the durable and nondurable goods components from the **expenditure approach** should be considered building blocks as well because of their historical consistency.

Below is a table of historical percentages for each component:

Table 1 - The GDP Tax - Foundational Building Blocks

GDP Components	**Historical % of GDP (1929-2011)**	**Historical % of GDP (1980-2011)**
Wages (Compensation)	56%	57%
Business Profits (Net Operating Surplus)	25%	24%
Durable and Nondurable Goods	31%	25%
Total (Tax Base > GDP)	**112%**	**106%**

The two GDP tax rate proposals below will generate approximately the same tax revenue as historical tax revenues:

<u>Proposal A - 20/20/10</u>

Wages	20.0%
Business Profits	20.0%
Goods	10.0%

<u>Proposal B – 22.5/22.5</u>

Wages	22.5%
Business Profits	22.5%
Goods	0%

For example, using the 1980-2011 historical % of GDP numbers from Table 1, the estimated revenue generated by each proposal is similar to the average annual tax receipts since WWII, 18.1% of GDP:

<u>Proposal A - 20/20/10</u>

Wages	20.0% X 57%	= 11.4%
Business Profits	20.0% X 24%	= 04.8%
Goods	10.0% X 25%	= <u>02.5%</u>
Total		= **18.7%**

<u>Proposal B – 22.5/22.5</u>

Wages	22.5% X 57%	= 12.8%
Business Profits	22.5% X 24%	= <u>05.4%</u>
Total		= **18.2%**

Proposal A would include a national consumption or sales tax to generate tax revenue from purchases of Goods. If introducing this new type of tax on a national level is too controversial, then the income components would need to have a higher tax rate like Proposal B to make up the difference in tax revenue. It is important that the same tax rate applies to both individuals and businesses to minimize tax avoidance.

GDP Tax Components Defined

Wages (Compensation)

Compensation includes wages and salaries and as well as supplements to wages and salaries. Wages and salaries are broadly defined to include commissions, tips, and bonuses; **voluntary employee contributions** to deferred compensation plans, such as 401(k) plans; employee gains from exercising stock options; and receipts-in-kind that represent income. Supplements to wages and salaries includes **employer contributions** to employee retirement plans as well as insurance plans. Fringe benefits would also be included in compensation.

Business Profits (Net Operating Surplus)

The Net Operating Surplus (NOS) is similar to the profits of a business. It reflects the surplus remaining after total costs are deducted from total revenue.

The NOS tax is simple to apply and administer. The Bureau of Economic Analysis tracks each industry's business profits and GDP. As a result, a business only needs to multiply their total revenue by the **NOS Tax Rate.** This rate is determined by multiplying the GDP tax of 20% by the profit of the business's industry divided by the industry's GDP. The IRS would calculate the **NOS Tax Rate** each year for each industry. As a result, the only step a business needs to take is to multiply their business gross revenue by their industry's NOS tax rate. Each business is assigned a NAICS code (North American Industry Classification System) when they apply for a federal identification number (EIN). Each NAICS code will have its own NOS tax rate.

For illustrative purposes, assume the entire US economy representing all industries is one business. In 2011, the **NOS tax rate** would have been approximately 5% [20% GDP tax rate times NOS divided by GDP]. The total NOS for all industries was $3854.9B and GDP was $15,094B which equals 25.54% [3854.9B NOS / 15094B GDP] so the NOS tax rate to apply to revenue to arrive at tax liability would be 20% X 25.54% or 5.1%.

Goods (Durable and Nondurable)

In order to generate the additional tax revenue needed to meet the historical tax revenue receipts , the **Fair Tax** proposal of a national consumption tax should be considered but only for durable and nondurable goods purchased. A 10% "exclusive" tax similar to the sales tax already employed by most local and state governments would be assessed. This "goods" tax would ensure that all citizens would pay some amount of taxes.

Progressivity

Progressivity has been built into each GDP component in this proposed tax plan. As a result, taxpayers with minimal earnings or businesses with minimal revenue will be expected to pay minimal or no taxes. However, to make up for lost revenue, the taxpayers and businesses with significant earnings and revenue will need to pay a higher tax rate over certain thresholds in order to generate the entire GDP tax revenue from each tax component.

<u>Wages Component (Compensation)</u>. Individuals earning wages below the poverty threshold would not be subject to the 20% compensation tax. For example, a family with a household size of 4 would have a $23,050 poverty threshold per the 2012 Poverty Guidelines. If a taxpayer's earnings exceeds this threshold, then only the dollars earned over this amount would be taxed at 20%. Higher income earners would pay a tax rate greater than 20% after certain income levels are reached in order to generate enough tax revenue to replace the lost tax revenue due to the poverty threshold exclusion built into the tax system.

Many economists and experts estimate that the “middle class” is defined as those with annual earnings between $25,000 and $100,000. If the Wages Component tax is built around this “middle class” definition, then taxpayers earning more than the “middle class” annual earnings amount would have their poverty threshold exemption phased out dollar for dollar for earnings exceeding the middle class amount of $100,000. The “middle class” definition would be adjusted each year for inflation. The US Census Bureau is the source of the poverty threshold amounts.

Business Profits Component (NOS). Just as the Wages Component permits for a poverty threshold allowance, the Business Profits Component could apply a similar principle for small businesses. Consideration might be given to not tax businesses with sales under a certain amount of annual revenue, say up to $50,000. Then for revenue between $50K and $100K, a 50% tax rate discount would apply.

As an alternative or in addition to the above idea, because 50% of businesses fail by the end of the 5th year in business, a tax rate discount might be considered for the first 4-5 years of a new business. For example, an 80% tax rate discount for the first year, a 60% tax rate discount for the second year, etc. However, new businesses that result from mergers and acquisitions would not benefit from these discounts. To ensure the total revenue from the Business Profits Component is collected, the 20% tax rate would be increased for those businesses with sales exceeding certain thresholds. The downside of incorporating business exceptions like the ones discussed above is that more chances of fraud and/or abuse will occur.

Perhaps one could argue against the concessions above for small business or startups by pointing out the fact that currently all businesses with employees are required to withhold and match FICA taxes (a total of 15.3% of compensation) whether or not the business is profitable. The FICA tax is a significant tax that all businesses are required to pay. In addition, many countries have the Value Added Tax (VAT) which tax is imposed whether or not a business is profitable. Currently, Great Britain has a 20% VAT (the following link provides a summary of countries and their VAT tax rates http://www.uscib.org/index.asp?documentID=1676).

Goods Component. Consider exempting food purchases for those on welfare using food stamps. Almost 100% of those getting food as a welfare benefit use “electronic benefit transfer” debit cards to purchase food. These cards could be programmed so the 10% tax is not assessed. Otherwise, this tax would be regressive for those on food stamps. However, the economic savings in taxes to these taxpayers should be added to the taxpayer’s compensation base to determine if any of their compensation is subject to the Wage Component tax.

Replace Other Taxes

The GDP tax should replace all or almost all current taxes. It should replace at least individual and corporate income taxes, payroll taxes, and the gift and estate taxes.

Territorial Tax System

The GDP tax would not tax worldwide income. By definition, we would only be taxing the wages and profits earned in our economy and the purchases made from the Goods we produce. As a result, we would become a territorial tax system instead of a "worldwide" tax system. All income earned from work performed abroad or from businesses located abroad, will be taxed by foreign countries. The GDP tax only applies to domestic operations of all businesses, regardless of ownership. It does not apply to foreign earnings of Americans.

Social Security Benefits

To qualify for future Social Security benefits, each taxpayer's compensation will be tracked to give credit to the taxpayer for having worked in the economy and contributed to the nation's GDP.

Exhibits, PowerPoint & Website

Several exhibits are included with this whitepaper discussing topics such as tax expenditures, Q&As, GDP tax information that states may consider to modify their tax systems, proposed tax code language for the GDP tax, and proposed language for an amendment to the constitution for the GDP tax and for spending limits.

In addition, a Powerpoint is available with graphs and other supporting materials for the GDP tax plan. Also, a website has been created that has a significant amount of information; including, spreadsheets, studies, graphs and in depth commentary on the various aspects of the proposed tax system. Some of the material available includes:

- Detailed definitions of each GDP component
- Examples of the business profits tax (Net Operating Surplus) and how each industry is taxed based on their NAICS Code (North American Industry Classification System)
- Examples of progressivity for each component
- Commentary on the importance of technology in implementing and administering the GDP tax
- Exhibits from various websites supporting the research and report
- BEA studies and whitepapers

Link to other resources https://sites.google.com/site/ssstaxsystem/

Attached Exhibits

- Exhibit A – Tax Expenditures
- Exhibit B – Selected States Summary of GDP Component History
- Exhibit C – Questions and Answers
- Exhibit D – Proposed Tax Code Language
- Exhibit E –Amendments to Constitution for taxing and spending limits and Proposed Language

Exhibit A

Tax Expenditures (Loopholes)

Many economists argue that tax expenditures harm our economy as well as unfairly redistribute wealth. As discussed earlier, most of the loopholes are going to the wealthy. Today there are approximately 170 tax expenditures in the individual and corporate income tax system. The discussion that follows addresses some of the tax expenditures that involve the most dollars (see table below).

Top Tax Expenditures FY 2011	
Major Categories	**Amount (in billions)**
Exclusion for Health Insurance	$173.7
Exclusion for Pensions/401(k)s	$135.4
Refundable Outlays (EITC etc.)	$108.2
Mortgage Interest Deduction	$88.7
Charitable Deduction - Individuals	$46.2
Total	$552.2

Below is a list of economists that participated in an NPR discussion concerning tax expenditures. Overall, these experts feel no loopholes should exist in our tax code.

- Dean Baker, co-director of the Center for Economic and Policy Research in Washington, D.C., and widely published blog "You could probably describe me as left of center. It'd be fair."
- Russ Roberts, George Mason University economics professor. "In the grand spectrum of economic policy, I'm a pretty hard core free market guy. I'm probably called a libertarian."
- Katherine Baicker, professor of health economics at Harvard University's Department of Health Policy and Management. We simply called her a centrist on the show.
- Luigi Zingales, professor of entrepreneurship and finance and the University of Chicago's Booth School of Business. "What I like to say is that I'm pro-market, but not necessarily pro-business."
- Robert Frank, professor of management and economics at Cornell University's Johnson Graduate School of Management. "I'm a registered Democrat. I think of myself as a radical pragmatist."

To better understand tax expenditures, the following are insightful comments by Donald Marron, an economist who directs the Urban-Brookings Tax Policy Center.

> A great deal of government spending is hidden in the federal tax code in the form of deductions, credits, and other preferences — preferences that seem like they let taxpayers keep their own money, but are actually spending in disguise. Those preferences complicate the code and often needlessly distort the decisions of businesses and families. The magnitude of these preferences raises the possibility of a dramatic reform of the tax code — making it simpler, fairer, and more pro-growth — that would amount to simultaneously cutting spending and increasing government revenue, without raising tax rates.

> Policymakers can raise new revenue — and potentially even pay for some tax-rate reductions — by cutting back on the many spending-like provisions in our tax code. Hidden spending should get the same scrutiny — and inspire the same enthusiasm for cuts — as the spending on entitlements, domestic programs, and defense that is targeted by today's fiscal hawks.
>
> It is important for policymakers to recognize that tax preferences are not merely "loopholes" exploited by narrow interest groups or "earmarks" that favor some congressmen's pet constituencies. Tax preferences are social safety-net programs. They are middle- and upper-income entitlements. They are preferences for capital income. And they are incentives for activities — such as owning a home, saving for college, or investing in new research — that many believe enhance our society. Given these realities, we should not be lulled into believing that cutting tax preferences will be as painless as closing a few loopholes. Such cuts will be as politically painful as cutting popular spending programs.

Health Insurance

The largest tax expenditure is health insurance. Katherine Baicker, Professor of Health Economics at Harvard School of Public Health, is one of the nation's foremost experts in the health care industry. Below is a summary of some of her comments from various sources (publications and websites).

> The current tax system is unfair because the federal government has long subsidized health insurance premiums for those who get insurance from an employer. The highest tax subsidies go to people with the highest incomes and the most generous health plan coverage, at the expense of those with lower incomes and less generous – or no – insurance. About 47 million Americans have no health insurance.
>
> The **current system** is driven by the fact that employment-provided insurance plans aren't taxed like wages. This **subsidy wasn't part of any well-reasoned scheme; rather, it's a "relic" of the World War II era.** Some employers began offering health insurance as a new kind of perk to lure workers after the federal government imposed controls on the customary bait—wages—and ruled that workers would pay no taxes on those benefits.
>
> Today, workers who get health insurance through their jobs still don't have to pay taxes on those benefits, but people buying insurance on their own do. They must use their after-tax earnings to shop for nongroup insurance or pay for care out-of-pocket without seeing any tax relief for these expenses. This is particularly regressive, since high-wage workers are more likely to get insurance through their jobs, more likely to have very expensive insurance packages, and are in the highest tax bracket (and consequently get the most benefit out of paying with pre-tax dollars). As if this inequity weren't bad enough, the policy also increases spending on low-value care. "Our tax dollars end up subsidizing costly broad-coverage plans more heavily than basic plans, and we have evidence that this promotes inefficient use of resources and dulls the incentive to create cost-saving technologies." The tax penalty for cost-sharing is one of the reasons health insurance doesn't look like auto insurance or homeowners insurance and ends up driving up quantity, not quality.

Donald Marron provides the following insight about health insurance:

> Other major preferences could accomplish their intended goals at lower cost and with less economic distortion if they were redesigned as credits. The exclusion for employer-provided health insurance, for example, is an exceedingly inefficient way to encourage people to maintain health-care coverage. One flaw is that it offers bigger subsidies to high-income households. Because the exclusion matches the tax rate for each income bracket, the government picks up 35% of the insurance tab for an attorney earning $500,000, but only 15% of the cost for a truck driver earning $50,000. Not only is that "upside down" structure unfair, it also reduces the exclusion's efficiency in promoting health coverage — since high-income families are more likely to get health insurance without a subsidy than are lower-income families. If policymakers want to get as much health-insurance "bang" as possible for the many bucks devoted to health-insurance subsidies, it makes no sense to offer additional government assistance to people who are likely to carry insurance anyway.
>
> Another flaw is that the tax exclusion raises the cost of health insurance for everyone. Because the exclusion is essentially open-ended (i.e., whatever amount an employer spends on a worker's health insurance is excluded from that worker's taxable income), workers have an incentive to choose expensive, high-end insurance plans that cover as much health care as possible. Such plans will usually minimize cost-sharing provisions like co-payments (which consumers usually pay for with after-tax dollars) while offsetting the costs through high premiums (which are paid for with pre-tax dollars). ***This system, in turn, drives up health-care costs overall — since the generous employer-provided coverage removes individual consumers' financial incentives to limit their use of health services.*** Absent this tax distortion, insurers would offer less expensive plans that relied more heavily on co-pays, co-insurance, and deductibles in order to both manage demand for health services and keep insurance costs low.

The health insurance loophole is inefficient in driving health care value and it is inequitable.

Retirement Plans (Deferred Compensation)

The second largest tax expenditure is retirement plans. Teresa Ghilarducci, the Bernard L. and Irene Schwartz Chair of Economic Policy Analysis at the New School for Social Research makes the following observations concerning 401K plans –

> What's so wrong with employees getting 401(k) plans instead of pension plans?
>
> A main drawback is that more 401(k) plans would make the nation's retirement crisis even worse. Traditional pension plans are better deals than 401(k) plans for taxpayers because they cost less, attract and retain suitable workers, and help stabilize the economy.
>
> 401(k) plans are bad deal for taxpayers. Dollar for dollar, a traditional pension plan yields more pension benefits than do 401(k) plans because 401(k) management and investment fees are three times higher. And professionals who manage money in pooled pension funds usually get higher returns than workers who manage their own 401(k) accounts. The only clear winners when pensions switch over to the 401(k) plans are brokers and bankers.
>
> Last, the unintended effect of widespread 401(k) plans is more volatility. In contrast to traditional pensions and Social Security, 401(k) plans fuel bubbles and make recessions worse.

> When the economy is booming, 401(k) plan asset values soar, making people spend more and work less. Not what you want in an expansion. Worse, when the economy plummets and takes 401(k) assets with it, people do the opposite; they cling to the labor market and rein in spending – again, two things you don't want in a recession.

In a recent article in Investment News, Mary Beth Franklin said:

> Most of your clients are probably among the estimated 25% of U.S. workers who have amassed adequate savings through their workplace-based retirement plans and IRAs. **But the majority of Americans aren't doing so well** and that's becoming abundantly clear as the first generation of workers to depend primarily on 401(k) plans—rather than increasingly rate defined-benefit pension plans—start to retire.
>
> "For most of the middle class, the dream of a secure retirement is slipping out of reach," Sen. Tom Harkin (D-Iowa), said as he gaveled his Committee on Health, Education, Labor and Pensions (HELP) into session last week…"This disappearance of pensions has had a profoundly negative impact on retirement security in this country," Harkin said, noting that only 20% of private sector workers are covered by a defined benefit pensions plan today, down from about 50% thirty years ago. "It's made even worse by the fact that the middle class is being squeezed between stagnant wages and rising costs," he said, pointing out that **half of all Americans workers have saved less than $10,000 and many nothing at all. "We are facing a retirement crisis."**
> Collectively, Americans have racked up what the Center for Retirement Research at Boston College has dubbed the retirement income deficit. That's the $6.6 trillion shortfall between what people have saved for retirement and what BCC estimates that they should have saved by now.

The wealthiest taxpayers represent the majority of those benefiting from this loophole and the disadvantages mentioned by experts above suggest this expenditure should be eliminated. These deferred compensation plans are not benefiting most taxpayers, especially those that need to be saving for retirement.

Mortgage Interest Deduction

Mr. Marron comments about this loophole – "The same is true of the mortgage-interest deduction, another "upside down" preference that is more valuable for people in higher tax brackets. ***Researchers find that the mortgage deduction does little to encourage home ownership. Instead, it encourages middle- and upper-income taxpayers to buy bigger homes and take on more mortgage debt — neither of which is an important social goal.*** There is a good case, therefore, for simply eliminating the deduction. "

The above economists on the NPR program said this loophole is "extremely regressive and a perverse form of subsidy". We are subsidizing the rich to help them get an expensive home and in the process real estate prices are higher which makes it more difficult for others to qualify to buy a home. This loophole causes distortions in the housing market. Housing costs will go down if this loophole is eliminated.

Charitable Deductions

In a study, Evaluating the Charitable Deduction and Proposed Reforms, prepared by the Urban Institute Center on Nonprofits and Philanthropy and Urban Institute-Brookings Tax Policy Center, the following observations are made:

> The charitable contribution deduction is a long-standing feature of the federal income tax. Enacted in 1917, four years after the income tax, it is linked to tax exemption and has become an important source of support for the charitable sector, and one of the principal subsidies or tax expenditures in the tax code.
>
> With respect to the entire charitable sector, the revenue sources for 2005 with support from **private contributions constituting about 13 percent of total support**. This 13 percent number includes giving by corporations, private foundations, bequest, and non-itemizers, so **private giving attributable to individual itemized contributions is considerably less than 13 percent**. Itemizers provide the bulk of contributions, mainly because this minority of the population has the majority of the country's wealth and income.
>
> As to the allocation of giving by donors, "**higher-income donors contribute** larger shares of their donations . . . to health, education, art, environmental, and similar organizations, and **less to religious organizations, those meeting basic needs**, and combined purpose organizations" such as the United Way (Gravelle and Marples 2010).
>
> The charitable deduction tends to be justified as a subsidy or an appropriate income adjustment according to ability to pay. Is the deduction unfair or regressive? One ability-to-pay issue refers not to the horizontal (equal treatment of equals) aspect of the deduction, but to its effect on vertical equity or progressivity. One objection sometimes voiced is that the deduction is unfairly regressive because a higher subsidy rate applies to higher-income donors.

And again, the wealthiest taxpayers represent the majority of those benefiting from this loophole and since those charities meeting the basic needs of people are not the charities benefiting from itemizers that give, this tax expenditure should be removed.

Exhibit B

Multi State Summary of GDP Components History

Selected states were analyzed to determine if states could adopt the GDP tax as their base for taxation since the Bureau of Economic Analysis gathers GDP data by state. The attached spreadsheet summarizes GDP data and analysis results from 1997 – 2010. It initially indicates that states could look to the GDP tax idea as replacement or addition to their existing tax system.

Gross Domestic Product by State (millions of current dollars)

ARIZONA

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
GDP	128026	139276	150876	161792	170008	177068	189060	201006	222569	246099	259157	261128	245664	249824	
WAGES	69443	76564	82618	91237	95335	97873	103589	111801	123320	135342	142483	143456	135882	135904	
GOS	50009	53715	58451	59686	63455	67056	72557	75407	84558	94284	98664	100263	93490	98234	
% OF GDP															
WAGES	54.2%	55.0%	54.8%	56.4%	56.1%	55.3%	54.8%	55.6%	55.4%	55.0%	55.0%	54.9%	55.3%	54.4%	**55.2%**
GOS	39.1%	38.6%	38.7%	36.9%	37.3%	37.9%	38.4%	37.5%	38.0%	38.3%	38.1%	38.4%	38.1%	39.3%	**38.2%**

CALIFORNIA

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
GDP	1039176	1114035	1211851	1319472	1339978	1387213	1461072	1569816	1688949	1798197	1870916	1900463	1828836	1877568	
Wages	568837	617735	673505	759206	777082	786803	826026	875655	925360	976892	1021317	1036267	991583	1010410	
GOS	404287	427167	466302	482056	490312	512365	545765	598153	664096	708541	734052	740497	717911	744076	
% 0f GDP															
Wages	54.7%	55.5%	55.6%	57.5%	58.0%	56.7%	56.5%	55.8%	54.8%	54.3%	54.6%	54.5%	54.2%	53.8%	**55.5%**
GOS	38.9%	38.3%	38.5%	36.5%	36.6%	36.9%	37.4%	38.1%	39.3%	39.4%	39.2%	39.0%	39.3%	39.6%	**38.4%**

FLORIDA

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
GDP	394959	420569	450555	481239	506509	536061	574382	621417	681225	731467	760936	748117	726184	736065	
Wages	221297	239854	255755	277562	292012	304181	324518	347950	379980	406064	417572	414096	396575	400635	
GOS	135569	139393	151565	159106	168615	182364	195754	213550	236831	255275	269687	261627	261451	264935	
% of GDP															
Wages	56.0%	57.0%	56.8%	57.7%	57.7%	56.7%	56.5%	56.0%	55.8%	55.5%	54.9%	55.4%	54.6%	54.4%	**56.1%**
GOS	34.3%	33.1%	33.6%	33.1%	33.3%	34.0%	34.1%	34.4%	34.8%	34.9%	35.4%	35.0%	36.0%	36.0%	**34.4%**

NEW YORK

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
GDP	661274	687860	731120	769291	809035	822408	842678	891462	959867	1030373	1076255	1079719	1072311	1128823	
Wages	373214	401123	425993	465418	480181	476767	490873	517203	548340	588234	630521	649248	615308	638150	
GOS	240272	237668	254193	251934	276288	290623	291599	307662	337452	364028	364341	351222	378545	408373	
% of GDP															
Wages	56.4%	58.3%	58.3%	60.5%	59.4%	58.0%	58.3%	58.0%	57.1%	57.1%	58.6%	60.1%	57.4%	56.5%	**58.1%**
GOS	36.3%	34.6%	34.8%	32.7%	34.2%	35.3%	34.6%	34.5%	35.2%	35.3%	33.9%	32.5%	35.3%	36.2%	**34.7%**

TEXAS

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
GDP	602160	634286	670604	731064	762885	782780	824489	903679	968553	1054414	1147404	1209267	1129537	1222904	
Wages	314492	345979	369906	403299	422013	427957	440655	462233	496295	539585	581481	615180	601259	619854	
GOS	240031	238659	247227	271033	281353	290767	316947	370654	396445	432035	476662	503024	440612	511389	
% of GDP															
Wages	52.2%	54.5%	55.2%	55.2%	55.3%	54.7%	53.4%	51.2%	51.2%	51.2%	50.7%	50.9%	53.2%	50.7%	**52.8%**
GOS	39.9%	37.6%	36.9%	37.1%	36.9%	37.1%	38.4%	41.0%	40.9%	41.0%	41.5%	41.6%	39.0%	41.8%	**39.3%**

Exhibit C

Questions and Answers

The following questions and answers will hopefully answer some of the questions about the GDP tax. In addition, issues concerning amendments to the constitution are also addressed. Some of the material was obtained from Robert E. Hall and Alvin Rabushka's book, *The Flat Tax* and Mr. Rabushka's paper, *A Compelling Case For A Constitutional Amendment to Balance The Budget and Limit Taxes.*

Q: **Mortgage Interest Deduction** – The only way I can afford my house is the large tax deduction I get for the interest on my mortgage. Won't I need to sell my house if I can no longer take the deduction?

A: By removing the interest deduction and also not taxing interest income will bring about lower interest rates which will reduce monthly mortgage payments which will offset the loss of the mortgage interest deduction for most taxpayers. Only the wealthiest taxpayers may lose out from the elimination of the mortgage interest but they receive compensation in the form of lower interest rates. Perhaps a transitional measure would allow present homeowners to deduct a percentage of their interest for a few years until they can renegotiate their mortgages or make other arrangements. (see *The Flat Tax*, page 164).

Q: **Tax Credits** - I own a building that is part of a low-income housing project, for which I get a low-income housing credit. If you take this credit away, what will happen to those poor people who live in low-income housing projects?

A: In our current tax system, all credits would disappear (such as the jobs credit for business employers who hire members of special targeted groups, credit for alcohol used as fuel, increasing research activities, renewable electricity production credit, the low-income housing credit , child and dependent care credits, etc.). All of these credits distort the economy and narrow the tax base, thereby raising rates for everybody else. These tax credits result in taxpayers' money being put into elaborate installations and activities that are at or below the margin of economic efficiency. It would be far more efficient for the government to subsidize these activities directly, rather than indirectly through the tax code. In particular, the government could give poor people housing vouchers to find housing in the market economy and use the welfare system to assist the poor with food, utilities, and other basic needs.

The tax system is not the proper place to undertake social engineering. The merits and financing of social programs are subjects for open public discussion during the annual appropriations process in which members of Congress have to vote on the record for each expenditure. These programs should not be tucked away in the tax system, which has contributed to our complicated tax system. (see *The Flat Tax*, page 165-166 and 172).

Q: **State Tax Systems** – How does the GDP tax affect state income taxes where the tax returns are linked to the federal tax system?

A: States also have historical GDP records like the federal government and their GDP components (wages and business profits) also reflect consistent trends. Therefore, states should consider the GDP tax to replace their current income tax systems.

Q: **Governments** – Does the federal government tax itself and are state and local governments taxed?

A: All governments pay no taxes themselves but their employees pay taxes on their compensation just like any other employees are taxed that work for businesses (or non-profit organizations).

Q: **Fringe Benefits** – What will happen to my fringe benefits under the GDP tax?

A: Fringe benefits arose in World War II as employers tried to find a way to pay their employees more under stringent wartime regulations. During the past fifty years, employees have often struggled harder for better fringe benefits than for pay increases because of the tax-free status of fringes.   Today, fringe benefits are an extremely important part of any compensation package, and your employer will not cut your benefits without compensating you in some other way.

Fringe benefits are among the largest contributors to narrowing the tax base (see earlier discussion about the negative impact of tax expenditures like health insurance premiums paid by employers). It is important to include the value of fringe benefits in the tax base; otherwise, tax rates, levied on a smaller tax base, will remain unnecessarily high. The GDP tax eliminates the distortion toward fringe benefits created by the fact that employers can deduct them, thereby receiving a subsidy that can be passed on to their employees. The best alternative, and one we expect your employer to select, is to offer you higher pay in exchange for lower fringes. You can then use the extra cash to buy whatever combination of benefits you desire or for any other purpose, such as travel, housing, educational expenses, etc. (see *The Flat Tax*, page 170).

Q: **Compensation** – Is it fair to start taxing workers compensation benefits and insurance for injury or sickness?

A: Workers' compensation benefits are money that replaces wages when a worker is disabled on the job. The wages themselves would have been taxed, so it stands to reason that the replacement should be taxed. Failure to tax workers' compensation benefits creates an inappropriate incentive for workers to remain off the job after a period of disability. (see *The Flat Tax*, page 172).

Q: Part of my compensation comes in the form of stock options. How are these taxed?

A: The full market value of the options is included in your compensation in the year you receive them, whether or not you exercise them.

Q: How would taxpayers be taxed on stock they receive as a result of their services and efforts in starting new businesses (such as founders stock)? And how are taxpayers taxed that receive payment for their services in the private equity market and from hedge funds for a share of the profits of an investment or investment fund in excess of their contributions (often referred to as "carried interest"?

A: Taxpayers that receive stock or interest in investments for services rendered would pay the compensation tax on the fair market value of these investments under the GDP tax and not receive capital gain treatment. Under the GDP tax, capital gains and interest income are not taxed.

Q: **Capital Gains & Losses**– What about capital gains? Won't the elimination of capital gains give a windfall to business and the rich?

A: Gains on the sale of assets are only taxed on businesses to the extent the assets sold were depreciable and only to the extent of depreciation taken (see **Q: Depreciation** under Business Taxes section below). However, gains from the sale of stocks, bonds, and other financial instruments and other assets are not taxed because these gains arise from the capitalization of after-tax income.

As the earnings of a business grow, the value of a share of stock also rises because stock constitutes a claim on the firm's after-tax income. Remember that all business earnings are fully taxed under the NOS component of the GDP tax. Another tax on the appreciation of shares would amount to a second tax on a single stream of income. Put another way, share values rise because investors have every reason to believe that retained earnings, which permit firms to expand, significantly increase the probability of higher future earnings. (for the ideas of this paragraph, see *The Flat Tax*, page 175-176).

Q: How are capital losses and other losses for individuals and businesses treated?

A: Losses from the sale of stocks, bonds, and other financial instruments and other assets are not considered in the GDP tax because these losses arise from the capitalization of after-tax income. Our current system allows taxpayers that are willing to take significant risks to receive a tax benefit for the losses they sustain. This is not fair to the taxpayers that do not take risks since they are currently subsidizing risk taking. In addition, business losses (from all types of entities such as self-employed, partnerships, and corporations) are not allowed because the NOS tax is based on gross sales and gross revenue.

Business Taxes

Q: **Depreciation** – Is the depreciation deduction built into the GDP tax?

A: The Net Operating Surplus (NOS) reflects the surplus remaining after total costs are deducted from total revenue, including depreciation which is the consumption of fixed capital. In national economic accounting (versus GAAP – General Accepted Accounting Principles), assets and depreciation are valued at current costs (versus historical costs), which are the actual or estimated market prices that prevail at the time assets are valued or depreciation occurs. Current costs are used in national economic accounting because they serve as the best practical approximation to the economic notion of opportunity costs. The GDP of each industry reflects its use of depreciable assets.

Q: What if a business buys an asset(s) that costs much more than the average cost of a similar asset that other businesses use in their related industry?

A: The GDP tax on NOS is based on a business's industry tax rate which is applied to sales/revenue. For example, if a business buys an expensive aircraft to do business travel which travel is considered "ordinary and necessary" for its business, then that business would not get special treatment for the excess travel costs. Otherwise, other taxpayers would be subsidizing the excessive costs of that business.

Q: What happens to the write-off provisions that currently exist in our tax system like accelerated depreciation, bonus depreciation and immediate write-off of an asset up to a certain amount under §179 of the Code?

A: Depreciation costs are calculated based on current costs (see above) and no special write-offs exist under the GDP tax. However, if Congress wanted to stimulate the economy, they might allow taxpayers to deduct the cost of a new assets up to a certain dollar amount similar to our existing bonus depreciation rules and/or write-off provisions under §179 of the Internal Revenue Code. However, taxpayers would need to recapture the amount (include in their taxable revenue amount) perhaps over the next 3-5 years plus pay interest since it would be like a loan. The Federal interest rates could be used to calculate interest charges – these rates change quarterly based on the terms of the loan. The taxpayer should be required to provide proof of the asset acquisition before the deduction would be permitted against their revenue (before applying the NOS % and tax rate to arrive at the final tax liability).

Q: **Gain on Sale of Assets** – Under the GDP tax, there is no tax on capital gains. However, when business assets are sold at a gain, the amount of gain that represents depreciation taken in prior periods would be added to the revenue of the business in the year of the asset sale for NOS tax purposes since NOS represents a business's revenue subject to tax AFTER reducing it for the allowed depreciation.

For example, if a business asset cost $100,000 at the time of acquisition and was then sold a few years later for $50,000 and if the depreciation taken during the life of the asset was $60,000, then the adjusted tax basis at the time of the sale would be $40,000 and the gain on the asset would be $10,000. Since the gain of $10,000 is less than the depreciation taken of $60,000, then $10,000 needs to be added to the business's revenue amount to be taxed (at that business's NOS tax rate). However, if the asset sold for less than $40,000, then no gain and therefore no recapture of depreciation. In addition, no loss on the sale of the asset would be deducted from the NOS taxable income amount. Also, if the asset sold for over $100,000, then the gain in excess of the depreciation taken of $60,000 would not be taxed since it would represent capital gain income which is not taxed under the GDP tax system.

Q: **Personal Use of Business Assets** – Should a business be required to pay taxes on the gain from the sale of a business asset(s)?

A: Under the current tax system, part of the Tax Gap is due to overstating business expenses. This occurs when businesses buy assets like vehicles and aircraft to use in their business but do not exclude the personal use of these assets. Under the GDP tax, unless the taxpayer provides proof that the business asset was used for personal reasons, the gain due to the recapture of depreciation will not be reduced (see example above). The IRS should continue to require businesses to report the sale of asset(s) through the use of Form 1099 to help enforce the collection of taxes when gains result from the sale of business assets.

The administrative cost of enforcing our current system is very inefficient. For example, the cost to the taxpayer as well as the IRS in terms of money and time to examine the business and personal use of aircraft is overwhelmingly costly and takes months to examine because most taxpayers do not have the detailed records required to comply with the complicated tax laws impacting "listed property" 'like aircraft and vehicles. Listed property is defined as an asset that can be used for personal and business purposes. These assets have historically been abused by taxpayers when deducting their costs on business tax returns. Under the GDP tax, the motivation and burden of keeping detailed records would shift to the taxpayer.

For a wealthy taxpayer that decides to buy the most expensive assets to use in their business, like a business aircraft, keeping detailed records to support personal use of the asset would be very important. These taxpayers would be highly motivated to keep these records so that when the asset is sold, the potential gain from recapture of depreciation would be minimized.

Q: **Double Taxation** – The current tax system sometimes taxes income twice. Isn't income no matter what its source still income?

A: Income is an individual's command over resources. Only people have income. The income of a corporation is just the income of its owners, the stockholders. The current system taxes the same income twice, once when the corporation receives it and again when it is paid as dividends to stockholders. Double taxation amounts to confiscation, which violates every concept and definition of fair. (see *The Flat Tax*, page 175).

Fairness

Q: Isn't the GDP tax a windfall to the rich?

A: Taxation of families with high incomes and few deductions would be dramatically reduced under the GDP tax. But those who have taken advantage of the many opportunities in the tax code to reduce or postpone taxes through tax shelters, large deductions, purchasing municipal bonds, and other gimmicks will pay significantly higher taxes. Those who work hard will do better; those who have concentrated on avoiding tax will do worse.

The GDP tax includes a generous allowance based on the poverty threshold per household. This will mean millions of working families will no longer pay any income and payroll taxes. Those in the middle class will face a lower rate of tax. The GDP tax will improve every taxpayer's incentive to work, save, and invest; a shift to producing income instead of avoiding or reducing taxes. (For the ideas of this paragraph, see *The Flat Tax*, page 185).

Q: Isn't the GDP tax unfair because rich people can live off interest and capital gains income and thereby pay no taxes?

A: The GDP tax puts the equivalent of a withholding tax on interest and capital gains. The business tax applies to business income before it is paid out as interest or if it is retained in the business and generates capital gains for stockholders. The interest, dividends, and capital gains received by individuals in all income categories have already been taxed under the business tax. The rich, along with all other recipients of business income, have already been taxed under the business tax – they cannot escape it. What they receive as dividends, interest, or capital gains is after-tax income, in exactly the same way that recipients of wages receive take-home pay. (For the ideas of this paragraph, see *The Flat Tax*, page 187-188).

Q: Isn't the GDP tax less progressive than the current income tax?

A: The simple GDP tax applies to every taxpayer (individual and business) and all pay the same rate except the wealthiest. This tax is much fairer than the current income tax with its unfathomable complexity and unconscionably high compliance costs. Until recently, fairness meant equal treatment under the law. Equating fairness and making the rich pay more is a modern invention of those who believe the tax system should be used to redistribute income to make everyone equal. (For the ideas of this paragraph, see *The Flat Tax*, page 185-186).

The GDP tax is progressive. Families and individuals with higher income pay a larger fraction of their income in taxes.   Taxpayers that make less than the poverty threshold amount do not have any tax liability and as their income exceeds these thresholds, only the excess earnings are taxed at the flat GDP tax rate. For those taxpayers that exceed the range that is considered and determined by the government each year to be the "middle class", the poverty threshold deduction is phased out dollar for dollar until it is gone. And finally, for those taxpayers that make significantly more than the middle class amounts, the GDP tax rate is increased as their income increases. The reason the highly compensated taxpayers pay a higher GDP tax rate is due to the fact that the goal of the GDP tax is to bring revenue into the Treasury that is comparable to historical tax receipts, approximately 18.5% of GDP. As a result, those highly compensated taxpayers need to make up the tax revenue lost due to the poverty threshold exclusion.

Q: Will businesses pay its fair share of taxes under the GDP tax?

A: It must be repeated over and over again that only people pay taxes. The true incidence or burden of income taxes on corporations is not fully known – some is effectively paid by owners, some by employees, and some by consumers (who are basically workers in another guise). The GDP tax is designed to collect all the tax that business owes, much of which escapes taxation under the current system because the IRS attempts to collect it from individuals instead of at the source (this is referring to pass through entities like partnerships and S corporations that do not pay tax but pass to partners and shareholders their share of the business's activities using a Form K-1 for the individual to ultimately pick up the income and pay the taxes).

Income from business sources is taxed at the same rate as income from employment (wages), so that all productive economic activity is taxed fairly – at the same rate. Under the current system, some business income is taxed at excessive rates because of the double taxation of corporate dividends and capital gains. Other business income is lightly taxed or even subsidized through tax shelters, such as farming income. (for most of the ideas of this paragraph, see *The Flat Tax*, page 187).

Economy

Q: How will the GDP tax help the American economy?

A: Studies shows that lower tax rates on businesses and employees, by improving incentives, increase the supply of labor, capital, and entrepreneurship. More people will join the labor force or work longer hours, especially in two-earner households; more people will risk their capital; and more people will undertake risky ventures to start up new businesses. (see *The Flat Tax*, page 192-193).

Q: What will happen to the stock market if the GDP tax goes into effect?

A: Expect the stock market to rise. Lower tax rates on corporations, coupled with the elimination of both the taxation of dividends and/or capital gains, will increase corporate income and make ownership of stock more attractive. (see *The Flat Tax*, page 193).

Q: Will foreign investment in the United States increase or decrease under the GDP tax?

A: The GDP tax would make the business climate in the US more attractive than most other nations. Foreign investment should pour into the US. The inflow of foreign investment will raise the value of the US dollar in foreign exchange markets. (see *The Flat Tax*, page 181).

Enforcement

Q: Will the IRS be necessary? What issues would the IRS want to address during an exam under the GDP tax?

A: The IRS will still be needed because enforcement will still be necessary but scaled back significantly, perhaps 75% or more. The only issues the IRS would focus on during examinations would include:

Individuals

- reasonable compensation and fringe benefits
- pension and retirement payments
- Bartering

Businesses

- Business receipts for sale of goods and services and compensation and fringe benefits paid to employees and contractors
- Sale of depreciable assets
- Ensuring businesses have been assigned the correct NAICS code for each line of business or industry they participate in so the correct NOS tax rate is properly applied

Exhibit D

Proposed Tax Code Language

The following text comes from Robert E. Hall and Alvin Rabushka's book, *The Flat Tax,* the 2nd Edition. The text has been modified to reflect the GDP tax. For example, the GDP tax includes fringe benefits in the compensation component of the GDP tax but in *The Flat Tax,* the authors do not include fringe benefits in the taxpayers' compensation because they do not allow the business to deduct the benefits in arriving at business taxable income. In addition, business taxable income is defined differently.

Also, if a national consumption tax is added, then proposed tax code language needs to be developed.

A GDP Tax Law

A BILL TO AMEND the Internal Revenue Code to implement a GDP tax system.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled

That (a) subtitle A of the Internal Revenue Code is amended to read as follows.

SECTION 1. SHORT TITLE

This act may be cited as the "Tax Reform Act of 2013."

Subtitle A – Income Taxes

Chapter 1. Computation of taxable income.
Chapter 2. Determination of tax liability.
Chapter 3. Exempt Organizations.
Chapter 4. Withholding.

CHAPTER 1. COMPUTATION OF TAXABLE INCOME

Sec. 101. Compensation defined.
Sec. 102. Business receipts defined.
Sec. 103. Cost of capital equipment and structures defined.
Sec. 104. Business taxable income defined.

Sec. 101. Compensation defined

(a) In general. Compensation means all cash amounts paid by an employer or received by an employee, including wages, pensions, bonuses, prizes, and awards.
(b) Certain items included. Compensation includes
   (1) The cash equivalent of any financial instrument conveyed to an employee, measured as market value at the time of conveyance
   (2) Workman's compensation and other payments for injuries or other compensation for damages
   (3) Goods and services provided to employees by employers, including but not limited to medical benefits, insurance, meals, housing, recreational facilities, and other fringe benefits
(c) Certain items excluded. Compensation excludes
   (1) Reimbursements to employees by employers for business expenses paid by the taxpayer in connection with performance by him or her of services as an employee
   (2) Wages, salaries, and other payments for services performed outside the United States

Sec. 102. Business receipts defined

Business receipts are the receipts of a business from the sale or exchange of products or services produced in or passing through the United States. Business receipts include

(1) Gross revenue, excluding sales and excise taxes, from the sale of goods and services
(2) Fees, commissions, and similar receipts, if not reported as compensation
(3) Gross rents
(4) Royalties
(5) Gains from the sale of plant and equipment determined by taking gross receipts less the remaining cost basis of the asset at the time of the sale but not below zero and limited by the amount of depreciation allowed or allowable
(6) The market value of goods, services, plant, equipment, or land provided to its owners or employees
(7) The market value of goods, services, and equipment delivered from the United States to points outside the United States, if not included in sales
(8) The market value of goods and services provided to depositors, insurance policyholders, and others with a financial claim upon the business, if not included in sales

Sec. 103. Cost of capital equipment and structures defined

The cost of capital equipment and structures includes any purchases of these items for business purposes. In the case of equipment brought into the United States, the cost is the market value at the time of entry into the United States.

Sec. 104. Business taxable income defined

Business taxable income is business receipts plus any gains on the sale of business depreciable assets to the extent of depreciation previously allowed or allowable.

CHAPTER 2. DETERMINATION OF TAX LIABILITY

Sec. 201. Personal allowances

(a) In general. For the year 2014, personal allowances are allowed against the compensation taxable income based on the size of the taxpayer's household size determined by the Poverty Threshold tables for the current year provided by the U.S. Census Bureau.
(b) Adjustments. Each year, personal allowances rise or fall based on the Poverty Threshold tables for the current year provided by the U.S. Census Bureau.

Sec. 202. Compensation tax

Each individual employed at any time during the year will pay a tax of 20 percent of his compensation, less his personal allowance, or no tax if his compensation is less than his personal allowance.

Sec. 203. Business tax

(a) Business defined. Each sole proprietorship, partnership, and corporation constitutes a business. Any organization or individual not specifically exempt under chapter 3, with business receipts, is a business.
(b) Computation of tax. Each business will pay a tax of 20% of its business receipts multiplied by the business's North American Industry Classification System's (NAICS) Net Operating Surplus (NOS) percentage, or zero if business taxable receipts is zero.
(c) The U.S. Census Bureau will provide the IRS the NAICS NOS rates for each industry to be used during the current tax filing season by the beginning of the government's fiscal year preceding the next calendar year tax filing season.
(d) Multiple NAICS codes. Each business must track the type of income by NAICS industry code to apply the correct tax rate to the appropriate business receipts.

CHAPTER 3. EXEMPT ORGANIZATIONS

Sec. 301. Exempt organizations

Organizations exempt from the business tax are

(1) State and local governments, and their subsidiary units
(2) Educational, religious, charitable, philanthropic, cultural, and community service organizations that do not return income to individual and corporate owners

CHAPTER 4. WITHHOLDING

Sec. 401. Withholding

Each employer, including exempt organizations, will withhold from the wages, salaries, and pensions of its employees and remit to the Internal Revenue Service an amount computed as follows: 20 percent of the excess of compensation in each pay period over the employee's annual personal allowance, prorated for the length of the pay period. Every employee will receive a credit against tax for the amount withheld.

The amendment made by this section shall apply to taxable years beginning after December 31, 2013.

Exhibit E

Amendments to Constitution for taxing and spending limits and Proposed Language

In 1982, Alvin Rabushka, Senior Fellow at Hoover Institution Stanford University, wrote a paper for the Taxpayers' Foundation titled *A Compelling Case For A Constitutional Amendment to Balance The Budget and Limit Taxes*. Below are important quotes to help explain the need for a constitutional amendment to deal with tax AND spending limits. I have included in RED the estimates of what some of the statistics are today (2013) vs. Mr. Rabushka's numbers in the early 1980s when he prepared the paper. As you read, it is obvious that we are in worse shape today than the early 1980s as Mr. Rabushka expressed the dire situation that existed at the time of his report.

> On November 26, 1798, a decade after the U.S. Constitution was written, Thomas Jefferson wrote, "I wish it were possible to obtain a single amendment to our Constitution. I would be willing to depend on that alone for the reduction of the administration of our government to the genuine principles of its Constitution; I mean an additional article, taking from the federal government the power of borrowing."
>
> Today, the need for such an amendment to the Constitution is greater than ever. Large and protracted federal deficits have brought havoc to today's economy. The nation's trillion dollar debt **($16.5T in 2013)** represents a true and onerous burden to the average American citizen. The carrying cost on the debt has skyrocketed. The bill we pay arrives in several forms: higher taxes, declining real income, higher interest rates and a recently ended recession.
>
> **Amending The Constitution**
>
> Article V of the Constitution provides two methods of proposing amendments. **The first method**, by which all 26 amendments have thus far been adopted, **requires the proposal of an amendment by two-thirds of each House of Congress, and ratification by three-fourths of the states**. The **second method allows for an amendment drawn by a constitutional convention, which must be called by Congress in response to the application of two-thirds of the states.** Whichever method is invoked, the proposed amendment must be approved by three-fourths of the states (38) before it becomes part of the Constitution.
>
> A balanced budget amendment could overcome the inherent bias for increased federal spending by restoring the link between federal spending and taxing decisions……. federal revenues could not grow faster than the private economy; the amendment thus prohibits the federal government from consuming an ever-increasing share of our income.

Americans have come to the realization that the problem of deficits in this country is not one that can be resolved by any' one individual or group of individuals. It is an institutional problem requiring a constitutional solution.

Had the founding fathers not taken for granted the concepts of limited government, they might have incorporated a balanced budget amendment into the original constitution. Indeed, it was the 16th amendment, which authorized Congress to "lay and collect taxes on incomes," that is at the root of our present discontent with the budget process. Without a progressive income tax code, government spending might be substantially lower and the need for a restraining amendment correspondingly less.

175 Years of Fiscal Prudence

The founding fathers adopted two explicit constitutional provisions and assumed a third which served to restrain spending. One reserved powers not expressly delegated to the federal government to the states and to the people. The second provided for per capita distribution among the states of taxes on income. The third, implicit, assumed that federal spending would not exceed federal revenues except in times of war or recession. All three have been abrogated or eroded, by time and events, especially by the adoption of the Sixteenth Amendment (income tax) in-1913. Indeed, it is the income tax amendment that lies at the roots of the current balanced budget amendment movement.

Someone born in the post-depression era would regard deficit financing as normal budget practice. Yet until the great depression, the balanced budget, save in wartime or recession, was considered part of our "unwritten constitution." ***Thomas Jefferson warned that "the public debt is the greatest of dangers to be feared by a republican government" and proposed the idea of a balanced budget amendment as early as September 6, 1789.*** Alexander Hamilton strongly urged the repayment of national debt. Presidents John Adams, James Madison, James Monroe, John Quincy Adams, and Andrew Jackson all urged avoiding public debt. A balanced budget was synonymous with sound political economy.

Until the Great Depression of the 1930s, budget deficits occurred only in times of war and recession. The budget surpluses generated in good times were invariably used to reduce the national debt these deficits produced.

Sustained deficits first arose during the depression years of the 1930s and the war years of the early 1940s, leaving in their wake a national debt of about $170 billion. These deficits were consistent with the national experience of war time and recession. When peace returned, deficits again disappeared. **Between 1947 and 1960, seven surpluses of $31 billion roughly offset seven deficits of $32 billion. However, for the first time in American history, no effort was made to reduce the national debt.**

Why the Congress Can't and Won't Control "Federal Spending and Deficits

Due to the operation of the unwritten norm of budget balance; the federal government was rarely troubled by budget deficits through almost 200 years of our history. Indeed, revenues and expenditures were not incorporated into an overall official budget until 1921.

But today federal budgets are wildly out of balance. Why?

The answer lies in the political reality that budget objectives and the budget process are in direct conflict. The Congress, as a whole, is concerned with stable prices, low interest rates, and full employment, which require some check on the scope of government spending. **As individuals, however, each congressman confronts pressures to increase spending. The reality of our system has shown convincingly that the collective need to control spending is no match for the pressures each individual member faces to increase it.**

In 1921, historical debates on congressional reform clearly address the structural problem we face:

> Our present system cannot be conducive to economic administration as it invited increased expenditures through the perfectly natural rivalry of numerous committees and the inevitable expansion of departments ...Our present system is designed to increase expenditure rather than reduce it.
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> Each committee in the House quite naturally is jealous of both its jurisdiction and success in legislation. It will therefore push to the limit its jurisdiction over legislation and its demand for appropriation that enlarges the function falling under its jurisdiction. Appropriations from the several committees become a race between or among rivals to secure funds from the Treasury rather than safeguard them ... The pressure is for outlay. **(debate on the Budget and Accounting Act of 1921)**

The concerns they represent reflect the empirical fact that the American political process is biased toward higher levels of federal spending; levels which do not reflect the genuine will of the people on the overall size of the budget. Federal spending is skewed toward these artificially higher levels because members of Congress have powerful incentives to spend the taxpayers' money yet they face few offsetting incentives to watch out for the taxpayers' interests.

Spending Biases

This bias toward more spending is due, first, to what analysts of government call the phenomenon of "**concentrated benefits versus dispersed costs**." This describes the fact that the benefits of any given spending program normally are concentrated among a small number of persons, while the costs of such a program are dispersed throughout a much larger class, the general taxpayer.

The competition between tax-spenders and tax-payers is highly unequal: it is simply not as worthwhile for an individual taxpayer to spend much time and effort to save a few dollars in taxes as it is for the spending interests to secure millions or billions of dollars for themselves. The latter intensely focuses on those few spending measures from which they derive benefit, while the individual taxpayer, who might normally be concerned about the broader impact, is less likely to organize for the purpose of defeating a particular spending measure. Spending interests are able to reward or punish legislators with their organized electoral support or opposition. Taxpayers find it more difficult to perceive their self- interest in the context of isolated pieces of legislation. Thus, whenever government programs are considered one by one, as they are in our budgetary system, there is a bias toward government growth. The result has been annual budget growth in the neighborhood of $100 billion (**over $1T annual deficits since 2008**), with even larger deficits forecast.

The explosion in federal spending is not due to the failure to elect the "right" people, it is an institutional defect. The federal budget process is inherently biased toward deficits, higher taxes, and greater government spending. The trends toward bigger government and economic instability reflect the decisions of reasonable men and women in Congress who, as individuals, cannot successfully resist the pressures they face to increase spending.

A second source of bias toward greater spending is the separation of benefits, which are short-run, from costs which are typically more long-run. The benefits of spending programs are immediate, both to the recipients and the sitting congressmen who supported them. The costs of spending programs-in the form of potentially higher future taxes, higher future inflation, higher future unemployment or higher future interest rates-will be evident only at some future time, to be borne, perhaps, by future congressmen. Since the electoral time horizon of all House members and one-third of the senators is never more than a year or two away, short-term benefits invariably take precedence over potentially long-run adverse economic effects due to higher government spending.

A third bias arises within the structure of Congress itself. The committee system, whatever its original intentions, finds members of Congress gravitating to those specific committees that allow them to serve their geographic constituencies 'by bringing home their "fair share." Farm state members typically serve on the agricultural committees, Western legislators on interior policy committees, urban legislators on urban policy committees, and so on. Reelection rewards those congressmen who successfully serve their constituencies, at the same time the actions of Congress as a whole damage the growth rate of the economy. The driving elements in each congressman's calculation is protecting his turf, getting his share of the pork barrel not transgressing his colleague's committee jurisdiction; in short, concerns about self, come first. It is not in the interest of an individual congressman to give up those dollars that benefit his constituents, since that reduction will have only a modest or even insignificant effect on overall spending. The same situation fits all 535 members of Congress. Unless the entire membership can agree to limit spending, no one member or group of members dare risk their constituents' wrath by surrendering benefits that have no appreciable effect on the total size of government spending, while their colleagues, who do not forego spending, continue to earn the support of their respective constituents. **The only viable solution to this dilemma is to alter the incentives which confront members of Congress. That is, we must change the rules under which congressmen operate.**

Thus in sharp contrast with historical experience, the federal budget process has failed to show restraint in the post WW II era. For the better part of 200 years, Americans held to a limited role for the federal government. Save for periods of war or recession, revenues from customs and excises were sufficient to fund those activities widely regarded as “proper" federal function. This consensus has broken down in the last fifty years (1920s-early 1980s). **The greater part of the current federal budget is devoted to activities not funded fifty years ago.**

In short, deficits matter!

In fact, deficits matter in ways other than those purely economic. **Yet another effect of excessive government spending has been the erosion of public confidence in government.** Surveys conducted by George Gallup, Louis Harris, the Institute of Social Research at the University of Michigan, and CBS/New York Times reveal major shifts in public opinion between 1957 and 1978. The percentage of respondents who said that government wastes money rose from 46 to 80. But the number of those who said they trust Washington to do what is right most of the time declined from 75 to 34 percent! **(In August 2012, Congress's approval rating was 10%) ……..**according to Gallup, **80 percent of the American people favor a constitutional amendment to require a balanced budget.**

SENATE JOINT RESOLUTION 58. A BALANCED BUDGET -TAX LIMITATION CONSTITUTIONAL AMENDMENT

Since 1979, members of the Senate Judiciary Subcommittee on the Constitution have sought to develop a "consensus" measure that would attract the support of as many proponents of a constitutional initiative as possible. Senate Joint Resolution 58, a combined balanced budget and tax limitation amendment was passed by the Senate on August 4, 1982 by a vote of 69-31 **(69% > 67% required vote)**. The House considered the companion resolution, H.J. Res. 350 on October I, defeating the proposed amendment by a vote of 236-187 **(56% < 67% required vote)**, thus failing to produce the two thirds vote required for passage of a constitutional amendment. **Nevertheless, the contents of that bill are very likely to be included in whatever amendment is finally sent to the states for ratification.** For this reason, it is worth examining each section of that proposed amendment to see how it would redress the present imbalance in our budgetary process.

BALANCED BUDGET

> ***Section 1.*** *Prior to each fiscal year, the Congress shall adopt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts. The Congress may amend such statement provided revised outlays are no greater than revised receipts. Whenever three fifths of the whole number of both Houses shall deem it necessary, Congress in such statement may provide for a specific excess of outlays over receipt by a vote directed solely to that subject.*

The Congress and the President shall ensure that actual outlays do not exceed the outlays set forth in such statement.

(I would add my idea to the amendment to have a default plan in place so that if Congress cannot agree on a budget plan, then the average of the prior3-5 years GDP would become the default amount to base the budget on at a rate of no more than 20%. Since GDP has grown every year since the 1920s except 1938, 1946, 1947 and most recently in 2009, and if tax receipts is based on the same 20% rate but at current GDP numbers, then Congress would be spending less than the tax receipts and therefore provide surpluses that could be used to pay down the national debt)

The purpose of Section 1 is two-fold. First, Congress would be required to plan to balance its budget every year. It would do so by adopting a "statement" or budget prior to the start of each fiscal year, in which planned outlays (spending) do not exceed planned receipts (revenue). Congress could violate this rule and plan for a deficit only by a three-fifths vote of the whole number of each House of Congress, not just three-fifths of those present and voting. In contrast, a simple majority could approve a budget surplus. Second, **Section 1 also mandates that actual outlays do not exceed the spending levels set forth in the approved statement or budget.**

It is important to point out that the amendment establishes the basis for a planned balanced budget. **It does not require that the budget be in actual balance during the course of the fiscal year.** In some circumstances, actual outlays may exceed actual receipts. For example, a recession might reduce actual receipts' below the level of receipts set forth in the planned statement. This is permissible under the amendment, but actual outlays could not exceed statement outlays. Deficits caused by increased spending, would also not be permitted.

TAX LIMITATION

Section 2. *Total receipts for any fiscal year set forth in the statement adopted pursuant to this article shall not increase by a rate greater than the rate of increase in national income in the last calendar year ending before such fiscal year, unless a majority of the whole number of both Houses of Congress shall have passed a bill directed solely to approving specific additional receipts and such bill has become law.*

The purpose of Section 2 is to prevent tax receipts from' growing more rapidly than the general economy, as occurs with our progressive tax code. Under the amendment, a "whole" majority of the membership of both Houses would have to vote to permit receipts to outpace general economic growth. In particular, Congress would be required to enact a bill expanding "a specified tax base and/or increasing specified tax rates."

WARTIME WAIVER

> ***Section 3.*** *The Congress may waive the provisions of this article for any fiscal year in which a declaration of war is in effect.*

In the event of a declaration of war, Congress has the discretionary authority to operate outside of the provisions of the amendment. Such a waiver would be on a year-to-year basis by concurrent resolution of Congress, as defined under Article I, Section 8, of the Constitution. Congress would have to adopt annually a separate waiver for each fiscal year at issue.

BORROWING AND REPAYMENT OF DEBT

> ***Section 4****. Total receipts shall include all receipts of the United States except those derived from borrowing and total outlays shall include all outlays of the United States except those for repayment of debt principal.*

The purpose of Section 4 is to exclude the proceeds of debt issuance from receipts. Thus, treasury notes and bonds would not count as receipts, but as the proceeds of selling debt. Similarly, **the term outlays is intended to include all disbursements from the Treasury of the United States, both "on-budget" and "off-budget" either directly or indirectly through federal or quasi-federal agencies created under the authority of acts of Congress.** Section 4 states that funds used to repurchase or retire Federal debt would not count as outlays. Interest accrued or paid in conjunction with the debt obligation would, however, be included in outlays.

The amendment permits Congress to plan for a budgetary surplus. Those surplus receipts, subject to the increase limit of Section 2, used to repay principal-that is, retire national debt-would not be counted as outlays. Should the government fully retire the national debt, the amendment would still allow the government to plan for an annual surplus, and even accumulate reserves. Interest earned on these reserves, however, would be subject to the revenue limit.

DATE OF IMPLEMENTATION

> ***Section 5.*** *This article shalt take effect for the second fiscal year beginning after its ratification.*

Section 5 stipulates when the amendment would take effect. If ratification were completed before September 30, 1985, the amendment would require Congress to adopt its first balanced budget statement before September 30, 1986; if ratification was completed between October I, 1985, and before September 30, 1986, the first balanced budget adoption would be required by September 30, 1987, and so on.

Below are some questions and answers about the Balanced Budget-Tax Limitation Amendment Mr. Alvin Rabushka provided in his paper:

> Q: Members of Congress face enormous pressures to increase spending. How would the amendment be enforced to overcome these pressures?
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> A: While there are no sanctions contained expressly within S.J. Res. 58 for the violation of any particular provision, the Congress and the President are expected to act in accordance with the Constitution. By establishing a focus upon two or three critical votes each year relating to the total level of taxation or the size of the deficits, in place of the present piecemeal focus on hundreds of separate spending measures, the amendment will enable the electorate to better identify those members of Congress most responsible for higher levels of spending, taxing, and deficits, with their harmful effects on inflation, interest rates, and unemployment.
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> Q. So far, Congress has disregarded those statutes that call for a balanced budget. Won't the Congress also find ways to circumvent the provisions of the amendment?
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> A: It is important to focus on the difference between an ordinary statute and a constitutional amendment. The reason that our civil rights have survived for 200 years is because they are expressly set forth in the Constitution. Without the protection of the Constitution, it is quite likely that many of our individual freedoms would have been eroded over time. Similarly, Congress win find it more difficult to flout the constitutional requirement of budget balance and tax limitation.
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> Q. Isn't it improper to read economic policy into the Constitution?
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> A: There are several answers to this question. First, the Constitution already contains numerous items which help formulate economic policy. Among these is the Sixteenth Amendment that made possible the income tax which has fueled rising levels of taxation and government spending. Secondly, the amendment does not dictate any given level of spending or taxing; it only overcomes the bias toward higher spending by eliminating the unlimited access to deficit spending and the availability of automatic tax increases. Under the amendment, Congress would have to vote explicitly to increase, decrease or maintain any given level of government spending. Finally, the amendment only seeks to re-impose prior constitutional limitations on deficits which constituted an “unwritten” rule of budget balance.
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> Q: Won't the amendment hamstring the ability of Congress to respond to urgent or genuine needs of the American people?
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> A: No. The amendment is automatically waived for one year in the event of a declaration of war. For other emergencies, the Congress can adopt by a three-fifths vote of the whole membership of both Houses a planned deficit, and, by a majority vote of the whole membership, higher taxes.

Q: Won't it be difficult to agree on the definition of national income and other economic concepts in the amendment?

A: No. The Congress may choose to rely on any of several measures of economic performance, so long as this economic indicator is used consistently from year to year, or that some transition period accompany the substitution of one indicator for another.

Q: S.J. Res. 58 is a balanced budget-tax limitation amendment. How does it work to limit spending?

A: First, the growth in planned receipts from the coming fiscal year cannot exceed the growth of national income for the prior calendar year. Second, the requirement that Congress adopt a "statement" in which outlays do not exceed receipts limits the rise in outlays to the growth rate of national income. Finally, since actual outlays cannot exceed statement outlays, government spending cannot grow more rapidly than the private economy.

Q: Isn't it impossible to balance the budget during the course of the fiscal year?

A: The amendment does not impose a requirement of actual balance during the fiscal year, only the adoption of a planned balanced budget. Although the amendment monitors the flow of actual outlays to insure that actual outlays to do not exceed those set forth in the budget statement, actual receipts may exceed or fall below the level set forth in the statement. The amendment imposes no requirement that Congress react to the actual flow of receipts, only to the actual flow of outlays.

Q: Won't Congress just shift more and more of its spending policies “off-budget"?

A: No. Budget outlays include both "on" and "off-budget" items. Section 4 states, "Total outlays shall include all outlays of the United States except for repayment of debt principal.”