

A SIMPLER INCOME TAX SYSTEM

By Thomas J. Davis, CPA

On April 15, I stumbled out of my office after another grueling tax season and tried to think of ways to make the next tax season easier. I came to the conclusion that it cannot be made easier because our tax system is an unholy mess. No one understands it completely, not the taxpayers, not the IRS, surely not Congress. Even CPA's do not understand all the ramifications that can occur. Our current tax code is so filled with exclusions, deductions, preferences, phase-outs, carryovers, special allowances and additional taxes that no one can compute the effect of an increase in income or expenses without a computer program.

Our tax system is like an old car. It is still running but belching smoke and coughing all the way home. Another tune-up will not fix it. It's time to junk it and buy a new system. I asked myself the question, "If I had my way and could come up with the easiest and fairest system possible, what would I do?" Here is my answer.

The first step I would implement is to have a flat tax. This is not a sort-of flat tax that Congress passed in 1986. My tax would be completely flat. If you believe, that people who make more money should pay more tax, the so-called progressive taxing system, you will not like my suggestion. Also, if you believe that you should be able to deduct your mortgage interest and property taxes while your neighbor who rents cannot, you will not like my suggestion. I am arguing that the tax rate should be the same for everyone, for example 23%. I made that number up. The actual could be 15% or 45%, whatever it takes to allow the Federal government to do what it does will determine the tax rate.

The beauty of the flat tax is that the exact tax can be withheld from all income earned. Your salary will have 23% withheld for tax. Interest earned from the bank will have 23% withheld. Dividends will have 23% withheld. Everything that is paid by a business to an individual, as income will have 23% withheld for income tax. The individual has paid his tax. He will not need to file a return. He will never even have to think about income taxes.

All business will file a tax return annually. A much smaller Internal Revenue Code will determine the deductions allowed. Each business will pay tax on the net income it earns. There will be no flow through entities. Each business can choose to be a corporation, a limited liability company, a partnership or a proprietorship for business and legal reasons. They will all be taxed the same. The tax will be 23% of its net income less any distributions paid to the owners. The distributions will have already been taxed as 23% is withheld when paid. There is no double taxation with this system.

All businesses will operate similar to corporations. They will pay quarterly estimates and file an annual tax return. They can choose a fiscal year end based on business reasons

since there are no tax reasons to require a calendar year end. Businesses will also be required to withhold the income tax and pay it to U.S. Treasury within a few days, similar to what they now do with employee payroll taxes. But no W-2's or 1099's will be needed.

Businesses most likely will still need the services of a CPA to prepare their annual tax returns once a year and to help with withholdings. We will also still be available to give business advice and prepare financial statements for the bank. That way I will still be employed.

Capital gains of individuals will have an additional requirement. The sellers of the capital asset will represent to the stockbroker, real estate agent, escrow agent, etc. the basis of their capital asset and the 23% of the gain will be withheld by them. Or if Congress chooses, they could tax capital gains at a lower rate.

Think of the simplicity of my plan. Everybody will know on the spot that for each extra dollar that he or she earns, he or she will keep 77 cents and Uncle Sam will get 23 cents. There will be no individual income tax returns, no W-2's or W-4's, no 1099's, no K-1's. No one will get anxious about filing their tax return on time or of having the right number of exemptions.

Because human nature is what it is, those who pay less tax will like my idea and those who will pay more are sure to find reasons why it is "unfair." But nobody can argue that it is not a simpler, easier tax system and as fair as any other system. I think I will send a copy of this letter to Mike Thompson and Senators Boxer and Feinstein. Maybe I can get something started.

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