

Tax Reform

*The Princeton Economic Institute
Proposal for Economic Growth
and Tax Reform*



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Preface

The Princeton Economic Institute Proposal for Economic Growth and Tax Reform is a serious effort at **REAL** reform. It builds upon the advice of our Founding Fathers who originally intended that government would be funded **EXCLUSIVELY** on an indirect system of taxation rather than a direct system of individual accountability. This means that the original design of the United States called for government funding to be provided by taxes that were placed on import/exports - similar to an excise tax or a retail sales tax. Federal income taxes were expressly prohibited because whenever a citizen is held individually accountable to report all assets in any form, a police state is created through their punitive laws. Therefore, our Founding Fathers forbid any form of an income tax in an effort to preserve liberty, which cannot exist without basic economic freedom.

The Princeton Economic Institute hopes that this proposal will be viewed for its non-partisan approach without the influence of special interests. No outside funds from any group, political party or individual have been used in the compiling of this project. All funds have been directly provided by Princeton Economic Institute out of revenues generated by our normal course of business - selling research. Princeton Economic Institute does **NOT** accept grants, subsidies, gifts or donations of any kind either from government or the private sector including corporations. This proposal is **NOT** intended to support any particular political party or candidate. We will welcome the endorsement of this proposal by those in the political arena that are seriously concerned about the economic disintegration of America and who may have independently reached a conclusion that something must be done.

If there is one thing that we all can agree upon it is the fact that something is seriously wrong. The only question then is: will we embrace the issue of reform with the spirit of revitalizing our nation for the benefit of all, or will we continue to allow government to be used as a tool to achieve the social goals of one group at the expense of another, which historically hurts only the majority.

The issue of tax reform is a serious issue that is being fought over for reasons of personal ego and misguided theory. Those in the Flat Tax camp refuse to listen to valid criticisms of their proposals simply because they have already endorsed such a scheme. Liberal Socialists are more concerned about punishing the rich than they are about creating a strong economy and a better life for the majority. The pure Retail Sales Tax group is more concerned about putting the IRS out of business than the real world implications of such proposals. In all cases, we need serious investigations - not more posturing and rhetoric.

As a nation, we have too many politicians and not enough statesmen. We cannot afford to allow personal egos to rule our future. What lies at stake here is more than personal victories - we must decide the fate of our nation. If we do **NOT** implement the **BEST** possible plan at this time, we may never again see such an opportunity. We must **HONESTLY** review **ALL** proposals and do what is **RIGHT** for our people. We must avoid the egotistical course of the politically correct that gave us the tax reform of 1986, the real estate crash and the S&L Crisis. This is our final hour to decide the very fabric of our nation. Let us choose reason rather than theory.

Introduction

The proposal outlined in this document does **NOT** represent the view of any particular group seeking to gain an unfair advantage at the expense of another. This proposal has been compiled based upon numerous polls and surveys of the population conducted by Time Magazine, CNN, ourselves and many others. The results of this inquiry clearly demonstrate that the middle-class has become frustrated by taxation demands placed upon them by all forms of government. When asked what is "**your**" preferred method of paying taxation with all plans clearly explained, the response has been overwhelmingly in favor of a retail sales tax. Of course some Flat Tax advocates will claim that their plan is ahead by 15% in the polls. But upon close inspection, we have found less than honest questions being asking in order to achieve the desired results. Without predetermined bias, our independent survey is showing no such lead for the Flat Tax. Therefore, this proposal has been developed by **FIRST** asking the people what they "honestly" prefer and not the lobby groups, Washington or any other special interest **WHATSOEVER!**

Furthermore, any "**reform**" must address not merely solutions but also **HOW** we have allowed our tax system to evolve into the nightmare it has become. If we do **NOT** understand **HOW** our system of taxation has become so corrupted, then we are likely to install just another tax reform adding to a long list of over 30 such previous reforms since 1950. In fact, one is hard pressed to find a single 4 year period during which some reform to the tax code did not take place. This in itself has led to a general level of distrust of government since one never knows what the future will hold when the laws are constantly changing.

The income tax itself was instituted during 1913 with two solemn promises. **First:** The income tax would **NEVER** become intrusive like the then current income tax of Germany. **SECOND:** That the income tax would be repealed once the cost of the war was settled. In both cases, these promises have **NOT** been kept and while one session of Congress might have been sincere in their intent, subsequent sessions of Congress are not bound by the sentiments of the previous.

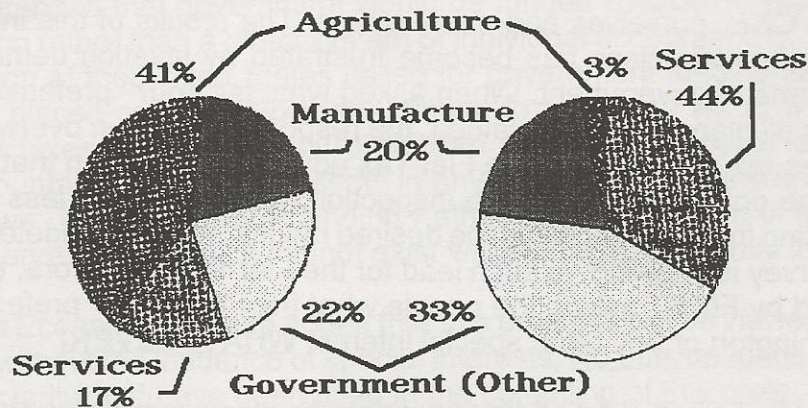
With these points in mind, tax "**reform**" should be more than merely changing rates or reshuffling the burdens between the classes or sectors within the economy. Reform means to **HONESTLY** reform the system while addressing the error of its ways. The Constitution specifically forbid **direct** taxation based on income **NOT** because our Founding Fathers sought to protect the rich, but rather they sought to protect all the people from the silent encroachment of government.

Regardless of what type of tax reform finally emerges, we **MUST** insist upon some very basic safeguards that will prevent the system from self-corrupting as it has since 1913.

- **Any tax increase MUST automatically expire after 4 years and require a national referendum to re-establish it or to extend it thereafter.**

US Civil Work Force

1900 1980



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Figure #1

Unless the above mechanism is part of the final tax reform, **NOTHING**, not even a Balanced Budget Amendment, will safeguard the United States from the gradual and silent encroachment of government that ultimately results in national suicide. History is littered with panics, potholes and politicians that have created more wars and suffering from their often well intended leadership. Far too often, government has continued to expand its quest to control society, which has **ALWAYS** led to its own fiscal irresponsibility. We must protect society from this silent and steady growth of government for it too will seek a monopolistic state as is the case with any large company within the private sector. We have not found angels to run Washington, only human beings who make the same mistakes of greed, ego, power and control as any board member within the private sector.

A clear example of such governmental tendencies to build empires is the New York-New Jersey Port Authority. Like the promise to repeal the income tax once the cost of the war was paid, this Authority also promised to repeal the tolls on the Lincoln Tunnel once the project was paid for in full. Instead, the revenue stream was used to build Art Centers and the World Trade Center. What the Port Authority has to do with building office space cannot be justified easily. Nevertheless, the Port Authority has become the nursery for political paybacks to friends of both states. What becomes clear is that government, in any form, has a very hard time giving back revenue even when there is no longer a purpose for the continuance of such revenue collection as originally designed.

History indeed warns us about the silent expansion of government through the countless words of Cicero, Adam Smith and Thomas Jefferson. For thousands of years historians have recorded the ultimate price of fiscal irresponsibility and how **DIRECT** forms of taxation have ultimately caused the collapse of every state in the past. Constantine the Great in his quest to protect and expand the empire of Rome, contributed to its ultimate downfall. As taxes rose substantially, causing avoidance to become so widespread, armies were converted to the effort of tax collection. Even today, the collapse of the utopian state in

Sweden became inevitable as nearly 70% of the population was directly or indirectly employed by the state. Currently, the US has followed this same dangerous course with little to show for it. In 1900, only 20% of the civil work force was employed by government (**Figure #1**). Today 33% contribute nothing to creating the national wealth of our nation but instead depend upon the income of the private sector to survive. Government employees are indeed "**public servants**" and, while we need government to some extent, we cannot afford such a high proportion of our national wealth being spent to maintain the public state. Combine this group with the unemployed, regardless of their class, race or religion, and this number dangerously approaches 45%. This is why tax reform is becoming a big issue in America because everyone that has a job needs to pay half of their income to keep the state going.

The problem of taxation is indeed a much broader issue than merely federal. State and local governments have been raising taxes at a far faster pace than even the federal government over the past 7 years. In many cases, property taxes have been single-handedly pushing many of the elderly out of their homes because property taxes are not adjusted for inflation and remain totally ignorant of the level of income required to service such taxation. For this reason alone, we must be very cautious about any form of a Flat Tax, which eliminates the deductibility of taxation paid by the individual to other branches of government. If such a system were installed, America could easily slip into a punitive tax system similar to that of Britain when the top combined tax rate had reached 102% of income during the 1970s.

The Princeton Economic Institute proposal seeks to realign our society, not by creating new vast bureaucracies, but by respecting the problems that have been created from the rising burden of taxation that has been slowly destroying the American standard of living. No more can a basic family survive on one income as was the case 30 years ago. No

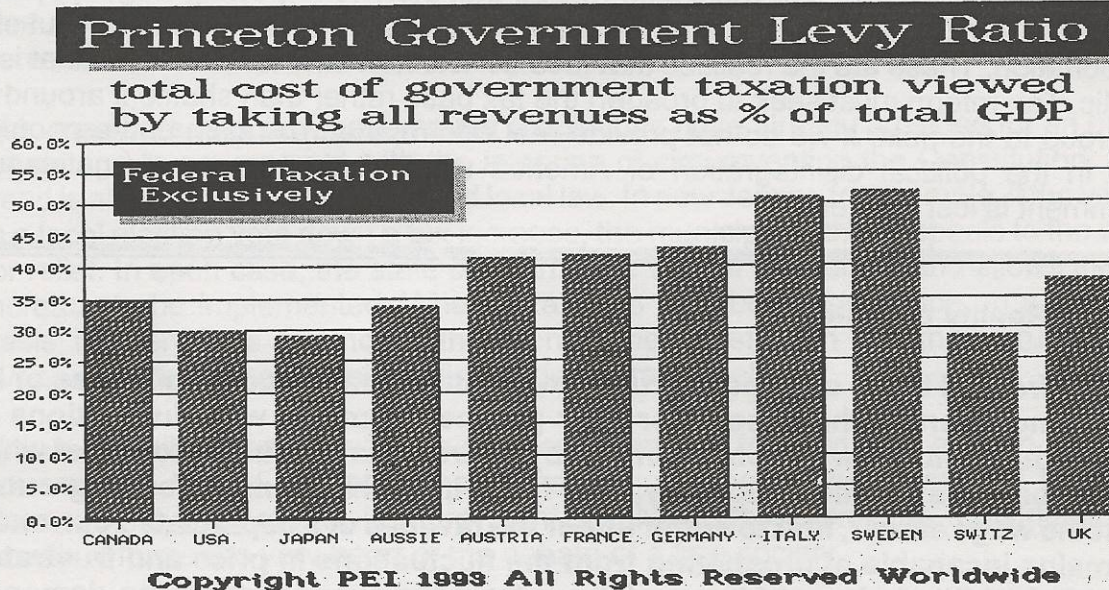


Figure #2

longer can many women afford to stay home to raise their children during the formidable years. The tax burden has risen so high in America that our very way of life and the stability of the family have now been placed at risk, all in the name of making life better for the very people that have become exploited.

There is no doubt that the cost of government is a direct deciding factor in the quality of life for its people. If we measure the cost of government by taking total revenues as a percent of GDP (*Gross Domestic Product = sum of economic activity*), we can see for ourselves that the nations with the highest cost base are those same nations with the highest levels of unemployment combined with the lowest levels of economic growth. (**See Figure #2**). If we are to consider tax reform, we **MUST** take into account the very reason why this issue is coming up in the first place.

We must guard against another tax reform like that of 1986 when the deductions in real estate were suddenly changed causing a collapse in property values. That attempt at tax reform began the S&L Crisis, which cost taxpayers hundreds of billions of dollars and caused national bankruptcy rates to soar. Such a threat now exists on the horizon - the Flat Tax. In many cases, it is the very same group of Washington insiders that supported the 1986 Tax Reform who are now trying to ram the Flat Tax through Congress today. We simply cannot allow this to happen again. Tax reform is a serious matter that must not be allowed to take place unless it is fully investigated. The appeal of filing your taxes on a postcard is largely in the minds of Washington insiders. Nearly 80% of Americans that file income tax returns today **DO NOT ITEMIZE** their taxes - in effect, this is already a flat tax for the majority. The issues at stake must go beyond rhetoric and find support in basic common sense facts. We must realize that according to the IRS, 17% of the economy is underground. The IRS also claims that self-employed persons only report between 60% and 80% of their income. We must also realize that there is a growing illegal population that are entitled to all sorts of social programs yet will **NEVER** file an income tax out of fear of deportation. These are the realities that face us. It is now time for tax reform that is also realistic. Tax reform must seek to broaden the tax base rather than shuffle it around from one group to the next. If we do not provide real reform, the frustration of the people will result in the political disintegration of America as all faith, hope and confidence in government is lost forever.

The Reality of History

Confronted by an evil and corrupt government and the consequences of its unsound finance, the speculator may prosper from the wild fluctuations in price, the capitalist will protect himself by hoarding and refusing to invest while commerce, having no nationality, will leave in search of more fertile ground; but the wage earner, first to suffer under the ravages of a depreciated currency, remains incapable of prospering from the fluctuations in price and frustrated by his inability to hoard his own labour from the ever encroaching demands of taxation. His dilemma is without peaceful resolution for he can but only flee to another land or sacrifice his life in defiance of the injustices of the greedy ruling class.

Key Points To Be Considered

The Princeton Economic Institute Proposal for Economic Growth and Tax Reform has been assembled with several key principles in mind.

- **1)** The cost of government as measured by total revenues as a percent of the total economic output (Gross Domestic Product) is a key factor in determining not merely interest rates, but the overall standard of living. The higher the cost of government the higher the general level of prices and unemployment. In addition, those nations who have demonstrated the highest cost levels according to this formula have also produced the lowest levels of economic growth. *(See Figure #2)*
- **2)** Despite the best of intentions, any form of government becomes in itself a special interest by which it will silently encroach upon the liberties of its own population. History has clearly demonstrated that all governments over time seek to broaden their scope of powers and overall size as it too competes for its share of the income and wealth generated by its own people. Whenever the size of government exceeds 25% of the total economy, an overall gradual decline in economic growth and general productivity begins to unfold. *(See Figure #1)*
- **3)** The Founding Fathers of the United States of America specifically prohibited any type of **DIRECT** taxation in the form of an income tax. The reason such a safeguard had been installed within the Constitution was based upon their experience and wisdom. Any government which has adopted a direct form of taxation has always, and without exception, evolved with intrusive regulation that has ultimately led to a loss of freedom and liberty. In order to pursue liberty, the very basic requirement demands that economic freedom is paramount.
- **4)** In many areas of law, government regulations have already provided for an unfair advantage to government with the intention of circumventing the Constitution. This trend is also evident within state and local law. In new Jersey, for example, if the voters in a local election vote down a tax increase, the municipality then appeals to the state for relief. In each case, the state overturns the vote of the people and allows the tax increase to be implemented. When taxation is allowed to take place on a **DIRECT** basis, the very laws and indeed the intent of the Constitution become corrupted and eventually cause the overall decline in democracy itself.
- **5)** In a so called free society, the people are entitled to decide the system by which government should operate - not academicians, politicians or special interests. Consequently, tax reform is more than merely a debate over the redistribution of wealth, it forms the very heart of the debate of a free society.

Dangers of Theory

Avoid Extremists & Their Examples

Typically, critics of any tax reform will rise to the occasion by quoting some extreme case to make a point. Socialists will immediately attack a flat tax or a consumption approach to taxation on grounds that such reforms will benefit the rich. Critics will argue that two couples living side by side who both earn \$75,000 but from different sources will be taxed differently under a flat or consumption tax. They will argue that the working couple earning \$75,000 in wages will pay taxes while the couple who inherited their wealth and earn \$75,000 in interest will pay nothing. Such arguments strive to divert the issue toward the extremes rather than honestly investigating the problems that face the majority.

This type of criticism is directed at achieving one goal - to maintain the Marxist philosophy of redistribution of wealth. Designing a system that is totally focused on the point of specifically attacking one group for the benefit of another is in itself a system of corruption and indicative of special interests. Once the door has been opened for one group to unfairly attack another, democracy begins to slowly weaken.

The Temperate Climate

What we must learn is a simple lesson from nature. Mankind cannot exist in the extremes of heat or cold but only within the bounds of a temperate climate. We must design a system that focuses upon the effects and benefits to the **MAJORITY** rather than assessing its impact upon a selective 1% of the population. Reform **MUST** provide a benefit to the **MAJORITY** rather than hinder and penalize them by inadvertent regulation intended to capture greater levels of income on a percentage basis from the upper class. Two examples of such regulation are capital gains and inheritance. While capital gains taxes may have been intended to impact the rich, the middle class has been severely harmed when they found that their home was subject to the same laws. Inheritance taxes designed to get at the families of billionaires have led to serious problems for the families of small business and farmers causing operations to be closed rather than continue from one generation to the next.

Separation Between Church & State

The various incarnations of the flat tax seek to correct one basic issue that our Marxist style of tax code has created - that is to reward the productive sector within society and to encourage its growth for the benefit of the whole. However, what we need to focus upon is how to achieve this goal while at the same time providing a fair and equitable situation for the majority without getting involved in a complicated code designed to exploit an individual for the benefit of another. If we believe that the state should be separate and apart from religion, then it also holds true that the actions of the state should **NOT** seek to enforce a code of social justice upon society as a whole. By attempting to force any group to contribute to another is, in effect, a basic political ploy. Such goals seek to redirect and redefine government into a moral religious institution that promotes the beliefs of one group against another no matter how well intentioned those aims

might be. From a Constitutional perspective, the 16th Amendment has reopened the door whereby the state is used to enforce social goals rather than provide the blind eye of justice approach to insure fairness and above all, equal opportunity, a just wage and a just price.

Socialism - As Outdated As Stale Bread

The socialists of Marx's day viewed the world through the eyes of a monarchy. But things have changed drastically over the past 150 years or so. **The individual who earns an income greater than the national average does NOT prey upon the misfortunes of others nor does he suppress the lower classes in our modern day circumstances. In most cases, they are the professionals, many of whom have created new technologies that save lives.** Such oppression was only possible in the past when both wealth and power coexisted within the same hands of a king or a landlord. Therefore, the mere fact that someone might be rich today does not pose a danger to society provided that same individual lacks the necessary power to dictate the fate of society as a whole or prevent others from an equal opportunity. There are no more feudal landlords. There are no monarchs. People fled Europe and came to the US because it was the land of economic freedom and opportunity. Instead of the feudal system taking half of our wages, it is government in the hands of socialists who tell us it is evil to work hard and that the most productive must be tempered and controlled with our wages garnished on a higher percentage for being industrious. The class warfare of today is no longer a valid social issue as it might have been in Europe during the 19th century. Instead class warfare has become a special interest of one group to steal the income of another out of pure and senseless material jealousy.

The Required Goal

The goal, therefore, **MUST** be that government pursues a fair and unbiased approach to a system of taxation that is honest and equitable while not restricting or inhibiting society from its individual pursuit of liberty. The necessary economic goal of a democratic government is to ensure Equal Opportunity for all, the prohibition of monopolies that might also seek an unfair advantage, and to guarantee a just wage and a just price. Government must **not** seek to force one group to help another but it must endeavor to prevent one group from discriminating against another. In essence, we need a government with its sole mission in life to guarantee an even playing field for all in opportunity, wages and prices.

The Princeton Economic Institute Proposal is therefore a plan for a system that achieves these goals without extremism. The flat tax, while trying to ease the burden upon the productive sector of society, falls far short of the democratic objective of non-interference by government. It still seeks to shift the burden of taxation in a Marxist style but merely in reverse. The Princeton proposal is designed to be a retail sales tax where consumption is taxed and not income or wages. The purpose of this plan is to achieve fairness. Higher incomes also naturally spend greater amounts of their total income thereby achieving greater revenue generation for the state. Likewise, the lower and middle income groups are protected by eliminating taxation of unprepared foods, housing rent and medical care which account for a larger proportion of their total income. Through this type of approach, we can accomplish our non-interference objectives, and encourage self-determination while maintaining a fair and equitable system of taxation for all.

The Princeton Economic Institute Proposal for Tax Reform & Economic Growth

1. Replace personal income tax with 10% national retail sales tax.

Abolish the personal income tax and replace it with a 10-percent, national retail sales tax. The products and services not subject to that tax include basic rent on housing, non-prepared food, health care, and medicine. The purchase and sale of stocks, bonds, gold bullion or futures contracts, option or warrants will also be exempt. This will immediately reduce the cost of American labor by 25 percent within the U.S. economy. Furthermore, a national retail sales tax will end the discrimination against American citizens, requiring all residents and visitors to pay their portion of the federal tax burden, regardless of legal status. According to the IRS, 17 percent of the economy is underground, contributing nothing toward the overall well-being of the nation. Only a sales tax will capture that revenue.

2. Stipulate a 15% raise in take-home pay.

Stipulate a 15-percent net increase in take-home pay for every wage earner. This will still result in a 10-percent reduction in the cost of American labor relative to current levels, thereby increasing American competitiveness.

3. Increase excise taxes.

A 10-percent increase in excise taxes, including the gasoline tax, should be implemented. Surveys have shown that after a retail sales tax, gasoline taxes are the best tolerated by the American public.

4. Implement a low, 2% national sales tax on real estate.

A national sales tax on real estate of two percent should be imposed. This will be split one percent for the buyer and one percent for the seller. This will apply to residential as well as commercial property. This will result in a drastic reduction from the current capital gains tax situation and eliminate the taxation of the elderly who have accumulated their savings in a large part within their home. This will enable the elderly to

sell their home once the children have gone and use part of that equity for retirement by reinvesting in a smaller retirement facility. Currently, such persons are forced to borrow against their homes, which is more cost effective than selling their home subject to capital gains tax rules.

5. Reform Business income taxes.

All business operations, whether partnership, proprietorship, or corporation, will be subject to a flat, 15% business income tax when income is less than double cost (excluding all bonuses, salaries etc for directors/owners). Deductions allowed will be research & development, charitable contributions, and \$1000 per employee credit to encourage job creation. Any business earning more than twice expenses (minus director or owner salaries, loans, transfers, dividends, or pension payments) will be subject to a flat, 25% income tax.

6. End all taxes on capital gains, gift, inheritance, savings and dividends, luxury and worldwide income.

7. Repeal the 16th Amendment

The repeal of the federal government's authority to impose an income tax on American citizens as authorized by the 16th Amendment. Based on previous Supreme Court rulings, business and corporations are still subject to income taxes; these changes do not apply to the states.

8. Mandate that any tax increase automatically expires after 4 years and require a national referendum to re-establish or extend it thereafter.

9. Take Social Security, Medicare & all trusts off-budget.

Social Security & Medicare must be taken off budget and allowed to become an honest trust fund where the capital contribution will be reinvested. The agency must be segregated, free from lobbying efforts on the part of the

private sector as well as the public sector. The guiding principle must be economic security as implied by the name. No funds held by the Social Security system may be diverted in any way whatsoever by Congress, including restraint upon investment of such funds or mandatory investment in Federal government bonds. A maximum of 50 percent of all funds may be invested in either the private sector or government sector. The fund will be allowed to buy listed stocks with a capitalization in excess of \$1 billion. Stocks must be U.S.-based operations only. Any bonds (private, state, local, or federal) must not be of an issue rated less than A+, of foreign origin, or of greater maturity than 10 years.

10. Incorporate a tax amnesty

Phase I of tax reform includes a tax amnesty program. Anyone who has income that has remained unreported and is currently not in negotiations with the IRS, may come forward and pay a flat, 15 percent income tax without penalty or interest. Those funds will be earmarked to allow the independent establishment of the Social Security managed trust fund. This will provide the seed capital, allowing the new system to be as secure and honest as any private pension plan as prescribed by law.

11. Balance the budget

A balanced budget should be the ultimate goal and spending should be subject to a mandatory across the board reduction if interest expenditures exceed 15% of total government expenditure exclusive of Social Security.

Summary

The enactment of this proposal will broaden the tax base. It does not shift the tax base from capital and investment to the working middle class. The elimination of income tax and the creation of stable, predictable rates will attract offshore capital into the U.S. The net sum of these points will create the single greatest economic expansion in the history of the United States and perhaps the western world.