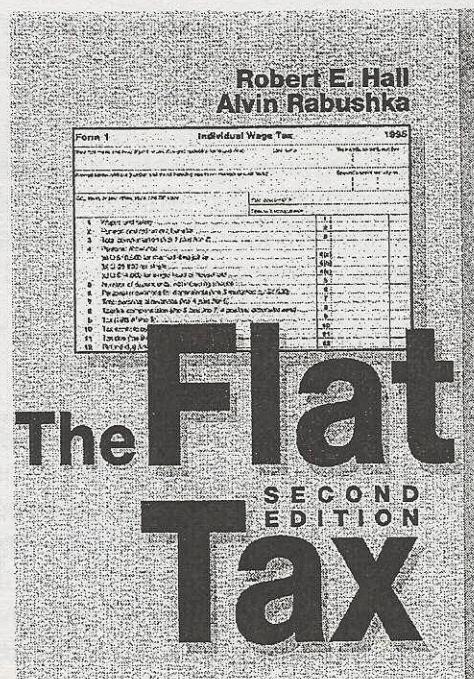


What's Wrong With The Flat Tax

If you want a postcard, they cost 20 cents. If you want
"real" tax reform - look elsewhere!

What is Wrong With The Flat Tax Proposals

The Flat Tax proposals may sound good and look good on paper. However, there is a serious difference between reality and theory! Of all the tax proposals, the flat tax seems to instill the most immovable and stubborn supporters. This camp simply refuses to listen to any criticisms out of fear that they will not be the banner carriers for tax reform. It is true that the flat tax was the first proposal kicked around in Washington among the Republicans. But in those days, they never honestly dreamed that real tax reform was possible. Instead, the Flat Tax supporters continue to hold on to an idea that served a purpose, but like computers, has quickly become outdated. Unlike a retail sales tax, which would reduce the size of the IRS and eliminate lobbyists, the flat tax accomplishes **NOTHING** in the area. Consequently, many citizen groups that support the Flat Tax do so because it **FAILS** to accomplish their real goals thereby maintaining the necessity for their presence into the decades ahead.



The following points are serious! they are **NOT** intended to antagonize the supporters of the flat tax. All we ask is that such supporters should put the nation first and their prospects for personal political victories aside. This is a time for serious national reflection - **NOT** back alley politics as usual.

1) The Flat Tax Can Create a Higher Combined Tax Rate:

- The flat tax sets all four levels of government free from the responsibility to the individual. If the taxes you pay to city, local and state governments are **NOT** deductible from your federal income tax, the combined rate of taxation can rise as it did in Britain where the top combined income tax rate in the 1980s had reached 102%. The flat tax may make the tax code on the federal level less complicated, but it does nothing to address the rising tax burden all citizens are experiencing on a combined basis. State, local and city taxes have increased far more than federal taxes over the past 7 years. The flat tax will create a much more dangerous situation for all Americans from a combined tax rate perspective while allowing Washington to pursue its own interests.

2) Flat Tax Continues The Discrimination Against Capital

- Under the Flat Tax, the current definition of income will continue to promote corporate mergers at the expense of the American worker.

3) The Flat Tax does Nothing to Prevent Future Tax Increases

- The Flat Tax does nothing to prevent Congress from raising your taxes under Social Security or Medicare since all trust programs are in reality commingled together in one general slush fund. Even a super majority is no guarantee against a future tax hike.

4) The Flat Tax Fails To Broaden The Tax Base:

- The Flat Tax is **NOT** capable of expanding the actual number of people that contribute to the revenues of society. The Flat Tax merely attempts to reshuffle the tax burden among the current group of taxpayers without addressing the growing underground economy and the increase in illegal aliens.

5) The Flat Tax Will Raise The Cost Of Business & Cost Jobs:

- The Flat Tax will actually raise the cost of business by disallowing the current medical benefits or SS matching funds as a deduction. All fringe benefits will also become taxable to the individual raising the overall cost of doing business in America. This poses a serious risk to our economy as did the 1986 Tax Reform. We cannot suddenly pull the rug out from our private system of health-care that has emerged in this nation.

6) The Flat Tax Will Open More Loopholes Than It Closes:

- When Congress eliminated the deductions for interest payments on automobiles in search of increased revenues, they merely gave birth to the leasing industry. Companies also prefer to lease equipment because it provides for an immediate tax deduction on equipment rather than depreciating such equipment over the course of years. The Flat Tax will create another new industry that transfers taxable income into tax free unearned income. Companies can, and will, move offshore importing their goods at the highest possible cost base. Profits from such divisions will then be paid to the parent company as a dividend or as interest on a loan to the subsidiary thereby converting taxable income into tax free income. The same will be true domestically where houses can be sold to a corporation and then rent paid transferring non-deductions into operating expenses.

7) The Flat Tax Will Cause a Major Recession:

- If the Flat Tax goes through in its current proposed form of disallowing deductions for interest by business, we will change the course of our economy in a very serious way. Businesses that hold large inventories typically finance those inventories. If such financing is not deductible, then inventories will be reduced. Without at least a transition, immediate orders will be sharply reduced or even dry up to zero in some cases as business are forced to draw down inventories. The next time you buy a car, you may be forced to place an order with a dealer who has one of each model on the floor - similar to how the furniture industry operates today.

8) The Flat Tax Continues The Discrimination Against Divorced Couples:

- All the studies show that children of divorced couples are being harmed by the current tax codes. The inability to deduct child support payments has already created a nightmare where the IRS continues to look at gross income regardless of how much of that income has been garnished by the family courts. The Flat Tax may even make this situation far worse by disallowing state and local tax payments, in addition to child support payments as well. In the end, the Flat Tax could cause more social destruction than economic benefits over the long-run.

9) The Flat Tax - Guilty Until Proven Innocent Approach:

- Under criminal law, a murderer is **ASSUMED** innocent until proven guilty. Under tax law, **ALL** American citizens are **ASSUMED** to be **GUILTY** and must prove their own innocence. The IRS can conduct a "life style" audit by following you around and then calculating what they assume might be your "real" income and then demanding that you pay it. If you wish to argue in court, the interest and penalties continue to run no matter how long it takes to fight. If you lose, they take everything! Even if an honest mistake is made, the IRS will treat you the same as if you intended to cheat on your taxes. Even if you enter bankruptcy, usually the IRS taxes are not dismissed. There is **NO WAY** out when it comes to dealing with the IRS. The Flat Tax does **NOT** eliminate these serious threats to your basic right of liberty - economic freedom!

10) The Flat Tax Offers No Real Reform - Just More of the Same Old 1986 Style of Tax Reform:

- Currently, 80% of Americans do **NOT** itemize their deductions. In effect, the majority already avoid the most complicated aspects of the tax code as if they had a Flat Tax today. What we need is **REAL** reform - not postcards! The Flat Tax in a real sense is nothing more than a mere continuation of the 1986 style of tax reform, which sought to lower the tax rate in exchange for eliminating deductions. We all saw what happened to real estate with that approach. We all saw what happened when deductions for interest payments for automobiles were eliminated. Can we afford more of the same old style reform? The cost of government through the tax burden has been rising on a net basis regardless of the actual tax rate as deductions have been evaporating. Even when it comes down to a charitable event, the IRS argues you are getting food or entertainment and that must be deducted from the amount of the contribution. In the end, we saw how this style of reform resulted in Perot capturing 20% of the popular vote in 1992 and the Democratic loss in 1994. The Flat Tax is merely a bad old idea coming back to haunt us all over again with a fresh coat of new paint. If you want a postcard, they sell them for 20 cents. If you want tax reform, the Flat Tax offers nothing new!

What's WRONG With a Pure 17% Retail Sales Tax

The pure form of the Retail Sales Tax has a few serious flaws in the center of its very attractive luster. These flaws are, however, restricted to the business side of the tax debate rather than the individual. Nonetheless, such problems are at least addressable if we split this type of tax reform into two parts and deal with the business side in a totally separate manner from that of the individual. The im-

impact to the individual by this approach is quite beneficial since it will enable a 17% national sales tax to be reduced down to merely 10% if corporate business taxes at a rate of 15% remained in place.



1) Do All Business Taxes Pass Through to the Consumer?

The purist in theory will always argue this case that all taxes are merely passed on to the consumer. Such a conclusion leads to an approach that all taxes should therefore be paid by the individual and business should be tax free. The problems here are as follows:

- **a) All Business is not exclusively American**

In our global economy, multinational companies are able to book their profits wherever they want internationally. They are **NOT** citizens and owe no loyalty to any nation. A pure retail sales tax stands to ask nothing of non-US entities at the whole expense of the American citizen.

- **b) Business has NEVER passed on tax-cuts to the consumer**

The elimination of taxes will **NOT** result in companies automatically passing those savings on to the consumer. There is **NO** empirical evidence whatsoever that indicates any cost savings to the consumer following major tax reduction in any nation including the Kennedy and Reagan tax cuts.

- **c) All taxes are not automatically passed-on due to competition**

Taxes have been rising rather significantly over the past 7 years more so on a local level rather than federal. Because competition is **NOT** restricted to only domestic players, a company cannot merely pass-on every tax increase to the consumer. American business faces more than mere domestic competition - there is a global marketplace out there where the cost of production does not remain fixed.

- **d) Prices ALWAYS rise to the maximum point of resistance**

When Japanese auto manufacturers were forced to raise prices due to the appreciation of the yen, US manufacturers followed suit only because they could. When manufacturers raised prices in Britain because the pound fell to US\$1.03, they did not reduce prices when the pound doubled in value. Business makes the consumer pay whatever the market will withstand.

- **e) Tax Free environments sometimes produce lower growth rates**

A totally tax free environment for business will **NOT** necessarily translate into jobs or lower prices for consumers in every case. In Australia, gold mining operations enjoyed a tax free environment for decades. Only recently in the past 5 years have they been subject to an income tax. As a result, growth rates have increased rather than declined largely due to the fact that any new development losses are at least deductible from future earnings. A tax free atmosphere shifts all the risk entirely to business. In order for a society to function on a dynamic basis, it requires a partnership between business and society to their mutual benefit.

2) Business Requires Infrastructure To Survive:

If taxes were the only consideration to a company, then why do we not see everyone moving to Cambodia? The reality is somewhat different from theory. A company requires a good infrastructure in order to survive. Therefore, business has a vested interest in seeing that services, roads and the environment are well maintained. Business also requires a well educated work force with some qualified skills. In total, business may not be a citizen, but like an illegal alien, it does have a demand for public services. It is, therefore, both fair and necessary to expect business to contribute to the well being of the nation just as much as it is to expect the illegal alien to pay for the services they receive while in America.

3) Domestic Taxation vs. International Taxation Trends

Another serious issue that is ignored by a pure Retail Sales Tax is none other than international trends in taxation. While Americans are taxed on worldwide income, most others are not! There are two issues at stake here that must be addressed.

- **a) Most non US citizens and companies are taxed on international income provided such income is earned in a tax free zone. Consequently, a pure retail sales tax that would abolish all income taxes for corporations operating in the United States poses some serious problems. Multinationals are capable of booking their profits anywhere in the world. Many currently book those profits in Hong Kong where they can enjoy a 15% tax rate. Since they are paying some income tax, the income is **NOT** subject to taxation elsewhere. If the US were to become a tax free zone for corporations, this would actually lead to a disadvantage for American operations. It would also **NOT** encourage multinational operations to book their profits in the US and could actually force some companies to look elsewhere.**
- **b) If corporations were free from income taxes in the United States, under most tax codes, profits earned in the United States would then become taxable in other nations. This could present a very dangerous situation for even American companies who might suddenly find their US profits subject to an income tax in overseas jurisdictions where they might interpret the US market to be a tax shelter or tax free zone.**