

IF AMERICANS REALLY UNDERSTAND THE INCOME TAX.

John O. Fox, *If Americans Really Understand the Income Tax* (Colorado: Westview Press, 2001),

John O. Fox has engaged in the practice of law in Washington, D.C., since 1964, specializing in tax and business matters. He has been teaching at Mr. Holyoke College entitled “Taxation and the Values of Democracy.”

John F. Kennedy once said:

Democracy is a difficult kind of government. It requires the highest qualities of self-discipline, restraint, a willingness to make commitments and sacrifices for the general interest, and also it requires knowledge. (Preface xiii, **If Americans Really Understand the Income Tax**).

Franklin Roosevelt said: “taxes ... are the dues that we pay for the privileges of membership in an organized society.”

I have been critically looking at our various systems in the United States to see how they affect in creating poverty and homelessness in the midst of affluence in the United States. I recognized one of them is tax policy. Social services for the poor and needy in the United States and other countries often correlated to tax system. I will discuss about how other countries do later but here I am going to discuss how John O. Fox argues about our tax system and discover how our tax system contributes as part of root causes of poverty and homelessness in the United States. Fox mentioned that “these laws told us about the kind of nation we were and were becoming.... the income tax provides a lens through which we can see our nation as it actually is... How we tax ourselves establishes and reflects many of our nation’s values. (Preface xvi and xvii, **If Americans Really Understand the Income Tax**).

Tax experts have recognized throughout the U.S. history that our tax system hasn’t been fair and needed major reform; even in the era of John F. Kennedy, Mortimer M. Caplin, *the former U.S. Commissioner of Internal Revenue (1961-1964) Senior Member, Caplin & Drysdale, Washington D.C., Professor Emeritus, University of Virginia School of Law* stated “when I served on President Kennedy’s Tax Task Force and, later, as his Commissioner of the Internal Revenue Service, I became convinced that America’s tax system needed major surgery. Multimillion-dollar loopholes for certain industries and classes of individuals, combined with onerously high tax rates for the great mass of taxpayers, were endangering public confidence in the entire federal tax structure. After returning to private practice, I urged Americans to send an outpouring of letters to members of Congress to end its ongoing destructive policy of legislating special tax privileges. That outpouring never occurred. While tax rates have fallen considerably, too many of the underlying laws have become increasingly complex and worse – much worse (Foreword, xi, **If Americans Really Understand the Income Tax**).

Our Current Tax System

In 1997, Congress cut the top tax rate on capital gains for the highest-income taxpayers by 28% and added countless special relief rules favoring one set of tax payers over another (p. 2).

Members of middle class often feel that they pay too much, and lower-and middle-income taxpayers overwhelmingly feel that the rich pay too little.¹

John O. Fox. *If Americans Really Understand the Income Tax*. Westview Press.

John O. Fox has engaged in the practice of law in Washington, D.C., since 1964, specializing in tax and business matters. He has been developing the arguments for this book over the past 15 years in conjunction with a course he teaches at Mr. Holyoke College entitled “Taxation and the Values of Democracy.”

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For this reason John O. Fox wrote a book on **If Americans Really Understand the Income Tax**. In the Preface, Fox wrote, “the individual income tax, the principle source of federal revenue for the last half of the twentieth century and long viewed as worthy of public support, has become something of monster: unimaginably complicated, frequently

¹ John O. Fox, *If Americans Really Understand the Income Tax* (Colorado: Westview Press, 2001), 7.

unfair, and an excessive drag on the economy. Widespread agreement exists at almost every level of our society that changes should be made.....

He raises serious questions as to what good does Congress achieve by favoring one form of income over another, one form of savings over another, one form of personal expenditure over another? What harm results? Congress has littered the tax laws with behavioral incentives and relief provisions to achieve discrete social or economic objectives it deems worthy; but what do these special laws achieve – for whom and at what cost? What are the consequences for the poor, middle class, and the rich and for the economy as a whole? Who is overtaxed? Undertaxed?we did not recognize what these laws told us about the kind of nation we were and were becoming..... the income tax provides a lens through which we can see our nation as it actually is... How we tax ourselves establishes and reflects many of our nation’s values. (Preface xvi and xvii, **If Americans Really Understand the Income Tax**).

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Reality of Our Current Tax System

In 1997, Congress cut the top tax rate on capital gains for the highest-income taxpayers by 28% and added countless special relief rules favoring one set of tax payers over another .²

Fox quoted report as follows from the source of Joel Slemrod and Jon Bakija, *Taxing Ourselves*, 2nd ed. (Cambridge: MIT, 2000), 18, table 2.1: In Government Tax Revenues, 1997,

Total federal tax revenues-	\$1,720 billion of which -	100 %
Personal income taxes -	\$746 billion -	43.4 %
Social insurance taxes -	\$647 billion -	37.6 %
Corporate income taxes -	\$210 billion -	12.2 %
Excise tax and custom duties-	\$79 billion -	4.6 %
Estate and gift taxes -	\$21 billion -	1,2 %
Miscellaneous -	\$17 -	1.0 %
Total state and local taxes	\$869 billion	100 %
Total federal, state and local taxes -	\$2,589 billion.	100 % (p. 6)

² John O. Fox, *If Americans Really Understand the Income Tax* (Colorado: Westview Press, 2001), 2.

Many believe that the system exacts excessive amounts from lower income households. Members of middle class often feel that they pay too much, and lower-and middle-income taxpayers overwhelmingly feel that the rich pay too little (p. 6-7).

Income exclusions and personal deductions undermine the effectiveness of progressive tax rates:

They rewarded most those people who have the most income (p. 12).

In our current tax system,

***Winners** are those who find employment with companies that allocate much of their compensation to tax-free fringe benefits that pay their personal expenses. Winners convert their ordinary income into capital gains by receiving a portion of their salary through special stock options to acquire their employer's stock. They receive tax-exempt scholarships to college or graduate school that pay for tuition, books and supplies. They receive tax-exempt wages for working abroad. They minimize the tax on their investment by acquiring bonds whose interest is tax exempt, by acquiring an expensive home and later selling it for large profit without paying any tax on their gain, by accumulating large cash values tax free within life insurance policies and then using the cash (also tax free) to pay their insurance premiums, and by deferring the tax on their gains in the stock market or in real estate. Winners inherit highly appreciated property and never pay an income tax on the appreciation or an estate tax on their inheritance. They deduct the interest on large mortgage for two splendid homes.... Winners deduct all of their charitable contributions, even if a tiny percentage of their income (p. 13).*

***Losers** in this national tax game are workers who have no fringe benefits, do not participate in tax-exempt retirement plans at their jobs, and never receive options to acquire their employer's stock. They receive no tax relief for their rent, yet their incomes on average are far less than homeowner's incomes. Losers are single people who are officially poor by government standards but are required to pay income taxes. They are mothers who receive neither child care assistance at work nor any relief for their child-care costs under the tax laws. Losers include students who must earn their college tuition without any, or with only a modest, tax break. Losers invest in taxable savings accounts and have to realize their capital gains to pay their bills. Losers are among the 70% of taxpayers who cannot deduct their charitable gifts, even when these gifts are relatively large percentage of their income (p. 13).*

The values that our government expresses in this tax law often are not in the best interest of most Americans (p.13).

The economies of some higher-taxed countries, such as Norway, Finland, and Austria, fared far better than the economies of some countries with considerably lower-taxes, such as the United States, Australia, and New Zealand (p. 16).

Fox's main thesis is that the *tax system would promote a stronger economy if Congress lowered tax rates across the board and eliminated most of the special provisions protecting income from tax* (p.16).

Definition of Income

Economist generally view income as an increase in our capacity or power to spend, save, or invest. In its various permutations, this increased capacity or power represents our economic gain. Wages are the most common example (p. 21)

We commonly think of income as the cash we earn directly, such as from work, savings and investments. Under Haig-Simons, income can be any form of economic gain, including in-kind receipts of services or property. An architect, for example, is deemed to receive \$10,000 of fee income for designing a building regardless of whether the client pays her \$10,000 in cash, performs \$10,000 of repairs on her home, or gives her \$10,000 in land. if you spend a week for free at your employer's beach house on the island of St. Thomas as your reward for achieving the highest sales volume in your office this year, and the house normally rents for \$5,000 per week, you have \$5,000 income under Haig-Simons, just as if you had received a \$5,000 bonus and paid it for your personal use of the house. Haig-Simons does not reward you for finding a friendly employer... for example, whether your employer pays your \$3,000 health-insurance premium or pays you the \$3,000 and you pay the premium, you have realized \$3,000 of income under Haig-Simons (p.26-27).

Under Haig-Simons, income includes the appreciation of our stock during the year even if we retain the stock (p. 28).

It is known fact that we are experiencing ever **widening gap** between the rich and poor; the top 20% of the total household in the United States own 85% of the total wealth. According to Fox, one of the causes widening the gap comes from our tax system; *A system that does not tax people annually on the appreciation of their assets expands the wealth gap between the rich and all others unless the rich are taxed heavily in other ways* (p.28).

*World War I catapulted the United States into the forefront of military powers and the income tax into the forefront of federal taxes. The war's massive revenue demands far exceeded what could be produced by tariffs, **excise taxes**, the sale of leasing of public lands and natural resources, and loans. Ever since, Congress has depended on the vast revenue-producing capacity of the income tax to subsidize our nation's efforts in war and peace* (p. 34).

Individual and corporate income taxes now generate about 91% of all federal revenue for our national defense, interest on our national debit, and all foreign and domestic programs other than those paid from special government trust funds, such as Social Security and Medicare. Each income tax, however, does not contribute equally. Each did so, more or less, early on; but since 1944, the individual income tax always has contributed more revenue than the corporate income tax.

Today it produces more than four times as much (p. 35);

TAX: HISTORICAL BACKGROUND 1913-Present (p. 40 – 51)

Woodrow Wilson: 1913-1920 (p. 41)

The 1913 tax was designed to be a class tax: Only the richest would pay it.

Andrew Mellon: 1921-1932 (p.

For over 50 years, the individual income tax has been the preeminent federal tax to support social and economic programs paid from the general budget. These programs range from housing to education, from job training to safety in the workplace, from natural resource development to environmental protection, from public health to basic scientific research, from community development to the exploration of space, from welfare for the poor to assistance for the most advantaged. Through all of its manifestations, both in taking from us and giving back, the individual income tax has become the dominant expression, and symbol, of the federal government (p.35).

Two world wars, the Great Depression, the ambition of a welfare state, the liberal programs of Lyndon Johnson's Great Society, and post-World War II obligations as the world's most powerful country transformed a modest central government into a goliath. With our population 260% that of 1913, income tax collections exceed 1913 collections by about 2,000 percent. The federal budget approaches \$1.9 trillion. The government total debt exceeds \$5.5 trillion (p. 35).

The process of tax legislation is written in p. 37.

Conflicting themes of Tax Policy.

Collecting Taxes versus Advancing Social and Economic Agendas

Politicians are aware that promising lower taxes can pay off handsomely at the ballot box. Political pandering aside, Congress's need to collect income taxes often conflicts with its desire to advance social and economic agendas that promote housing, health care, education, retirement, and much more. In fact, the great paradox in the evolution of income tax policy is that Congress became as concerned with protecting income from tax as with taxing income(p. 38).

True and False Egalitarian Policies

The art form of American government in the 20th century was to fit egalitarian principles within the structure of our capitalistic system. No one denies that unfettered capitalism, with its free-market outcomes, allows for extremes of wealth and poverty. Egalitarianism in this country attempts to moderate these extremes while assuring those who are successful in the world of work and investments that they will receive just rewards for their efforts (p. 39).

Congress undermines the effectiveness of progressive tax rate by allowing so much income of middle and upper-income taxpayers, beyond a basic amount to cover household needs, to escape status as taxable income. Income exclusions and deductions achieve a seductively misleading egalitarian coloration because potentially they are or someday may be accessible to everyone. Such access gives the impression that all of us are equal in the eyes of the tax law. But congress knows better. Inviting everyone to the tax starting line in no sense produces equal results (39). People with the largest incomes invariably come out best for two reasons: On average, they have the largest exclusions and deductions; and their tax savings from each \$1 excluded or deducted from income is greatest. progressive tax rates are egalitarian; special income exclusions and deductions, as drafted by Congress, are anti-egalitarian. ... The great bulk of the tax savings from special social and economic programs in the tax laws redound to the benefit of more able taxpayers.

These special income exclusions and deductions primarily explain the gap each year between economic income and taxable income. They also explain why our tax liability may have little to do with our ability to pay. ... Many people pay more, and some much more, than 10% of their income in federal income taxes. Because their opportunities to avoid taxes are vast, those with the highest incomes have as a group the largest discrepancies in tax burdens. In fact tax inequities abound among the rich: Some pay a great deal in taxes; other pay relatively little (p. 40).

Two categories of expenditure: costs of producing income and personal expenditures (consumption expenses), p. 22.

Definition of ability to pay (P, 100)

Definition of Income Tax

Policy favors the rich and ignore the poor. War between the rich and poor:

Argument

Conservative Points:

Liberal Points.

Common Points:

Relationship between taxing and economic activity

Recommendation