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Presidential Advisory Panel on Tax Reform:

There are two major problems with the current US income tax code: (i) it is far too complicated and (ii) there are "black" and "grey" economies that escape taxation. The proposals of a flat tax or a VAT both have merit, but I believe a combination of the two tax approaches with some variation would make sense. Since there is merit in using the tax structure to encourage home ownership, philanthropy and investment. Also we need to tax income that today escapes. I suggest the following:

- (1) A flat income tax on income with deductions for: (i) state tax (both income and sales tax), (ii) interest on home mortgage and business loans, (iii) charitable giving and (iv) medical expenses. The tax on capital gains would be at a reduced rate, e.g. on half of the gain.
- (2) A sales or VAT tax on all items. With a sales tax it would be possible to exempt food and other essential items, but a VAT would have advantages in collection. If a VAT is imposed, perhaps a negative tax applied to the income tax would be appropriate for low income people. The negative tax might take the form of a credit per person applied to the income tax. For families with income below the tax credit, a "negative tax" amounting to the decrement would be paid to the tax payer.

Since most states derive a substantial portion of their income from sales and income taxes, by revising those taxes to correspond to the Federal tax code, the Federal Government could collect those taxes and remit to the states, thereby saving considerable expense.

I have not suggested actual rates for the two forms of tax; the rates should be balanced appropriately and should meet the objective of being tax revenue neutral. I would urge that the flat Federal income tax rate be less than 15%, and perhaps no more than 12%. One could argue that income in excess of a t.b.d. level be taxed at a higher rate, such as a rate 50% above the nominal rate, but this should be done only if the plan cannot otherwise achieve the objectives. The VAT or sales tax should be no more than 6% because, added to state taxes, this tax could have a significant negative impact.

I urge that the tax system be changed in a major way to simplify the code and tax preparation and to make it more difficult for cheaters to avoid taxes. My suggestions above would certainly contribute to such a goal. Moreover, with the extraordinary shortage of accountants today (because of such new demands as Sarbanes-Oxley), this would be a good time to introduce such a revision. Perhaps it would be wise to introduce the change over several years (i.e., by applying the new income tax to an increasing portion of income and the balance of income taxed according to the current code. Some time would be necessary to introduce the VAT/sales tax system. Since most states already have the infrastructure in place to collect sales taxes, perhaps the states should collect the federal tax and remit to the Federal Government, and the Federal Government should be the tax collector for income, remitting the appropriate portion to the states.

Sincerely,

