

# [Taxation](https://assignbuster.com/taxation-essay-samples-3/)

According to Arlen and Weiss (1995), a well designed tax system is one that raises the necessary programs as efficiently, fairly and as simple as possible. The objective of any tax reform is to reconcile any existing goal conflict and reform the current taxation system in such a way that it minimizes the complexity, economic inefficiency and the unfairness that have characterized the taxation system for generations (pp. 20) . In the colonial America, the colonists were paying taxes under the molasses Act, modified in 1764 to include import duties on the various commodities including sugar, wine and foreign molasses.

This act was known as the sugar Act. Since this act did not raise substantial amount of revenue, another act known as the Stump Act was added in the year 1975. This Act imposed a direct tax on all the newspapers printed in the colonies and on most legal and commercial documents. In the year 1794, there was the ‘ Whiskey Rebellion’ started by settlers on the grounds that the existing tax system was discriminatory, which made the settlers to riot against the tax collectors.

The result of this was that the congress in the year 1798 enacted the Federal Property Tax to pay for the expansion of the army and the navy (Fox, 2001, p. 19). This was in anticipation of any possible war with the France. The same year saw the out break of the ‘ Fries rebellion’ in opposition to the newly created tax. The first income tax to be suggested in the United States was during the war of 1812 and this was based on the on the British Tax Act of 1798 and which applied progressive rates to income.

Though the tax was developed in the year 1814, it was never imposed because the treaty of Ghent was signed in the following year, ending the war and thus the need for extra revenue. In the year 1861, there was a Tax Act that proposed that there shall be levied, collected and paid upon annual income of every person residing in the soils of the United states whether derived from any kind of property, professional trade, any form of employment in the states or elsewhere from any source whatsoever.

Like the presiding act, this new act was passed but was never imposed. Another tax Act was signed in 1862 and under this act, the rent or any rental value could be deducted from the income in an effort of determining the tax liability (Gorod, 2005, p. 41). The aim of enacting this act was to raise revenue for the civil war. In 1864, another act aimed at raising additional revenue to fund the war was enacted. This was later to be modified by the end of the war with several attempts being made to make the tax permanent.

This Act was later repealed in 1872 and in its place there was installed significant tariff restriction which until the year 1913 served as the major source of revenue. In this year, there was the 16th amendment passed allowing the congress to tax the citizens’ income from whatever source derived. Other tax reforms following the above discussed has been quite short. These reforms and tax regimes however share a common trait in that they have been forged in the crucible of national crisis. The various wars have been the most impetus for reform but economic depression has also been a major catalyst.

While the crisis can be seen as prompting the reforms, they cannot be seen as the ones shaping it. The specifics of the various tax regimes can be seen as having emerged from a political process that can be seen as balancing revenue imperatives against the political constraints (Solomon, 2002, pp. 33). Tax reform of 1996. In the year 1996, the house committee on ways and means scheduled a public hearing on issues relating to the impact of replacing the Federal income tax on the state and local government and tax exempt entities.

The hearing focused on the effects of the proposed replacement tax systems which included a national retail sales tax, a value added tax, a consumption based flat tax, a cash flow tax and a pure income tax. Many of these proposed reforms were based on newly introduced legislation. Under the law existing at that time, the federal income tax system, state and the local government as well as the payments to such entities, were subject to special rules (Gates, Collins, 2002, p. 65). The state and local governments were not subject to tax and income derived the exercise of any essential government function.

The individual taxpayers who would itemize deductions would be able to deduct state and local income, real property and personal property taxes. The businesses were by then generally allowed to deduct such payments as well as sales taxes as ordinary and necessary business expenses. In regard to revenue, the majority of the state and local revenues are derived from various sources other than the individual and corporate income taxes. However, many of the states that collect income taxes model their systems on the federal taxation system.

Thus, in the light of this modeling, any reform in the federal tax system is bound to have significant corollary effects on the state and local tax system. Non government tax exempt entities as well are subject to the special rules under the prevailing law. The existing law did not subject the various organizations in the non profit sector to pay federal taxes on the dues and the contribution that they receive. This also related to the other forms of income subject to their exempt purpose. Other issues were also pending in regard to the law at that time (Wesley, 2007, pp. 4). The House Committee on Ways and Means gave out a press release announcing a new set of tax reforms. It gave out some basic alternatives to replace the existing tax regime which as stated earlier included a national retail sales tax, a value added tax, a flat consumption tax, a cash flow tax and a pure income tax. In this regard, the national retail sales tax is imposed on the retail sales price of taxable goods or services. This tax was aimed at replacing the states sales tax which at that time had many deficiencies and controversy over its usage (James, 2005, p. 0). Under this tax system, a rate of 15 % was to be imposed on the gross payments for the use, consumption or enjoyment in the United States of any taxable property or service. This property or service would under this system not be exempted to the fact that it is not produced in the United States or rendered within or without the same. In other words, the system would require the seller of the taxable item to remit the tax himself. In this regard, specific rules would be provided for all transactions involving governmental units and the non governmental organizations.

Additionally, these rules would apply to the purchasers of the principle residence and financial intermediation services. The non profit organizations’ dues, payments and contributions would be taxed under this law. However, the payments to a non profit organization would be subject to the tax only if the property or the service provided in exchange for the payment is not substantially related to the exempt purpose of the of the organization or if it is commercially available.

On the other extreme, the provision of property or personal service by a non profit organization would be treated as a taxable transaction in an amount equal to the fair market value of that property or service (Pizzigati, 2004, pp. 72). However, under the new system, the property or personal service acquired for resale or to be used in the production of a taxable commodity would not be subjected to tax. For the governmental units, any federal state or local governmental unit would not be subject to exemptions from the tax for sale, purchase, consumption or enjoyment of a taxable good or service by unit.

In addition to the above, an extra 15% rate would be imposed on the wages of the federal, state and local government employers. In regard to principal residences, a purchaser under the new system may elect to pay tax in equal installments over a period of thirty years with respect the property purchased and used as a principal residence. Other rules have been specified by these proposed tax system all of which are aimed at eliminating any controversies and setbacks that may occur in process of executing the law providing for the proposed tax system (Reed, Swain, 1997, pp. 7). Another proposed tax system was the value added tax which is generally a tax imposed and collected on the value added at every stage in the production process and also in the distribution process. Several methods of computing the taxable base for VAT exists though VAT can generally be thought of as the difference between the value of outputs and the purchase of inputs of an enterprise. A VAT based on the destination principle under the newly introduced adjustments imposes tax on imports and provide tax rebates on the exports.

These imports charges and exports rebates are referred to as border adjustments and are generally a part of nearly all VAT systems in place. Under the proposed border adjustments, exported goods would not be subjected to the VAT through zero rating of exported goods. On the other extreme, importers would be subject to a tax on the full value of the imported commodities. A similar treatment would under the proposed reforms be provided for both imported and exported services (Kim, Snow, 1996, pp. 97).

The consumption based flat tax is generally any tax system with only one marginal tax rate. Many of the flat tax rates that have been developed do more than just applying one rate to the current individual income tax base. In general terms, the tax described in the proposed reforms was to be imposed at a single rate upon the individuals and the businesses, a case in which the individual is taxed on the amount by which the individual’s wages and distributions gotten from the deductions from the qualified plans exceed the individual’s standard deduction.

On the other hand, the business tax is a subtraction method VAT with deductions for wages and contributions to the retirement plans. In the proposed system, the receipt of compensation expenses is subject to tax at the individual level at the same flat rate applicable to businesses. On an alternative view, the proposed system can be viewed as a VAT that provides with in built exemptions for a minimum amount of consumption. Under the system, an individual would be subjected to a tax equal to 20% of the excess of certain earned income received over the year and the standard deduction for the year.

In this regard, earned income subject tax would be wages paid in cash for the services provided within the country, employment compensation and distributions for the retirement plans. The standard deduction would therefore be the sum of a basic standard deduction plus the additional standard deduction. Ways are provided for the calculation of this additional standard deduction based on a specified sum multiplied by the number of dependants of the taxpayer.

The taxable income would then include the otherwise taxable income of his or her dependents and in this case the children in the minor age (Stuart, 2007, pp. 28). Regarding the business side, the system imposed a tax rate of twenty percent of the business taxable income of any individual engaged in any business activity. This is regardless of whether such a person is a single individual, a partnership, a corporation or otherwise. The business taxable income would mean gross activity income reduced by specified deductions.

In this regard, the gross activity income constitutes the gross receipts from the sale or exchange of property by any person in connection to a business activity and the export of a property or a service in connection to any business activity. The proposed tax system would allow for deductions to cater for the cost of the business inputs meant for the business activity and for the wages paid in cash to the employees for the performance of services. In addition, it would also provide for deductions for the contribution to the retirement benefit plans or arrangement (Sobel, 2006, p. 6).

At this point, the cost of the business inputs would mean the amount paid for the property sold or used for any business activity and the amount paid for services other than that of the employees. Inclusive in this category also is any excise tax, sales tax or a custom duty or any other separately stated levy imposed by the federal, state or the local government for that matter in connection to any business activity. The system would provide special rules for the financial intermediation service activities and non cash compensation provided by employers not engaged in business activities.

In the same manner, the system sought to make several changes to the treatment of the qualified retirement plans specifically expanding the availability of qualified retirement benefit plans. This would be done by repealing non discrimination rules, removing restrictions relating to self employed individuals and tax exempt organizations. Included in this list also is the contribution limits. The system also sought to provide rules regarding the transfer of excess pension assets (Jackson, Saba, 1997, 103).

The cash flow tax as provided by the new system can be seen as a personal consumption tax imposed on the net cash flow of an individual taxpayer. The bill in which the system was proposed provided that in addition to certain other itemized deductions each individual tax payer would be entitled to two standard deductions which including a family living allowance and a personal and dependent deduction. In addition to the named deduction, the system would allow deductions for qualified home mortgage interest and charitable contribution.

Also to be allowed were certain qualified educational expenses. Certain credits against the amount of tax due were also to be allowed. In essence, a foreign tax credit would be allowed and generally a credit would also be allowed for the employee share of taxes paid by the taxpayer. In addition to the two credits, an earned income credit for the low income individuals would be allowed. Certain transition rules were also provided for the purpose of individual tax (Walsh, 2003, pp. 13).