Tax reform: flaws of current tax system in us

Finance

Tax Reform

Since the 19th century, Americans seek tax reforms to reduce forms of taxation subjected on citizens and corporations. In the US, the issue of taxes is a touchy subject with the government and other stakeholders seeking to find a mutual ground (Shapiro, 2005). This paper will examine tax reforms in the US, discussing pertinent issues like corporate tax loopholes, benefits of corporate S status, gift tax laws and abolition of estate taxes. This paper shall provide alternatives to the federal system of taxation. Tax reforms are essential to the realization of corporate and national growth (Shapiro, 2005).

Common Tax Loopholes

In principle, the US has one of the highest rates of corporate tax globally. However, in practice, US corporations pay low taxes. The Government Accountability Office estimates that the average tax burden is 25. 2% because corporations use loopholes to escape taxes. This lack of tax payment emanates from the many exceptions and loopholes in the US tax code (Reinhart, 2008). Some of the common corporate tax loopholes include deferral of income earned overseas, deductions for overseas shipping jobs, and reductions for domestic production, last-in first-out system of accounting, deduction of accelerated depreciation, corporate jet reduction and deduction of punitive damages (Shapiro, 2005).

Deferral of overseas income allows multinational companies to defer payment of income taxes on profits realized overseas until they transfer the profits home. In reality, corporations leave their profits overseas thereby deferring taxes indefinitely (Shapiro, 2005). In addition, the transfer pricing accounting technique allows corporations to transfer profits from the US to offshore havens so the profits become overseas earnings. The federal government accrues a $100 billion loss per year because of offshore tax abuses (Steuerle, 2008). The federal government should prohibit transfer of profits earned in the US to offshore accounts by illegalizing the transfer pricing system of accounting. The government should also require companies to account for overseas profits and pay taxes on such profits (Reinhart, 2008). Companies also elude taxes through deduction of punitive damages. The tax code provides that when companies pay punitive damages, they can write them off as necessary and ordinary company expenses. Therefore, after paying punitive damages, companies typically pay lesser taxes than they should pay. For instance, Exxon's settlement of $1. 1 billion for the oil spill in Alaska, in reality, cost the company $524 million after deducting taxes. It is paramount that the federal government does away with this deductibility to seal the loophole (Steuerle, 2008).

Benefits of S Status

The US government established rules on S corporations in the mid 20th century to simplify the process of business ownership. However, when a company attains S status through the ratification of the IRS, the company's owners or shareholders enjoy lenient taxation protocols. In S corporations, profits and losses pass to shareholders thus tax payment occurs once (by individual shareholders). S status for corporations is, therefore, disadvantageous to the federal government because S corporations are ineligible from paying federal income taxes (Reinhart, 2008). While some states charge state tax to S corporations, the companies are still ineligible from federal tax (Shapiro, 2005). The federal government also suffers loses when company owners give personal loans to S corporations (Steuerle, 2008). When S corporations incur losses, owners can inject company capital then deduct the losses from their personal returns. This means the business owner will pay low amounts of personal returns to the government.

Gift Tax Laws

The US tax law on gifts is quite unfair to the taxpayer. This law on gifts holds that a donor pays tax on the transfer of money or property to another person if the donor receives nothing in return for such a transfer. The gift tax law applies regardless of whether or not the donor intended the transfer of property or money to be a gift (IRS, 2012). This law is unfair because it punishes a donor for offering a gift despite not benefiting from the gift. A viable change to the gift tax law is the imposition of the tax on the recipient rather than the donor because the beneficiary enjoys all the benefits of the gift.

Abolition of Estate Tax

Estate taxes refer to taxes charged on the assignment of taxable estates belonging to a deceased individual who either died intestate or testate (IRS, 2012). Estate taxes also apply to payments of certain life insurance benefits. Estate taxes should not be abolished because they enhance the maintenance of integrity in real estate. Estate taxes are beneficial to the federal government and states because they ensure continued funding for other endeavors such as education systems. Abolition of estate taxes would deter the achievement of millions of dollars, which fund development in states and the nation as a whole. Estate taxes do not apply to inherited property with a value less than $5 million. This protects the regular person who inherits property of a low value (Shapiro, 2005).

Alternative to the Federal Taxation System

Currently, partnerships do not pay taxes, but rather the government taxes partners' income from their shares. Corporations except S corporations pay double taxes because both the company and personal incomes are subject to taxation. In order to make taxation laws fair, the federal taxation should be changed to allow for single taxation, either on a business or personal level. In addition, the federal government should scrap the Alternative Maximum Tax (AMT) law that imposes a flat rate of 20% to corporations (IRS, 2012). Scrapping this tax will allow corporations to pay taxes based on company income regardless of how low income is.

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