

Political Economic Digest Series 22

Dear Political Economic Digest Series Participant,

Welcome to the twenty second issue of Political Economic Digest Series. In the last issue of Political Economic Digest Series we discussed about Marijuana its uses and its debate on legalization. In this issue, we will be discussing about the concept of Flat Tax. We hope you'll enjoy this reading.

What is Tax?

A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government [...] a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government [...] whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name.

Proportional, progressive, regressive, and lump-sum

An important feature of tax systems is the percentage of the tax burden as it relates to income or consumption. The terms progressive, regressive, and proportional are used to describe the way the rate progresses from low to high, from high to low, or proportionally. The terms describe a distribution effect, which can be applied to any type of tax system (income or consumption) that meets the definition.

A progressive tax is a tax imposed so that the effective tax rate increases as the amount to which the rate is applied increases.

The opposite of a progressive tax is a regressive tax, where the effective tax rate decreases as the amount to which the rate is applied increases. This effect is commonly produced where means testing is used to withdraw tax allowances or state benefits.

In between is a proportional tax, where the effective tax rate is fixed, while the amount to which the rate is applied increases.

A lump-sum tax is a tax that is a fixed amount, no matter the change in circumstance of the taxed entity. This in actuality is a regressive tax as in actuality those with lower income must use higher percentage of their income than those with higher income and therefore the effect of the tax reduces as a function of income.

The terms can also be used to apply meaning to the taxation of select consumption, such as a tax on luxury goods and the exemption of basic necessities may be described as having progressive effects as it increases a tax burden on high end consumption and decreases a tax burden on low end consumption.

What is Flat Tax System?

The "flat tax" is an income tax system in which everyone pays the same tax rate regardless of their income. Flat tax systems are in place in several states in the U.S.

Fairness and Simplicity by Eliminating Deductions

Advocates of flat tax systems argue that a flat tax is fair because everyone pays the same tax rate. In addition, flat tax systems eliminate deductions, tax credits, and most exemptions, thereby eliminating biases towards certain behaviors and activities.

Eliminating deductions, tax credits, and complex tax brackets also simplifies the tax code, making compliance easier. Some proponents of the flat tax would like to see the Federal Form 1040 replaced by a simple post card on which you write your wages and multiply it by one tax rate.

Tax Only Earned Income

Another part of the flat tax philosophy is to remove double taxation, by only taxing earned income. Things like dividends, interest on savings, or capital gains that result from investment or increases in asset value would not be taxed under a pure flat tax system. This is seen as increasing the fairness and simplicity of the system, as well as encouraging investment.

Economic Growth and The Flat Tax

Supporters of flat tax systems claim that a flat tax encourages economic growth by avoiding a system in which you are penalized in higher taxes for being productive and earning more money. They argue that progressive tax systems create a penalty against things like hard work, risk taking, and entrepreneurship. The flat tax is supposed to avoid this by taxing every dollar at the same rate.

At the state level, reducing the top income tax rate by moving to a lower flat tax rate is thought to attract and encourage business investment and bring in high income individuals. This is thought to increase overall tax revenue and economic stability.

Arguments Against a Flat Tax

Opponents argue that flat tax systems place an undue burden on the lower and middle class by removing deductions and expanding the tax base to include every level of income. They claim that moving to a flat tax system shifts the tax burden from the rich to the poor, those who are most effected by taxes and least able to pay. By exempting unearned income like interest or dividends, opponents argue, that the working class is supporting the idle rich. Some flat tax systems in the U.S. get around this by exempting from tax those who fall below certain income limits or by offering special exemption or tax credits for lower income individuals.

Opponents of the flat tax argue that progressive tax systems are fair because they tax disposable income (income minus expenses). This viewpoint says that its only fair that the rich pay more because they have more disposable income and therefore a greater ability to pay. They argue that the economy would be better stimulated by decreasing the taxes of the middle class, who make up the largest part of the general public, which would give more people more disposable income to spend on products.

Extracted From: <http://taxes.about.com/od/statetaxes/a/Flat-tax.htm>

Countries with Flat Tax System

Hong Kong: Some sources claim that Hong Kong has a flat tax, though its salary tax structure has several different rates ranging from 2% to 20% after deductions. Taxes are capped at 16% of gross income, so this rate is applied to upper income returns if taxes would exceed 16% of gross otherwise. Accordingly, Duncan B. Black of Media Matters for America says "Hong Kong's 'flat tax' is better described as an 'alternative maximum tax.'" Alan Reynolds of the Cato Institute similarly notes that Hong Kong's "tax on salaries is not flat but steeply progressive." Hong Kong has, nevertheless, a flat profit tax regime.

Lithuania, which levies a flat tax rate of 15% (previously 20%) on its citizens, has experienced -15.8%, +1.3%, and +5.8% change in GDP from 2009-2011. The growth in 2011 is listed as being high compared to other nations in the region and 46th globally. **Hungary** introduced a flat tax at 16% on 1 January 2011.

Similarly, other countries that have adopted the system of flat tax are Bolivia (13%), Czech Republic (15%), Kazakhstan (10%), Mongolia (10%), Russia (13%), Serbia (12%), Ukraine (15%) and many more.

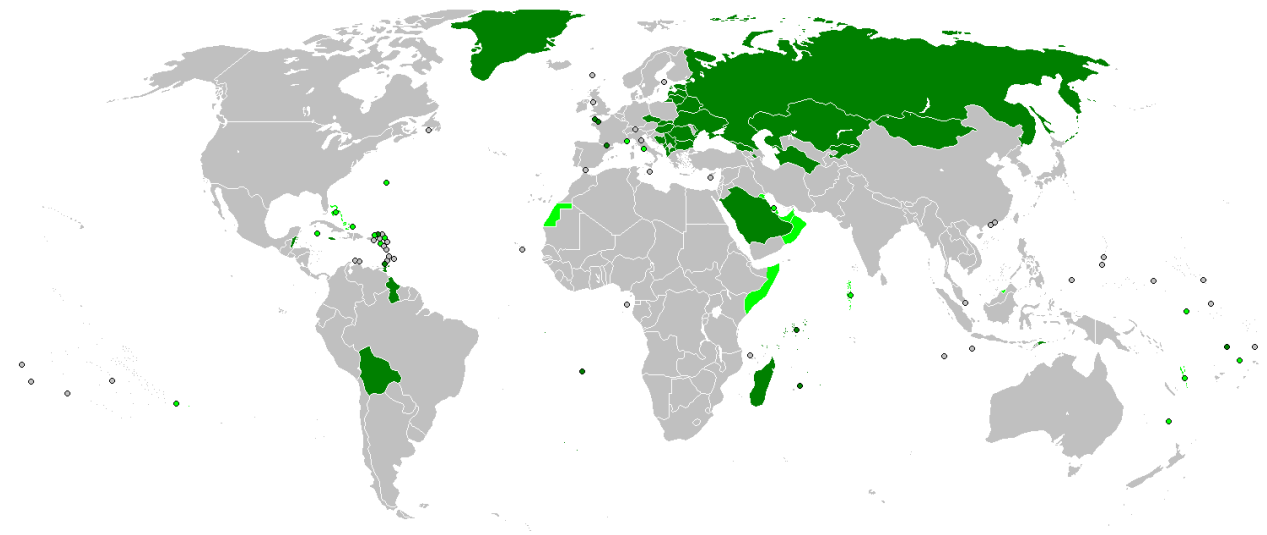


Image: Countries with flat tax system

Source: Wikipedia

5 benefits of a flat-tax system, and why it still isn't likely in Canada

By Jon Hembrey, CBC News

A common refrain during tax season is that the whole system of credits and sliding rate scales is just too complex. One of the ideas that has cropped up in recent years is to replace the system with a simple flat tax, but it turns out to be a whole lot more complicated and controversial than it might seem at first glance.

On the plus side, imagine filling out a return that consists of a single sheet of paper or web page. Simply total up taxable earnings and multiply by a single rate that is applicable to all people regardless of income level to determine how much you owe. That, in essence, is a flat tax system.

Proponents say a flat tax system would reduce the time it takes to fill out a return and, for the most part, eliminate the need to consult — and pay — a tax professional like an accountant or lawyer.

A flat tax can come in a number of different forms of varying complexity (as in all matters tax-related, it seems). But one of the mostly commonly advocated versions would see the complete elimination of all credits, exemptions and graduated rates based on income in favour on just one rate, along with an upfront deduction amount.

An incentive to work

People who have been pushing for a flat tax system says it is a simple and fair alternative that, if set up properly, could maintain existing government revenues.

Opponents, on the other hand, say it shifts the tax burden onto lower- and middle-income earners.

For Niels Veldhuis, senior economist with the Fraser Institute, the argument for changing the tax system isn't about burdens but about productivity. He says a flat tax would increase the incentive for Canadians to work, earn more money and, in turn, invest that money back into the economy.

The current system of graduated rates takes a larger percentage of a person's income the more money they make, and this is a disincentive for hard work, he says.

“You're sending a signal to young, aggressive Canadians who want to take risks, who want to start businesses, who want to save and invest. And what you're telling them is the more successful you become, the more and more we're going to penalize you,” Veldhuis says.

Unleashing that entrepreneurial spirit, so the argument goes, will create more investment, jobs and opportunities which will, in turn, increase government tax revenues.

Proponents of the flat tax also say providing a large upfront exemption amount would help lower-income Canadians because they would have to pay little, if any, tax.

Veldhuis points out that an upfront exemption amount also means that the tax system is still progressive because the more you make, the higher the amount you pay.

For instance, if there was a personal exemption of \$15,000 and a flat rate of 15 per cent, a person who earns \$20,000 would pay \$750 a year on the \$5,000 of taxable income, which works out to 3.75 per cent of their total income.

Under that same system, a person who earns \$40,000 would pay \$3,750 or 9.38 per cent of their \$25,000 in taxable income. However, as total income starts to rise the percentage paid in tax begins to flatten as it approaches 15 per cent.

'Huge boon for the rich'

For Simon Enoch, director of the Saskatchewan office of the Canadian Centre for Policy Alternatives, the "devils are always in the details" when it comes to a flat tax system. But in general he is opposed to the idea because it would likely shift the tax burden onto lower- and middle-income earners.

"I think by definition it is a huge boon for the rich because, obviously, the top marginal rate would be cut down," he says.

Enoch says a flat tax would also require a complete overhaul of the delivery of social services, because the current the system of graduated rates is used to redistribute income to those whom society has deemed worthy of the credits and exemptions.

The wealthy, moreover, would be unable to earn money if it were not for a whole host of societal benefits paid for by the government, including the regulatory and legal system, Enoch says. The rich need to foot the bill for these institutions that have supported them and their business or investment ventures.

"I think we need to have a discussion about what sort of society do we want, and those people that do succeed, do they have an obligation to sort of pay back the success they've had?"

Tax reform prone to misunderstandings

Much of the tax reform debate seems to revolve around questions of fairness and whether that means higher-income earners pay close to the same as others in terms of a percentage of income or substantially more under a system of graduated rates.

Lisa Philipps, associated vice-president of research at York University and a tax law professor at Osgoode Hall Law School, says there is room for more reasoned debate about the tax regime in Canada.

But the issue is prone to misunderstandings and "demagoguery" as the complexity of the income taxes in general is not reducible to simple election slogans.

A number of countries, including Russia, Czech Republic and Slovakia, have instituted single-rate systems over the past decade or so. The issue has played a role in the U.S. Republican primaries, but it appears to be less of a concern in Canada.

Although the Conservative government has suggested that rates could be flatter and lower, at a party convention in June 2011 a motion in favour of a flat tax system was rejected. So it's unlikely Canadians will see a tax return that takes only minutes to fill out any time soon.

Extracted from : <http://www.cbc.ca/news/business/taxseason/story/2012/02/28/f-tax-season-flat-tax.html>

We're Ignorant Idiots! Please Tell Us Why A Flat Tax Is Not Fair

Can someone please give us a rational argument why implementing a Flat Tax system in America is not fair? We don't know if we can continue posting without thoroughly understanding this issue first. From a percentage basis, each person pays an equal amount of their income towards taxes, and from an absolute basis, richer people pay more!

Why don't we just start taxing people according to height? The shorter you are, the more you have to pay! Brilliant idea, thanks. Here's a commentary from a site that really got me thinking about the word "comrade" and the phrase "melt your pots for bullets."

Gee whiz, last I checked, we live in America not North Korea. Why people believe it's fair to tax one class of citizen a higher percentage than another confuses us. Is this not a pure form of discrimination? Fine, let's agree that anybody below the poverty line of \$25,000 for a family of four (\$10,000 for a single person) are exempt from all income taxation.

Here's a reasonable 15% Flat Tax Example:

"Poor" Man Income: \$50,000 / year.

"Rich" Man Income: \$1,000,000 / year.

How much does the poor and rich man pay as a percentage of their income? 15% each = equality!

How much tax does the poor man pay in absolute dollars? \$7,500.

How much tax does the rich man pay in absolute dollars? \$ 150,000

The rich man earns 20X more than the poor man, but also pays 20X more than poor man in taxes!
Equality!

Let's put a twist to this example. Let's say the rich man is a 50 year old ER doctor who saves lives every single day. He spent 15 years after high school studying, and \$300,000 in tuition to become a doctor. Is

it right to reward this doctor who studied harder than most of the population with a higher tax rate just because he makes \$1 million a year? One could argue this doctor deserves a tax holiday, or should spend regressively less on his taxes. But then, the honorable \$50,000/yr school teacher says she's helping people too, and should pay less taxes as well. It gets complicated, but not with a flat tax!

CONCLUSION

Should we tax everybody who makes more than us an even greater amount than we are taxed to help subsidize our own living? Should I buy the domain name: "Financial Socialist Samurai of America?" We are craving for rational reasons from the personal finance community as to why the flat tax is not fair. Everybody understands racism and bigotry is bad. Why then do we accept discriminating against income levels?

Mathematically, the flat tax makes perfect sense and expunges words such as "should, fair, subsidize" from the tax argument. What the government has is a serious spending problem, and Obama needs to hire Financial Samurai as an economic advisor. The first thing we'll tell him is the mother of all personal finance advice: spend less than you earn! We have a monster budget deficit due to reckless spending and this must stop. The second thing we'll tell Obama is: discrimination is illegal! Damn, maybe we shouldn't have revealed the secrets, for now it'll be hard to make millions from the government.

Extracted from: <http://www.financialsamurai.com/2009/10/09/were-idiots-please-tell-us-a-flat-tax-is-not-fair/>

Do Higher Taxes Lead To Socialism In America?

Someone once said, "nothing is certain except pressing the reply all button by mistake and taxes." How true the saying as we face rising taxes under the new administration. Supposedly 32% of Americans filers pay ZERO TAXES! I doubt this statistic sits well with the other 68% of files who pay taxes. I also doubt the percentage of non-tax payers could be that high, but either way, even 15% is a lot. The good thing for high income earnings is that the highest marginal tax rate has come down by almost half since the 70's. Furthermore, generally if you are paying no taxes, your adjusted gross income is less than \$8,350 as a single, or \$16,700 as a married couple. Wouldn't you rather make more money and pay taxes than make little money and pay nothing?

Given we don't blog for a living, and several readers asked me this afternoon "whether I think higher taxes lead to Socialism in America, Yes or No only", my answer and thesis is therefore: "Yes, higher taxes do lead to socialism in America."

SOCIALISM

Some people bristle when they hear the word "Socialism." I just use the word Socialism as a term for the redistribution and equalization of wealth. Socialists share the belief that capitalism unfairly

concentrates power and wealth among a small segment of society, and therefore creates an unequal society. It's true, life is unfair. I wish my parents were Bank of Mom & Dad billionaires who bought me a condo during college, and then a black Ferrari afterwards, but nope. No such luck! Socialism is just a political ideology that occurs every time America gets in a whole lot of DO-DO-BROWN.

The hyper-capitalists of America helped bring us down with their inventive slicing and dicing, and securitization of leveraged products. And ironically, it was the hyper-capitalists who got bailed out the most over the past 18 months. The survivors over at AIG, Bear Sterns, RBS, Citibank, Bank of America, and Merrill Lynch are back in a commanding position now that the "bull market" has returned. Just look at their share prices. Remember, Andrew Hall at Citigroup is getting a \$100,000,000 bonus due to his correct bets on oil this year!

Everybody knows that the Obama administration plans to raise the highest marginal tax rate from 35% to 40%. Sucks for those making over \$372,950. It also sucks for those making over \$171,550, because your marginal tax rate will probably go from 33% to 36%. The proposed increase in taxes is a given, and serves to redistribute the wealth from the "rich" to the "poor." Unfortunatley for the rich, this comes at a bad time because the economic collapse has been 10X more effective in equalizing wealth than by simply raising federal taxes by 5%. See "The Less You Have, The Less You Lose."

The question we should ask ourselves is: "Is Socialism bad?" It's probably downright evil for hyper-capitalists because it incentivizes those who can make more to do less. But, for the rest of us, who aren't making big bucks, and who need some help from this current recesssion, maybe Socialism isn't so bad after all. Maybe we should support Obama's big government initiative, and taxation policies as we might all benefit? We never know when disaster will strike, and it's worth knowing that if it does, we have big brother ready to take care of us.

ASYMMETRIC THINKING

Most would love to pay lower taxes, but there is an asymmetric thought process here. The more you make, the more you dream of paying zero taxes because the absolute savings is huge. If you make \$1 million dollars a year, your effective tax rate is around 40%, and your marginal tax rate is over 50% if you live in places such as California and NYC. Thoughts of wiping out \$400,000 in tax expense makes the rich salivate, and some unfairly start cursing the "deadbeats" who don't pay a single cent. Yet, ask the rich to trade places with the poor, and you won't get a single taker. Funny ain't it?

Some of the "poor" on the otherhand think the "rich" are greedy capitalists who already make enough and should stop complaining. I would hypothesize that if the poor eventually got rich, many would change their way of thinking. Take this interesting phenomena for example: The vast majority of college students are poor by definition, and the majority are for higher taxes and big government programs (Democrats) to help the people. In college, it's just cooler being a Democrat and demonstrate against big bad corporates. I remember picketing against one shoe corporation for providing deplorable conditions and wages in Vietnam. I believed in my cause, and I also had nothing better to do because my homework was done!

Yet, why is there a gradual political shift 10 years out of college? It's because people vote with their pocket books, and the cool poor college kids are finally earning some taxable dollars. Interestingly though, if you become extremely wealthy, the balance shifts back to the Democrats, because it really doesn't matter how much you tax them, they have enough money to last many lifetimes.

PROPOSAL

The Flat Tax is the easiest solution to America's tax debate. If the flat tax is 15%, and you earn \$1,000,000 you pay \$150,000 in federal taxes. If you make \$60,000, you pay \$9,000. How is this not fair? How is this not easy to understand either? On an absolute level, the richer person pays \$141,000 more in taxes, and on a relative basis, the richer person also pays 16.7X more in taxes because his income is 16.7X more!

With a Flat Tax system, there is less gray area and less painful hours of tax preparation to go through. Could it be that the multi-billion tax prep industry have super-lobbyists with big bucks brainwashing government officials never to change our complicated system? Conspiracy theorists believe so! Simpler and fairer tax systems help discourage tax cheats as well and would help increase the overall revenue to the government.

REALITY & ACCEPTANCE

Unfortunately, there's less than a snowball's chance in the Sahara, America will adopt a flat tax system over the next 8 years. The rich need to embrace higher taxes. In this market upswing, the rich are gaining the most anyway. We've been spoiled by lower taxes for the past decade, and it's now time to pay the piper.

If you're making much more than Obama's \$250,000 bogey, do your best to defer every dollar above \$250,000 into a deferred retirement plan. If your firm doesn't go bankrupt, you would certainly gain from deferring your income to when you don't have any income i.e retirement. The funny thing is, even if you amass \$2 million cash, you are considered average based on the interest income generating power of \$60-80,000 a year. Finally, see if you can set up residency in one of the seven no income tax states. At the end of the day, if the US gets out of this funk, even with higher taxes, we all win!

Extracted from: <http://www.financialsamurai.com/2009/09/01/do-higher-taxes-lead-to-socialism-in-america/>

WILLIAMS: An argument for the flat tax

The ascendancy of lawyers, bankers and political professions is as sure a sign of any that our society is becoming less free and more tyrannical.

In many ways, these professions have replaced scribes and Pharisees as the money changers in our temples. Just as the scribes and Pharisees interposed themselves between the average believer and God, so lawyers, bankers and politicians have interposed themselves between the citizen and society.

However, when we as individuals begin to open our hearts to one another and rekindle moral excellence as the primary social currency, the need for oppressive laws and taxation lessens. Not to mention the deadening impact lawyers and so many laws have on the cultivation of virtues in the first place.

It's to the point where we've stopped talking about what's right and wrong and more about what's legal or illegal — what one can successfully get away with, instead of what one should do. What's right or wrong hinges more on recent case law — whether Napster or the recording industry won, for example. When trying to determine whether a course of action is good for the soul or the community of which we're a part, it's more "What did the Supreme Court recently say?" than "What would Jesus do?"

Certainly the rule of law is a pillar upon which a functional society is upheld, but you can have too much of a good thing to the exclusion of other goods. In order to return to the time when virtue was the focus of the family and society — in its homes, churches and schools — a lot more has to be done than simplifying our laws, but it's certainly one thing we can do.

Thomas Paine, the great American freedom fighter, echoed the common sentiment among Americans that government is a necessary evil in a society of free men. It is a device that must be used sparingly and eyed with suspicion, for its tendency is to accumulate, in the name of protection, what truly belongs to a just and good people.

Because the laws governing society have become so complex, ordinary people often feel helplessly lost and feel they have to rely on experts just perform basic, ordinary functions as citizens. Laws governing the voting process require proof of identification that can be difficult to obtain. The system of taxation has become opaque, fuzzy and susceptible to all forms of trickery and abuse.

Small-business owners find themselves bound by a mind-numbing set of regulations that impede the basic economic engine of our country from growing, stifle innovation and discourage the entrepreneurial spirit. And our members of Congress have succumbed to the self-serving and amoral dictum, when fighting to fund this or that worthless project, that it's going to be spent somewhere, so why not in my district? We certainly have lowered the standard for what's right and wrong, haven't we? In no small part because the laws are so complex and self-contradictory that we've almost been left with no other way to look at moral matters.

Good laws and regulations surely are essential in ensuring orderly societal direction and providing for the public good. A just, sound legal system can, in many ways, foster entrepreneurship and international trade. And by protecting the rights of minorities, they exemplify the best that Western civilization has to offer.

One idea for simplification would be to abolish progressive taxation and institute a single flat tax on all personal and business income. The Bible teaches us to tithe 10 percent of our income. It does not ask one person to tithe more of his or her income if he or she is rich and less of his or her income if he or she is poor.

By tithing 10 percent, each pays to the common trust an equal proportion of their means. This practice alone would virtually eliminate the need for the army of accountants, tax lawyers and government agencies dedicated to enforcing and mitigating the laws of this country. But more importantly, it's what the Founders envisioned — a tax levied based on the population, and not ability to pay. Perhaps they saw the inherent political danger in allowing politicians to vary this or that constituency's tax burden, which would be an invitation to the very kind of class warfare we're engaged in today.

Imagine a nation in which everyone pays the same amount to the government. What would such a nation look like?

First, you'd eliminate the classes of people who are able to persuade politicians to tax another class for its own benefit. How different would our nation look if everyone who lobbied for this or that benefit had to contemplate paying out of his or her own hard-earned paycheck to fund it? The calculus certainly would change.

The entire nation would have to buy into a proposal — literally — before a constituency could act in its own self-interest. Taxpayers at the low-income end of the spectrum might think twice about whether they want to be taxed on the few dollars they earn to obtain some benefit, or whether they'd rather take their chances and work harder to get more pay. Instead of eagerly anticipating, for instance, the health care bill that was signed into law this year because it would benefit them at no cost, those who thought this way during the debate might have looked closer at the legislation if they knew that they, too, would be paying higher taxes — just as much higher as the rich guy on the other side of town — to receive that benefit.

The advantage to a flat-tax system, then, is that the all-in approach would force all to think a bit more clearly before they lobby for a benefit they themselves will have to help pay for. Of course, this would never happen. Far too many tax lawyers stand to lose in a truly fair tax system, and what would Congress do all day if it didn't have tax loopholes and favors to write for its members' campaign contributors?

Extracted from: <http://www.washingtontimes.com/news/2010/aug/1/williams-an-argument-for-the-flat-tax/?page=all>

For more information on the Flat Tax System follow the link below:

Youtube link: <http://youtu.be/qBAr0MzRFU0>

Questions to think about

- 1) Would a flat tax system work for Nepal?
- 2) Is there any other tax system that could be relevant to Nepal?