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Re-vision for Oklahoma tax reform

By Jade Walle, CPA

In the November/December 2019 edition of **CPAFOCUS**, fellow OSCP member Brent Watson, CPA, penned an insightful article entitled, "2020 Vision for Oklahoma Tax Reform," where he described 12 current problems and 12 practical steps Oklahoma should consider as it relates to state taxation including sales, use, property and income taxes. You might have noticed that the word "steps" was used here, as opposed to the often-used term, "reform," and the reason why will be explained shortly.

Make no mistake, Mr. Watson's article and the 12 steps described are feasible, logical, fair and sound. The fact that we begin the discussion for tax "reform" assuming we must operate within the confines of the existing state income and sales tax system is fallacious and is reminiscent of the idea of a false dichotomy, also commonly referred to as the either/or fallacy. Simply said, when we're offered a choice for either item A or item B, the construct we are operating within is that there are no other alternatives, such as C, D, E, etc. As it relates to state taxation, we must ask ourselves the obvious question, "Have we operated in the current taxation environment so long, that we do not even question whether it is right or wrong, or whether a different system might meet what CPAs generally agree are the most important aspects of how a taxation system should work?"

The AICPA responded in its Oct. 17, 2005 release "Understanding Tax Reform: A guide to 21st Century Alternatives," saying we should evaluate tax reform based on the following principles:

- Simplicity;
- Fairness;
- Economic growth and efficiency,
- Neutrality;
- Transparency;
- Minimizing noncompliance;
- Impact on government revenues;

- Certainty, and
- Payment convenience.

In Mr. Watson's aforementioned article, he cited Adam Smith's book, "The Wealth of Nations" (1776), where Smith argued that taxation should follow the four principles of:

- Fairness;
- Certainty;
- Convenience; and
- Efficiency.

Mr. Watson's article highlights 12 areas where the Oklahoma sales, use, property and income tax systems could be improved, arguably all to address various aspects of an effective system of taxation described above. The reality is that there are a multitude of other incremental improvements that should or could be made to the Oklahoma taxation system, but the mere fact that so many bug fixes are necessary points to the larger issue and ultimate question: Should Oklahoma continue to operate in its current income and sales and use tax system with any proposed fixes simply a well-meaning but futile endeavor within a tax system that is not sustainable? The fact that Mr. Watson's article had to be written in the first place, is evidence that the current system does not accomplish Adam Smith's and the AICPA's principles for a proper system of taxation.

The next question we would expect is, "What would you replace the current income, sales and use tax system with?" Good question, and I am extremely glad you asked.

Currently, several states, including Alabama, Georgia, Minnesota, Idaho and Nebraska, are seriously considering doing away with their current income and sales and use tax systems, which means no more state income tax returns, in favor of a state FairTax.

The FairTax is actually a 21-year-old proposal

(H.R. 25) at the federal level with more than \$21 million of grass roots research behind it that would replace the IRS and our current income (individual, corporate and business), payroll, self-employment, estate, gift, capital gains and AMT with a single rate consumption tax on all new goods and retail services, at a rate that is revenue neutral to the treasury. To keep the FairTax from being regressive in nature and hitting the poor the hardest, which sales taxes are generally believed to do, it incorporates a family consumption allowance, commonly referred to as the “prebate,” where all FairTax paid for expenditures for the basic necessities of life (e.g., medicine, diapers, milk, shelter, etc.) are refunded at the beginning of each month based on annually determined U.S. DHHS poverty levels, in the vain of the current standard deduction.

When the math is examined, the prebate actually makes the FairTax more progressive than the current U.S. income and payroll tax system, due in large part to the regressive payroll withholding tax’s elimination, which accounts for more than 40% of U.S. Treasury receipts, and hits the working poor especially hard. Coupled with keeping our entire paycheck given no payroll withholding taxes, the working poor benefit greatly in a FairTax system relative to an income and payroll tax system. Rather than keeping track of our income, expenditures or various products we consume and whether or not they are a necessity or a product politicians deem essential, etc., the prebate is a simple mechanism where every legal resident has the FairTax refunded that they will inevitably spend on life’s necessities at the beginning of each month, without a cadre of lobbyists attempting to influence legislation to differentiate between which mustard brand should or should not be free of tax at the register (e.g., Grey Poupon gourmet mustard is taxed but

French’s mustard is not, etc.). You might have surmised, and it is in fact true, that when we purchase used items, (e.g., used car, clothing, etc.), a resident can legally avoid paying taxes since the FairTax is a tax once and only once, on all new goods and services. Imagine the boon to the recycling industry, waste reduction and energy and environmental conservation! Further, business to business sales transactions are not taxed, as the FairTax is only imposed on the final retail sale to the consumer (e.g., new shirt at Walmart or haircut at Supercuts), which means the build-up of embedded taxes in the cost of everything we consume is eliminated, which lowers the ultimate retail cost of goods and services. What a straightforward, efficient, fair, convenient and simple idea. Were these aspects of a tax system that the AICPA touted above?

At this point, Alabama is the state furthest along in their journey to embrace tax reform at the state level, having introduced in their current 2020 session state bill HB4, the Alabama Economic Freedom Act. Upon examination of Alabama’s HB4, it eliminates the state’s personal and corporate income, estate, inheritance, sales and use taxes with a single rate consumption tax (8.03% in Alabama’s case) on the purchase of all new goods and services, at the register so to speak, with no FairTax charged as businesses sell to other businesses. Based upon Alabama’s particularly needed jurisdictional allocations, HB4 outlines that 80% of the tax collected at the point of sale will go to the state’s treasury apportioned amongst the state’s Education Trust Fund, State General Fund and other allocations. The remaining 20% collected is apportioned 40% to each state county, prorated by population, and 60% to each state municipality.

Occam’s Razor dictates that a theory should provide the simplest possible

viable explanation for a phenomenon. Others suggest that good theory exhibits an aesthetic quality, that a good theory is beautiful or natural. As it relates to taxation, the fact that we need articles to outline how to make the current tax system less cumbersome and intrusive in our daily lives points to the fact that the current system is anything but efficient, convenient or fair. The FairTax on the other hand naturally promotes economic expansion, convenience, freedom (from intrusion, tax forms, tax returns, record keeping, audits, civil-asset forfeiture, etc.), and is proven to reduce illegal tax evasion relative to an income tax, since it takes two to tango, so to speak, to evade a sales tax. The FairTax is naturally efficient, even as it relates to the exponentially increasing problem of illegal income tax evasion.

An Oklahoma FairTax system would need only minimal analysis for the particulars of Oklahoma, given the fact that the FairTax is the most researched piece of potential legislation in U.S. history. The research, including studies from the former head of Harvard’s Economic Department, indicates an economic powerhouse would be unleashed by becoming a 0% individual and corporate income tax state. An Oklahoma FairTax system could in fact be one of the key ingredients in accomplishing Governor Stitt’s desire to improve Oklahoma’s tax laws and become a Top Ten state, if not even a top five state. As it relates to our vision for true tax reform, as opposed to rearranging the deck chairs on the Titanic, an Oklahoma FairTax system would fundamentally reform the state’s tax system, be fair to the poor due to the prebate and eliminate arguably one of the most freedom-stripping tax systems of all, the income tax, in addition to the seldom complied-with use tax. 🏹