

THE **FREEDOM TAX**™ Blueprint

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UNITED STATES CODE

TITLE 26 -- INTERNAL REVENUE CODE

SUBTITLE A -- THE INCOME TAX

Chapter 1 -- Taxation of Income

Subchapter A. Determination of Tax

SEC. 1. IMPOSITION OF TAX.

(a) **TAX IMPOSED.**— There is hereby imposed a tax of 10% on all income regardless of source, payor, or recipient.

(b) **INCOME DEFINED.**— For purposes of subsection (a), the term “income” means gross income as defined by section 2, minus the deductions set forth in section 3.

SEC. 2. GROSS INCOME DEFINED.

(a) **GENERAL DEFINITION.**— For purposes of section 1, the term “gross income” means money or value received in exchange for the providing of a good or service or from the investment of capital, including (but not limited to) the following items:

- (1) Compensation for services, including fees, commissions, tips, and similar items;
- (2) Employee fringe benefits, including stock options plus the employer-paid portion of the employee’s taxes paid on behalf of the employee as contributions to the Social Security and Medicare Programs;
- (3) Government entitlement and welfare benefits, including unemployment

compensation;

- (4) Trade and business income;
- (5) Rent and royalty income;
- (6) Net gains derived from dealings in property;
- (7) Interest;
- (8) Dividends;
- (9) Annuities, income from life insurance and endowment contracts, and Social Security and other retirement payments; and
- (10) Income from the discharge of indebtedness.

(b) ITEMS NOT CONSTITUTING GROSS INCOME.— The term “gross income” as defined in subsection (a) does not include —

- (1) The value of property acquired by gift, bequest, devise, or inheritance;
- (2) Subject to such terms and conditions as may be prescribed in regulations of the Secretary or his delegate, (A) amounts received as compensation for injuries or sickness, (B) amounts received under accident and health insurance plans (except for amounts constituting wages or payments in lieu of wages), (C) scholarship and fellowship grants, (D) meals and lodging furnished for the convenience of the employer, or (E) amounts received under insurance contracts for the loss of use or occupancy of the recipient’s principal residence;
- (3) Proceeds from a life insurance policy;
- (4) Distributions of income, as defined in section 1(b), from pension plans or similar arrangements, or from partnerships or other entities (other than corporations);
- (5) Contributions to the capital of a corporation, limited liability company, or partnership;
- (6) Property (including cash proceeds) received from the sale or exchange of a capital asset, or
- (7) Income derived from sources outside of the United States, including but not limited to (A) income from a trade or business carried on abroad; (B) commissions, salaries, and wages earned abroad; and (C) dividends and interest

income from foreign sources.

[Point: *There will be no U.S. taxation of the foreign earnings of a U.S. corporation upon a “repatriation” of those earnings.*]

(c) CAPITAL ASSET DEFINED.— For purposes of paragraph (6) of subsection (b), the term “capital asset” means property (whether or not connected to a trade or business), but does not include —

(1) stock in trade or other property of a kind which would properly be included in inventory if on hand at the close of the year of the trade or business, or property held primarily for sale to customers in the ordinary course of the trade or business;

(2) property used in a trade or business of a character which is subject to the allowance for depreciation or real property used in the trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a person (or the donee of such property if gifted) whose personal efforts created such property, or

(B) in the case of a letter, memorandum, or similar property, the owner (or the donee of such property if gifted) for whom the property was prepared produced);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) property held by a dealer or trader in such property, or property held by a person (or the donee of such property if gifted) received as compensation for services unless such property was taxed as such under section 1.

SEC. 3. DEDUCTIONS ALLOWED.

(a) GENERAL.— For purposes of subsection (b) of section 1, the following deductions shall be allowed in computing income:

(1) TRADE OR BUSINESS EXPENSES.— With respect to a trade or business, all ordinary and necessary expenses paid or incurred during the tax year in carrying on that trade or business.

(2) EXPENSES FOR PRODUCTION OF INCOME.— With respect to rent and royalty gross income, all ordinary and necessary expenses paid or incurred during the tax year for the production or collection of such income; for the management, conservation, or maintenance of the property held for the production of such income; or in connection with the determination, collection, or refund of any tax.

(3) INTEREST AND DIVIDENDS.—

(A) INTEREST.—With respect to a trade or business or other activity for the production of income, there shall be allowed as a deduction all interest paid or accrued within the tax year on indebtedness.

(B) DIVIDENDS.— In the case of a corporation, there shall be allowed as a deduction any dividend distributed by a corporation during the tax year with respect to its stock. For purposes of this subparagraph, the term “dividend” means any distribution of property (including money, securities, or other property) made by a corporation to its shareholders out of its earnings and profits, excluding —

(i) any distribution made in liquidation of the corporation or in connection with its reorganization, and

(ii) any distribution of the stock (including rights to acquire such stock) of a corporation made by such corporation to its shareholders with respect to its stock.

For purposes of this subparagraph, the Secretary or his delegate shall prescribe regulations for the determination of earnings and profits and computation of dividends distributed therefrom.

(4) NET OPERATING LOSS DEDUCTION.—

(A) IN GENERAL.— With respect to a trade or business or other activity for the production of income. there shall be allowed as a deduction

for the tax year an amount equal to the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year.

(B) NET OPERATING LOSS DEFINED.— For purposes of this paragraph, the term “net operating loss” means (for any tax year ending after the date of enactment) the excess of the deductions allowed under this section over the gross income.

(C) CARRYOVERS AND CARRYBACKS.— Under regulations prescribed by the Secretary or his delegate, a net operating loss for a tax year shall be carried-back and used as a deduction for the third tax year preceding the loss year and, to the extent unused, carried-forward and used as a deduction for each of two succeeding tax years and then as a carryover deduction for the seven tax years following the tax year of the net operating loss.

(5) TAXES.—

(A) GENERAL RULE.— With respect to a trade or business or other activity for the production of income, except as otherwise provided in this paragraph, the following taxes shall be allowed as a deduction for the tax year within which paid or accrued:

- (i) State and local real property taxes,
- (ii) State and local personal property taxes,
- (iii) State and local income taxes,
- (iv) State and local sales taxes, and
- (v) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels.

(B) SPECIAL RULES.— For purposes of subparagraph (A),

(i) no deduction shall be allowed for local taxes assessed for local benefits of a kind tending to increase the value of the property assessed, except to the extent such taxes are properly allocable to maintenance or interest charges, and

(ii) in the case of real property taxes imposed upon such property sold during the tax year, such taxes shall be properly allocated between the buyer and the seller.

(6) LOSSES.— With respect to a trade or business or other activity for the production of income, there shall be allowed a deduction for any loss sustained

during the tax year and not compensated for by insurance. No loss deduction shall be allowed from the sale or exchange of a capital asset, including for a worthless security (a bond, debenture, note, or certificate, or other evidence of indebtedness issued by a corporation or by a government or political subdivision thereof, with coupons or in registered form).

(7) BAD DEBTS.—

(A) GENERAL RULE.— With respect to a trade or business, there shall be allowed a deduction for trade or business debts which become wholly worthless during the tax year if the debt arose in the course of the carrying on of a trade or business.

(B) RESERVE FOR BAD DEBTS.— In lieu of any deduction under paragraph (A), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable allowance to a reserve for bad debts.

(C) WORTHLESS SECURITIES.— This paragraph shall not apply to a debt evidenced by a security described in paragraph (6).

(8) DEPRECIATION EXPENSE.—

(A) GENERAL RULE.— With respect to a trade or business or other activity for the production of income, there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property (i) used in a trade or business, or (ii) held for the production of income.

(B) USE OF CERTAIN METHODS AND RATES.— The term “reasonable allowance” as used in paragraph (A) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under the following methods: (i) the straight line method, (ii) the declining balance method (using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described under clause (i)), (iii) the sum of the years-digits method; and (iv) any other method consistent with generally-accepted accounting principles and used in the books and records of the trade or business or the activity for the production of income.

(9) OTHER DEDUCTIONS.— For purposes of this section, a deduction shall be allowed for expenditures not resulting in the acquisition of tangible

property but advancing the interests of the particular trade or business, such as circulation expenditures, organization expenditures, research and experimentation expenditures, software development expenditures, soil and water conservation expenditures, and trademark and trade-name expenditures.

(10) ALLOCATION OF GROSS INCOME AND DEDUCTIONS.— In the case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned, or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of tax or to clearly reflect the income of any of such organizations, trades, or businesses.

(11) ACTIVITIES NOT ENGAGED IN FOR PROFIT.—

(A) GENERAL RULE.— No deductions shall be allowed under this subsection with respect to any activity not engaged in for profit, in excess of the gross income derived from such activity.

(B) PRESUMPTION.— If the income derived from an activity (determined without regard to whether or not such activity is engaged in for profit) for 2 or more of the tax years in the period of 5 consecutive tax years which ends with the tax year, then, unless the Secretary or his delegate establishes to the contrary, such activity shall be presumed for purposes of this chapter for such tax year to be an activity engaged in for profit.

(b) SPECIAL RULES.— For purposes of subsection (b) of section 1, the following additional rules shall apply in computing income:

(1) NET GAINS DERIVED FROM DEALINGS IN PROPERTY.—

(A) GENERAL RULE.— The gains from dealings in property under paragraph (6) of section 2(b) for a tax year shall reflect deductions for reasonable and ordinary expenses paid or incurred to effect such dealings and the costs to acquire such property (including any net loss sustained from such dealings for the immediate prior tax year and carried over to the tax year under subparagraph (B)).

(B) LOSS CARRYOVER RULE.— For purposes of subparagraph (A), any net loss determined under subparagraph (A) for a tax year shall

be carried over to the next succeeding tax year and treated as a loss sustained in such succeeding tax year.

(2) ANNUITIES AND RETIREMENT INCOME.— Under paragraph (7) of section 2(b), payments from an annuity, life insurance of endowment contract, retirement plan, or the Social Security Program shall be taxable to the extent that the payments, in the aggregate as made, exceed the recipient’s acquisition cost for such annuity, contract, or right to receive payments from the retirement plan or the Social Security Program.

(A) ACQUISITION COST.—For this purpose, the term “acquisition cost” shall include all amounts paid or incurred by the recipient to acquire the annuity, contract, or right to receive payments from the retirement plan, or Social Security Program. Such term shall also include, in the case of a retirement plan, contributions made by the recipient’s employer on his behalf to such plan (which were taxed under this subtitle when made). Such term shall include, in the case of the Social Security Program, all FICA taxes deducted from the recipient’s salary and wages, plus the employer-paid portion of such taxes (which were taxed under this subtitle as contributions to the Program on his behalf) and shall include all FICA taxes paid by the recipient with respect to his self-employment earnings.

(B) RECORD-KEEPING REQUIREMENT. — For purposes of subparagraph (A), the payor (whether or not a Federal, State, or local government agency) shall keep and maintain adequate records of all contributions, salary and wage deductions, and other payments made by or on behalf of the recipient and shall make the computation of the portion of each payment under subparagraph (A), which is income subject to taxation.

Subchapter B. Procedure and Administration

SEC. 21. AT-SOURCE TAXATION OF INCOME. —

(a) GENERAL RULE.— The tax imposed by section 1(a) on the items of income described in paragraphs (1), (2), (3), (7), (8), and (9) of section 2(a) shall be imposed and collected at their source of payment by the payor of such income, before the payment is paid or credited to the recipient of such income.

(b) SPECIAL RULES.—

(A) ANNUITY AND OTHER RETIREMENT INCOME.— In the case of income described in paragraph (9) of section 2(a), subsection (a) shall be applied as provided by subsection (b)(2) of section 3.

(B) NON-MONEY INCOME.— In the case of income paid in non-money form, subsection (a) shall be applied in accordance with regulations prescribed by the Secretary or his delegate.

SEC. 22. RETURN REPORTING AND COLLECTION OF THE TAX.

(a) GENERAL RULE.— Returns with respect to the income tax imposed by section 1(a) on the items of income described in paragraphs (4), (5), (6), and (10) of section 2(a) shall be made for each tax year.

(b) INCOME AT-SOURCE TAXED.— Income described in paragraphs (1), (2), (3), (7), (8), and (9) of section 2(a) shall be disregarded from, and not reported in, any return made under subsection (a).

(c.) CONSOLIDATED RETURNS.— An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by section 1 for the tax year in lieu of separate returns. The making of a consolidated return shall be on the condition that all corporations which are members of the affiliated group consent to all the consolidated return regulations prescribed under this subsection prior to the last day prescribed by law for the filing of such return. The making of such return shall be considered such consent. In the case of a corporation which is the member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(1) REGULATIONS.— The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

(2) COMPUTATION AND PAYMENT OF TAX.— In any case in which a

consolidated return is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under paragraph (1) prescribed before the last day prescribed by law for the filing of such return.

(3) DEFINITIONS.—

(A) AFFILIATED GROUP.— As used in this subsection, the term “affiliated group” means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if —

(i) stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(ii) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least of the includible corporations.

As used in this subparagraph, the term “stock” does not include nonvoting stock which is limited and preferred as to dividends.

(B) INCLUDIBLE CORPORATION.— As used in this subsection, the term “includible corporation” means any corporation except an insurance company, a foreign corporation, or a regulated investment company.

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The above is a representation of how key portions of the Tax Code, relevant to the determination of the income tax liability, would appear if the *FreedomTax* were to be enacted. Other simplifications, along with conforming changes, would have to be made to the remainder of the Internal Revenue Code — not to mention the vast array of tax penalties to be eliminated, now so essential to the enforcement of the existing income tax.

And, below is a non-exhaustive list of the current provisions in the Tax Code which the *FreedomTax* provisions presented above would replace:

(A.) In existing SUBTITLE A of the Internal Revenue Code (regarding Normal Taxes

and Surtaxes), these components in Chapter 1:

- (1) Subchapter A -- Determination of Tax Liability.
All Code sections, secs. 1 thru 59 -- a total of **82 sections** at latest count (82 because some jumbled-up sections have the same section number, but have different capital letters at the end).
- (2) Subchapter B -- Computation of Taxable Income.
All Code sections, secs. 61 thru 291 -- **159 sections** at latest count.
- (3) Subchapter C -- Corporate Distributions and Adjustments.
All Code sections, secs. 301 thru 346 -- **18 sections** at latest count.
- (4) Subchapter D -- Deferred Compensation.
All Code sections, secs. 401 thru 483 -- **33 sections** at latest count.
- (5) Subchapter E -- Accounting Periods and Methods of Accounting.
Essentially to be retained, but evaluated.
- (6) Subchapter F -- Exempt Organizations.
All Code sections, secs. 501 thru 530 -- **22 sections** at latest count.
- (7) Subchapter G -- Corporations Used to Avoid Income Tax on Shareholders.
All Code sections, secs. 521 thru 565 -- **18 sections** at latest count.
- (8) Subchapter H -- Banking Institutions.
To be evaluated.
- (9) Subchapter I -- Natural Resources.
All Code sections, secs. 611 thru 638 -- **10 sections** at latest count.
- (10) Subchapter J -- Estates, Trusts, Beneficiaries, and Decedents.
All Code sections, secs. 641 thru 692 -- **28 sections** at latest count.
- (11) Subchapter K -- Partners and Partnerships.
All Code sections, secs. 701 thru 777 -- **36 sections** at latest count.
- (12) Subchapter L -- Insurance Companies.
To be evaluated.
- (13) Subchapter M -- Regulated Investment Companies and REITs.
All Code sections, secs. 851 thru 860G -- **18 sections** at latest count.
- (14) Subchapter N -- Income from Sources Outside the United States.
All Code sections, secs. 861 thru 1000 -- **78 sections** at latest count.
- (15) Subchapter O -- Gain or Loss on Disposition of Property.
All Code sections, secs. 1001 thru 1111 -- **36 sections** at latest count.
- (16) Subchapter P -- Capital Gains and Losses.
All Code sections, secs. 1201 thru 1298 -- **55 sections** at latest count.
- (17) Subchapter Q -- Readjustment of Tax.
All but one of Code sections, secs. 1301 thru 1351 -- **2 sections** at latest count, but sec. 1341 likely to be retained.
- (18) Subchapter R -- Election re International Shipping Activities.
All Code sections, secs. 1352 thru 1359 -- **8 sections** at latest count.
- (19) Subchapter S -- Tax Treatment of S Corporation and Their Shareholders.
All Code sections, secs. 1361 thru 1379 -- **14 sections** at latest count.
- (20) Subchapter U -- Empowerment Zones.
All Code sections, secs. 1391 thru 1397F -- **9 sections** at latest count.
- (21) Subchapter V -- Title 11 Cases.

- All Code sections, secs. 1398 thru 1399 -- **2 sections** at latest count.
- (22) Subchapter W -- District of Columbia Enterprise Zone.
All Code sections, secs. 1398 thru 1399 -- **4 sections** at latest count.
- (23) Subchapter X -- Renewal Communities.
All Code sections, secs. 1400E thru 1400 -- **7 sections** at latest count.
- (24) Subchapter Y -- Short-Term Regional Benefits.
All Code sections, secs. 1400L thru 1400U-3 -- **12 sections** at latest count.

ALSO, in addition to the listing under (A.) above, not needed under the *FreedomTax* and therefore to be repealed --

- (B.) Chapter 4 in SUBTITLE A (re Taxes to Enforce Reporting on Certain Foreign Accounts) -- all Code sections, secs. 1471 - 1474 -- **4 sections** at latest count.
- (C.) Chapter 6 in SUBTITLE A (re Consolidated Returns) -- all Code sections, secs. 1501 thru 1564 (the necessary provisions from this Chapter covered in *FreedomTax* sec. 22(c).) -- **9 sections** at latest count.
- (D.) All of SUBTITLE B (re Estate and Gift Taxes) -- all Code sections, sec 2001 thru 2058 -- **92 sections** at latest count.
- (E.) Chapter 41 of SUBTITLE D (re Public Charities) -- all Code sections, secs. 4911 thru 4912 -- **2 sections** at latest count.
- (F.) Chapter 42 of SUBTITLE D (re Private Foundations and Other Tax-Exempt Organizations) -- all Code sections, secs. 4940 thru 4967 -- **21 sections** at latest count.
- (G.) And, Chapters 43 (re Qualified Pension Plans, etc.) -- all Code sections. Secs. 4971 thru 4980I -- **19 sections** at latest count.
- (H.) Chapters 44 thru 50 of SUBTITLE D (re other matters) -- All Code sections, secs. 4981 thru 5000C) -- **8 sections** at latest count.
- (I.) SUBTITLE F (re Procedure and Administration) -- major revision and streamlining.
- (J.) SUBTITLE H (re Financing of Presidential Election Campaigns) -- All Code sections, secs. 9001 - 9042 -- **25 sections** at latest count.

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Drafting Perspective: When the time comes to draft the actual implementing language, there likely will be many refinements to be made to the above. Nevertheless,

the above is to serve as the guiding blueprint for the actual language to be drafted for the new *FreedomTax* Code.

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