

## TAX DEDUCTION FOR YOUR PET

A bill has been introduced in the House of Representatives authorizing a \$3,500 exclusion from income (above-the-line deduction) for family pets.

That's right. Your dog Fluffy or my wife's cat Anna may be recognized for tax purposes on your 1040 return.

The bill is House Resolution 3501. I can't imagine this bill, or any version of this bill ever being passed by Congress. And I'm not going to debate the merits of the bill.

### Simplifying the US Tax Code

This bill is a wonderful springboard to discuss something that has been a consistent theme in American politics for years—simplifying the US Tax Code.

Everyone—almost everyone, anyway—would agree that the Tax Code is long overdue for a substantial overhaul.

Exhibit One in the discussion could be HR 3501, but not in the way you might think.

So much of the Code is written not to tell us what to do, but to tell us what not to do.

In other words, closing tax loopholes.

Leave a door open, and we'll all take advantage. Leave something undefined, or at least ambiguous, and platoons of attorneys and tax professionals will construct arguments creating additional tax benefits for their clients.

HR 3501, if enacted, would probably require additional enabling legislation to cover the at least the following:

### Questions Regarding Fluffy's Deductibility

- Pet Tax Numbers, similar to SSN. How else will you track which pet has been deducted, and by whom?
  - How long does Fluffy need to live in the household?
    - Does the family lose the deduction if they get tired of Fluffy and give him away?



- When Fluffy has puppies, do they each qualify for exemptions?
- Do guppies qualify?
- If the family separates, who claims the exemption?
- State recognition of the Pet Exemption is a whole new world of tax complexity.
- Some states, like California, will not automatically allow this deduction on the return.
- Other states, like New York, would likely have to submit legislation to remove it.

### Federal and State Tax Conformance

Every year, all states must pass conforming legislation that specifies what parts of the Federal code the state will recognize, and what parts it will not recognize.

Inconsistencies between Federal tax law and State law are thereby created. And the 50 states are not consistent between each other.

These situations happen all the time, and occur far more often than most people realize.

Many of these situations have to do with the depreciation of capital assets. Federal policy in a given year may be to stimulate additional capital purchases. So Congress passes a law that allows companies to claim huge amounts of depreciation expense, but only for one or two tax years.

Some states will conform to this law, but more will not. The taxpayer must keep two sets of depreciation schedules—one Federal, one State—for the lifetime of that asset. More if the assets are in multiple states.

One of the main reasons the states won't recognize these changes in Federal tax policy is that the states don't have the power to print money.

In other words, the states must live within their means and not spend more than they take in. That's a pretty simple concept. Most of us live our lives, or try to, on that same principle.

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## **Tax Simplification Won't Be Easy**

The complexities arising from a seemingly simple thing like Fluffy's deduction argues for tax simplification.

President Obama has said that tax simplification will be an objective in his administration. It's a fine idea, but one that will be very, very hard to implement in a coherent, even-handed, fair way.

Part of the problem is that Federal tax policy changes in response to the overall economic environment. Thus, a change intended to generate a net good also means the sacrifice of tax revenue. The Federal government can get away with it, because they print the money.

The states don't print money, and can't get away with it. So they refuse to go along. This is just one of many, many examples of the complexities of the tax system we have created.

## **The Bottom Line of Simplification**

We all recognize the need for roads, schools, aircraft carriers, care for the elderly, and all the rest.

And we all recognize that we must pay taxes to get the benefit of all these things.

We'd just like to do so in a way that is easier to understand and easier to implement, and is still "fair" to all taxpayers, whatever "fair" means.

Doesn't look good for Fluffy.