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THE PROGRESSIVE CONSUMPTION TAX REVISITED

*Steven A. Bank**

FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM BETTER AND SIMPLER. By *Edward J. McCaffery*. Chicago: University of Chicago Press. 2002. Pp. xiii, 178. $28.

Over the last decade, it has become increasingly evident that our current federal income tax is too complex, too easily evaded by the wealthy, and too likely to distribute the burdens of taxation to the people least able to bear it. Several years ago, frustration with these realities led to a groundswell of reform proposals, ranging from replacing the current graduated income tax rates with "flat," or proportionate, rates to abolishing the income tax altogether in favor of a national sales tax.[1] While this tax reform frenzy dissipated almost as quickly as it began, the seeds of discontent remain.

Professor Edward McCaffery[2] seeks to revive the tax reform debate in *Fair Not Flat: How to Make the Tax System Better and Simpler*. In his book, the University of Southern California law professor proposes combining elements of both the flat tax and sales tax proposals of the mid-90s.[3] The twist in his proposal is that he abandons the flat rate that most politicians and commentators erroneously characterized as the most significant innovation of the flat tax. The flat rate always concealed the more radical proposal to exempt savings and investment from the tax base. McCaffery should be commended for highlighting this feature and acknowledging its true significance. In doing this, however, he forgoes the flat tax's rhetorical appeal by explicitly embracing the introduction of progressivity through graduated rates. The proposal is therefore unique in the politically charged world of tax reform because it combines features that should be appealing to

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1. *See* Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U. L. REV. 329, 329-30 (1996) [hereinafter Bank, *Origins of a Flat Tax*] (describing the eight proposals that were either circulated or formally submitted to Congress during 1995).

2. Maurice Jones Jr. Professor of Law, University of Southern California; Visiting Professor of Law and Economics, California Institute of Technology.

3. This is not McCaffery's first enunciation of the idea. *See* Edward J. McCaffery, *The Missing Links in Tax Reform*, 2 CHAP. L. REV. 233, 248-51 (1999); Edward J. McCaffery, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 TEXAS L. REV. 1145 (1992).

members of both ends of the spectrum. For liberals, it embraces the progressive ideal of the modern income tax. For conservatives, it fully exempts savings and investment from taxation and therefore operates as a consumption tax. It appears to be the perfect compromise — a progressive consumption tax.

While McCaffery's plan is unique, it is not unprecedented. There have been at least three serious attempts to persuade Congress to adopt some form of a progressive consumption tax. In 1921, during consideration of the first post-World War I revenue act, Representative Ogden Mills of New York introduced a bill to replace the income surtaxes with a "graduated spendings tax."[4] Treasury Secretary Henry Morgenthau revived Mills's proposal in 1942 by proposing to combine a refundable war-time tax with a permanent graduated surtax on spending.[5] Finally, during the latest round of radical tax reform proposals in 1995, Senators Sam Nunn, Pete Domenici, and Bob Kerrey introduced a bill to replace the income tax with the Unlimited Savings Allowance ("USA") Tax, a measure McCaffery discusses (p. 57-58), and which was recently reintroduced in modified form.[6]

There are significant similarities between each of these attempts to introduce a progressive consumption tax — similarities that may provide important lessons for the fate of McCaffery's plan. Each time a progressive consumption tax was proposed, there was substantial dissatisfaction with the complexity of the income tax and there was already support for proposals to adopt a consumption tax. Moreover, many contemporary scholars supported the progressive consumption tax during each period. Notwithstanding such seemingly favorable conditions for the adoption of a progressive consumption tax, each proposal was summarily rejected.

This Review considers why the progressive consumption tax has never been embraced. While the prior rejections were in part a result of their unique circumstances, there are several common themes. In each instance, opponents complained that the progressive consumption tax failed to reduce the complexity characterizing the current income tax. Furthermore, proponents miscalculated the source of opposition to the progressive consumption tax. First, they failed to understand that consumption tax proponents were committed to a flat rate sales tax. Second, they underestimated the support for an income tax base by those who supported graduated rates. Instead of finding a compromise between the two positions, proponents of the progressive consumption tax alienated both sides. Given such problems, it is not

4. *See infra* Part II.A.

5. *See infra* Part II.B.

6. *See infra* Part II.C.

surprising that the proposals received little more than passing consideration.

Although McCaffery's plan is a vast improvement, there is little reason to believe that it would fare better than its predecessors. Compromises are often difficult in the context of radical reform. The progressive consumption tax, however, may be an illusory compromise. Part I describes McCaffery's proposal. Part II provides a brief history of the progressive consumption tax and three instances in which it was unsuccessfully proposed. Part III discusses why McCaffery's proposal is also unlikely to be adopted and Part IV concludes by suggesting an alternative compromise.

I. The Proposal

McCaffery's proposal combines a flat sales tax with a supplemental graduated tax on consumption. Under the sales tax component, everyone would be subject to either a national retail sales tax or a value added tax ("VAT") at a uniform ten percent rate.[7] To exempt consumption on necessities, McCaffery proposes a credit that would effectively refund the sales tax paid for the lowest bracket of consumption (p. 101). This credit is analogous to the exemptions and standard deduction under current law. Using the numbers he provides for illustration purposes, a family of four would pay no tax on their first $20,000 of expenditures, and only a ten percent national sales tax on the next $60,000 spent (pp. 100-01). For families who spend more than $80,000 annually, a supplemental tax would be imposed at rates starting at ten percent and rising to as much as fifty percent.[8]

McCaffery defines "consumption" as the amount remaining after deducting all savings and investment from a taxpayer's income. As McCaffery explains, in an ideal income tax system, income is defined as consumption plus accumulation, or, expressed algebraically, $I = C + A$ (pp. 11-12). This "Haig-Simons" definition of income, named after

7. P. 100. A sales tax would be imposed at the point of retail sale while the value added tax would be imposed at each point in the manufacture and sale of a product in which value is added by the seller.

8. P. 101. The actual rates would be as follows:

Spending	Rate (%)
0-20,000	0
20,000-80,000	10
80,000-160,000	20
160,000-500,000	30
500,000-1,000,000	40
over 1,000,000	50

P. 91 tbl.5.5.

the professors who derived it,[9] can also be used to define consumption. Under this formulation, C = I — A, or consumption is income minus accumulation. In other words, if an income tax exempts savings and investment, it becomes a consumption tax.

This allows McCaffery to use the current system in implementing his proposal. Each taxpayer would have something akin to an individual retirement account, which McCaffery calls a "Trust Account," to represent the amount saved or invested (p. 98). Contributions to the Trust Account would be deducted from income and withdrawals would be included in income. Loans would also be included in income, although they would be deductible if contributed to a Trust Account. Conversely, debt repayment, including interest, would be deductible as a form of investment. Under McCaffery's simplified formulation, "Taxable Consumption" would consist of W-2s (wages) plus what he calls "D-2s" (debts) minus what he calls "S-2s" (savings) and some currently deductible items such as medical expenses and charitable contributions (p. 98). McCaffery would also abolish the estate and gift tax. As he puts it, "[d]ead people don't spend" (p. 63). Instead, the heirs would be taxed when they spend.

II. THE PRECEDENTS

The progressive consumption tax concept is not a new one in either academic or political thought. On at least three occasions in the last century, an influential legislator or Treasury itself introduced the idea as an alternative to heavy reliance on the income tax. In each instance, despite many contemporary scholars' backing, the proposal was dismissed with little debate.

A. *1921*

The end of World War I brought demand for radical reform of the tax system. While the income tax helped to meet wartime revenue demands, the cessation of hostilities revealed its defects. As Thomas S. Adams, a Yale economics professor and special advisor to the Treasury wrote in August 1921, "[p]lainly there is 'something the matter with the income tax.' About the necessity of thoroly [sic] revising the income tax law at this session of Congress there is general agreement."[10] Both Democrats and Republicans called for tax reform,

9. *See* HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (photo. reprint 1980) (1938); Robert Murray Haig, *The Concept of Income — Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1, 7 (Robert Murray Haig ed., 1921).

10. *See Internal-Revenue Hearings on the Proposed Revenue Act of 1921 Before the S. Comm. on Finance*, 67th Cong. 45 (1921) [hereinafter *S. Hearings on the Proposed Revenue Act of 1921*] (brief of the Trades Council of the Manufacturers' Club of Philadelphia); Tho-

perhaps in part motivated by widespread dissatisfaction with the tax among businesses and the public.[11] The House Ways and Means and the Senate Finance Committees each "received thousands of letters" expressing "a demand for revision."[12]

In this call for tax reform, there was substantial pressure to adopt a national sales tax to replace the excess profits tax and the high surtaxes on individual income. A variety of groups supported the sales tax concept, including the Business Men's National Tax Committee, the Tax League of America, and the New York Board of Trade; and prominent business leaders such as Otto Kahn, Jules Bache, and Charles E. Lord joined them in their efforts.[13] Sales tax proponents understood the need for an income tax during the war, but as Lord explained in a speech to the National Industrial Conference Board:

> [t]he emergency . . . is past and we should promptly discard a theory of taxation which is both so uncertain and working so many evil results, and should seek a method which will be surer in its incidence, more equitable in its operation [and] simpler in its collection . . . . Can such a way be found? Certainly; as soon as we commence to tax what people spend instead of what they save, we are on the right road.[14]

Congress was receptive to the sales tax concept. During the hearings before the House Ways and Means Committee on the Revenue Act of 1921, Republican Alanson Houghton of New York asked:

> Would you put a tax on a man who by saving increases the total funds of investment money in the country and so develops business, industry, and farming, or would you put the burden on the man who spends it on flowers, in yachting, and a thousand and one ways that do not produce a permanent increase in revenue?[15]

To Houghton and others, the answer was obvious: place the burden on the wasteful spender.

The sales tax concept gained support in the Senate as a way to replace the revenue from the excess profits tax and high surtax rates in

mas S. Adams, *Fundamental Problems of Federal Income Taxation*, 35 Q. J. ECON. 527, 528 (1921).

11. ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 190 (1940).

12. *S. Hearings on the Proposed Revenue Act of 1921*, *supra* note 10, at 22 (statement of Sen. Boies Penrose, Chairman); James A. Emery, Address, *in* PROCEEDINGS OF THE NATIONAL INDUSTRIAL TAX CONFERENCE, SPECIAL REPORT No. 9, at 4, 5 (1920) [hereinafter PROCEEDINGS OF THE NATIONAL INDUSTRIAL TAX CONFERENCE].

13. *See* BLAKEY & BLAKEY, *supra* note 11, at 190; RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 128 (1954).

14. Charles E. Lord, Address, *in* PROCEEDINGS OF THE NATIONAL INDUSTRIAL TAX CONFERENCE, *supra* note 12, at 45, 49.

15. *Hearings on Internal-Revenue Revision Before the House Comm. on Ways & Means*, 67th Cong., 86 (1921) [hereinafter *House Hearings on Internal-Revenue Revision*] (statement of Rep. Houghton), *reprinted in* INTERNAL REVENUE ACTS OF THE UNITED STATES, 1909-1950 (Bernard D. Reams, Jr. ed., 1979).

operation during the war. On April 12, Senator Reed Smoot (R-UT) introduced a measure for a temporary sales tax[16] that was referred to the Senate Finance Committee for further discussion.[17] The controversial nature of this proposal was evident during the ensuing hearings. Almost fifty individuals or groups, nearly evenly divided for and against, testified on the general concept of a sales tax. Their testimony consumed more than four hundred and fifty pages of the official record and took place over several weeks.[18] Proponents argued that a general sales tax was simpler to administer and relieved the inequitable burden imposed on higher incomes under the income tax.[19] While opponents generally conceded the need for reform, they argued that the sales tax was a regressive levy imposed not in accordance with an individual's ability to pay.[20] In a vote divided along party and regional lines, Smoot's proposal was eventually defeated in Committee by only one vote.[21]

As a compromise, Representative Ogden Mills, a Republican from New York, proposed a graduated rate "spendings tax."[22] According to Mills, because of the high surtax rates on individual income, evasion had "demoralized the whole system" both by significantly eroding the tax base and by reducing liquid capital.[23] Moreover, because it would be passed on to the consumer, a general sales tax would impose a significant burden "on the shoulders of those least able to bear it, that is, the people of moderate incomes who have to spend the major part

16. 61 CONG. REC. 151 (1921) (statement of Sen. Smoot). A companion bill authored by Representative Isaac Bacharach (R-NJ) was introduced in the House. *See Prepare to Press for Tax on Sales*, N.Y. TIMES, Apr. 11, 1921, at 1.

17. 61 CONG. REC. 151 (1921) (statement of Sen. Smoot).

18. *See S. Hearings on the Proposed Revenue Act of 1921*, *supra* note 10.

19. *See, e.g.*, *id.* at 56 (statement of C.H. Smith, Chairman, Tax Comm., Nat'l Ass'n of Mfrs.) (urging a sales tax on grounds of simplicity and convenience); *id.* at 77 (brief of Tax League of America) (stating that the sales tax "is characterized by simplicity, equity, capacity to produce the needed revenue, economy of administration, and the very essential quality of honesty").

20. *See, e.g.*, *id.* at 360 (statement of Walter W. Liggett, Comm. of Mfrs. and Merchs. of Chicago) ("[W]e consider the proposed Smoot sales-tax bill one of the most iniquitous measures that has ever been devised. We consider that the Smoot sales tax bill is a step backward to the days of the Roman empire . . . ."); *id.* at 412 ("I am fearful, therefore, lest we find ourselves saddled with a great new tax machine, a tax which is inherently unjust in that it is a tax on consumption, a tax which bears more heavily on the poor than on the rich . . . .").

21. JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 90 (1985).

22. *See House Hearings on Internal-Revenue Revision*, *supra* note 15, at 144 (statement of Rep. Mills); *see also Spendings Tax Plan Proposed by Mills*, N.Y. TIMES, July 22, 1921, at 18.

23. *House Hearings on Internal-Revenue Revision*, *supra* note 15, at 153 (letter from Rep. Mills).

of those incomes for the necessities of life."[24] Mills suggested that a graduated spending tax offered a middle ground between these two alternatives. Under Mills's plan, individuals would be permitted to deduct from income all amounts saved and invested, plus amounts spent on certain necessities, including medical care and charitable contributions. A tax would be imposed at a rate of one percent for every $2,000 spent above a $2,000 exemption, up to $18,000, and one percent every $1,000 spent thereafter up to $50,000.[25] Amounts expended in excess of $50,000 would be taxed at a forty percent rate.[26] According to Mills, the graduated spendings tax "can fairly claim the virtues of the sales tax, being in effect a tax on money spent for consumption, without being regressive in character or laying a disproportionate burden on those least able to bear it . . . ."[27] It "combines the advantages of the sales tax, and yet maintains the principles underlying our tax system."[28]

While the graduated spendings tax was backed by scholars such as Thomas Adams and businessmen such as Macy's president Jesse Straus,[29] it was summarily rejected by the House Ways and Means Committee.[30] Those who advocated retaining the high surtax rates and the excess profits tax on corporations viewed the progressive consumption tax as an affront to the principle of ability to pay.[31] Representative William Stevenson (D-S.C.) asked,

> I wonder how he [Mills] would think a man like the late Russell Sage was bearing his part of governmental expenses when he was drawing his millions and living on $60 a month or thereabouts, and all of that exempt under the plan of Mr. Mills? . . . I understand very well why he is in favor of this bill. It is because it cuts down the income taxes, it cuts down the big corporate income taxes, it cuts down enormously where he is interested.[32]

Mills's use of existing evasion as a rationale for a progressive consumption tax was equally unpersuasive. As Representative John C. Box (D-Texas) commented, "[t]his bill [Mills's graduated spendings tax] proposes to relieve the men who have done these things [evade

24. *Id.* at 153 (letter from Rep. Mills).

25. *Id.* (letter from Rep. Mills).

26. *Id.* (letter from Rep. Mills).

27. *Id.* (letter from Rep. Mills).

28. *Id.* (letter from Rep. Mills).

29. *See* Adams, *supra* note 10, at 537-40; *Expects Price Cuts to Increase Prices*, N.Y. TIMES, May 28, 1920, at 26 (reporting that Macy's president proposed a graduated expenditures tax in a speech to the Economic Club).

30. *See* 61 CONG. REC. 5138 (1921) (statement of Rep. William Green (R-Iowa)).

31. 61 CONG. REC. 5141 (1921) (statement of Rep. James Frear (R-Wis.)).

32. 61 CONG. REC. 5232 (1921) (statement of Rep. Stevenson).

taxes], in large part at least, because they have done them. . . . This bill proposes not merely to favor the rich, but the guilty rich, the criminal rich."[33]

Mills's plan fared no better with sales tax proponents because it embraced the principle of graduated taxation.[34] One Senator supported a manufacturer's sales tax because it would "strike down the vicious principle of graduated taxation," which he argued was "but a modern legislative adaptation of the Communistic doctrine of Karl Marx."[35] The Tax League of America, a group formed to lobby for the sales tax, argued: "[a]bolish the income tax altogether or abolish the surtaxes and make it a flat tax, and many difficulties disappear."[36] Because the spendings tax preserved this element of the existing system, it fundamentally failed to appeal to supporters of a sales tax.

Further damaging Mills's plan in the eyes of both groups was the belief that it failed to deliver either the simplicity of the retail sales tax or the relative familiarity of the income tax. The retail sales tax not only promised to reduce reliance on the complex income tax, but it would permit the government to combine all sales taxes into one general sales tax.[37] By contrast, the spendings tax appeared complex to contemporary observers. As Representative Stevenson asked, "[p]ut into effect the proposition to tax according to what a man spends and graduate it according as he spends it, and the United States Government will have to have an auditor behind every man in the country who has any money to spend. How would you ever carry it out?"[38] For Stevenson and others, the untested nature of the proposal made it difficult to accept Mills's reassurances that it "is not any more complicated" than under existing law.[39]

33. 61 CONG. REC. 5233 (1921) (statement of Rep. Box).

34. Sales tax supporters did appear to approve of some progressivity in the form of an exemption. *See, e.g., S. Hearings on the Proposed Revenue Act of 1921*, *supra* note 10, at 170 (statement of Carlos B. Clark, National Retail Dry Goods Association) (proposing $2,500 exemption for singles and $5,000 exemption for heads of household).

35. PAUL, *supra* note 13, at 128 (quoting Senator Moses) (internal quotation marks omitted).

36. *S. Hearings on the Proposed Revenue Act of 1921*, *supra* note 10, at 90 (brief of Tax League of America).

37. *See id.* at 46 (brief of the Trades Council of the Manufacturers' Club of Philadelphia).

38. 61 CONG. REC. at 5232 (1921) (statement of Rep. Stevenson).

39. *See, e.g., House Hearings on Internal-Revenue Revision*, *supra* note 15, at 150 (statement of Rep. Mills); *id.* (statement of Rep. Frear) ("I can see many objections, at least, they occur to me. Has any tax expert in the United States, or elsewhere, ever adopted or suggested that plan?"); 61 CONG. REC. 5138 (1921) (statement of Rep. Green) (stating that the proposed spendings tax "will work a perfect revolution in our form of taxes, and the committee was afraid to undertake it at this time").

B. *1942*

As the 1930s came to a close, scholars once again argued that the existing income tax system needed to be "radically reformed."[40] While experts differed as to whether this reform should move the income tax closer to a consumption or accretion tax,[41] advocates of both "agree[d] that either system would be an improvement over the present system or lack of system."[42] Notwithstanding this agreement, the push for radical tax reform did not take place until the country entered World War II. The motivating force was the need to curb rampant inflation and consumer spending.

The shift of manufacturing capacity from consumer to military goods created an acute scarcity problem.[43] Workers were earning more, but they had less to buy. Instead of simply doing without, they spent more, driving up prices. Treasury Secretary Henry Morgenthau announced that "unnecessary spending . . . is now reaching boom proportions and . . . is threatening to drive the cost of living to heights which will affect every American home."[44] Beyond just affecting the cost of living, inflation threatened the country's ability to finance the war itself.[45] While administrative rationing was utilized for select goods, by far the preferred method of rationing was through the price mechanism.[46] The sales tax was one method of dampening consumer spending through increased prices. President Roosevelt had consistently opposed a sales tax during the Depression and advocated using lowered exemptions and higher surtax rates to control spending in the Revenue Act of 1941.[47] When this was rejected, however, he admitted in his January 1942 Budget Message that "[i]n the face of the present financial and economic situation . . . we may later be compelled to reconsider the temporary necessity of" a sales tax.[48] Prominent mem-

40. Irving Fisher, *The Double Taxation of Savings*, 29 AM. ECON. REV. 16, 17 (1939).

41. *See* Steven A. Bank, *Mergers, Taxes, and Historical Realism*, 75 TUL. L. REV. 1, 44-51 (2000) [hereinafter Bank, *Mergers, Taxes, and Historical Realism*].

42. Fisher, *supra* note 40, at 17.

43. *See* W. Allen Wallis, *How to Ration Consumers' Goods and Control Their Prices*, 32 AM. ECON. REV. 501, 501 (1942).

44. Edward Ryan, *Morgenthau Again Asks Spendings Tax*, WASH. POST, Sept. 6, 1942, at 8.

45. *See* C.P. Trussell, *Morgenthau Demands Tax on Spending to Stop 'Boom,'* N.Y. TIMES, Sept. 6, 1942, at 1.

46. Wallis, *supra* note 43, at 501.

47. *See* W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 91 (1996).

48. *See* Memorandum, Div. of Tax Research, U.S. Dep't of the Treasury, The Sales Tax Controversy (Mar. 17, 1942) [hereinafter The Sales Tax Controversy], *in* Papers of Roy Blough, Harry S. Truman Presidential Library, Box 44 [hereinafter Blough Papers], *available at* http://www.tax.org/THP/Civilization/Documents/Sales/hst6647/6647-1.htm (last vis-

bers of the administration lined up with Congressional Democrats in backing a retail sales tax.[49]

As a compromise,[50] Treasury proposed a progressive consumption tax similar to the one offered by Mills in 1921.[51] The progressive feature both mitigated the inequities of the sales tax and "attach[ed] a penalty to spending that became more severe as spending increases."[52] According to a Treasury staff memorandum, "[p]rogressive rates make it possible to enact a spendings tax that will make spendings in excess of any desired amount prohibitively costly. This is impossible under a sales tax without at the same time levying an intolerable burden on the great masses of the people."[53]

After receiving the go-ahead from Senator Walter George (D-Ga.), chair of the Senate Finance Committee,[54] Treasury Secretary Henry Morgenthau introduced his progressive spendings tax proposal to the entire Committee on September 3, 1942.[55] According to Morgenthau, the purpose was "to reduce consumer spending directly by withdrawing funds otherwise available for expenditure, and to reduce it also indirectly by creating a strong tax incentive to saving."[56] According to Randolph Paul, general counsel to Treasury, the spendings tax had two components.[57] The first was a flat rate tax of ten per-

ited Aug. 25, 2003). The country faced a similar problem during World War I, but academics argued that a significant rise in the marginal rates would curtail unnecessary spending. *See* STEVEN R. WEISMAN, THE GREAT TAX WARS 322 (2002).

49. BROWNLEE, *supra* note 47, at 92-93.

50. *Id.* at 93 ("Morgenthau, on the recommendation of Randolph Paul and Roy Blough, tried to bridge the gap between the administration and Congress by proposing the adoption of a graduated spendings tax . . . .").

51. *See* Memorandum, Div. of Tax Research, U.S. Dep't of the Treasury, Proposal for a "Consumption Expenditure Tax" (July 9, 1942), *in* Blough Papers, *supra* note 48, Box 6, *available at* http://www.tax.org/THP/Civilization/Documents/Spending/hst9369/9369-1.htm (last visited Apr. 30, 2003). The Department of the Treasury had been studying this proposal since at least the spring of 1942. *See* The Sales Tax Controversy, *supra* note 48.

52. Memorandum, Div. of Tax Research, U.S. Dep't of the Treasury, Comments on the Proposal for a Spendings Tax (July 29, 1942) [hereinafter Comments on the Proposal for a Spendings Tax], *in* Blough Papers, *supra* note 48, Box 6, *available at* http://www.tax.org/THP/Civilization/Documents/Spending/hst9370/9370-1.htm (last visited Apr. 30, 2003); *see* BROWNLEE, *supra* note 47, at 93; PAUL, *supra* note 13, at 293.

53. Comments on the Proposal for a Spendings Tax, *supra* note 52.

54. *See* Memorandum from Roy Blough, to the Secretary of the Treasury, (Aug. 27, 1942) [hereinafter Blough Memorandum], *in* Blough Papers, *supra* note 48, Box 6 (describing a meeting between Secretary Morgenthau, Roy Blough, Randolph Paul, and Senator George), *available at* http://www.tax.org/THP/Civilization/Documents/Spending/hst9371/9371-1.htm (last visited Apr. 30, 2003). According to Blough, "Senator George indicated that he thought the principle of a spendings tax had much to recommend it." Blough Memorandum, *supra*.

55. *Morgenthau's Statement*, N.Y. TIMES, Sept. 4, 1942, at 16.

56. *Id.*

57. *See* Randolph E. Paul, General Counsel, U.S. Dep't of the Treasury, Statement Before the S. Finance Comm., Executive Session in Support of the Recommendations of the

cent on spendings for consumer goods and services.[58] This would be collected at the source through income tax withholding and credited at the end of the year to the extent that the difference between income and savings or investment, plus an exemption amount, did not equal or exceed the ten percent tax on spending.[59] At the end of the war, the amount collected through this tax would be gradually refunded.[60] As the *New York Times* reported, this aspect of the proposal was effectively "enforced savings . . . without interest."[61] The second component was a spendings surtax imposed at progressive rates on expenditures in excess of $1,000.[62] The surtax rates ranged from twenty percent on spending under $2,000, to seventy-five percent on spending over $10,000.[63] Rather than using the withholding mechanism, this tax would be collected by requiring taxpayers to report their spendings, or the difference between their income and their savings, and pay the tax due on that level of expenditure.[64] This tax would not be refunded after the war.

As in 1921, many scholars and businessmen supported the Treasury proposal. Irving Fisher, a professor of economics at Yale who advocated for a consumption tax throughout his career,[65] was considered "instrumental" in the development of the Treasury proposal.[66] According to Fisher, the income tax subjected savings and investment to double taxation and therefore constituted a deterrent to expansion.[67] He contended that not only could Treasury's proposed progressive consumption tax curtail spending and stem the inflationary tide, it could eventually replace the income tax altogether.[68] This recommen-

Secretary of the Treasury for an Additional War-Time Revenue Program (Sept. 3, 1942) [hereinafter Paul Testimony], *in* Blough Papers, *supra* note 48, Box 6, *available at* http://www.tax.org/THP/Civilization/Documents/Spending/hst9367/9367-1.htm.

58. Paul Testimony, *supra* note 57.

59. *Id.*

60. *Id.*

61. John MacCormac, *Spending Tax Gets a Cool Reception; Sales Levy Urged*, N.Y. TIMES, Sept. 4, 1942, at 1.

62. *Randolph Paul Testimony*, *supra* note 57.

63. *Id.*

64. *Id.*

65. *See* IRVING FISHER & HERBERT W. FISHER, CONSTRUCTIVE INCOME TAXATION: A PROPOSAL FOR REFORM 3-5 (1942); *cf.* Irving Fisher, *Are Savings Income?*, 9 AM. ECON. ASS'N Q. 21, 24 (1908) (contending that savings should be excluded from the definition of income, leaving, therefore, only consumption); Irving Fisher, *The Role of Capital in Economic Theory*, 7 ECON. J. 511, 532-33 (1897) (same).

66. NICHOLAS KALDOR, AN EXPENDITURE TAX 12 (1955).

67. *Revenue Act of 1942: Hearings on H.R. 7378 Before the S. Comm. on Finance*, 77th Cong. 2166 (1942) [hereinafter *S. Hearings on the Revenue Act of 1942*] (statement of Irving Fisher, Professor Emeritus of Economics, Yale University).

68. *Id.* at 2164, 2171 (statement of Irving Fisher).

dation echoed the one made by industrialist C. William Hazelett,[69] who argued that graduating the consumption tax rate could create an "excess living standards" tax akin to the excess profits tax employed against corporations.[70] Under the progressive consumption tax, Hazelett explained, "we define income as what it really is. There is no economic income but the living standard of the taxpayer."[71]

Notwithstanding this support, the progressive consumption tax proposal fell flat on its face. It was called "Morgenthau's morning glory — It opened Tuesday morning and it folded before noon."[72] The *New York Times* reported Treasury's proposal "met a cold reception from the Senate Finance Committee,"[73] while the *Washington Post* reported the proposal "created a near sensation," followed by a "hostile committee reaction."[74] The day after it was introduced, one Senator declared "[t]he plan is dead. Not a man on the committee is for it."[75] Following a few days of heavy lobbying, Morgenthau attempted to reintroduce the spendings tax proposal,[76] but neither the Senate nor the House included it in its version of the bill.[77]

As Treasury initially feared, the graduated spendings tax proposal only served to open the door for proponents of a retail sales tax.[78] "After a full morning passed in expounding [on] the spending tax,"[79] several members of the Senate Finance Committee demanded that

69. *Id.* at 929 (statement of C. William Hazelett). Hazelett had previously testified before the Senate Finance Committee about using taxation to encourage investment in government bonds and to penalize "idle" money. *See Survey of Experiences in Profit Sharing and Possibilities of Incentive Taxation: Hearings on S. Res. 215 Before a Subcomm. of the S. Comm. on Finance*, 75th Cong. (1938); *see also* C. WILLIAM HAZELETT, INCENTIVE TAXATION: A KEY TO SECURITY (1939).

70. *S. Hearings on the Revenue Act of 1942*, *supra* note 67, at 934 (statement of C. William Hazlett).

71. *Id.* (statement of C. William Hazlett).

72. Robert C. Albright, *Gallery Glimpses*, WASH. POST, Sept. 6, 1942, at B3 [hereinafter Albright, *Gallery Glimpses*].

73. MacCormac, *supra* note 61, at 1.

74. Robert C. Albright, *Sales Levy Proposed by Treasury in Place of Spending Tax Plan*, WASH. POST, Sept. 4, 1942, at 1 [hereinafter Albright, *Sales Levy Proposed by Treasury*].

75. MacCormac, *supra* note 61, at 1 (quoting Sen. Joseph Guffey (D-Pa.) (internal quotation marks omitted)); *see Treasury Charts Effect of Surtax on One Group*, N.Y. TIMES, Sept. 4, 1942, at 16 ("The chorus of opposition to the Treasury's spending tax plan among members of the committee was almost without a dissenting note.").

76. Ryan, *supra* note 44; Trussell, *supra* note 45.

77. *Morgenthau Asks Stiffer Tax Bill*, N.Y. TIMES, Sept. 18, 1942, at 12.

78. *See Taxes Are Eased on Scarce Metals*, N.Y. TIMES, Sept. 3, 1942, at 15. Despite Treasury's reluctance on the sales tax, one reporter commented "he [Morgenthau] had a [sales tax] plan ready," suggesting that Treasury conceded the political support for the sales tax despite its preference for the graduated spendings' tax proposal. *See* Albright, *Gallery Glimpses*, *supra* note 72.

79. Albright, *Gallery Glimpses*, *supra* note 72.

Randolph Paul return in the afternoon to provide an alternative Treasury proposal for a sales tax.[80] One complaint was the complexity of the spendings tax proposal. As Paul explained, this was the dilemma for Treasury: "When a new revenue proposal is presented in general terms, congressmen want to know how it will be implemented. When the particulars of a proposal are immediately offered, the mass of detail makes it seem too complicated."[81] Treasury chose the latter route and paid the price. Senator Harry Byrd (D-Va.) called it "the most complicated and unworkable that has been submitted by tax experts to the Senate Finance Committee in the nine years of my membership. It has all the evils and none of the virtues of a sales tax."[82] Senator Bennett Champ Clark (D-Mo.) echoed such concerns, branding it "[t]he most complicated monstrosity I've seen."[83] A second problem appeared to be the graduated rates. Given the later adoption of a "Victory tax," which contained elements of the spendings tax proposal but imposed a flat rate of tax,[84] some observers speculated that the attempt to introduce progressivity was "the crucial issue in controversy between opposing proponents of sales and spendings taxes."[85] As a compromise, the graduated spendings tax fell flat. According to one survey, business executives preferred "an out-and-out sales tax" to Morgenthau's hybrid proposal.[86]

Sales tax opponents were equally unsatisfied with Treasury's progressive consumption tax compromise. Senator Robert La Follette, a Progressive from Wisconsin, commented that while he appreciated the objective of "trying to undo the regressive effects of a sales tax," the Treasury proposal did not go far enough. He noted in particular the failure to allow a deduction for rent and medical expenses, two items that loomed large in the budget of lower-income people.[87] The problem was that the proposal was neither fish nor fowl. The *Wall Street Journal* described it as "an income tax walking about on its

80. *See* Albright, *Sales Levy Proposed by Treasury*, *supra* note 74.

81. PAUL, *supra* note 13, at 312.

82. *Treasury Charts Effect of Surtax on One Group*, *supra* note 75 (internal quotation marks omitted).

83. *Id.* (internal quotation marks omitted). Also complaining about the proposal's complexity were Senators Brown, Davis, Herring, Radcliffe, and Taft. *See id.*

84. The Victory tax imposed a flat rate tax with a deduction for certain forms of savings and investing, such as payment of insurance premiums, repayment of debt, and purchase of War Bonds. The intent was to refund the tax paid at the end of the war through the use of a credit. *See* PAUL, *supra* note 13, at 289.

85. Roy G. Blakey & Gladys C. Blakey, *The Federal Revenue Act of 1942*, 36 AM. POL. SCI. REV. 1069, 1080-81 n.9 (1942).

86. *Taxes Are Eased on Scarce Metals*, *supra* note 78.

87. Albright, *Gallery Glimpses*, *supra* note 72.

hands."[88] La Follette, perhaps sensing that the more unpalatable sales tax alternative was gaining favor, attempted to improve the proposal by introducing an amendment to add additional deductions, but the motion failed.[89]

C. *1995*

Although the progressive consumption tax concept experienced a brief renaissance in the 1970s,[90] it was not formally proposed again until the mid-1990s. At that time, no fewer than eight plans to radically change the existing federal income tax system were proposed.[91] Tax reform even became a central issue during the 1996 presidential campaign, with a flat tax, backed by Steve Forbes and House Majority Leader Dick Armey (R-Tx.), and a national retail sales tax, advocated by Senator Richard Lugar (R-Ind.) and House Ways and Means Committee Chairman Bill Archer (R-Tx.), taking center stage.[92] While the details of each of the major proposals differed, they were linked by a desire to move from an income to a consumption tax base.

The USA Tax was a bipartisan response to the rush to adopt some form of flat rate consumption tax. It had been under development for at least three years,[93] but was not introduced until tax reform became an issue in the 1996 campaign. As Senator Sam Nunn (D-Ga.) acknowledged, "there are already two other proposals to completely replace the current income tax code being discussed — a flat tax and a national sales tax .... [W]e are introducing this legislation today to make sure that our proposal is fully included in this important national debate."[94]

Under the USA Tax, the current income tax would be supplemented with an unlimited deduction for savings and investment.[95] When combined with personal exemptions and a "family living allowance" similar to the standard deduction, a family of four's first $17,600 of consumption would be exempt from tax.[96] Excess spending would be subject to a progressive tax with three graduated rates ranging from

88. PAUL, *supra* note 13, at 312.

89. *See id.* The amendment was defeated eight to four, whereas the proposal had initially been voted down on a unanimous twelve to zero vote. *Id.*

90. *See* U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977) (suggesting the progressive consumption tax as one alternative for reform of the current income tax).

91. Bank, *Origins of a Flat Tax*, *supra* note 1, at 329.

92. *Id.* at 329-30.

93. *See* LAURENCE SEIDMAN, THE USA TAX 11 (1997).

94. 141 CONG. REC. 11,227 (1995) (statement of Sen. Nunn).

95. *Id.* at 11,228 (statement of Sen. Nunn).

96. *Id.* (statement of Sen. Nunn).

nineteen percent to forty percent, plus a credit for payroll taxes.[97] In addition to this "household consumption tax," the sponsors of the USA Tax also proposed replacing the corporate income tax with an eleven-percent value added tax on business purchases.[98]

Once again, the USA Tax concept enjoyed significant scholarly support. In addition to Princeton economist David Bradford, who had authored the Treasury Department study recommending a similar tax in 1977 and whose ideas were influential in the development of the concept,[99] the proposal emerged from a Center for Strategic Studies commission staffed by academics and policymakers.[100] As McCaffery notes, however, in attempting to be more appealing as a political compromise, the USA Tax sacrificed some ideological consistency (pp. 60-61). First, it failed to include borrowing in income (p. 58). A taxpayer could pay for consumption with borrowed funds and deduct salary as savings, leaving the taxpayer owing no tax (p. 59). Professor Alvin Warren commented that this "permits deferral of taxation beyond the date of consumption" and creates a timing mismatch that could be important if the graduated rates change between borrowing and repayment.[101] Second, the USA Tax failed to repeal the estate and gift taxes. As Laurence Seidman pointed out, "anyone who believes that each person should be taxed according to what he actually withdraws from the economic pie should . . . support the termination of estate and gift taxes because these transfers of wealth do not entail any actual consumption."[102]

As with its predecessors, the USA Tax was never seriously considered.[103] In addition to its ideological inconsistencies, the original bill was deemed "overly complicated."[104] The USA Tax bill, just like Treasury's graduated spendings tax proposal in 1942, was written to provide answers for all potential questions. As a result, Senators Nunn and Domenici introduced 291 pages of proposed statutory changes.[105]

97. *Id.* at 11,228-29 (statement of Sen. Nunn).

98. *Id.* (statement of Sen. Nunn).

99. *See id.* at 11,233 (statement of Sen. Nunn); U.S. TREASURY DEPT, *supra* note 90.

100. *See* SEIDMAN, *supra* note 93, at 11.

101. Alvin C. Warren, Jr., *The Proposal for an 'Unlimited Savings Allowance,'* 68 TAX NOTES 1103, 1108 (1995); *see* SEIDMAN, *supra* note 93, at 142.

102. SEIDMAN, *supra* note 93, at 58.

103. The bill was never voted on by either the House or the Senate. Murray Weidenbaum, *The Fundamental Internet Tax Debate*, 24 WASH. Q. 41, 51 (2001).

104. Bradley D. Belt, *Wedding Bills; The Best Solution Will Marry Elements of Competing Tax Plans*, WASH. POST, Jan. 14, 1996, at C3; *see* Robert A. Rankin, *Tax Reform, Anyone? Fairness Debate Grows as Frustration Climbs*, SAN ANTONIO EXPRESS-NEWS, June 2, 1996, at 1L.

105. MICHAEL J. GRAETZ, THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE 215 (1999).

This provided an unmistakable target for critics of the bill. Professor Ronald Pearlman explained that while "it is easier to envisage the USA Tax as enacted legislation . . . one of the prices of more details is more devils, and one of the devils in the USA Tax is the substantial degree of complexity resulting from the Unlimited Savings Allowance and the retention of certain present-law business tax rules."[106] Professors Alvin Warren and Marty Ginsburg each examined the operation of the tax under the bill's provisions and found it to be more complicated and more susceptible to evasion than advertised.[107] For both sales and flat tax proponents, this complexity was fatal to the bill's chances.

In addition to its complexity, for many the USA Tax failed to deliver on its claims of fairness. As one commentator observed, it was simply too bipartisan to get adopted in "today's polarized environment. The Left still would rather attempt, however futilely, to soak the rich the old-fashioned way, while the Right is enraptured with the flat tax."[108] Even if they accepted a consumption rather than an income tax base as a fair mode of taxation, supporters of the progressive income tax considered the USA Tax unacceptable. This was in part because the bill's top marginal rate of 40 percent kicked in at the comparatively modest income level of $29,000 for a married couple.[109] Thus, they charged that the proposal retained the regressivity of the other consumption tax proposals.[110] For flat tax and sales tax supporters, the problem was that the proposal deviated from the ideal of a single rate and it failed to lower the burden for the top marginal rate taxpayers.[111]

The bill's sponsors and its proponents attempted to modify it in response to these complaints. A year after it was introduced, Senator Domenici proposed to reduce the top rate from forty to thirty percent and eliminate the middle bracket.[112] This would nudge the bill closer to rates proposed under the flat tax bills. Although he conceded that the USA Tax "is more complicated and less understood than its chief

106. Ronald A. Pearlman, *Fresh From the River Styx: The Achilles' Heels of Tax Reform Proposals*, 51 NAT'L TAX J. 569, 573 (1998) (citations omitted).

107. *See* Martin D. Ginsburg, *Life Under a Personal Consumption Tax: Some Thoughts on Working, Saving, and Consuming in Nunn-Domenici's Tax World*, 48 NAT'L TAX J. 585 (1995); Warren, *supra* note 101, at 1103.

108. James P. Pinkerton, *Big Government and Other Taxing Matters*, WASH. POST, Mar. 17, 1996, at X04.

109. *See* Lawrence Zelenak, *The Selling of the Flat Tax: The Dubious Link Between Rate and Base*, 2 CHAP. L. REV. 197, 200 (1999); Belt, *supra* note 104.

110. *See* Rankin, *supra* note 104. This ignored the credit provided for the payroll tax, which, as McCaffery notes, is one of the most regressive (as well as one of the most significant) taxes in the revenue system. Pp. 17-19.

111. *See* Belt, *supra* note 104.

112. *See* David Staats, *Savings Key to New Tax Plan*, ALBUQUERQUE J., July 2, 1996, at A1.

rival, the flat tax," he did not offer any concrete suggestions for its simplification.[113]

In each of the last several sessions of Congress, Representative Phil English (R-Pa.) has introduced the Simplified USA Tax Act in response to the perceived complexity of the Nunn-Domenici version.[114] One noted feature of his bill is that it replaces the unlimited deduction for savings with an unlimited Roth IRA. Although this strays from the original cash-flow consumption tax notion, it eliminates the need for the complicated transition rules in the USA Tax bill designed to address the "old savings" problem.[115] Simply put, this problem exists where a wealthy individual could spend from pre-USA Tax savings while depositing new income in their savings account, effectively consuming large amounts with zero tax liability, which the Nunn-Domenici bill countered with extensive transition rules. In addition, English's plan proposes to reduce the rates along the lines of those originally suggested by Domenici. Thus, under the Simplified USA Tax, the rates would range from a low of 15% on taxable income less than $40,000 to a high of 30% on taxable income in excess of $80,000.[116] Despite these and other responses to the principal criticisms of the USA Tax,[117] the Simplified USA Tax has never received serious consideration in Congress.

III. ASSESSING THE MCCAFFERY PROPOSAL IN LIGHT OF HISTORY

McCaffery's proposal differs from previous incarnations of the progressive consumption tax. The 1921 and 1942 proposals contemplated supplementing, rather than replacing, the income tax.[118] The USA Tax proposed to repeal the income tax, but excluded borrowing from the base and retained the estate and gift tax. The primary obstacles to the adoption of these earlier proposals, however, were unrelated to these differences. Each proposal appeared too complex

113. *Id.*

114. *See* Simplified USA Tax Act of 2003, H.R. 269, 108th Cong. (2003); Simplified USA Tax Act of 2001, H.R. 86, 107th Cong. (2001); Simplified USA Tax Act of 1999, H.R. 134, 106th Cong. (1999).

115. *See Business Coalition's Praise for Simplified USA Tax*, 98 TAX NOTES TODAY, 200-29 (1998) (press release from American Business Conference).

116. *See* Simplified USA Tax Act of 1999, H.R. 134, § 15(a) (describing tax rates for married individuals filing joint returns).

117. It also eliminates the VAT tax on businesses and repeals the estate and gift tax. *See* Karen Macpherson, *Simpler U.S. Tax, Child Support Break Proposed*, PITTSBURGH POST-GAZETTE, Oct. 3, 1998, at A15.

118. *See* Adams, *supra* note 10, at 539. Some might argue that this demonstrates that in 1921 and 1942 the income tax system was not "broken" in the same sense as today. This ignores the views of contemporary legislators. In each case, legislators believed the income tax was fundamentally flawed and in need of radical reform or replacement. *See supra* text accompanying notes 10-12, 40-42.

and was considered inequitable either because it used a progressive rate or failed to include income in the base. The question is whether McCaffery's proposal overcomes these hurdles.

A. *Complexity*

In *Fair Not Flat*, McCaffery's most savvy gambit on the complexity issue has been to limit the details of his proposal. Unlike in 1942 and 1995, when the extensive progressive consumption tax proposals were susceptible to opponents' criticisms regarding the proposal's apparent complexity, *Fair Not Flat* is more a description of the concept than the details. As McCaffery writes, "I will not . . . add[] fuel to think-tank fires. Complexity can wait. The devil may indeed dwell in the details, but we first need to find an angel or two in the abstractions that govern tax" (pp. 6-7). Even where he provides details, he does not commit to them like his predecessors did in 1942 and 1995.

While it is fair to permit McCaffery to outline his proposal before scrutinizing the details, it is equally fair to demand that he provide or commit to some details before permitting him to proclaim the simplicity of his proposal. For example, throughout the book McCaffery carefully avoids deciding whether to replace the bottom brackets of the progressive consumption tax with a sales tax or a VAT. The two are not interchangeable. He may prefer the VAT, but recognizing that "the phrase 'value-added tax' has been the political death knell for consumption tax proposals,"[119] he refuses to embrace it. McCaffery even calls this aspect of the proposal "optional," which would negate the simplicity advantages of relieving lower-income taxpayers from filing a return (p. 138).

In a perhaps more serious omission, McCaffery offers little insight as to what the taxation of business would look like under his proposal. He acknowledges that "there are good reasons to consider . . . eliminating" business taxes, but he reminds the reader that "I haven't addressed business taxes in this book" (p. 125-26). He thus fails to offer any alternatives to our current corporate tax scheme. Some speculate that he would use the VAT to replace the corporate income tax, which is what Nunn and Domenici proposed in their 1995 USA Tax Act bill.[120] By not committing, however, McCaffery's claim to simplicity is tenuous. If he concedes that maintaining the status quo with respect to the tax structure would be necessary to secure passage of his proposal, his progressive consumption tax would suffer from some of the same inconsistency that he derides under our current

119. GRAETZ, *supra* note 105, at 308.

120. *See* Laurence Seidman, *Fair Not Flat: How to Make the Tax System Better and Simpler*, 96 TAX NOTES 1409, 1412 (2002) (book review).

hybrid system.[121] It may be less inconsistent than the current system, but not necessarily less than other reform proposals.

McCaffery's problem is that the progressive consumption tax does not appear simple on its face. The tax connects two seemingly incongruous concepts — progressivity and a consumption tax — and does so using the existing structure. Although there is a tendency to "oversell the gain in simplicity" from adopting a sales tax,[122] it is presumed to be less complex than the current system. Progressive consumption tax proponents have historically borne the burden of establishing that their proposal would not introduce a new brand of complexity. It is not clear that the omission of details will help carry that burden.

B. *Fairness*

Unlike the complexity objection, McCaffery directly addresses concerns about the equity of his proposal, emphasizing that "fairness is the most important element of a good tax system" (p. 40). He recognizes, however, that the fairness of the progressive consumption tax concept is not immediately apparent to either side in the tax reform debate: "I have few fully committed allies in my quest for a better, fairer tax system," McCaffery explains (p. 94). "My liberal friends . . . typically object to the idea of consumption taxes. My conservative friends typically object to the idea of progressive rates" (p. 94). McCaffery's failure to overcome these objections to base and to rate, respectively, is in part because he compares his proposal to the imperfect current system rather than the idealized system imagined by supporters of other reform proposals.

1. *Base*

According to McCaffery, the real problem with the fairness of an income tax or a prepaid consumption tax such as a wage or payroll tax is that it concentrates the heaviest taxation during the midlife years (p. 16). This exaggerates an individual's ability to pay by ignoring the need to save for retirement in nonearning years. By contrast, a progressive consumption tax more smoothly distributes the burdens of taxation over an individual's lifetime by only imposing a tax when income is actually spent (p. 17). This timing concern may be mitigated to some extent by the very inconsistencies McCaffery derides in the

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121. For example, if he maintains the current system of business taxation while subjecting all other income to the progressive consumption tax, corporate income would be taxed currently, but partnership and other investment income would not because that income is tied to the individual tax system.

122. *See* Joel Slemrod, *Tax Minimization and Corporate Responsibility*, 96 TAX NOTES 1523, 1528 (2002).

current system, such as tax-deferred pension plans and individual retirement accounts. Nevertheless, the progressive consumption tax would surely push us further toward the ideal consumption tax.

McCaffery anticipates some of the major objections that have been raised by income tax supporters. One is that a consumption tax is regressive because lower-income people consume a larger percentage of their income than do rich people. McCaffery suggests that the progressive consumption tax addresses that concern, but his primary response is that his proposal is much more effective than the status quo at taxing the rich (p. 40). A variety of features permit the rich to avoid the high marginal rates under our current system, including the failure to tax unrealized appreciation and the ability to borrow tax-free against that appreciation.

A second objection is that a consumption tax leaves savings and income from savings out of the tax base. Since these resources contribute to a taxpayer's ability to pay, their omission creates an inequity between wage earners and wealthy savers. Moreover, permitting this capital to grow tax-free would allow the wealthy to become too powerful. Once again, McCaffery's principal response is that the status quo is worse (p. 40). While unrealized appreciation goes untaxed, the one form of savings that is consistently taxed under the current system — interest from bank accounts — is the form of savings most likely to be held by the middle and lower classes (p. 40). Furthermore, he suggests that if we assume progressive rates, the progressive consumption tax is a more effective indirect tax on capital than an income tax, although it is only imposed at the point of spending (p. 40). Even if this latter point is convincing to income tax supporters, it is likely to alienate flat tax proponents who seek to reduce the burden on capital.

McCaffery's responses are likely unpersuasive because he compares the consumption tax to the imperfect status quo rather than the perfect system imagined by income tax supporters. While his proposal is not completely free from imperfections,[123] it likely would be an improvement. Nevertheless, the current system is not the only alternative to a consumption tax. Income tax supporters don't accept the failings of the current system as evidence of the need to switch to a consumption tax. For example, progressive income tax proponents considered Ogden Mills's argument that the wealthy evaded taxes anyway to be a strange argument for shifting to a tax base that primarily benefited the wealthy.[124]

123. For example, by not taxing gifts in a graduated marginal rate consumption tax, wealthy taxpayers whose heavy consumption predated the tax can give away cash to their children who can spend at a lower rate. This might be better than the current system, but it undercuts the progressivity of the tax.

124. *See supra* text accompanying note 33.

McCaffery has proposed some measures to address income tax supporters' concerns, but these make his proposal more unpalatable for consumption tax proponents. For example, under his proposal the trust accounts would be subject to two rules. First, he would impose a "loose diversification requirement on investments in the Trust Accounts . . . [to] prevent the accounts from developing concentrated power within particular markets or industries" (p. 147-48). Second, he would prevent individuals from lobbying or running for office (á la Ross Perot) using funds in the trust accounts (p. 148). These rules may assuage income tax proponents' fear of unchecked sources of power, but only at the expense of consumption tax supporters who have no desire for government oversight of their money.

2. *Rate*

McCaffery acknowledges that "[c]onservative objections to progressive rates are not as easily answered as liberal concerns about consumption taxes" (p. 94). He notes that recent flat tax proposals were progressive because their exemptions were equivalent to zero rate brackets (p. 87). This exemption reflected the principal that spending on ordinary consumer items should be taxed more than bare necessities (p. 88). If this is true, then it follows that spending on luxuries should be taxed more than spending on ordinary consumer items (p. 89). He argues that this line of analysis — based on the notion that higher levels of spending are less essential than lower levels — is easier to justify than the traditional notion that higher levels of income are less essential than lower levels (p. 87).

As with his arguments in favor of the consumption base, McCaffery's justification for progressivity is based on a comparison with the current system. In other words, McCaffery argues that if we want progressivity, it is more defensible in the context of a consumption tax than an income tax. Flat tax supporters, however, don't accept the initial premise that tax rates should be progressive. Moreover, McCaffery's additional arguments that other regressive measures such as payroll, state, and local taxes will cut against the progressivity of his proposal (pp. 94-95), and that estate tax repeal will benefit the wealthy (p. 95), do not depend upon adoption of a progressive consumption tax.

IV. CONCLUSION

McCaffery is a passionate advocate for the progressive consumption tax and *Fair Not Flat* is the most lucid and persuasive account yet written for its adoption. Nevertheless, if history is any guide, McCaffery's proposal is still unlikely to garner substantial support, at least as a complete package. Notwithstanding its progressive rate, it fails to directly include savings in the tax base and thus appears to violate progressive income tax advocates' notions of ability to pay. It also discards the flat rate principle that is responsible for much of its appeal among flat and sales tax advocates. Because of these multiple dependent variables, satisfying one group is likely to upset another and, in any event, it is difficult to resolve all such concerns while maintaining the appearance of simplicity. Perhaps this is a failing of all fundamental tax reform proposals, but in that case it is appropriate to acknowledge that the progressive consumption tax is indeed a fundamental tax reform proposal rather than the compromise it often claims to be.

After eighty years, it may be time for progressive consumption tax advocates themselves to consider a compromise. One possibility is Professor Michael Graetz's proposal to combine a 10-15 percent sales tax with a 20-25 percent flat-rate income tax for income in excess of between $75,000 and $100,000.[125] The advantage of this proposal is that it maintains both the progressivity and income tax base that progressive income tax supporters seek while replacing a large part of the income tax with the flat rate income and sales taxes that consumption tax supporters desire.[126] Graetz calls this the "Back to the Future" tax reform because it would return us to the pre-World War II era when the income tax only affected a small, but wealthy, segment of the population and served as a progressive counterweight to the regressive consumption taxes.

This combination income and sales tax would be more faithful to the original vision of a hybrid tax. When the first post-Sixteenth Amendment income tax was adopted in 1913, it was considered a supplement to the tariff-based consumption taxes that made up the bulk of federal revenues.[127] The combination of the two types of taxes appealed to many contemporary observers on fairness grounds. As James Duncan of the American Federation of Labor noted in 1921,

> whatever inequalities appear in the two systems, the income tax and the sales tax, as against the rich or the poor, I feel that these inequalities tend to disappear when both systems are put in operation . . . . One tends to counteract the defects of the other, and both, working together, strike a just balance, or as near just as we are likely to make it.[128]

Although McCaffery rejects Graetz's plan for its failure to settle on a consistent, comprehensive, tax base (p. 102), it is distinguishable

125. *See* GRAETZ, *supra* note 105, at 265.

126. While the income tax portion of the tax would be flat-rate, the tax would be progressive because of the huge exemption.

127. *See* Bank, *Origins of a Flat Tax*, *supra* note 1, at 388-97.

128. *S. Hearings on the Proposed Revenue Act of 1921*, *supra* note 10, at 159-60 (brief of Felix Vorenberg, representing Mass. Retail Merchants' Ass'n together with Newspaper Comment) (quoting from Boston Post, Mar. 25, 1921 (internal quotation marks omitted)).

from the hybrid income tax we have today. Our current system's mix of income and consumption taxes is based on a variety of ad hoc tax policies and principles, encrusted from years of contradictory and conflicting decisions. By contrast, the original hybrid was a deliberate decision to utilize different tax bases for different segments of the population. Consumption taxes failed to reach accumulated wealth and imposed a regressive burden on the poor and middle class. The progressive income tax, with its substantial exemption, was capable of balancing that burden without forcing the bulk of the population onto the income tax rolls. Perhaps McCaffery is right that the original hybrid arrangement broke down with the introduction of a realization requirement in 1920 (p. 29), but this has long since disappeared as a constitutional requirement.[129] The realization requirement may be easier to phase out completely if its effect is limited to a relatively small segment of the population. In any event, a compromise between the two modes of taxation may not only return the federal revenue system to its historical roots, but it may be the best hope for moving toward the ideal of a fair not flat tax.[130]

129. See Bank, *Mergers, Taxes, and Historical Realism*, *supra* note 41, at 78-79 & n.489; Stanley S. Surrey, *The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions*, 35 ILL. L. REV. 779, 792 (1941) (arguing that the Court's decision in *Helvering v. Horst*, 311 U.S. 112 (1940), overturned the constitutional requirement for realization the Court announced in Eisner v. Macomber, 252 U.S. 189 (1920)). *But see* Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution, Macomber, and Mark to Market*, 13 VA. TAX REV. 1, 99 (1993) (arguing that the constitutional requirement still exists).

130. Graetz recently commented that McCaffery's proposed modifications of the USA Tax "would move it considerably closer to" his proposal. *See* Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261, 283 n. 109 (2002).