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In addition to the CEA, Dr. Bradford's nonacademic experience includes service as Deputy Assistant Secretary for Tax Policy in the United States Department of the Treasury (1975-1976) where he directed a study resulting in a published volume, *Blueprints for Basic Tax Reform*, that is widely regarded as the forerunner of the major U.S. income tax reform enacted in 1986. A member (1984-1990) of the Economic Policy Council of the State of New Jersey, he also served (1985-1988) as Vice Chairman of the New Jersey State and Local Expenditure and Revenue Policy Commission. In 1988 he was appointed by President Reagan to the Railroad Retirement Reform Commission, which issued its report in 1990.

Dr. Bradford's research has centered on public sector economics and he is particularly noted as an authority on taxation. His published papers address a wide range of topics, including investigations of conscription for military service, public utility pricing, criteria for public investment, local government and the economic structure of urban areas, and a variety of income tax issues. Recent work including insurance companies. His 1986 book, *Untangling the Income Tax*, provides a comprehensive review of income taxes and their alternatives, including consumption taxes. He is editor of *Distributional Analysis of Tax Policy*.

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Mr. Leslie B. SAMUELS: I first want to say that I very much appreciate the attendance. The topic of tax reform has been reported in the press and is a part of the political debate as well as the tax policy debate. The idea of tax reform is an important part of tax politics. Today's *Wall Street Journal* reported on how some proponents of certain tax reform proposals had scheduled events for April 15th, tax day. One group is going to bury the Internal Revenue Code someplace and another is going off to Boston Harbor to throw the Code into the water.[1]

Although we are not going to have that kind of conversation today, it is important to realize that these sound bite events on tax reform are occurring at various levels. If one is going to reach a conclusion about tax reform, however, it is extremely important to have a serious, long-term debate on tax reform in this type of setting.

In thinking about tax reform, I would like to mention a few points about our current tax system to put matters into context.[2] We have basically a hybrid system. At the federal level, we have the individual income tax which counts for roughly 45 percent of revenues. Social Security and Medicare payroll taxes constitute about 34 percent. Corporate income tax, on which an enormous amount of time is spent and which makes some private practitioners great amounts of money, accounts for about 11 percent of total federal tax receipts. The balance of 9 percent comes from some excise taxes, customs duties and the like. Consequently, we collect a little more than 55 or 56 percent from the individual and the corporate income tax combined. Thus, the income tax is obviously a very important part of the system, but it is not the only part.

Additionally, we collect significant taxes at the state and local level. As a percentage of our economy, the total revenue collected at the state and federal levels is roughly 30 percent.

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1 *See* Ronald G. Shafer, *A Special Weekly Report From the Wall Street Journal's Capital Bureau*, **Wall St. J.**, Mar. 27, 1998, at A1.

2 *See* Tax Code Revision, Dep't of Treasury Testimony Before the House Ways & Means Comm., *available in* 1995 WL 357674 (statement of Leslie B. Samuels, Assistant Secretary of Tax Policy) (1995) [hereinafter Teasury Testimony] (summarizing advantages and disadvantages of various tax reform proposals).

About one third, about 10 percent, is at the state and local level. I will return to this point in detail later, but I want to emphasize that very serious questions about how tax reform proposals affect state funding and other federal-state relationships must be considered in the discussions of tax reform at the federal level. Thus far, these issues have not received adequate attention.

When you compare our tax system to those of our major trading partners, the so-called G7 countries, the United States is among the lowest: Tax collections are roughly 30 percent of our Gross Domestic Product ("GDP"). The United States has been comparable with Japan, but Japan's tax burden has gone up a little bit. If you look at France, the rate is significantly higher at about 40 percent of GDP. Germany is close to France. Of course, France and Germany are facing both economic problems and restrictions on free movement of labor. Some commentators believe that their high level of taxation, including taxation on labor income, has adversely affected their economies. When you consider where the United States stands in relation to our trading partners, our 30 percent tax burden is at the bottom of the scale.

As I mentioned at the outset, our income tax is a hybrid system when you compare it to a pure income tax concept from an economist's point of view. What we have and what we had from the outset of the income tax, is not a pure income tax; it is a hybrid system. For example, our income tax system has significant provisions that defer or exempt income. Certain pensions receive favorable treatment; employer provided health insurance is permitted on a tax-free basis in our system; we have tax-exempt municipal bonds; and certain capital gains are taxed when realized at favorable rates.

On the deduction side, you find items that are deductible that you would not find in a theoretically pure income tax. For example, deductions for charitable contributions, home mortgage interest deductions and the deduction for real estate taxes on homes are not allowed in a pure income tax system. I mention some of these differences because they reflect society's choices about what is important and what should be subsidized or favored through the tax system. This is very important to keep in mind in discussing tax reform proposals.

Every year, both the Treasury and the Joint Committee of

Taxation publish lists of tax expenditures which show those provisions of the current income tax law that vary from a more pure income tax. It is a very extensive list. Unfortunately, at least from the perspective of the average taxpayer and even businesses who do not benefit, the list of tax expenditures continues to grow. We have seen that quite recently.

We have a system that reflects our complex economy as well as our political system. It also embodies the social and economic priorities in our society. The factors that have put our tax system where it is today will clearly come into play in designing a new tax system, or in substantially revising the current system. It seems that in considering potential advantages and disadvantages of a new tax system, we must focus on the types of provisions and the types of choices that society is likely to continue to want included in a tax system.

It is clear, however, that the process that has molded our tax system has in reality created an overly complex set of rules for the average taxpayer. I do not think there is really any great dispute about that. Although, about 70 percent of individual taxpayers claim the standard deduction, which eliminates a lot of complex record-keeping, such as keeping track of potential itemized deductions, nevertheless about 50 percent of individual taxpayers go to paid preparers to prepare their tax returns. This fact speaks not only to the marketing skills of the paid preparers, but it also says a lot about the average taxpayer's concern about the system and their concern about the forms and the instructions. I have seen that in talking to people who have a very simple return, but who worry that there might be something that they do not understand. They do not want to do something wrong. They want to make sure that their return is prepared in a proper manner. Thus, that means that half the people go to paid preparers.

The system is not only complex for the average taxpayer, but it is also quite complex for businesses. Businesses have the resources to deal with the complexity, and sometimes they welcome it because they think they get an advantage. Nevertheless, a great deal of money is spent on internal compliance, tracking tax provisions, education and acquiring advice from outsiders.

Unfortunately, recent legislation, for example, the 1997 Tax Act, has made the system even more complicated for the average taxpayer. There are now child credits with income limits.[3] Taxpayers will figure out education tax credits.[4] New savings incentives were enacted.[5] When you add the new credits to the tax system, the alternative minimum tax will eventually apply to individuals that no one thought would be subject to the alternative minimum tax when it was first put into place.

We have a system that unfortunately has become more complex. The forces responsible for this complexity are probably going to continue. One of the reasons the tax system has become more complex is that under our budget rules, it is easier to put provisions into the tax code that implement a particular group's social or economic point of view. It is easier under the budget rules to place something into the tax system rather than having a direct spending program, even though in many cases a direct spending program would likely be much more efficient. It is almost irresistible to politicians to put in new tax benefit provisions; it is much more attractive for Congress to say that they are cutting taxes rather than increasing spending. This is a part of our political system that is not going away.

Having said that, I think that the best thing that could happen to the tax system for the next several years is nothing. Of course, there should be some technical corrections and I expect that legislation this year will be targeted at reforming the Internal Revenue Service. Apart from that, both the Government and the taxpayers deserve a rest. That would be the best thing for the system. If that actually happened, it would permit discussion of fundamental tax reform.

The term "fundamental tax reform" generally, although not always, is code for moving to a consumption-based tax system. I think there are proposals that should be put into that tax reform category, such as modifying the current system in a 1986 tax reform type of effort. We should not dismiss that type of reform.

3 *See* I.R.C. § 24 (1998) (providing maximum credit of $500 with respect to each qualifying child of taxpayer); I.R.C. § 32(m) (1997) (providing for supplemental child credit).

4 *See* I.R.C. § 25A (1998) (establishing Hope and Lifetime Learning Credits); I.R.C. § 135 (1997) (providing education credit when U.S. savings bonds are used to pay for higher education); I.R.C. § 530 (1998) (providing for educational individual retirement accounts).

5 *See* I.R.C. § 219 (1997) (concerning retirement savings accounts); I.R.C. § 408 (1997) (concerning individual retirement accounts); I.R.C. § 408A (1998) (establishing "Roth" I.R.A.); I.R.C. § 530 (1998) (providing for education individual retirement accounts).

But I think what we are going to discuss today, and what you hear in sound bytes from politicians, is moving from our current hybrid income tax system to some type of consumption tax system.

When thinking about the consumption tax proposals, let me put them in a framework for discussion. There are certain kinds of touchstones or principles that generally are referred to in tax policy discussions of this type. I will briefly describe some of them.

The questions one generally should ask are: First, will a tax system raise sufficient revenues? Will there be compliance problems? Second, will the system be fair? An important issue is what "fairness" means. Third, will the system promote economic growth? Finally, will the system be easy to administer and comply with? Those are the principles questions that generally frame the tax reform discussion.

As you will see in discussing most tax policy issues, there are important trade-offs and tensions between these principles. For example, tax fairness and simplicity are often at odds with each other. I would also say simplicity almost always comes in last in designating tax rules because other considerations tend to overwhelm it.

In addition to these criteria, in any type of a radical change, you need to consider rules to reduce windfall gains and windfall losses during any transition period. That is a quite important. Some people will take the position that transition rules are mere details. While transition rules can tend to be very complex and detailed, they involve making important decisions about allocation of wealth between different groups as you go through transition periods.

For example, in a consumption tax system, one needs to consider the treatment of elderly taxpayers who have accumulated their assets in our income tax-type system. Generally, older taxpayers will have paid tax on income that they have saved and invested. If you went directly from one system to the other and the elderly then start to consume their savings, they would then be taxed on their consumption. Also, the value of their assets may be adversely affected as a result of a consumption tax. It can happen in several different ways, and it is a very important issue.

In a consumption tax system, the treatment of financial institutions and financial transactions generally is thought to present special problems. David has thought a lot about that and written some very thoughtful papers on it. There are some ways to deal with these problems, but he would probably agree that it raises special and complicated problems.

In considering a consumption tax, you have to decide how to coordinate a new consumption tax system with the fiscal policies of state and local governments, some of which rely on a sales tax, a type of consumption tax. Moreover, many states rely on using the federal income tax system as their blueprint for their income tax system. So, if you change the federal system, you are placing the state in a very different position.

In discussing a consumption tax, there are a variety of proposals and I am not going to go into the details. Generally, consumption tax is levied only on income that is spent on consumer goods and services; income that is saved is effectively exempt from tax. That is generally the way people think about it. There are different forms of consumption tax. One is the retail sales tax. There is a consumed income tax that then-Senator Nunn and Senator Domenici proposed.[6] There are various types of value-added taxes. There is the flat tax, which is a form of consumption tax promoted by Mr. Armey[7] and Mr. Forbes.[8] There is a progressive "X-tax" which David Bradford will speak eloquently about.

In considering the possible benefits of a consumption tax under the criteria I mentioned, there are a number of difficult and challenging questions. First, will a consumption tax encourage and promote economic growth? Often this issue is framed as whether a consumption tax will increase private savings, thereby lowering the cost of capital, and make our economy work on a more efficient basis?

The question of whether the savings rate will increase as a re-

6 S. 722, 104th Cong. (1995) (proposing individual income and corporate income taxes be replaced with two consumption-based taxes).

7 H.R. 1040, 105th Cong. (1997) (promoting replacement for individual and corporate income taxes with consumption tax with two components: wage tax and cash flow tax on businesses).

8 *See* John Harwood, *Campaign 96: Presidential Hopeful Forbes Talks Up Flat Tax But May Stengthen Case It's a Rich Man's Policy,* Wall St. J., Jan. 2, 1996, at 381 (describing plan for 17% "flat tax" on wage income).

sult of a consumption tax is a difficult question to answer. Advocates who believe that it will suggest that increasing the after-tax rates of returns on savings will increase overall savings. It is my understanding of the empirical studies that the evidence is uncertain on this issue.[9] Some people save to reach a specific target, so that if you increase the after-tax rate of return, they will say, "Well, I will achieve my target faster so I do not have to save this much." Some people are just savers and some are just spenders. It is hard to predict exactly what will happen. If economic benefits are produced by a consumption tax, they could be small. This is a fundamental part of the debate. I think it is a difficult question to answer.

I would mention in this context, although it is not an empirical study, that the Japanese government recently imposed a relatively small consumption tax, a 3 percent tax that has now just been raised to 5 percent. I was told by officials of the Japanese Ministry of Finance that when their consumption tax was imposed, projected Japanese savings rate fell. Now, I do not know what to conclude from that comment because other things were happening in Japan, but these officials did not feel that the consumption tax was going to have a positive impact on their savings rate. Maybe the Japanese officials really do not think much about the issue because Japan has such a high savings rate. This example demonstrates to me the difficulty involved in answering the hard question of what impact a consumption tax will have on savings in a complex economy.

Now, I would like to discuss the question of fairness. This is the debate of whether a progressive type tax is fairer than a consumption tax. David Bradford's X-tax is designed to deal with the progressivity issue.

To put the issue of fairness on the table, let us consider an example of one way to think about this issue. Herb Stein, who was a head of a Council of Economic Advisors some years ago, has used this example. A couple makes $40,000 and consumes $40,000. Compare that couple to an individual that earns $200,000 from interest on U.S. Government bonds and $200,000 on capital gains from trading in foreign securities—I picked

9 *See* Treasury Testimony, *supra* note 1 (noting that decline in private savings rates in U.S. could be attributed to number of factors other than tax policy).

those two sources of income for a particular reason[10] – and THAT only spends $40,000 a year. So, she spends the same amount as the couple that makes $40,000. Under a consumption tax, they would both be taxed on the same basis. I think there is a question of whether society would think that is a fair tax system. You can tell from the way I posed the example that I do not think society would accept that result as a fair system. I do not think it is a fair system.

If you impose a consumption tax, because it is based on consumption, you inevitably will change the distribution of the tax burden among groups as compared to our existing tax system. Because the consumption tax is based on consumption not capital income, you inevitably will reduce the tax on the highest groups of income earners. That raises the question of whether our society will find that acceptable.

I believe that our current tax system is moderately progressive. I am sure that those people who are at the very top think it is too progressive, but I think it is moderately progressive.[11]

Thus, you have to look at that issue of fairness in terms of distribution of tax burden among income groups. Then you have to look at the transition rules because big winners and losers will result if a new consumption tax system is adopted. The question is how to make society feel that the transition is fair—that winners and losers are treated in a reasonable way. How do you treat your seniors? How do you treat business investment made under the old system? How do you treat companies that are highly leveraged that could be in a very different situation if you changed to a consumption tax?[12]

When you think about those types of questions and the possible adverse impact on society and on the economy, the proponents of switching to a consumption tax have an obligation of showing in a convincing way that the potential benefits of a consumption tax are substantially greater than the significant risks to the economy. I would add that no other economy in the world has chosen to abandon an income tax and rely solely on a con-

10 Panelist's Note: Interest on U.S. government bonds and capital gains on foreign securities are generally not included on the business tax base of a consumption tax.

11 *See* Treasury Testimony, *supra* note 1.

12 Panelist's Note: In a typical consumption tax, interest is not deducted in calculating the business tax base subject to tax, thus affecting businesses with high borrowings.

sumption tax. Some countries have consumption taxes, but the consumption tax is part of a broader system. Moreover, in judging a consumption, it is realistic to assume that it is not going to be a pure system. It is going to be modified, as demonstrated, by our experience. These modifications are likely to dilute or eliminate theoretical benefits from a pure consumption tax proposal.

So, those are the questions that one must address. I would only add that we have had a recent political experience with one attempt at a mini consumption tax, the proposal for the so-called BTU tax in 1993. Those of us who were involved in that proposal were seared by the experience. We realized that the country does not like big changes one way or the other. They seem to like it in the middle. The political process is a serious issue in terms of moving to another system as is what a radical proposal would actually look like when it came out of the legislative process.

Mr. David F. BRADFORD: I also want to say thanks for the opportunity to be here and address this large group on a beautiful afternoon. I also want to preface this by giving just a couple of very quick reactions to some of the things Les said, but I will postpone in depth reactions to what I hope would be an interaction with the audience as well.

I was reflecting on why people go to tax preparers. I remember what it was like preparing my tax return myself, which I still do actually with the help of Turbo Tax. Before Turbo Tax, I was petrified that I would not have all the forms or there would be some darn mistake. My attitude toward my own tax preparation changed dramatically when I went to work for the U.S. Treasury Department and discovered that no tax lawyer on the Treasury Tax staff, as far as I could tell, filed a return on April 15th. That is when I found out that as a matter of course, you filed for an extension, and you do not worry too much about having all the right forms because somehow it all works out.

I think most people share the view I had before I went to the Treasury, that this is a terribly important thing and you are terrified about making a mistake. That is probably the main reason they go to tax preparers.

Another quick reaction, I was interested in the description of and the reminder of the new legislation which introduced all of these wonderful new incentives to pay for your kids' education, and to save, and so on. I was yet again grateful for having, to my own surprise, succeeded so well that I make too much money to take advantage of those things. So, I do not have to cope with that. I was very happy to find that out.

My last preliminary statement is conditioned by the agreement with a pessimism about doing something coherent and sensible in our political system. We have lots of reasons for being grateful for our political system so we should not complain too much. I would also worry about anything that we might try to do, what it might look like after it has been through the political meat grinder.

Having said that, I will try to lay out here the case for reforms along the lines that Les has described. I have a title for this little talk. My title is, "Tax Reform: Waiting for a New Consensus of the Experts."[13] First, this title reflects several of my own views that there was an old consensus of the experts that contributed to a whole series of tax reforms, including the Tax Reform Act of 1986. Secondly, the title reflects that the old consensus is gone. While there are plenty who still favor it, it is no longer the consensus. Thirdly, nothing much coherent is going to happen in the near future until the new consensus emerges. Finally, a new consensus is visible on the horizon. I will try to explain why that new consensus probably will arise and what modest hopes it can fulfill.

I begin first with the old consensus. We are not governed by experts. Income tax policy must reflect basic political preferences of the electorate, but experts like you and Les inevitably shape the crucial details of regulatory systems, such as the income tax system. For example, most people, certainly most politicians, believe that rebating tax on exports and charging tax on imports would benefit the U.S. economy. Among the most important factors preventing this belief from being translated into practice is the consensus among tax policy experts that the intuitive views of politicians are incorrect.

For most of this century, there was substantial agreement among experts about the general principles of an ideal income

[13] Editor's Note: A modified version of David Bradford's speech was published by *Tax Notes*. *See* 98 **Tax Notes** 899-901 (May 18, 1998).

tax, known in tax jargon as the Haig-Simons concept, (or Schanz-Haig-Simons, if we are bowing to other earlier predecessors who thought of the ideas).[14] This concept remains highly influential today and it is still, as far as I can tell, the guiding tax principle of the U.S. Treasury, as it was when I was there.

A competing concept has been gradually edging out Haig-Simons as the guiding principle: Consumption. The major component of Haig-Simons income is consumption and the other is savings. Consumption generates a very similar distribution of tax burdens among people of various levels of ability to pay if the appropriately calibrated rates are applied.

From the point of view of tax design, it is my opinion that it would be very convenient if all you experts were convinced that consumption were the preferred framework for the income tax. The main reason for adopting the consumption approach is simplicity. To give an idea of why this is so, let me review the consumption-type tax that I have labeled the X-tax and explain why it resolves some very tough problems that are almost impossible to solve in the income tax as we now understand it.

The X-tax is a variant of the flat tax which was introduced by Robert Hall and Alvin Rabushka of Stanford.[15] It is a two component system consisting of a business tax paid by all businesses, whether corporate, proprietorship or partnership, and a compensation tax paid by all who receive compensation for service, as employees or the equivalent. All businesses pay tax at, illustratively, 30 percent, on a base consisting of the receipts from all sales of all types, including sales out of inventory or sales of other existing assets, less the outlays for purchases from other businesses. Tax aficionados will recognize this as a subtraction-style value-added tax ("subtraction-style VAT"), and thus a form of consumption tax because all inter-business transactions net out. The only thing that generates tax revenue on balance is sales to the public and we can call that consumption. What businesses sell in the aggregate to the public certainly can be thought of as consumption. That is one reason we would call that kind of a value-added tax, a consumption tax.

Now, there is a twist in the X-tax. In addition, businesses de-

[14] Named after Georg von Schanz, Robert Haig and Henry Simons, this concept defines income to be net accretion to wealth plus consumption.

[15] *See* ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX (2d ed. 1995).

duct their payments to workers, whether for past, present, or future services. These are taxed at the recipient level under the compensation tax, the second component. All workers pay tax on the amount received from businesses (or payments of the same character from non-tax paying entities such as governments and universities).

If the tax rate on compensation were the same as the business tax, we would still have the equivalent of a subtraction-style VAT. Instead, however, total compensation is taxed progressively, with an earned income credit at the low end, a zero bracket range, and successively higher graduated rates on higher levels of compensation. For example, the graduated rates might be 10, 20 and 30 percent on successively higher levels of compensation above some exempt amount. Maintaining the top rate of the individual compensation tax at the same rate that applies under the business tax is an important design principle.

No other receipts at the individual compensation tax base, such as interest, dividends, etc., would be included. That is important. It is that individual element, the earned income credit equivalent and the graduated rates, that give you the progressivity in this system. Certainly on an average basis, it would not be a problem duplicating the progressivity of our current tax system. What we would have then is a consumption tax plus adjustments to worker's burdens according to the levels of their earnings. That is the X-tax.

Why should anybody favor such a thing? Why should the experts out there reach a consensus on such a thing as a replacement for the individual and corporation income taxes? Most importantly, the X-Tax satisfies one of the important requirements of our tax system, vertical equity. That is, it can match the present tax system's progressivity. This is presumably a requirement of reform, even though it is not really necessary that progressivity be provided by the thing we call a tax instead of things we call transfers. Why should we suddenly decide we are going to radically change the progressivity of our system?

Second, and now I come to the substance, the X-tax makes taxation much simpler and more transparent than we have now. (It would, for example, render moot essentially all of the *Journal's* program today). For today's purposes, I propose just to illustrate some advantages of such an approach.

All of the important problems, the hard problems, that are solved by the X-tax have to do with what is typically labeled "capital income." Most importantly, financial transactions of all kinds (dividends, capital gains, etc.) are completely gone from the tax base of both individuals and companies. Let me give you some examples of what happens by doing that.

FINANCIAL INNOVATION: In the past couple of decades and in an earlier panel, you have seen amazing innovations in finance in this country and around the world. A great deal of the ingenuity of Wall Street's rocket scientists is directed toward obtaining the best tax results in connection with any particular economic activity, including making a profit at the expense of the U.S. and other governments. On the other hand, the tax rules themselves often get in the way of desirable financial innovation, resulting in a waste of ingenuity. Both the wasted ingenuity and the obstacles to innovation would be gone under the X-tax. People could fiddle around all they want and make all those creative arrangements they want, and it would not affect their tax liabilities.

RESOLVE THE INTEREST DEDUCTION MESS: Moreover, the X-Tax would resolve the interest deduction mess. The almost incomprehensible web of special rules relating to the treatment of interest payments and receipts that has grown up in the existing tax system would be gone.

CAPITAL GAINS: I need hardly remind you what a controversial and complex subject this is. The fights over capital gains would be a thing of the past (business assets are accounted for on a cash flow basis; individually owned financial instruments do not enter the tax base).

ADJUSTING THE BASE FOR INFLATION: This is a technical matter. Removal of the financial transactions from the tax means that adjusting the base (as opposed to the brackets) for inflation would be feasible, relatively simple, and confined to the business level (actually, the adjustment would be completely automatic but for transition considerations to which I allude briefly below). It is very easily shown that even very modest rates of inflation result in very substantial incentives and changes of tax burdens. Correctly regarded as important by tax experts, indexing the tax base for inflation is generally considered impractical in the existing system. Adjusting the base for inflation would not be difficult at all under the X-tax if you wanted to do it.

LEVEL PLAYING FIELD FOR INVESTMENT: Under the existing income tax, owner occupied housing is favored. It is taxed at a very low effective rate compared to, let's say, a General Motors assembly plant. Under the X-tax, uniform treatment of business investment would be automatic, regardless of legal entity and rate of inflation, for example, and requiring no judgment about the correct amount of depreciation. Owner occupied assets of all kinds including automobiles and yachts and so forth, as well as houses, would automatically be taxed the same as business investment. Most economists think that it is very important that there would be very major gains through this change. These are gains that are kind of hard to explain to people because they are not obvious, but most economists believe that you could really get a big payoff from that. We would be richer. We would be more prosperous. Wages would be higher.

CUT THE COMPLEXITY OF RETIREMENT SAVINGS: The immensely complicated rules relating to the qualification of a retirement saving for sheltered treatment under the present system would become entirely unnecessary. Essentially, all savings would receive the same treatment now reserved for qualified retirement plans, meaning exemption of the yield. So those rules designed to prevent tax abuse (as opposed to fiduciary matters), which make this area one of the most specialized in the world of tax practice, would be superfluous. Of course, you would still want to protect people's pensions plans from going bankrupt but the tax aspect would be gone.

INTEGRATE CORPORATION & INDIVIDUAL TAXATION: Closely related is the automatic integration of corporation and individual tax accounts. Such integration has long sought by tax reformers and is somewhat controversial. The complex rules regulating corporate restructuring and distributions, deriving basically from a need to distinguish corporate debt and equity, and rules distinguishing (Subchapter C) corporate from other legal forms of business enterprise, resulting in strange incentives to organize subsidiaries as pass-through or not, or hybrid entities, etc., would be gone. You would not need to distinguish Subchapter C entities from others.

FACILITATE INDIVIDUAL FILING: This is an incidental advantage. A rarely noted feature of the X-Tax is that it would facilitate individual filing, thereby eliminating marriage taxes and subsidies. Many people worry about the marriage tax or the marriage bonus; either way most people are worried about the tax. Whether this is desirable as a matter of policy is obviously debatable, but the division of property income that makes individual filing difficult under the present income tax is not a problem for the X-Tax since "property income" is taxed uniformly at the business level.

WHAT IS WRONG WITH THE X-TAX? LOSING CHERISHED DEDUCTIONS: It is commonly thought that the X-Tax would necessarily do away with cherished features of the existing income tax system. Some of these are deductions, such as the mortgage interest deduction, or the subsidy to state and local bond interest, which would truly be unnatural components of the X-Tax. Others, such as the reciprocal deduction and inclusion of alimony, the deduction of charitable contributions and state and local taxes, and the exclusion of employer-provided health care, would present the same policy issues as in the present income tax. Most, however, can be accommodated without losing the simplification advantages I have cited.

TRANSITION IMPOSSIBLE? What about the transitional difficulties that Les mentioned? Could we get from here to there without unduly penalizing older citizens or randomly sprinkling around gains and losses? You cannot make big changes like this without making some gains and losses, but I think the gains and losses could be substantially moderated relatively easily. Because the X-Tax is so simple and uses mostly information already required for the income tax, it can be instituted as a new schedule on the income tax. The first couple of years, pay 80 percent of the bottom line of the existing tax and 20 percent of the X-Tax. Then make the proportions 60 percent-40 percent and so on. After the required number of years, the existing tax system would be phased out. That is an example that does not require complicated transition rules.

(Although it would take me beyond the scope of today's presentation to develop the point, I should note that transition considerations do, however, suggest we should consider substituting income style accounting for business investment, together with an interest allowance on undeducted basis, for the universal expensing regime I have described above. This is too bad, but does not, I think, extract a huge loss in the advantages I have described.)

THE BIG ENCHILADA: The big problem that keeps the experts from unanimously supporting the X-Tax is that it exempts capital income from tax, a fact that many people consider a terribly regressive thing to do.

In my view, these experts have been paying too much attention to words and not enough to substance. To illustrate my point, consider what it would take to convert that X-tax to an income, rather than a consumption base. All that would be required would be to substitute conventional income accounting for business capital expenses, substitute depreciation allowances, and inventory accounting etc. for the immediate write-off characteristic of the X-tax business component.

It seems evident to me that postponing my deduction for a capital outlay by some number of years is not the difference between rags and riches. That is not how the great fortunes are made in this or any other economy. Great fortunes are made by inventing Microsoft DOS or monopolizing the cigarette industry. Such sources of wealth are taxed alike under either the consumption-type or the income-type value-added tax.

WHAT IS IN A NAME? The labels "consumption" and "capital income" divert commentators from looking at what is actually going on. The valid point is that, in principle, the difference between income and consumption taxes is the treatment of the risk-free reward to waiting, certainly below 2 percent per year. I say "in principle" because in practice, actual income taxes are very far from the Haig-Simons ideal that I mentioned at the beginning.

WAITING FOR A CONSENSUS: Eventually, the tide of expert opinion will shift decisively in favor of the consumption ideal, and I hope we will postpone major reform until that happens. Such a new consensus, however, will not bring an end to tax politics. Rather, it will open up at least a possibility of a significantly simpler income tax system, one that accomplishes its essential distributional and revenue raising functions more objectively and with far less waste.

Professor Jacob L. TODRES: Although I think we could go on fruitfully for quite a bit of time, I think we have to stop and let our keynote speaker address us. I do just want to point out that David Bradford's pamphlet that was distributed is a very good source for an introduction to the area.[16]

MR. BRADFORD: Please mention my co-author.

PROF. TODRES: Joel Slemrod is the co-author. I found it very informative preparing for this and I recommend it to those of you who have an interest in seeing what the actual details are, rather than just the news snippets which is a lot of what we get. On behalf of the school and the *St. John's Journal of Legal Commentary* and myself, I thank you gentlemen very much for coming here and for carrying the debate.

16 DAVID F. BRADFORD & JOEL SLEMROD, MAKING TAX CHOICES, A GUIDE TO THE ISSUES AND THE ALTERNATIVES (Nathan Associates Inc., 1996) (on file with the *St. John's Journal of Legal Commentary*).