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Ist the Tax System Beyond Reform

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DUNWODY DISTINGUISHED LECTURE IN LAW

IS THE TAX SYSTEM BEYOND REFORM?

George K. Yin[*] [**]

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Immediately after the 1994 election gave the Republican Party control of the U.S. House of Representatives for the first time in forty years, Congressman Bill Archer (R-Tex.) held a press conference in the Committee on Ways and Means hearing room.[1] Archer, who was in line to become the new chair of the House Tax-writing Committee, announced his intention to abandon the income tax system altogether and replace it with a broad-based tax on consumption.[2] He would repeat this vow many times during the succeeding six years.

At the first of a series of hearings held by the Committee on Ways and Means on "Replacing the Federal Income Tax," Archer elaborated on his thinking:

> [T]oday could be perhaps one of the most important hearing days in the history of this Committee, because we are undertaking a very ambitious challenge, and that is to look at ways to replace the current Income Tax Code. . . .
>
> . . . Many of you know that I have spoken out very strongly about this and I have reached the conclusion that after many, many efforts to reform the current system, it is unfixable, if that is a correct English word; that it is certainly too broken to be fixed. And I believe we should look at options to replace it. . . .
>
> . . .
>
> In my opinion, our challenge is to do no less than pull the current Income Tax Code out by its roots and throw it away so that it can never grow back. When we abolish the income tax from the books as an insurance policy, I would not mind seeing the repeal of the 16th amendment to make doubly sure that the income tax won't rise from the dead and ever again haunt the American people. As for what replaces it, I believe the answer is a broad-based consumption tax . . . .[3]

In subsequent discussion, Archer made plain his belief that only a transactions-based consumption tax remitted exclusively by businesses, such as a national retail sales tax, would be acceptable as a replacement,

1. Dustin Stamper, *Archer and Armey: A Look Back and a Look Forward*, 105 TAX NOTES 650, 650 (2004).

2. *See* Barbara Kirchheimer, *Republicans Eager to Push Their Tax Agenda in New Congress*, 65 TAX NOTES 799, 799 (1994); *Archer Seeks Alternatives to Current Income Tax System*, CONGRESS DAILY, Nov. 10, 1994 (noting Bill Archer's intention to replace the existing income tax system and his consideration of a consumption tax system); William M. Welch, *Republicans See an Overhaul of Tax System*, USA TODAY, Nov. 11, 1994, at 6B.

3. *Replacing the Federal Income Tax: Hearings Before the H. Comm. on Ways and Means*, 104th Cong. 4 (1995) (statement of Rep. Bill Archer, Chairman, House Comm. on Ways and Means) [hereinafter *1995 W&M Hearings*].

and only if it were a *complete* replacement for the income tax.[4] He specifically rejected, for example, a "personalized" consumption tax involving some reporting by individuals,[5] such as the Hall-Rabushka "flat tax" sponsored by Congressman Dick Armey (R-Tex.), who was then House Majority Leader.

This Article focuses on two aspects of Archer's famous vow. Part I explains why a national retail sales tax is *not* a viable alternative as a complete replacement for the income tax.[6] Although Archer retired from the House after the 2000 election without having made any progress on his objective—indeed, he never even introduced a bill in Congress to repeal the income tax and replace it with a tax such as a retail sales tax[7]—subsequent events have made clear the continuing interest in this plan. For example, in the 2004 election, the Republican Senate candidate from South Carolina, Jim DeMint, ran on a platform to replace all federal taxes with a national sales tax.[8] Although his position was sharply criticized by his Democratic opponent, he prevailed with 54% of the vote.[9] In the current Congress, Congressman John Linder (R-Ga.) has re-introduced H.R. 25, which seeks to replace the individual and corporate income tax, the estate and gift tax, and the payroll tax with a national sales tax, and his bill has garnered about fifty co-sponsors.[10] President George

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4. *See id.* at 534, 552 (voicing his support of a tax on goods and services such as a national sales tax), and 330 (explaining that new tax must be complete replacement for entire income tax); Bill Archer, *Goals of Fundamental Tax Reform*, *in* FRONTIERS OF TAX REFORM 3, 8 (Michael J. Boskin ed., 1996).

5. *See 1995 W&M Hearings*, *supra* note 3, at 553; Archer, *supra* note 4, at 5; Stamper, *supra* note 1, at 651 (describing inability of Congressmen Archer and Armey to reach consensus on a reform alternative); *Tax Reform 'Odd Couple' May Take Debate on Road*, CONGRESS DAILY, May 13, 1997.

6. Another transactions-based consumption tax remitted only by businesses is a credit-invoice value-added tax. Although such a tax would avoid some of the problems of a retail sales tax, it too would not be a viable alternative as complete replacement of the income tax. *See* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH. PROPOSALS TO FIX AMERICA'S TAX SYSTEM 209 (2005) [hereinafter TAX PANEL REPORT]; *infra* text accompanying notes 132-37. Part I of this Article focuses exclusively on the retail sales tax and Part II includes a brief discussion of a credit-invoice value-added tax and other broad-based consumption taxes.

7. *See* Stamper, *supra* note 1, at 651.

8. Peter F. Harrell, *South Carolina: Debate Poses Question of Who Has Momentum*, CQ TODAY, Oct. 14, 2004.

9. *See* MICHAEL BARONE & RICHARD E. COHEN, THE ALMANAC OF AMERICAN POLITICS 2006, at 1501-02 (2005).

10. *See* Fair Tax Act of 2005, H.R. 25, 109th Cong. (2005). A companion bill, S. 25, was introduced in the Senate in January 2005, by Sen. Chambliss (R-Ga.) and as of June 1, 2006, it had three co-sponsors. Fair Tax Act of 2005, S. 25, 109th Cong. (2005). Sen. DeMint (R-S.C.) introduced his own bill, S. 1921, in October 2005. S. 1921, 109th Cong. (2005). Unlike H.R. 25 and S. 25, S. 1921 would not repeal federal payroll taxes and would impose a business transfer tax (a

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W. Bush, Speaker J. Dennis Hastert, and other prominent congressional leaders have all commented favorably about the possibility of a national sales tax.[11] Finally, syndicated radio talk show host Neal Boortz and Congressman Linder have written a book, entitled *The FairTax Book*, in support of this plan, and the book reached the top of the New York Times best seller list during the latter half of 2005.[12] Thus, it is timely to evaluate the viability of this idea. It is also fitting to discuss the idea in Florida, one of the few states in the nation without any state individual income tax and with a heavy reliance upon a retail sales tax to finance the state's needs. If Florida can do it, why can't the nation?

But if I succeed in Part I in establishing that a national retail sales tax is not a feasible option, are we then left with a tax system that is, in Congressman Archer's view, "too broken to be fixed" and effectively beyond reform? Part II begins to evaluate this further claim. It describes other possible ways to replace the income tax with a broad-based tax on consumption and concludes that a proposal specifically rejected by Archer, the Hall-Rabushka flat tax, provides a viable structural framework within which a replacement tax system could be designed. It then speculates on why Archer nevertheless rejected this option and suggests that pessimism about the tax legislative process may have played a role.

Part III discusses the legislative process. It identifies two trends—a greater top-down organizational structure and an increasingly fractured and externally focused legislative body—that may justify pessimism about the successful passage of real tax reform by Congress. In short, there may be more truth than we might like to believe in Archer's assertion that the current tax system is presently beyond reform. Part IV concludes the Article.

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subtraction-method value-added tax) on all businesses as well as a retail sales tax on all households.

11. *See* Martin A. Sullivan, *Economic Analysis*: *The Rise and Fall of the National Sales Tax*, 105 TAX NOTES 916, 917 (2004).

12. *See generally* NEAL BOORTZ & CONGRESSMAN JOHN LINDER, THE FAIRTAX BOOK: SAYING GOODBYE TO THE INCOME TAX AND THE IRS (2005) [hereinafter FAIRTAX] (supporting the implementation of a national retail sales tax). The book was on the best seller list for seven weeks, reaching #1 on August 21, 2005, and leaving the list after October 2, 2005. In describing the events that have led to the bizarre, scheduled, complete repeal and reinstatement of the estate and gift tax in 2010 and 2011, Professors Michael Graetz and Ian Shapiro ominously warn that a similar set of events might lead to enactment of a national sales tax in this country. *See* MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 273-78 (2005). For an earlier description of grassroots interest in a national sales tax, see Paul Starobin, *No Returns*, NAT'L J., Mar. 18, 1995, at 666. Some part of the interest in, and support for, a national sales tax may be due to misconceptions about the distributional impact of the tax relative to the existing income tax system. *See* Joel Slemrod, *The Role of Misconceptions in Support for Regressive Tax Reform*, 59 NAT'L TAX J. 57, 57, 63-64 (2006).

I. WOULD A NATIONAL RETAIL SALES TAX BE A VIABLE REPLACEMENT FOR THE INCOME, PAYROLL, AND ESTATE AND GIFT TAXES?

A. *Description of Proposal*

To consider a possible retail sales tax alternative, this Article examines and analyzes H.R. 25, Congressman Linder's bill that is described in his *FairTax* book. As noted, the Bill would repeal the individual and corporate income tax, the estate and gift tax, and the payroll tax, replacing all of them with a national retail sales tax.[13] The Bill is intended to be "revenue neutral"; that is, the replacement tax is intended to raise approximately the same amount of revenue as the taxes that would be repealed.[14] In their book, the authors state up front that their proposal is "about honesty," and that the proposal is not designed to provide any tax cuts.[15] As they explain, deciding on the proper size of government is another fight for another day.[16]

The Bill also recognizes the regressive nature of a sales tax due to the fact that lower-income people consume a greater proportion of their annual income than higher-income people.[17] To overcome this aspect of the tax, the Bill would provide a "prebate," or monthly cash grant, to every family in the country.[18] The size of the grant would reimburse each family for the amount of sales tax imposed on the poverty level of spending for that family.[19] For example, according to the authors of *The FairTax Book*, the poverty level of spending for a family of four in 2005 was just over $25,000 a year.[20] Their plan would allow every family of four in America, rich or poor, to receive in monthly checks an amount equal to the sales tax imposed on that level of spending.[21] In effect, every family of four would be permitted to consume around $25,000 each year, representing the basic necessities of life, before paying any sales tax.[22] In addition, of course, every family and business would not have to pay any income, payroll, or

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13. H.R. 25 §§ 101-103, 201. Section 201 of the Bill adds a new sales tax subtitle to the Internal Revenue Code, and except as otherwise provided, any further references in this Article to this Bill shall be to the proposed new Code sections in that subtitle that are added by § 201 of the Bill.

14. FAIRTAX, *supra* note 12, at 76.

15. *Id.* at 2.

16. *Id.* at 2-3.

17. *See id.* at 83-85.

18. H.R. 25 (adding proposed new I.R.C. § 301).

19. *Id.* (adding proposed new I.R.C. §§ 301, 303(a)).

20. FAIRTAX, *supra* note 12, at 86.

21. *Id.* at 85-86.

22. *Id.*

estate and gift tax.

Although a retail sales tax is familiar to many, it is important to examine exactly how the proposal contained in H.R. 25 would work. Suffice it to say, the proposed tax would not resemble any that has been tried by any state.

As with state sales taxes, the basic taxable event would be the retail sale in the United States by a business of a good or service to be used by the purchaser for personal consumption purposes. As shorthand, this article will refer to this event as a "business-to-household" transaction. Thus, an individual's purchases for personal purposes at Wal-Mart would be taxed.[23] Wal-Mart would collect from the purchaser federal sales tax equal to a percentage of the purchase price at the time of the purchase.[24] Any tax collected would be in addition to any state or local sales tax collected from the purchaser at that time.[25]

In contrast, a sale of the same item by a business to *another business* to be used by the latter to produce goods or services—a "business-to-business" transaction—would not be taxed.[26] This purchase is exempted to avoid the imposition of two or more taxes on a single act of consumption, a process known as "cascading." The theory is to tax the transaction only when the good or service produced by the second business is consumed by a household. Furthermore, a "household-to-household" transaction would not be taxed because sales tax would already have been paid by the first household.[27]

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23. H.R. 25 (adding proposed new I.R.C. § 101(a)).

24. *Id.* (adding proposed new I.R.C. § 103(a)).

25. *See* FAIRTAX, *supra* note 12, at 158.

26. H.R. 25 (adding proposed new I.R.C. § 102(a)(1)). Purchases for investment purposes would also not be taxed. *Id.* (adding proposed new I.R.C. § 102(a)(2)).

27. *Id.* (adding proposed new I.R.C. § 2(a)(14)(A)(i)(II), 2(a)(16) (excluding "used property" (meaning any property on which tax has been paid or which is held by households as of the effective date of the new law) from taxable goods, thus exempting household-to-household sales)). This rule would seem to exclude from the tax base subsequent consumption benefits arising from a good while held by a household. For example, suppose household #1 buys a new house from a home builder for $300,000 and pays sales tax on the purchase. Suppose the value of the house appreciates to $500,000 at which point household #1 sells it to household #2. The additional $200,000 of consumption benefit gained by household #2 would seem to escape sales taxation because the house would qualify as "used property" at the time of the second sale.

The nontaxation of subsequent consumption benefits provided by households is analogous to the nontaxation of self-provided services. But self-provided services are not taxed for administrative reasons, that is, the absence of a market transaction to determine the value of the self-provided service. In contrast, in the foregoing example, there is a market transaction between households #1 and #2 to reflect the value of the additional benefits obtained by household #2. The additional consumption benefits obtained by household #2 could be taxed by imposing tax on the purchase by household #2 but granting credit for the tax paid upon the purchase by household #1. STAFF OF J. COMM. ON TAXATION, 104TH CONG., DESCRIPTION AND ANALYSIS OF PROPOSALS TO REPLACE THE FEDERAL INCOME TAX 95 (Comm. Print 1995) [hereinafter JCT–1995 PAMPHLET].

So, for example, if a person buys a new house from Barry Rutenberg Homes to be used as a family residence, the buyer would owe sales tax on the purchase because it is a sale by a business to a household. If, instead, the person purchases the same new house from Rutenberg Homes to be used for a new law practice, that transaction would not be taxed because it is a business-to-business transaction. Rather, the cost of the person's legal services, which should presumably incorporate the cost of the building in which the practice is located, will be taxed when the services are consumed by a household. Finally, if a person purchases a used house from another family, the transaction again would not be taxed because it would be one between households. The Bill, however, would tax individuals on their payment of rent to a landlord for housing used for personal purposes, since that is simply another way a "household" pays a "business" for housing consumption.[28]

The purchase of almost all goods, including food, clothing, and prescription drugs, would be taxed.[29] The consumption of services would also be taxed.[30] In addition to amounts paid to the barber and the beauty parlor, the purchase of health, legal, accounting, or any other service for personal purposes would be subject to tax. It should be noted that Florida extended its sales tax to many services about twenty years ago, but the effort proved too controversial and the law was repealed after being in effect for only six months.[31] The purchase of insurance for personal

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This approach, however, may result in the taxation of some investment income where the increase in the value of the good was anticipated at the time of the purchase by household #1. *See id.* at 95-96.

28. H.R. 25 (adding proposed new I.R.C. § 2(a)(14)(A)(i) (including leaseholds or "rents" of property as taxable property)). This rule, in conjunction with the exemption for sales of "used property," *see supra* note 27, and the fact that the imputed rent earned from owner-occupied housing is not subject to sales tax, means that under H.R. 25, owners of housing will continue to be favored over renters of such property and that pre-existing housing will be favored over new housing. This may inefficiently encourage the continued ownership of existing housing and discourage the acquisition of new housing. *Cf.* STAFF OF J. COMM. ON TAXATION, 105TH CONG., IMPACT ON INDIVIDUALS AND FAMILIES OF REPLACING THE FEDERAL INCOME TAX 123 (Comm. Print 1997); JCT-1995 PAMPHLET, *supra* note 27, at 99 ("Imposing a consumption tax only on sales of new durables creates windfalls for current owners of existing durables."). Some might argue that the purchase of housing is not wholly consumption but is in part a purchase "for investment purpose," and therefore should be partially exempt from the sales tax. H.R. 25 requires, however, that to qualify as exempt investment-purpose property, the property must be held *exclusively* for investment purposes. H.R. 25 (adding proposed new I.R.C. § 102(a)(2)).

29. The purchase of intangible property (other than leaseholds, land, and computer software) would be exempt. H.R. 25 (adding proposed new I.R.C.§ 2(a)(6), 2(a)(14)(A)(i)).

30. *Id.* (adding proposed new I.R.C. §§ 2(a)(14)(B), 101(a)).

31. *See* Walter Hellerstein, *Florida's Sales Tax on Services*, 41 NAT'L TAX J. 1, 14-15 (1988). The short-lived tax excluded medical services. *Id.* at 3. Upon repeal, Florida increased its sales tax rate from 5% to 6%. *Id.* at 15. Interestingly, the *FairTax* authors describe Florida as "do[ing] pretty much what we are proposing." FAIRTAX, *supra* note 12, at 156.

protection, such as premiums paid on health, life, homeowner's, or auto policies, would also be taxed.[32]

Among the taxed services would be financial services.[33] These are often overlooked or misunderstood because the cost of such services is usually embedded in the financial product. For example, many people have checking accounts with a bank that markets its product as "free checking," but a moment's reflection would reveal that the bank's service is surely not free. In fact, the bank has use of any balance the depositor maintains in the checking account and invests that money at a profit. In the meantime, it pays the depositor little or no interest on that money. The amount the bank makes on the money is the fee it receives from the depositor for providing all of its banking services. Under H.R. 25, this fee would be a taxable purchase of services by the depositor and therefore would be subject to sales tax.[34] Thus, every person would need to determine the amount of interest foregone on any deposits and pay tax on that foregone amount.

Fees for financial services may arise in other contexts. For example, when a person pays 7% interest on a home mortgage loan, or 18% interest on consumer credit card purchases, the person is clearly paying more than the prevailing interest rate for the mere use of the money borrowed. The extra amount paid is a fee to the business that is lending the money. H.R. 25 would also treat that as a taxable fee on which sales tax would be due.[35]

In the early 1990s, Massachusetts enacted an even shorter-lived sales tax on services. *See* Samuel B. Bruskin & Kathleen King Parker, *State Sales Taxes on Services: Massachusetts as a Case Study*, 45 TAX LAW. 49, 49-50 n.7 (1991). Its tax was repealed retroactively two days after it went into effect. *Id.*

32. H.R. 25 (adding proposed new I.R.C. §§ 2(a)(14)(A)(ii), 801(a)(2)(D) (stating that insurance premiums not allocable to a policy's investment account is a fee for taxable financial services)). If a taxpayer's health insurance premiums are taxed, and the taxpayer is also taxed upon paying for a doctor's services (for which the insurance company provides reimbursement), there is the possibility of the taxpayer being taxed twice on the same consumption. The Bill provides taxpayers with an "insurance proceeds credit" in this situation, although it is unclear how easily it would be administered. *Id.* (adding proposed new I.R.C. § 206).

33. *Id.* (adding proposed new I.R.C. §§ 2(a)(14)(A)(ii), 801(a)).

34. *Id.* (adding proposed new I.R.C. § 801(a)(1)(B), 801(a)(3)). The imputed interest income earned by the depositor in this transaction is not taxed under current law.

35. *Id.* The "proper" interest rate of a loan or deposit, as distinguished from the fee element, will depend upon the specific terms of the financial instrument, such as whether a loan is secured. The Bill, however, arbitrarily assumes that a representative interest rate for instruments of varying terms would constitute the "interest" element of all instruments of that term, with any excess (or shortfall) in the return being the fee element. *Id.* (adding proposed new I.R.C. §§ 512, 801(a)(3), 805).

The difficulty of taxing financial services where there is no explicit fee charged has led most countries with VATs to exempt the consumption of such services from the tax base. *See* JCT-1995 PAMPHLET, *supra* note 27, at 109. Complete exemption of financial services, however, creates its

So, for example, if a person were to purchase a new house for $300,000 from Rutenberg Homes as a family residence, the buyer would have to pay sales tax on a number of transactions. The basic $300,000 purchase would be taxed, and collected by Rutenberg Homes. A portion of the interest paid on the $200,000 mortgage loan incurred to make the purchase would also be taxed, and collected by the mortgage company making the loan. The cost of any homeowner's insurance would be taxed. And the cost of any other services—for example, those provided by the closing attorney, the real estate agent, the surveyor, the home inspector, the termite company, and so forth—would also be taxed and collected by each of those service providers.

One other important aspect of H.R. 25 deals with the services provided by government. Households, of course, consume valuable services provided by governments as well as by private businesses. If the cost of services purchased from private businesses is taxed, but the cost of government services is not, the tax system may create an undesirable bias in favor of the consumption of services provided by governments. Thus, H.R. 25 would generally treat the providing of government services to households as events that would be taxed.[36]

But how much does one pay for government services? If a person pays $10 to an attendant upon entering a national park, or an $8 toll for crossing a major bridge, it is simple enough to add a few dollars more to cover any sales tax imposed.[37] But other government services, such as public services, are provided "for free." Of course, like the case of financial

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own problems because many businesses provide (or may begin to provide, after enactment of the new tax system) both financial and non-financial services. *Cf.* TAX PANEL REPORT, *supra* note 6, at 245. Consider an auto dealership which makes loans to customers to finance the purchase of cars. If the sale of an auto is a taxable transaction but the sale of financial services is not, the dealership will have a tax incentive to discount the price of its cars and then charge its customers higher implicit financial fees. *See id.*

36. In theory, the concern expressed in the text might only apply to services where there are comparable public- and private-sector providers. *Cf.* STAFF OF J. COMM. ON TAXATION, 104TH CONG., IMPACT ON STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS OF REPLACING THE FEDERAL INCOME TAX 61 (Comm. Print 1996) [hereinafter JCT-STATE AND LOCAL GOVERNMENTS]. For example, both governments and private businesses provide transportation or utility services; thus, taxing the purchase of service from one type of provider but not the other may inefficiently bias the consumer's choice of service. Under the Bill, when governments provide these types of services (services to consumers for a fee), their consumption is taxed in exactly the same way as services provided by private businesses. H.R. 25 (adding proposed new I.R.C. § 704 (implementing taxation of "government enterprises")). But the bill goes further and attempts to tax the value of public services provided by government, such as national defense, even where there is no clearly comparable private sector provider.

37. Note, however, that an explicit fee charged by government may not represent the market value of the good or service being consumed. The fee may be less than market value, incorporating a government subsidy, or more than market value, incorporating a government tax.

services, public services are not free—they are simply paid for indirectly. So how does one determine a person's cost of national defense, police and fire protection, clean air and water, homeland security, food and drug safety, highways and roads and infrastructure, and so on and so forth, for purposes of taxing the person's consumption of those government services?[38]

The solution devised under the Bill is to tax consumption of these services *indirectly* by taxing the cost of government inputs to provide these services to households. Thus, under the Bill, all purchases of goods and services *by* federal, state, and local governments would be subject to the sales tax.[39] In effect, the government would serve as a proxy for the households it serves, and would pay sales tax on their behalf. Governments would also have to pay sales tax on the compensation they pay to their employees—this is part of the cost of government services provided to households, with the government again paying the tax as proxy for the consumption of those services by those households.[40]

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38. The cost of primary, secondary, and university-level educational services, as well as job-training courses, whether provided by government or the private sector, is in effect treated as an investment in human capital under the Bill and therefore is not taxed. *See* H.R. 25 (adding proposed new I.R.C. § 2(a)(4), 2(a)(8)(D)). The exception is explicitly limited to *tuition* costs, and does not include the cost of room and board or sports, recreational, and other common "after-school" activities. *Id.* (adding proposed new I.R.C. § 2(a)(4)). It will be difficult to achieve comparable tax treatment of these types of educational services provided by the private sector and by government. *See infra* note 40. Because universities engage in research activities that are comparable to those undertaken by the private sector, the President's Tax Reform Panel recommended that the cost of university-level education, but not primary and secondary school education, be included in the consumption tax base. *See* TAX PANEL REPORT, *supra* note 6, at 251; *see generally* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 67-68 (discussing the complexity of classifying education services in a consumption-based tax system).

39. H.R. 25 (adding proposed new I.R.C. § 703(a)).

40. *Id.* (adding proposed new I.R.C. § 2(a)(12)(A)(ii), 2(a)(14)(B)(i)). Taxing the cost of government inputs and compensation paid to government employees means that the financial and administrative services provided by government in making transfer payments to households is also generally subject to tax. *Cf.* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 55.

Because the cost of educational services provided by the government would not be taxed, the government would not be required to pay tax on compensation paid to its employees, such as teachers, who provide educational services to the public. H.R. 25 (adding proposed new I.R.C. § 2(a)(14)(B)(ii)(IV)). This exception presumably would not extend to the compensation of other school employees, such as after-school or cafeteria workers. It is unclear how the compensation of school administrative personnel would be treated. It is also unclear how the compensation of professors employed by public universities would be treated since they commonly perform functions that go beyond the direct teaching of students.

Under the Bill, amounts paid to certain non-profit organizations in the nature of dues or contributions would be exempt from sales tax. *Id.* (adding proposed new I.R.C. § 706(a)). Amounts paid to such organizations, however, for goods or services produced by them would generally be taxed in the same manner as amounts paid to private businesses. *Id.* (adding proposed new I.R.C. § 706(d)). Finally, amounts paid *by* such organizations for goods and services would be taxed in

One problem with taxing the cost of government inputs, but not outputs, is that it may allow some part of the value added by the government to escape taxation. For example, suppose the government incurs $100 to provide a household with a public service whose fair market value is $120. Under the Bill, only the $100 purchase by government would be subject to sales tax. The $20 in consumption value produced by government would not be taxed.[41] One way to rationalize this result is to treat the proper tax base of the sales tax as the total consumption value *produced by businesses*.[42] Under this view, upon purchase of a good or service, the government would not be merely a proxy for the households it serves, but would be the ultimate consumer itself. In the example above, the tax base should therefore be only $100. Any additional value provided by government to households would then be analogous to nontaxable self-provided services.[43]

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the same manner as consumption by a household except to the extent the purchases consist of business inputs for taxable goods or services produced by the organization. *Id.* (adding proposed new I.R.C. §§ 101(a), 706). The theory of taxing most purchases *by* non-profit organizations is the same as the theory behind the taxation of purchases by governments: The organization serves as a proxy for its beneficiaries, and the tax paid by the organization is in lieu of collecting a tax from the beneficiaries when they consume goods and services provided by the organization for which a fee is not charged. Curiously, unlike governments, non-profit organizations would not be required under the Bill to pay sales tax on the compensation paid to their employees. *Id.* (adding proposed new I.R.C. § 2(a)(12)(B)(ii), 2(a)(14)(B)(i), 2(a)(14)(B)(ii)(II)); *see* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 52-58 (discussing the conceptual issues raised by governments and nonprofit organizations under a consumption tax).

41. To the extent the $20 of value added by government is a reflection of the labor provided by government employees, H.R. 25 would tax the added value because the Bill taxes the government on the compensation paid to its employees.

42. The alternative view discussed thus far would treat the proper sales tax base as the total value of goods and services *consumed by households*.

Even if the proper tax base is the total consumption value produced by businesses, it would still be appropriate to tax government on the compensation it pays to its employees in order to avoid distorting the choice between hiring employees rather than independent contractors (whose cost of services would be taxable to government). For the same reason, the Bill requires any "household employing domestic servants" to pay sales tax on the compensation paid to its employees even though compensation paid by a business to its employees is not subject to the tax. H.R. 25 (adding proposed new I.R.C. § 2(a)(12), 2(a)(14)(B)); *see* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 57-58 (noting the need to treat comparably the cost of employees and independent contractors to governments, non-profits, and non-business employers).

43. *See generally* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 55-58. Under the Bill, the consumptive value of self-provided services is not taxed.

The precise rationale for and manner of taxing state governments under the Bill may have constitutional implications. Such taxation is potentially objectionable under either the Tenth Amendment (including principles of federalism) or the doctrine of intergovernmental tax immunity. A Tenth Amendment challenge would likely be overcome because the sales tax will merely regulate the state's activities, i.e., its purchases of goods and services and its payment of compensation to its employees, and would not "seek to control or influence the manner in which

States regulate private parties." South Carolina v. Baker, 485 U.S. 505, 514 (1988); *see also* Reno v. Condon, 528 U.S. 141 (2000) (upholding a federal statute that regulates states as owners of databases); *cf.* New York v. United States, 505 U.S. 144 (1992) (holding unconstitutional federal law requiring states to take title to radioactive waste material, upon request from owners of such material, if state has not provided appropriate disposal site for such material); Printz v. United States, 521 U.S. 898 (1997) (striking down federal law requiring state officers to conduct background checks on prospective handgun purchasers).

The resolution of a possible challenge under the doctrine of intergovernmental tax immunity is less clear. The current interpretation of that doctrine focuses upon the "legal incidence" of a tax, which appears to refer to the party which is legally liable for the tax under the law. *See* 1 LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 1225-33 (3d ed. 2000). Thus, a federal tax imposed on the interest income of state and local bondholders, or a state tax imposed on the purchases of private parties who contract with the federal government under a cost-plus contract, do not violate intergovernmental immunity because in neither case is the tax imposed directly on the other government. *See Baker*, 485 U.S. at 526; Alabama v. King & Boozer, 314 U.S. 1, 12-14 (1941). The fact that the other government may bear some of the economic burden of the tax is not relevant.

Under H.R. 25, however, the purchaser, including a state or local government, is generally liable for the tax unless the purchaser pays the tax to a seller and receives an appropriate receipt from the seller. H.R. 25 (adding proposed new I.R.C. §§ 101(d), 703(a)(2)). Moreover, in the case of goods or services purchased outside the United States but used within it, the purchaser is the sole party responsible for the tax. *Id.* (adding proposed new I.R.C. § 103). Thus, it appears that for at least some purchases, a state will be considered the party with the legal liability for the tax. Moreover, the state seems clearly to be the party with legal liability for the sales tax imposed on compensation paid to its employees.

But analysis of an intergovernmental immunity challenge would not necessarily end there. As the Supreme Court explained in *South Carolina v. Baker*, "All federal activities are immune from direct state taxation, but at least some state activities have always been subject to direct federal taxation." *Baker*, 485 U.S. at 523 n.14 (citation omitted). The precise contours of which state activities, if any, may *not* be directly taxed by the federal government is unclear, but it appears that there may be a class of property or activities so uniquely tied to a state as to cause a direct federal tax on such property or activity to constitute an impermissible tax on the sovereign government itself. *Cf.* New York v. United States, 326 U.S. 572, 582 (1946) ("There are, of course, State activities and State-owned property that partake of uniqueness from the point of view of intergovernmental relations. These inherently constitute a class by themselves. Only a State can own a Statehouse; only a State can get income by taxing. These could not be included for purposes of federal taxation in any abstract category of taxpayers without taxing the State as a State."); *Baker*, 485 U.S. at 523 n.14.

If there is such a class of state property or activities constitutionally protected from direct federal taxation, H.R. 25 might be vulnerable to challenge. In addition to being imposed directly on the states in certain circumstances, the proposed sales tax would potentially apply to property or activities uniquely associated with a state. For example, the sales tax would apply to purchases by a state to replace its statehouse or other unique state-owned property. In addition, by taxing the state on the compensation paid to its employees, the Bill could be viewed as taxing state activities such as the service a state provides in making transfer payments to its citizens and, more generally, the state's exercise of its tax and spending authority on behalf of its citizens. *See supra* note 40. Furthermore, the fact that the Bill would tax governments, but not businesses, on the compensation paid to their employees might cause a court to view the tax as an impermissible, discriminatory tax on the state. *Cf. Baker*, 485 U.S. at 526-27. In response, it might be argued that, as described in the text, the sales tax on government purchases and compensation is simply an indirect way of taxing

B. *Analysis of Proposal*

This brief description of the tax reveals some of its complexity and vulnerability. Certainly, a key difficulty will be differentiating between "households" and "businesses" and making sure that every business-to-household transaction is taxed. For example, the mere conversion of an item from business to household purposes, such as the use for personal purposes of a computer originally purchased for a person's law practice, would be a taxable event. Under the Bill, individuals will be deemed to have sold such items to themselves for fair market value at the time of conversion, and have to pay sales tax on that deemed purchase.[44] Likewise, the making of a gift or the granting of a fringe benefit by an employer to an employee would be a taxable event.[45] In addition, difficult questions may arise upon the purchase of an item, such as an automobile or a business meal, that is to be used for *both* business and household purposes.[46]

It will also be critical to make sure all business-to-business transactions are *not* taxed, in order to prevent cascading. Cascading creates economic distortions by causing tax burdens to vary depending upon how a good or service is produced.[47] Businesses respond to cascading problems by

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the households that the government serves and is not a tax on the state as such.

44. H.R. 25 (adding proposed new I.R.C. § 103(c)). In the reverse situation, individuals who convert personal-use items (on which tax has already been paid) to business use are entitled to a credit for the tax previously paid. *Id.* (adding proposed new I.R.C. §§ 201(a)(1), 202(a)).

45. *Id.* (adding proposed new I.R.C. § 901(e), (g)). Employee gifts and fringe benefits may substitute for the taxable purchase of consumption and therefore should be taxed under a retail sales tax. For example, suppose an airline pays $1,000 cash compensation to an employee who uses the money to purchase an airline ticket. The purchase of the ticket is a taxable event under a retail sales tax. Therefore, if the airline compensates the employee by providing a free airline ticket in lieu of the $1,000 cash, the fringe benefit must similarly be taxed. Otherwise, the tax system would inefficiently cause more fringe benefits to be provided to employees than would be the case in a no-tax world.

The taxation of fringe benefits is difficult because of identification, valuation, and liquidity problems. Certain consumption tax systems, such as the Hall-Rabushka flat tax, avoid some of these problems by denying a deduction to the employer granting the benefit rather than trying to tax the recipient of the benefit. *See* ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX 119-20, 142-43 (2d ed. 1995). A retail sales tax offers no comparable opportunity for taxing gifts and benefits in an alternate way. For a brief discussion of the Hall-Rabushka flat tax and other consumption tax alternatives, see Part II of this Article.

46. In general, the Bill contemplates that the purchase of any good or service will be subject to tax unless more than 95% of it is used for an exempt purpose, such as business use. *See* H.R. 25 (adding proposed new I.R.C. § 705(a)(2)). Businesses that pay tax on the purchase of mixed use property or services are then entitled to a credit upon establishing the portion of the item used for business purpose. *See id.* (adding proposed new I.R.C. § 705(a)(3)).

47. *See* JOHN F. DUE & JOHN L. MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE

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vertically integrating.[48] In the past, one of the principal arguments against taxing many services is the difficulty in differentiating between services provided to businesses and those provided to households.[49]

These difficulties also make the tax vulnerable to those inclined to cheat the system. Many people are, and can certainly be made to look like, *both* a household and a business, and if either the buyer is a business or the seller is a household, there is generally no tax. Thus, if a person buys a new house from Rutenberg Homes in the guise of a lawyer seeking a place for a law practice, and the person later sells the same house in the guise of a household selling a family home, no tax will ever be paid on the consumption of the house.[50]

More generally, the structure of a retail sales tax makes it particularly vulnerable to noncompliance. The sales tax system tries to collect the same amount of revenue as under current law, but from only the roughly 10 million retail businesses in the country and not the over 150 million households and businesses that are collection points for current taxes.[51] And, it turns out, reliance is placed on exactly the sector—retail businesses—that is among the least compliant under current law.[52] This structure "creates a concentrated pressure point for evasion."[53]

Under current law, a retailer might gain a $10 profit from selling a $100 good. If the retailer fails to report the income from the transaction, the tax savings might be 30% of the $10 profit, or about $3. In contrast, failing to report the transaction under a 30% sales tax produces potential tax savings of $30. This example illustrates the great reliance a sales tax places upon one sector of the economy to collect the nation's revenue.

AND ADMINISTRATION 59-60 (2d ed. 1994); Bruce Bartlett, *Replacing Federal Taxes with a Sales Tax*, 68 TAX NOTES 997, 1000-01 (1995).

48. *See* William F. Fox & Matthew Murray, *Economic Aspects of Taxing Services*, 41 NAT'L TAX J. 19, 28 (1988).

49. *See 1995 W&M Hearings*, *supra* note 3, at 307-08 (statement of Sijbren Cnossen); DUE & MIKESELL, *supra* note 47, at 91-92; Sijbren Cnossen, *VAT and RST: A Comparison*, 35 CAN. TAX J. 559, 596-98 (1987); Fox & Murray, *supra* note 48, at 29; Hellerstein, *supra* note 31, at 7-8. As a practical matter, states have had difficulty excluding business purchases from their sales tax base, with one estimate indicating that roughly 40% of state sales tax revenue is attributable to business purchases. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, 2 STATE TAXATION ¶ 12.01, at 12-3 (2005).

50. The authors of *FairTax* claim that both the buyer and the seller would have to conspire to cheat to avoid paying sales tax, FAIRTAX, *supra* note 12, at 118-19, yet in this example, only the initial purchaser must be a potential cheater.

51. Chris Edwards, *Options for Tax Reform*, 106 TAX NOTES 1529, 1549 (2005).

52. *See IRS Updates Tax Gap Estimates*, IR-2006-28, INTERNAL REVENUE SERVICE, Feb. 14, 2006, http://www.irs.gov/newsroom/article/0,,id=154496,00.html [hereinafter *IRS Tax Gap Estimates*] (attributing an important portion of underreporting of income and employment tax to non-farm proprietors, partnerships, and S corporations).

53. Edwards, *supra* note 51, at 1549.

No doubt, the monthly cash grants provided to every family in America would be another major vulnerability. The amount of the grant will depend in part upon the size of the family and whether it includes a married couple, so there will be incentives to fabricate the existence of families, exaggerate their size, and misrepresent marital status.[54] In anticipation of these difficulties, the Bill would require every family in the country, defined as one or more persons with certain familial relationships who share a common residence, to register annually with a "sales tax administering authority" and to supply it with required information.[55] Given the continually changing composition, marital status, and residence of some families, one can expect ample inadvertent as well as intentional errors in the administration of these grants.

Of course, the seriousness of these problems depends in large part upon the rate of the sales tax: The higher the rate, the greater the distortions from cascading and unintended exemptions from the tax, and the stronger the incentive to game the system.

President Bush's Advisory Panel on Federal Tax Reform recently analyzed the "FairTax" proposal and concluded that a sales tax rate of 34% would be needed just to replace the income tax and to fund the family cash grants.[56] This rate would apply on top of any applicable state or local sales tax.

For several reasons, this estimate substantially understates the likely required sales tax rate. First, the estimate assumes an overall noncompliance level for the sales tax that is consistent with the level of noncompliance in the current tax system.[57] But compliance under current law is bolstered by the existence of many repeated and often identical transactions between the same parties that are taxable events under the income and payroll tax, which facilitates the use of third-party reporting and withholding mechanisms to collect those taxes. The recurrent payment

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54. H.R. 25 (adding proposed new I.R.C. §§ 301, 303(a) (indicating "monthly poverty level," which determines the size of the cash grant, is dependent upon family size and whether family includes a married couple)).

55. *Id.* (adding proposed new I.R.C. § 302(a), (d)). Proposed § 302(e) states that "[r]egistration is not mandatory for any qualified family," but it is not clear what this statement means because without registration, a qualified family is not entitled to the cash grant. *Id.* (adding proposed new I.R.C. § 302(d)-(f)).

56. TAX PANEL REPORT, *supra* note 6, at 208, 217. Unless otherwise specified, this rate and all other sales tax rates described in this paper are expressed in a "tax-exclusive" way. A "tax-exclusive rate" represents the percentage of tax paid relative to the purchase price, but not including the tax paid as part of the purchase price. Thus, for example, a "10% tax" means that if a taxable good without any tax costs $100, the buyer will have to pay an additional $10 in sales tax. This is the typical way in which state sales tax rates are expressed and understood.

57. *See id.* at 216-17 (assuming noncompliance rate of 15%); *IRS Tax Gap Estimates*, *supra* note 52 (estimating overall tax system noncompliance rate to be just over 16%, and income tax noncompliance about 18%).

of wages by an employer to an employee is the prime example. Although in theory, both an employer and an employee might benefit if the employer failed to withhold taxes on any wages paid and the employee failed to report the wages for income and payroll tax purposes, any deviation in that noncompliance with respect to a subsequent payment of wages would likely be noticed by the IRS. Thus, to succeed, an employer and employee would probably have to agree to continue the same pattern of noncompliance for the entire duration of the employee's employment. Quite understandably, most people are unwilling to take that risk. Consequently, income and payroll tax noncompliance with respect to this large category of transactions is virtually nonexistent.

In contrast, noncompliance under current law in connection with non-repeat transactions for which there is no third-party reporting or withholding obligation is estimated to be over 50%.[58] Because almost all taxable transactions under a retail sales tax would have this non-repeat characteristic, the rate of noncompliance in such a tax system should be expected to be closer to this higher level.[59] According to the Advisory Panel, if one assumes an overall noncompliance level for the sales tax of 30%, which still seems fairly optimistic, the required sales tax rate would have to be increased to 49%.[60]

Second, as we have seen, the proposed sales tax base in H.R. 25 is far more comprehensive than any that has been successfully tried in any state.

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58. *See* TAX PANEL REPORT, *supra* note 6, at 216-18. The authors of *The FairTax Book* acknowledge that under current law, "most [tax] avoidance comes from small businesses and personal taxable transactions." FAIRTAX, *supra* note 12, at 118.

59. Even if a particular consumer made repeated purchases from the same vendor, there would not necessarily be any specific pattern to the transactions that would attract the attention of an auditor. A consumer who sporadically and improperly claims sales tax exemption for certain personal consumption purchases would exhibit the exact same pattern of activity as that of a consumer who sporadically and *properly* claims sales tax exemption only for certain business-related purchases.

60. *See* TAX PANEL REPORT, *supra* note 6, at 216. Proponents of the FairTax tout the fact that those who are in the underground economy and do not pay their income taxes today would have to pay sales tax on their consumption purchases tomorrow if a national sales tax were in effect. *See* 151 CONG. REC. H9439 (daily ed. Nov. 1, 2005) (reporting Rep. Linder's statement that by taxing consumption the underground economy would be taxed); FAIRTAX, *supra* note 12, at 96. This position is inconsistent with their further claim that current federal taxes, including taxes on income and payroll, are already embedded in the price of today's goods and services. FAIRTAX, *supra* note 12, at 54-57. If current taxes are included in today's prices, then those in the underground economy should presumably be paying them when they make their purchases. In any event, under a retail sales tax, it will presumably continue to be difficult to collect tax from the *sales* made by those same persons, so it is unclear whether a sales tax would produce any net gain with respect to collecting tax from the underground sector. *See 1995 W&M Hearings*, *supra* note 3, at 241 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy), 513-14 (statement of Rep. Dick Armey), 619-20 (testimony of Alan Reynolds); JCT-1995 PAMPHLET, *supra* note 27, at 83.

The Panel re-estimated the required rate with an assumed tax base equal to the median size base used by the states, and found that the required sales tax rate would then be 89%.[61] In other words, on the purchase of a $300,000 house, the buyer would need to pay roughly $270,000 in sales tax! And if a larger mortgage is needed to finance that additional cost, the purchaser would have to pay more sales tax on that as well.

But it gets worse. As noted, the Panel's estimates would finance only the replacement of the individual and corporate income tax. The sales tax rate would have to be higher than the Panel's estimates if, as proposed in H.R. 25, the new sales tax would also replace the payroll and estate and gift tax. Based on what these taxes raised in 2005, I estimate that the amount of revenue needed by H.R. 25 would be roughly two-thirds greater than what the Panel projected.[62] In other words, the required sales tax rate could easily be well over 100%.[63]

Finally, the Panel's estimates are "revenue neutral" compared to a baseline of the amount of revenue the President's FY 2006 budget proposals are estimated to raise.[64] Among other things, the President's budget proposals assume a permanent extension of tax cuts now scheduled to expire before 2011, enactment of various savings tax incentives not found in current law, and curtailment of the "relief" annually provided by Congress to prevent more taxpayers from being made subject to the alternative minimum tax (AMT).[65] If the Panel had estimated a revenue-

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61. *See* TAX PANEL REPORT, *supra* note 6, at 216. This estimate assumed that the cash grants would not be needed because of the exemptions built into the sales tax base, and also that the noncompliance level of the tax system would be 30%. *Id.*

62. In 2005, the corporate and individual income tax raised about $1,205 billion in revenue, whereas the income tax plus the payroll and estate and gift tax raised about $2,024 billion. *See* OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2007 237 tbl. 17-1 (2006) [hereinafter OMB, FY 2007]. Thus, if the revenue raised by the sales tax in H.R. 25 is to replace the latter figure, the tax would need to raise an additional $819 billion, or roughly 68% more revenue than was raised by just the income tax ($819/$1,205).

63. The staff of the Joint Committee on Taxation has previously estimated a required 57% sales tax rate for an earlier version of H.R. 25 to be revenue neutral. *See* Sullivan, *supra* note 11, at 917-18 (copy of April 2000 memo from Lindy L. Paull, Chief of Staff of the Joint Committee on Taxation, to John Buckley). The staff's estimate assumed (1) complete replacement of income, payroll, and estate and gift taxes, (2) a noncompliance level in the sales tax system comparable to the current tax system, and (3) the comprehensive sales tax base included in H.R. 25. *Id.* As discussed in the text, if one assumes a higher noncompliance level and a less comprehensive base, it would again appear that a sales tax rate well in excess of 100% would be required.

64. *See* TAX PANEL REPORT, *supra* note 6, at 42; Jonathan Z. Ackerman & Rosanne Altshuler, *Constrained Tax Reform: How Political and Economic Constraints Affect the Formation of Tax Policy Proposals*, 59 NAT'L TAX J. 165, 176 (2006); Leonard E. Burman & William G. Gale, *A Preliminary Evaluation of the Tax Reform Panel's Report*, 109 TAX NOTES 1349, 1349 (2005).

65. *See* OFFICE OF MGMT. AND BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2006 281-83 (2005). The Administration's FY 2007

neutral alternative relative to current law, the required sales tax rate might have to be higher still.[66]

Those people who are familiar with the FairTax proposal may be puzzled by these conclusions because proponents of the proposal have suggested that a tax rate of only 23% would be required.[67] Part of the explanation is that the FairTax estimates apparently did not assume any level of noncompliance.[68] A larger reason, however, is that the FairTax analysis includes an inherent inconsistency. As previously mentioned, H.R. 25 would require the federal government to pay the sales tax on all of its purchases of goods and services as well as on the payment of compensation to its employees, and this large amount of "revenue" paid by the federal government was used to reduce the required amount of sales tax that would have to be paid by the private sector. In effect, the taxes paid by the federal government kept the required sales tax rate low. At the same time, however, no accommodation was made for the increased cost

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budget includes the same proposals. *See* OMB, FY 2007, *supra* note 62, at 252-54.

66. According to Ed Lazear and Jim Poterba, the revenue effects of extending the tax rate reductions of 2001, 2003, and 2004 and not providing the AMT relief are "of roughly the same magnitude." *See* Edward P. Lazear & James M. Poterba, *Reforming Taxes to Promote Economic Growth*, ECONOMISTS' VOICE, Dec. 2005, at 1, 6, http://www.bepress.com/ev/vol3/iss1/art3. The potentially positive growth effects of a national sales tax might eventually allow the rate to come down somewhat. *See* Laurence J. Kotlikoff, *Saving and Consumption Taxation: The Federal Retail Sales Tax Example, in* FRONTIERS OF TAX REFORM, *supra* note 4, at 176; Laurence J. Kotlikoff & Sabine Jokisch, *Simulating the Dynamic Macroeconomic and Microeconomic Effects of the FairTax* 24-25 (Nat'l Bureau of Econ. Research, Working Paper No. 11858, 2005); STAFF OF J. COMM. ON TAXATION, 105TH CONG., JOINT COMMITTEE ON TAXATION TAX MODELING PROJECT AND 1997 TAX SYMPOSIUM PAPERS (JCS-21-97) 21-33 tbls. 1, 2, 3, 4 & 5 (1997) (reporting generally positive growth effects of switch from current income tax to broad-based consumption tax, with magnitude of effects varying by time and with the assumed monetary and international capital flow response). *But see infra* text accompanying notes 121-22.

Two private sector estimates of the required revenue-neutral tax rate under H.R. 25 have been made. *See* William G. Gale, *The National Retail Sales Tax: What Would the Rate Have to Be?*, 107 TAX NOTES 889 (2005); Paul Bachman et al., *Taxing Sales under the FairTax – What Rate Works?*, Sept. 2006 draft, http://people.bu.edu/kotlikof/ (follow "Taxing Sales under the Fair Tax—What Rate Works?" hyperlink). Gale estimates that under assumptions of the comprehensive tax base contained in the Bill and full compliance, the required rate would be about 44%. *See* Gale, *supra* at 895 tbl. 1, 896. In contrast, Bachman et al. estimate that under the same assumptions, the revenue-neutral rate would be about 31%. *See* Bachman et al., *supra* at 2.

67. This is a *tax-inclusive* rate. H.R. 25 (adding proposed new I.R.C. §§ 2(a)(5), 101(b)(1) (proposing tax rate of 23% of "gross payments" with gross payments *including* any sales tax paid)); FAIRTAX, *supra* note 12, at 151-53. A "tax-inclusive" rate is the percentage of tax paid relative to the purchase price, but including the tax paid as part of the purchase price. A 23% tax-inclusive rate is equivalent to a 30% tax-exclusive rate. As previously noted, except as otherwise provided, all sales tax rates described in this paper are expressed as tax-exclusive rates because it is the typical way sales tax rates are understood. *See supra* note 56.

68. *See* TAX PANEL REPORT, *supra* note 6, at 217 box 9.2.

to the federal government when it taxes itself, and the resulting higher *revenue needs* of the federal government.[69] It is like persuading one's child that if she would only transfer the dollar in her left pocket to her right pocket, she will be a dollar better off and therefore won't need as large an allowance. It's a pretty good deal for the parent, but not so good for the child.[70]

Finally, the President's Tax Reform Panel also noted that the family cash grants would create the largest entitlement program in American history.[71] The program would initially cost at least $600 billion a year, and would be larger than either Social Security, Medicare, or Medicaid.[72] This piece of news should give pause to even the most ardent proponents of the FairTax.

A recent iteration of the FairTax proposal asserts that the promised tax rate of 23% could be achieved if enactment of the tax were combined with "a relatively modest 20% scale-back of non-Social Security real federal expenditures . . . ."[73] This condition is not contained in H.R. 25 and seems

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69. *See id.*; FAIRTAX, *supra* note 12, at 148 (noting that because federal government itself would be a major taxpayer, sales tax rate can be kept low), 78 (asserting that under the FairTax, government's costs would not increase as a result of paying sales tax); Gale, *supra* note 66, at 890, 893.

70. The same inconsistency is presented elsewhere in the FairTax book:

> Once the FairTax takes effect, you'll be receiving 100 percent of every paycheck, with no withholding of federal income taxes, Social Security taxes, or Medicare taxes—and you'll be paying just about the same price [inclusive of any sales tax due] for T-shirts and other consumer goods and services that you were paying before the FairTax.
>
> But there's something more: Under the FairTax Plan, you'll also be receiving a check every month from the federal government equal to the amount of sales tax you would spend on the basic necessities of life for that month.

FAIRTAX, *supra* note 12, at 59-60. Free lunch, anyone?

Note that the FairTax analysis also takes into account the tax received from state and local governments in estimating the required sales tax rate, but then similarly ignores the resulting effect of the tax on their budgets. Thus, if the proposal were enacted, either state and local governments would have to cut their other expenditures to accommodate this new tax paid to the federal government, or else they would need to raise their taxes by the amount of the new tax. In other words, the estimated sales tax rate under FairTax is kept "low" in part by shifting some of the responsibility for raising taxes or cutting spending to state and local governments.

71. *See* TAX PANEL REPORT, *supra* note 6, at 208.

72. *Id.* at 212. A program of this size is based on an assumed 34% sales tax rate. *Id.* A higher sales tax rate would require a larger grant program. Further, as noted below, a sales tax with this size grant program would still result in an increased tax burden on the middle class (and a reduced burden on those at the highest income levels). *Id.* at 213-14. To overcome that distributional change, an even larger grant program would be required. *See id.* at 214.

73. *See* Laurence J. Kotlikoff & David Rapson, *Comparing Average and Marginal Tax Rates Under the FairTax and the Current System of Federal Taxation* 3 (Apr. 2006),

to represent a concession that the rate promised in the Bill would be insufficient to make the tax proposal revenue neutral.[74] Moreover, it is inconsistent with the earlier assertion of FairTax proponents that the tax proposal holds the size of government constant.[75] A lot of tax proposals can be made to appear more attractive if they are paired with an assumed cutback in government expenditures. In addition, if the theory behind the modification is that the proposed family cash grants would substitute for the cutback in government spending, along the lines of a recent proposal offered by Charles Murray,[76] then the cash grants would seem to be doing double-duty. On the one hand, they would replace the 20% reduction in other government spending, and on the other hand, they would also offset the regressive nature of the sales tax. Those people who "lose out" in both ways—that is, those who suffer from the cutback in government spending and also have to pay higher taxes as a result of the national sales tax—may not find that the cash grants are adequate compensation for their losses. Finally, of course, it would be necessary to determine whether the proposed cutback in government spending would indeed be sufficient to support the promised tax rate, and what its distributional effect would be.[77]

To summarize, it is evident that any proposal requiring a sales tax rate and new entitlement program anywhere near the level and size described in this article will simply not be a feasible alternative to the current tax system. A few further points to consider are discussed below.

1. Impact on the middle class. As one might anticipate, the middle class would get squeezed under the FairTax. The size of the family cash grants could be adjusted to offset the effect of the tax on any desired range

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http://bakerinstitute.org/Pubs/conferences/2006_tax_003.pdf.

74. Larry Kotlikoff has criticized the Tax Reform Panel's rejection of the FairTax in part because the Panel was not able to "consider scaling back federal spending . . . to pay for the FairTax's rebate." Laurence J. Kotlikoff, *Grading the President's Tax Reform Panel's Plan*, ECONOMISTS' VOICE, Apr. 2006, at 1, 4, http://www.bepress.com/ev/vol3/iss6/art3 [hereinafter Kotlikoff, *Grading*]. Thus, the Panel "required the sales tax to generate more revenue than the FairTax stipulates." *Id.* Apparently, the claim is that non-Social Security spending, measured as a percentage of GDP, has risen by 20% since 2000 when the FairTax proposal was first developed and thus, the FairTax should not be "charged" with having to raise revenue for this new cost. *Id.* But there is nothing in H.R. 25 which conditions enactment of the tax based upon any particular level of government spending.

75. *See supra* note 16 and accompanying text.

76. *See* CHARLES MURRAY, IN OUR HANDS: A PLAN TO REPLACE THE WELFARE STATE (2006) (proposing to replace all income-transfer programs, including Social Security, Medicare, and Medicaid, with a $10,000/year payment to every American adult); Kotlikoff, *Grading*, *supra* note 74, at 4; Kotlikoff & Jokisch, *supra* note 66, at 3 (explaining that the FairTax reduction in non-Social Security expenditures pays for the FairTax cash grants).

77. The cash grants would generally be of equal amount to equal-sized families in the country, rich or poor. The government spending programs that would be reduced may not have the same distributional effect.

of lower-income households. But all households with consumption amounts greater than the tax-free amount covered by the cash grant would pay a flat rate of tax on their taxable consumption. Given the progressivity of the current tax system, enacting a revenue-neutral FairTax as a substitute would mean a reduction in the tax share of upper-income households relative to the tax share of middle-income households.[78] This problem could presumably be overcome by adjusting the size of the cash grant based on the income level of the household. For example, the Tax Reform Panel developed a "targeted" cash grant program which phases in and out the amount of the cash grant based on the income level of the household.[79] This program was estimated to cost $780 billion in 2006 and would require a sales tax rate of at least 37% (instead of the 34% estimate based on the assumptions of low evasion and a comprehensive sales tax base).[80] In addition to the larger cost of a targeted program, it would be much more difficult to administer than a program providing equal-size grants for households of equal size, particularly given the loss of the "income" metric with the repeal of the income tax system.[81]

2. Impact on state and local governments. The impact of the FairTax proposal on state and local governments would be quite complicated and significant. In general, the Bill anticipates that the states would carry out most of the activities necessary to administer the sales tax. For example, the "sales tax administering authority," which generally would be an agency of each state involved in the collection of the tax, would: receive tax filings and collect taxes from sellers and buyers who are liable for remitting the tax; have summons power, examination, and audit responsibility; have enforcement authority through the use of levies,

78. *See* TAX PANEL REPORT, *supra* note 6, at 213. According to the President's Tax Reform Panel, the FairTax proposal would on average reduce the share of taxes paid by households in the very lowest income category (cash income of $15,000 or less) and the very highest category ($200,000 or more), with households in all other income categories paying on average a greater share of taxes under the FairTax than under the Panel's baseline tax system. *See id.* at 213 fig. 9.4. Moreover, as previously noted, the Panel's baseline system is not the same as current law. *See supra* note 64 and accompanying text. Thus, relative to the distribution of taxes under current law, the FairTax proposal may be even more adverse to the middle class than is shown by the Panel's analysis.

79. *See* TAX PANEL REPORT, *supra* note 6, at 214.

80. *See id.* The 37% sales tax rate would only pay for the cash grants and repeal of the income tax. *Id.*

81. Without a useful measure of "income," it will be difficult to determine the "income levels" of households and hence the size of the cash grants to be received by them. *See* George K. Yin, *Accommodating the "Low-Income" in a Cash-Flow or Consumed Income Tax World*, 2 FLA. TAX REV. 445, 490 (1995). The distributional impact of a change to a retail sales tax may be less problematic if the effect is measured on a lifetime, rather than annual, basis. *See* Sullivan, *supra* note 11, at 920; David R. Burton & Dan R. Mastromarco, *The National Sales Tax: Moving Beyond the Idea*, 71 TAX NOTES 1237, 1243 (1996).

garnishment, and the filing of liens; and be responsible for setting up an administrative appeals process.[82] State involvement would be voluntary, with cooperating states receiving 0.25% of any taxes collected as their administrative fee.[83] The Bill sponsors, however, apparently expect enough states to participate in the administration of the tax to enable the IRS to go out of business. The Bill specifically denies any authorization of funds to the IRS after FY 2009, even for the administration and enforcement of income, payroll, and estate and gift taxes for years prior to their repeal, and generally requires the destruction at such time of all IRS records relating to such taxes.[84]

States that agree to collect the tax would have a certain amount of autonomy in administering the sales tax pursuant to an agreement made with the federal government. The Treasury Secretary, for example, would be barred from administering the tax within a cooperating state unless a federal court first determines that upon notice from the Treasury Secretary, the state has failed to cure repeated, material breaches of the underlying federal-state agreement, and that "it is in the best interest of the citizens of the United States that the [state's] authority to administer the [sales] tax . . . be revoked . . . ."[85] On the other hand, the Bill also provides that in the event inconsistent rules are provided by any of the states and the Treasury Secretary, the latter's rules shall prevail.[86] Taxpayers, thus, may be required to comply with inconsistent rules provided by each of the states (assuming those rules are not material breaches of the underlying federal-state agreement) unless and until the Treasury issues guidance which would control over any contrary state rule.

Judicial involvement in the process of settling disputes arising from the sales tax is unclear. Under current law, the usual route to U.S. Tax Court is through the issuance of a notice of a tax deficiency by the IRS to the taxpayer involved.[87] The Bill preserves the Code provisions relating to the issuance of a notice of deficiency and the availability of the Tax Court, but limits the application of these procedures only to tax deficiencies arising

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82. H.R. 25 (adding proposed new I.R.C. §§ 2(a)(10) (defining "sales tax administering authority"); 501(a) (detailing receipt of reports); 508(a) and (b) (authorizing summonses and examination and audit responsibility); 601 (setting forth collection of tax); 602(a) (giving power to levy, garnish, and file liens); and 604(a) (allowing for administrative appeal)). The sales tax administering authority also would have responsibility for preparing a document describing taxpayer rights "in plain English." *Id.* (adding proposed new I.R.C. § 605(a)). It is unclear how this last requirement would be monitored and enforced.

83. *Id.* (adding proposed new I.R.C. § 401(a), (b), (d)(2)).

84. *Id.* § 301(a), (b). The Bill authorizes creation of an excise tax bureau and a sales tax bureau within the Department of the Treasury. *Id.* § 302.

85. H.R. 25 (adding proposed new I.R.C. § 401(e)).

86. *Id.* (adding proposed new I.R.C. § 406(b)).

87. I.R.C. §§ 6211-6213 (2000).

from the asserted underpayment of federal *excise* taxes (which are not repealed).[88] Thus, it is unclear what judicial rights taxpayers might have upon exhausting their administrative appeals with respect to the *sales* tax. The Bill grants jurisdiction to each cooperating state for the taxable events relating to the sales tax occurring within that state, but also provides that such grant "shall not be in derogation of Federal jurisdiction over the same matter."[89] The federal government is provided the right to exercise "preemptive jurisdiction" over matters relating to the new sales tax.[90]

How all of this would play out for the states is anyone's guess. One important consideration is that five states currently do not have a general sales tax.[91] Thus, unless they change their fiscal policy in reaction to the new national sales tax, it presumably would not be cost-effective for those states to develop the capability to administer the federal tax, even if they were willing to do so. As a result, there will likely be some continuing need for a federal tax collection agency, whether labeled the "IRS" or something else, to administer the sales tax in at least a few states.[92]

A second point is that those states with general sales taxes do not have systems that conform to one another, and no state maintains a sales tax base anywhere near as comprehensive as the proposed FairTax sales tax base.[93] Once again, there may be changes among the states to conform their sales tax systems to the new federal system, but based on the income tax experience of federal and state governments, it seems highly unlikely that total conformity will ever be achieved.[94] Thus, it will not necessarily

88. H.R. 25 § 202(b)(3).

89. *Id.* (adding proposed new I.R.C. § 407).

90. *Id.*

91. The states are Alaska, Delaware, Montana, New Hampshire, and Oregon. CCH.com, Five States Without Sales Tax, http://www.toolkit.cch.com/pops/P99_07_4000_01.asp (last visited Oct. 10, 2006).

92. The Bill authorizes the Secretary of the Treasury to administer the sales tax where necessary. *See* H.R. 25 (adding proposed new I.R.C. § 404).

93. For a state-by-state comparison of key sales tax features, see HELLERSTEIN & HELLERSTEIN, *supra* note 49, at ¶¶ 12.02 tbls. 12.3–12.9, 12.05 tbl. 12.10. An effort was launched in 2000 to simplify and harmonize the state sales and use tax systems, and federal legislation has been introduced to facilitate the collection of sales and use tax from remote sellers in the event a sufficient amount of simplification and uniformity among state sales tax systems is achieved. *See id.* ¶ 19A.01[1] at 19A-6; Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (1st Sess. 2005).

94. *See 1995 W&M Hearings*, *supra* note 3, at 313 (statement of Sijbren Cnossen) (stating that successful merging of state and federal retail sales tax systems would require an "unprecedented consensus" on nationwide harmonization of the various sales tax bases). Those states with income tax systems that are modeled on the federal tax system make on average about forty modifications to the federal system, and there are a number of variations among the state systems to reflect local concerns. *See* Ralph B. Tower & Caroline M. Boyd, *Tax Base Modifications: The Hidden Barrier to Simplification*, 112 TAX NOTES 35, 36, 40 (2006).

be a simple matter for a state with a general sales tax to administer the new federal sales tax. Some goods and services will likely be taxable for one purpose but not the other, and other rules might vary. Likewise, assuming that a number of states do become involved in the administration of the federal tax, substantial coordination will be required to ensure equitable treatment of taxpayers in different states with respect to the federal tax. Federal tax administration will be necessary to carry out this monitoring and coordination function.[95]

Another effect on state and local governments relates to the administration of their income taxes. Currently, forty-three states and the District of Columbia have some form of an income tax, and many "piggyback" onto the federal system.[96] In addition, as of 1994, over 4,000 local jurisdictions imposed some type of income tax.[97] With repeal of the federal income tax, all of these jurisdictions will lose their ability to rely upon the federal system. Thus, repeal of the federal income tax may increase the tax administration costs of those jurisdictions that decide to retain their income tax. In addition, assuming that loss of the federal model results in greater nonconformity in the systems of the state and local jurisdictions that retain the tax, tax administration costs may also increase for those taxpayers who are subject to income tax in more than one

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95. *See* H.R. 25 (adding proposed new I.R.C. § 402(d) (authorizing Treasury regulations to assist states in administering the sales tax in a uniform fashion)). The federal sales tax should probably not present a uniformity clause problem even if the separate state administrations of the tax result in the tax being applied differently in the states. *See* Poe v. Seaborn, 282 U.S. 101, 117-18 (1930) (holding federal income tax was uniform despite different impact on taxpayers in community property and non-community property states); Florida v. Mellon, 273 U.S. 12, 17 (1927) (holding that the federal estate tax was uniform despite the different effect of federal credit for state inheritance taxes in states without an inheritance tax); John A. Miller, *State Administration of a National Sales Tax: A New Opportunity for Cooperative Federalism*, 9 VA. TAX REV. 243, 258-60 (1989). According to Professors Rotunda and Nowak:

> [T]he uniformity clause poses a very narrow restriction on Congress' power to impose indirect taxes. As long as Congress avoids drawing geographic boundaries along state political lines, a taxpayer probably will not succeed in challenging an indirect tax on uniformity grounds unless the taxpayer can prove that Congress specifically intended the tax to affect one or more states differently.

1 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 5.4, at 520 (3d ed. 1999).

96. Seven states have no state individual income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. *See* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 7. Two others, New Hampshire and Tennessee, tax only dividend and interest income. *Id.* All but five states with income tax systems model their systems on the federal system. *See* Tower & Boyd, *supra* note 94, at 42 n.8; *cf.* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 7 tbl. 1.

97. *See* 1 Advisory COMM'N ON INTERGOVERNMENTAL RELATIONS, SIGNIFICANT FEATURES OF FISCAL FEDERALISM: BUDGET PROCESSES AND TAX SYSTEMS 70 tbl. 20 (1995).

jurisdiction.[98] It is possible that some coordinating agency will be formed to provide and maintain a uniform or model set of income tax rules to be used and modified by the state and local jurisdictions. Perhaps this coordinating agency would bear the initials, IRS.

Finally, and potentially more important than these administrative issues, would be the direct financial consequences of the FairTax proposal on state and local governments. First, state and local governments may find it more difficult to raise and maintain sales tax revenue, a source of tax revenue traditionally reserved to them, after enactment of a national sales tax.[99] Second, as previously noted, H.R. 25 would require all governments, including state and local governments, to pay the new sales tax on all of their purchases of goods and services and all of the compensation they pay to their employees.[100] As a result, the new law will shift some of the responsibility for raising taxes (or cutting spending) from the federal government to state and local governments. Last, repeal of the income tax would eliminate several important ways in which the federal government currently subsidizes state and local governments, such as the tax exemption of interest income on state and local bonds and the deductibility by households of non-business-related state and local taxes.[101]

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98. *See* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 70-71; Bartlett, *supra* note 47, at 1000. For taxpayers who are subject to income tax in only one jurisdiction, the possible, continued existence of a state or local income tax after repeal of the federal income tax is a disquieting reminder that the simplification benefits of repeal may be minimal.

99. The income tax base, of course, would be wide open to state and local governments as a possible source of revenue. Those governments, however, may shy away from that source because of the administrative burden of maintaining their own income tax system.

100. *See supra* notes 39-40 and accompanying text.

101. *See* I.R.C. §§ 103(a), 164(a) (2000). The income of state and local governments derived from the exercise of any essential governmental function is also not taxed by the federal government. *Id.* § 115(1). In addition, the federal government has historically allowed estates to reduce dollar-for-dollar (up to certain limits) their federal estate tax liability by the amount of estate and inheritance taxes paid to the states. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 49, at 21-5. In response, states enacted "soak-up taxes" to make maximum use of this federal subsidy. *See id.* at 21-5, 21-52. The state death tax credit was repealed effective for the estates of decedents dying after 2004 and replaced by a deduction (the credit is presently scheduled to be revived for the estates of decedents dying after 2010). *See* I.R.C. § 2011(a), (b), (e) and (f). Because the amount of the estate tax levy in thirty-two states and the District of Columbia was tied to the amount of the federal credit, repeal of the credit meant repeal of the state taxes unless the state legislature took action to decouple the two amounts. Thus far, twenty-five states have allowed their estate and inheritance taxes to lapse as a result of this change in the federal treatment of those taxes. *See* CONG. BUDGET OFFICE, EFFECTS OF THE FEDERAL ESTATE TAX ON FARMS AND SMALL BUSINESSES 3 box 1 (2005). Assuming that the state death tax credit is not revived after 2010, the remaining states will face interstate competition to reduce or eliminate their estate and inheritance taxes. *See generally* Jeffrey A. Cooper, *Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective*, 33 PEPP. L. REV. 835 (2006).

3. Impact on cross-border transactions. H.R. 25 provides a destination-based sales tax, which means that the relevant taxable event is consumption within the United States rather than the U.S. production of the good or service being consumed.[102] Thus, consumption in the United States of a good produced abroad and imported into the United States is subject to the sales tax.[103] On the other hand, a good produced in the United States but sold and consumed abroad as part of an export sale is exempt from the tax.[104] The imposition of tax on imports and the exemption of tax on exports are commonly referred to as "border tax adjustments."[105]

A destination-based tax raises questions with respect to both export and import transactions. On the export side, it will be important to differentiate correctly between an exempt export sale and a taxable domestic sale. Similarly, the conversion of export goods or services to domestic use would be a taxable event.[106]

On the import side, the principal issue is collecting tax on goods acquired outside the United States but consumed domestically. Since tax collection responsibility cannot easily be extended to foreign sellers of goods, the Bill would require a purchaser to self-report and pay tax on goods acquired outside the United States but consumed within it.[107] This process is analogous to the collection of "use" taxes imposed by the states on the out-of-state purchase of goods used within the state, but as expected, compliance with the law and payment of those taxes is problematic.[108] Because H.R. 25 also taxes the consumption of a wide spectrum of services, this same issue would apply to foreign-purchased services consumed in the United States. It will be difficult both to identify the place of consumption of a service and to enforce an appropriate tax.[109]

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102. *See* TAX PANEL REPORT, *supra* note 6, at 167-68.

103. *See id.*

104. H.R. 25 (adding proposed new I.R.C. § 102(a)(1)(B)).

105. *See* TAX PANEL REPORT, *supra* note 6, at 168 (referring to tax on imports and the exemption of tax on exports as "border tax adjustments").

106. H.R. 25 (adding proposed new I.R.C. § 103(c)).

107. *Id.* (adding proposed new I.R.C. § 103(b)(1)).

108. *See* JCT-STATE AND LOCAL GOVERNMENTS, *supra* note 36, at 23-24; JCT-1995 PAMPHLET, *supra* note 27, at 47-48; DUE & MIKESELL, *supra* note 47, at 262-64, 275 (describing the use tax as the "weak link" in state sales tax administration although revenue loss may not be large). Because so many states maintain general sales taxes, the ineffectiveness of the use tax may not be a major problem since the state where use occurs ordinarily grants credit for sales taxes paid to the state where the purchase occurs. Even if the United States, upon enactment of a national sales tax, were to provide for a similar credit for foreign sales taxes paid, it is unlikely that many foreign countries will impose high enough sales or value-added taxes to reduce significantly the problem of out-of-country purchases. Moreover, the United States would still presumably want to ensure that it receives the proper share of any worldwide sales tax liability incurred by the consumer.

109. Consider a resident of Detroit, Michigan or Laredo, Texas who crosses a bridge and

According to reports, the difficulty of taxing out of state services used in Florida was an important cause of the demise of the Florida tax on services.[110]

The trade impact of H.R. 25 is unclear. In comparison to a no-tax world, the Bill should be trade-neutral since both exports and imports would be taxed in the same manner as other goods and services sold in the same market.[111] But to the extent the Bill in fact results in the imposition of sales tax on intermediate, business-to-business transactions, the Bill will not be trade-neutral since the border adjustments will affect only the tax levied at the final stage of production.[112] Moreover, the proper baseline for assessing the trade impact of the Bill should presumably be to current law rather than a no-tax world; thus, even a trade-neutral replacement will likely have trade implications, both overall and for specific industries.[113] One consequence is certain: If H.R. 25 is enacted, all tax treaties would need to be renegotiated.

4. Transition. A change from the current income tax to any consumption tax system raises an important transitional issue regarding the treatment of capital accumulated under the income tax but consumed under the consumption tax. Suppose a taxpayer earns $100 of income on

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obtains a haircut in Windsor, Ontario or Nuevo Laredo, Tamaulipas, respectively, and then returns to the United States. Should this person be treated as having consumed this service in the United States? If so, how would sales tax be collected?

Under the Bill, certain services, such as financial services, which are easily performed anywhere in the world, are deemed to be consumed within the United States if the person purchasing the services is a resident of the United States. H.R. 25 (adding proposed new I.R.C. § 806(a)).

110. *See* Hellerstein, *supra* note 31, at 15. The specific case that bedeviled Florida was the taxation of advertising services acquired by non-Florida taxpayers outside of the state but used to reach Florida consumers. *See id.* at 14.

111. Thus, a good produced in the United States but sold for consumption outside the United States would be free of the federal sales tax, like goods produced and sold outside the United States. A good produced outside the United States but imported and sold for consumption within the United States would be subject to the sales tax, like goods produced and sold within the United States. *Cf.* TAX PANEL REPORT, *supra* note 6, at 168; *1995 W&M Hearings*, *supra* note 3, at 236-37 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy). Currency adjustments may also offset trade effects.

112. For example, the federal sales tax on the U.S. consumption of imported goods would only be levied at the retail stage without any possibility of the tax having been erroneously levied at earlier stages of production. This tax result will be more favorable than the treatment of domestically produced goods on which cascading has occurred. Similarly, U.S. export sales would be exempt from federal sales tax at the retail stage but there would be no border adjustment for sales tax erroneously imposed at earlier stages. *See 1995 W&M Hearings*, *supra* note 3, at 311 (statement of Sijbren Cnossen); CHARLES E. MCLURE, JR., THE VALUE-ADDED TAX: KEY TO DEFICIT REDUCTION? 106 (1987) [hereinafter MCLURE, VAT].

113. *See 1995 W&M Hearings*, *supra* note 3, at 237 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy); MCLURE, VAT, *supra* note 112, at 40-42.

the very last day of year one and spends the money on personal consumption on the very next day, the first day of year two. If the current income tax applied to both years, the taxpayer would owe tax as a result of earning the income in year one, but there would be no further tax consequences to the consumption in year two. If a retail sales tax applied to both years, there would be no tax consequences to the income being earned in year one but the consumption in year two would be taxed. If, however, an income tax applied to year one and a retail sales tax applied to year two, the taxpayer would be taxed twice: upon earning the money in year one and then again upon consuming in year two what remains after paying the first year's tax. This treatment of the taxpayer is analogous to taking away all of the taxpayer's basis in any assets (including "basis" in cash) held by the taxpayer at the time the new consumption tax goes into effect.

This transitional issue obviously raises a question of fairness to the affected taxpayers. Floridians might be especially concerned since older taxpayers who have accumulated assets during their working years will be disproportionately affected. One can easily envision lawmakers being inclined to temper this effect by, for example, allowing taxpayers to consume tax-free from all or a portion of their accumulated capital at the time of the new tax system.[114]

Balanced against this fairness concern, however, is a critical efficiency consideration. The amount of "relief," if any, provided to taxpayers in the treatment of their accumulated capital under a national sales tax may be so important as to determine whether the switch to such a tax results in efficiency gain or loss.[115] In other words, if lawmakers are excessively generous in resolving this transitional issue, they may defeat one of the principal reasons to make the tax change in the first place.

To see why this may be so, consider a change from the current income tax to either a consumption tax like a national sales tax or a tax that applies only to wages or labor compensation. Both the sales tax and the wage tax are potentially efficiency enhancing as compared to the income tax, because unlike the income tax, both are neutral in the tax treatment of current versus future consumption. A sales tax and a wage tax differ, however, in their treatment of accumulated capital. As we have seen, a sales tax taxes accumulated capital (as well as future earnings thereon) when such amount is consumed. In contrast, a wage tax exempts the accumulated capital, as well as any future earnings thereon, from any

114. Resolution of this transitional issue will have important distributional consequences since any tax on accumulated capital will fall disproportionately on those with high income.

115. *See 1995 W&M Hearings*, *supra* note 3, at 235-36, 241-42 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy); Alan J. Auerbach, Tax Reform in the 21st Century 21 (May 6, 2006) (working paper), *available at* http://www.econ.berkeley.edu/~auerbach/.

future taxation. Thus, in contrast to an income tax (which taxes only the future earnings on accumulated capital when the income is earned and not the accumulation itself), the sales tax increases the burden of taxpayers with accumulated capital whereas the wage tax grants them a windfall. The fact that some analysts have found that a switch to a sales tax would produce efficiency gain whereas a switch to a wage tax would produce efficiency loss suggests how important this transitional issue may be.[116]

5. Intrusiveness of the tax. Finally, one goal often articulated by FairTax proponents is the desire to reduce the intrusiveness of taxation by, for example, transforming April 15 into just another beautiful spring day.[117] Yet the extremely broad breadth of H.R. 25, which, as drafted, probably includes many items that people do not even realize are taxable consumption, has the potential of converting *every* day into "tax" day, reminiscent of a ditty about an unpopular tax plan offered by former Treasury Secretary Andrew Mellon,[118] or perhaps a line from the Beatles'

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116. *See* ALAN J. AUERBACH & LAURENCE J. KOTLIKOFF, DYNAMIC FISCAL POLICY 78-81 (1987). The intuition is that the tax on accumulated capital is in the nature of an unavoidable "lump-sum" tax which does not distort the pre-tax choices of the taxpayer. Revenue raised by this tax can be used to reduce taxes that distort such choices, thereby producing overall efficiency gain. In contrast, by granting an unexpected windfall to taxpayers with accumulated capital, a wage tax does exactly the opposite. The windfall does not provide any positive incentives for the affected taxpayers yet must be paid for by higher other taxes which distort pre-tax choices. The efficiency of a tax on accumulated capital will depend in part upon whether it is expected to be repeated, the extent to which the tax is anticipated, and the distributional impact of the tax. *See* Louis Kaplow, *Capital Levies and Transition to a Consumption Tax* 2-5 (Nat'l Bureau of Econ. Research, Working Paper No. 12259, 2006).

117. *See* FAIRTAX, *supra* note 12, at 50.

118. The first two stanzas of the ditty are as follows:

Tax the people, tax with care,
Tax to help the millionaire;
Tax the farmer; tax his fowl;
Tax the dog and tax his howl;
Tax his hen and tax her egg;
And let the bloomin' mudsill beg.
Tax them just all you can,
This is, friends, the Mellon plan.

Tax his pig and tax his squeal,
Tax his boots, run down at heel;
Tax his horses, tax his lands,
Tax his blisters on his hands;
Tax him just all you can;
This is, friends, the Mellon plan.

65 CONG. REC. (Part 3) 2051, 3031 (1924) (remarks of Rep. William Lankford (D- Ga.)); *see* John Lee, *'Death and Taxes' and Hypocrisy*, 60 TAX NOTES 1393, 1394 (1993) (quoting "the ditty").

song, "Taxman."[119] Moreover, for many taxpayers, these daily tax obligations may be in addition to income tax filings that will still need to be made for state and local tax purposes.

II. CONSUMPTION TAX ALTERNATIVES TO A NATIONAL RETAIL SALES TAX: WHAT WAS CONGRESSMAN ARCHER'S OBJECTION TO THEM?

As shown in Part I, a key weakness of a retail sales tax is its focus on just one type of transaction—a retail sale of a good or service by a business to a household—as the single event prompting tax liability. This exclusive reliance upon retail sellers and consumers places practical constraints on both the base and rate of the tax. The difficulty differentiating between household and business purchasers at the retail level limits the extent to which services can be included in the tax base.[120] In addition, this difficulty, as well as concerns about potential noncompliance at the retail level, limit the practicable rate of tax. The experience in the states is instructive: No state sales tax system maintains a tax rate or base anywhere near as high or comprehensive as that posited by H.R. 25. Moreover, as we have seen, the tax rate that would be necessary to provide a revenue-neutral alternative to the current tax system is likely to be considerably higher than that provided by H.R. 25.

The proponents of the FairTax may be completely aware of this inherent limitation of a retail sales tax and may view it instead as a strength. They may believe that it places a natural check on the amount of tax revenue that can be raised by the federal government and, consequently, on the potential size of government. But if we take them at their word that deciding on the proper size of government is another fight for another day,[121] then it is plain that a national retail sales tax is not a viable alternative to the current tax system.

Because the production of most goods and services occurs in stages, it is possible to spread out the tax administration responsibility among a greater number of participants than simply retail sellers and consumers. A value-added tax (VAT) is structured to impose tax at every stage of the production process and offers certain pragmatic advantages over a retail sales tax.

The following example compares the tax consequences under a retail sales tax, a credit-invoice VAT, and a subtraction-method VAT. Assume that a particular good is produced in three stages with the business at the first, second, and third stage contributing value of $60, $40, and $20,

119. "If you drive a car, I'll tax the street / If you try to sit, I'll tax your seat / If you get too cold, I'll tax the heat / If you take a walk, I'll tax your feet." THE BEATLES LYRICS 102 (1975).

120. *See supra* note 49.

121. *See supra* note 16.

respectively, to the product for a final consumption value of $120 to a retail consumer. Table One depicts the tax consequences of this transaction under the three tax systems based on an assumed consumption tax rate of 30%.

Table One[122]

	A. Retail Sales Tax	B. Credit-Invoice VAT	C. Subtraction-Method VAT
1. Stage One Business			
a. purchase	-0-	-0-	-0-
b. sale to Stage Two business	60	60	60
c. tax on sale	-0-	18	-0-
d. value added	60	60	60
e. credit	-0-	-0-	-0-
f. net tax	-0-	18	18
2. Stage Two Business			
a. purchase from Stage One business	60	60	60
b. sale to Stage Three business	100	100	100
c. tax on sale	-0-	30	-0-
d. value added	40	40	40
e. credit	-0-	18	-0-
f. net tax	-0-	12	12
3. Stage Three Business			
a. purchase from Stage Two business	100	100	100
b. sale to Retail Consumer	120	120	120
c. tax on sale	36	36	-0-
d. value added	20	20	20
e. credit	-0-	30	-0-
f. net tax	36	6	6
4. Total tax (rows 1f + 2f + 3f)	36	36	36

For reasons explained in Part I, under a retail sales tax, no tax should theoretically be levied on the business-to-business transfers between the businesses at Stages One and Two and Stages Two and Three.[123] Instead, tax on the entire consumption value of $120 is levied only at the third (retail) stage even though only $20 of value is actually added at that stage.[124] The Stage Three retail business in this example must assess and remit a tax of $36 ($120 x 30%).[125]

122. All purchase and sale amounts listed are exclusive of the consumption tax.

123. *See supra* notes 26-27 and accompanying text; Table One, col. A, rows 1c and f, 2c and f.

124. Table One, col. A, row 3c.

125. Table One, col. A, rows 3c and f.

In contrast, under either a credit-invoice or subtraction-method VAT, all three businesses participate in the tax system. A credit-invoice VAT is sometimes viewed as imposing only a small amount of tax at each stage of the process, based on the value added at that stage, but that description is not technically correct. In fact, the tax levied at each stage is equal to the tax on the value added at that stage *and all earlier stages of production.* The business at each stage is then generally allowed a credit equal to the tax paid at earlier stages. As a result, the net after-credit tax remitted by each business is generally equal to the tax on the value added by that business.[126]

As shown in Table One, under a credit-invoice VAT, the Stage One business must assess and remit a tax of $18, representing 30% of its $60 sale to the Stage Two business.[127] There is no exemption for, and therefore no need to monitor the existence of, a business purchaser. The Stage One business must provide the Stage Two business with an invoice documenting the $18 of VAT paid at Stage One. The Stage Two business must, in turn, assess a tax of $30, representing 30% of its $100 sale to the Stage Three business.[128] Note that this $100 of taxable value represents the value added by *both* the Stage Two and Stage One businesses. The Stage Two business is then allowed an $18 credit equal to the tax previously levied at the first stage, representing the tax on the value added at Stage One. Thus, the $12 net amount of tax that must be remitted by the Stage Two business, as reflected in its sales and purchase documents (showing $30 of tax assessed and $18 of tax already paid), equals the tax on the value added by that business.[129] This same process is repeated at Stage Three.

It is important to note that under either a retail sales tax or a credit-invoice VAT, the same amount of tax of $36, representing the sales tax on the entire consumption value of the good, must be levied at the final (retail) stage.[130] Thus, to the extent there are practical constraints on the amount of tax that can be assessed at this last stage, both systems potentially face the same limitation.[131] On the other hand, because the *net* amount of tax (after credits) that must be remitted by the business at the final stage is less under a credit-invoice VAT than under a retail sales tax,

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126. In certain instances, an appropriate credit for taxes previously paid is not permitted, which results in an excessive amount of tax being paid. *See infra* note 134.

127. Table One, col. B, rows 1c and f.

128. Table One, col. B, row 2c.

129. Table One, col. B, rows 2e and f.

130. See Table One, cols. A and B, row 3c.

131. It is also for this reason that a credit-invoice VAT can be designed to be every bit as transparent as a retail sales tax, contrary to the concerns of FairTax proponents. *Compare* FAIRTAX, *supra* note 12, at 153-54, *with* George R. Zodrow, *The Sales Tax, the VAT, and Taxes in Between—or, Is the Only Good NRST a "VAT in Drag"?*, 52 NAT'L TAX J. 429, 434-35 (1999).

there is less concern about potential noncompliance under the former system and therefore perhaps less constraint on the permissible tax rate. If, for example, the retail business at Stage Three successfully evades its tax responsibilities, the loss of tax revenue would be $36 under a retail sales tax but only $6 under a credit-invoice VAT.[132] By levying tax repeatedly on the same value added, and then granting credit for duplicate taxes previously imposed, a credit-invoice VAT provides a more secure source of revenue than a retail sales tax.[133]

Another key difference between a retail sales tax and a credit-invoice VAT is that the latter eliminates the need to monitor and exclude business-to-business transactions. One can think of any tax paid on a business-to-business transaction under a credit-invoice VAT as simply a prepayment of the tax that would otherwise be due upon the final retail sale to a household, with the prepayment thereby reducing the net amount of tax that must be remitted by the retailer. This feature is an important advantage over a retail sales tax, as the elimination of possible cascading allows the VAT to apply to a more comprehensive base.[134]

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132. *See* Table One, cols. A and B, row 3f. This assumes that the Stage Three retailer who fails to report the retail sale does not also claim credit for taxes paid at prior stages of production. If credit is successfully claimed (even though the retail sale is not reported), then the revenue loss in this example under a credit-invoice VAT would also be $36. Table One, col. B, rows 3e and f. The claiming of the credit, however, may attract attention to the unreported retail sale; in contrast, a retail sales tax provides no comparable check to potential noncompliance by the retail business. *See* Zodrow, *supra* note 131, at 433.

133. A credit-invoice VAT nevertheless faces its own enforcement challenges. One common scheme is for a business at the initial or an intermediate stage of production to provide an invoice documenting the amount of VAT paid by a business at the next stage (thereby entitling the later-stage business to a credit for VAT previously paid) and then to disappear before the tax authorities receive the tax purportedly assessed. *See* NATIONAL AUDIT OFFICE, REPORT BY THE COMPTROLLER AND AUDITOR GENERAL, TACKLING VAT FRAUD 25-26 (2004), *available at* http://www.nap.org.uk/publications/nao_reports/03-04/0304357.pdf (prepared for House of Commons). The business providing the invoice may or may not be real. *See id.* A credit-invoice VAT also requires a refund mechanism for businesses entitled to credits in excess of any taxes assessed. Export businesses whose sales are taxed at a zero rate (consistent with the destination principle) are most typically in a refund posture. The VAT refund process used abroad has been characterized as the "Achilles heel" of VAT systems. *See* Graham Harrison and Russell Krelove, *VAT Refunds: A Review of Country Experience* (Int'l Monetary Fund, Working Paper No. WP/05/218, 2005), *available at* http://www.imf.org/external/pubs/ft/wp/2005/wp05218.pdf. Because a retail sales tax is not designed to assess tax prior to the retail level, it has no theoretical need for any refund mechanism.

134. *See* Cnossen, *supra* note 49, at 596-98. Cascading may occur under a credit-invoice VAT if an intermediate participant in the line of production of a good or service is not part of the tax system. For example, in the transaction illustrated by Table One, suppose a policy decision is made to allow the business at Stage Two to be excluded from the tax system, perhaps because it is a "small business." Thus, no tax would be assessed upon the sale of the item between the businesses at Stages Two and Three, and the Stage Two business would not need to remit any tax. Unfortunately, this also means that neither the Stage Two business (because it would be outside the tax system) nor the Stage Three business (because no tax would have been assessed on sale to the

Like a retail sales tax, however, a credit-invoice VAT cannot easily be adjusted so that the amount of tax imposed is sensitive to the ability to pay or other relevant personal characteristics of the household making the purchase. Providing a tax exemption for the purchase of "necessary" goods and services is a crude way to achieve distributional goals for the tax system, and also greatly complicates the system.[135]

A subtraction-method VAT taxes each business directly on its value added to goods and services produced over a particular period.[136] It dispenses altogether with the point of sale being the event where tax liability is assessed.[137] Rather, value added and tax liability are each determined based on the difference between what a business receives for its outputs and what it pays for its inputs during the period being reported.[138] For example, if the transactions illustrated in Table One are assumed to be the only sales and purchases of the three businesses during a reporting period, then each business would have to report and pay tax on its value added of $60, $40, and $20, respectively, for the period.[139] Unlike a credit-invoice VAT, there is no repeated levying of tax at each stage of production on the same value added, nor a credit system to eliminate the duplicative taxation.

A subtraction-method VAT differs from a credit-invoice VAT in two significant ways.[140] First, because it does not levy duplicative taxes on the

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Stage Three business) would be able to claim credit for taxes previously assessed at Stage One. Thus, upon sale of the good to a household, the Stage Three business would have to assess and remit tax of $36, unreduced by any credits. *See* Table One, col. B, row 3c. To some extent, this tax would duplicate the $18 of tax assessed and remitted by the Stage One business. *See* Table One, col. B, rows 1c and f. It is for this reason that if some special dispensation needs to be made to a business, it is generally preferable to include the business in the tax system but to allow its sales to be taxed at a zero rate of tax. This would potentially allow the zero-rated business to claim credit for and refund of the taxes previously assessed and remitted by the business at the previous stage. *See* MCLURE, VAT, *supra* note 112, at 72-75. The disadvantage is that the zero-rated business would still be "part of the tax system," at least to the extent of having to claim credits and refunds and maintain sufficient records to support such claims.

135. *See* 3 OFFICE OF THE SEC'Y, DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECON. GROWTH 92-100 (1984); *1995 W&M Hearings*, supra note 3, at 224, 261 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy); MCLURE, VAT, *supra* note 112, at 35; Sijbren Cnossen, *Consumption Taxes and International Competitiveness: The OECD Experience*, 52 TAX NOTES 1211, 1215-16 (1991).

136. *See* TAX PANEL REPORT, *supra* note 6, at 163 box 7.3.

137. *See id.*

138. *See id.*

139. The Stage One business would report total sales of $60 and total purchases of $0, for value added during the period of $60 and tax liability of $18 (30% x $60). The other businesses would determine their tax liability in the same way. Table One, col. C, rows 1a, b, d, and f, rows 2a, b, d, and f, and rows 3a, b, d, and f.

140. In addition to the issues mentioned in the text, a subtraction-method VAT without any household component would likely be less transparent than either a credit-invoice VAT or a retail

same value added which are then reduced by credits, a subtraction-method VAT does not provide as secure a source of revenue as a credit-invoice VAT. In the example illustrated in Table One, suppose no tax is assessed for whatever reason on the sale of the item by the Stage One business to the Stage Two business.[141] Under a credit-invoice VAT, this would mean that the $30 of tax levied by the Stage Two business upon sale of the item to the Stage Three business (which, again, represents the tax on the value added by both the Stage One and Two businesses) would have to be remitted by the Stage Two business, without reduction (as a result of a credit) for taxes previously paid.[142] Thus, the total amount of tax paid in this transaction would not be changed despite the failure to assess tax at the first stage.[143] In contrast, under a subtraction-method VAT, the failure by the Stage One business to pay tax on its value added would reduce the total amount of tax collected. In computing their value added, the Stage Two and Three businesses could continue to deduct their $60 and $100 cost of inputs, respectively, without regard to whether tax was paid on the value added represented by that cost. Thus, under a subtraction-method VAT, tax of $12 and $6 would be remitted by the Stage Two and Three businesses, respectively, for total tax collected of only $18. The $18 tax on the value added by the Stage One business would be lost.[144]

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sales tax. *See* MCLURE, VAT, *supra* note 112, at 85-86.

141. The reason might be noncompliance, but it also might be because the Stage One seller is not a business at all, but a household not required to assess and remit tax.

142. Table One, col. B, row 2c. The Stage Three retail business would still assess a $36 tax upon sale of the good to a consumer, claim credit for the $30 tax already assessed at Stage Two, and therefore remit only $6 of tax.

143. Tax of $30 and $6 would be remitted by the Stage Two and Three businesses, respectively, for total tax collected of $36. The Stage One seller might provide the Stage Two business with a bogus invoice documenting tax paid, which invoice could be used by the Stage Two business to reduce the amount of tax it must remit to the tax authorities. The existence of this invoice, however, would expose the Stage One participant to some risk if no tax is ever remitted by that participant.

144. David Weisbach describes this feature of a subtraction-method VAT as "openness." *See* David A. Weisbach, *Ironing Out the Flat Tax*, 52 STAN. L. REV. 599, 613 (2000) [hereinafter Weisbach, *Flat Tax*]. In contrast, a "closed" system, like a credit-invoice VAT, conditions the availability of a tax benefit to one business, such as a tax credit, on the payment of taxes by some other business at an earlier stage of the production. *Id.* He explains that the practical difference between a "closed" and "open" consumption tax is that the former can better protect the potential transitional tax upon consumption of accumulated capital. *Id.* at 614; *see also* MCLURE, VAT, *supra* note 112, at 75 (describing the "naïve" version of a subtraction-method VAT). The trade-off is that, as previously noted, a closed system can result in cascading where an intermediate participant in the line of production is not part of the tax system. *See supra* note 134. An open system does not contain the same problem. If the Stage Two business were outside the tax system, the Stage One business would still report $60 of value added and pay a tax of $18 under a subtraction-method VAT and the Stage Three business would report $20 of value added and pay a tax of $6. Table One, col. C, rows 1f and 3f.

Although this difference is important, it is not an inevitable distinction. The design of a subtraction-method VAT might be modified to provide a similar level of security as a credit-invoice VAT.[145] More importantly for purposes of the present discussion, either form of VAT would provide a more secure source of revenue and better address the problem of cascading than a retail sales tax.[146]

The other major difference is that a subtraction-method VAT offers a more flexible structure than a credit-invoice VAT (or a retail sales tax). In particular, as shown by Robert Hall and Alvin Rabushka[147] and later further developed by David Bradford,[148] a subtraction-method VAT can be easily modified to address distributional concerns. The key is to allow businesses to deduct the cost of their compensation for labor, as well as the cost of any inputs, and then to require households to pay tax on such labor compensation. Assuming that businesses and households are taxed at the same rate, then aside from administrative and compliance differences, this change should not affect the nature of the tax base or the amount of revenue raised by the tax. But with this design change, the distributional consequences of the tax system can then be controlled to some extent by permitting households to receive some labor compensation which is exempt from tax and taxing any remaining amount at progressive rates.[149] The Hall-Rabushka "flat tax" would provide an exemption amount and impose a flat rate of tax on household compensation in excess of the exemption, whereas the Bradford "X-Tax" variation would provide for

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145. For example, some degree of invoices might be required to support the amount of the deduction claimed for the cost of inputs under a subtraction-method VAT, and the system might be designed on a destination rather than origin basis.

146. Because each type of VAT collects the tax in stages, noncompliance generally places at risk only the portion of the tax due at a particular stage. In addition, each type of VAT permits some cross-checking of records across businesses that would be unavailable under a retail sales tax. Finally, neither VAT would require a seller to determine whether a purchaser is a household or a business. *See* TAX PANEL REPORT, *supra* note 6, at 205 box 8.5 (comparing generally the VAT and the retail sales tax); *cf.* LIAM EBRILL ET AL., THE MODERN VAT 23 (2001); MCLURE, VAT, *supra* note 112, at 103-07 (discussing the advantages and disadvantages of the VAT and retail sales tax).

147. HALL & RABUSHKA, *supra* note 45; Robert E. Hall & Alvin Rabushka, *The Flat Tax: A Simple, Progressive Consumption Tax*, *in* FRONTIERS OF TAX REFORM, *supra* note 4, at 27.

148. DAVID F. BRADFORD, THE X TAX IN THE WORLD ECONOMY: GOING GLOBAL WITH A SIMPLE, PROGRESSIVE TAX 2-5 (2004) [hereinafter BRADFORD, WORLD ECONOMY]; DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 76-82 (1986) [hereinafter BRADFORD, UNTANGLING] David F. Bradford, *What Are Consumption Taxes and Who Pays Them?*, 39 TAX NOTES 383, 384-85 (1988) [hereinafter Bradford, *What Are Consumption Taxes?*].

149. Once again, the distinction on this point between a credit-invoice and subtraction-method VAT is not inevitable. To address distributional concerns in the same way under a credit-invoice VAT, it would be possible to add a progressive wage tax to the VAT and to allow businesses to claim some level of credit for their wages. *See* David A. Weisbach, *Does the X-Tax Mark the Spot?*, 56 SMU L. REV. 201, 226-30 (2003) [hereinafter Weisbach, *X-Tax*]. The same option is not easily available under a retail sales tax since non-retail businesses are generally outside of the tax system.

progressive rates.[150]

In summary, a subtraction-method VAT, as modified by either Hall-Rabushka or Bradford, offers several advantages over a retail sales tax. It would provide a more secure source of revenue than a retail sales tax and could more easily apply to the comprehensive consumption of goods and services by generally avoiding the problem of cascading. Both advantages would reduce the necessary revenue-neutral rate for the subtraction-method VAT. In addition, it would be flexible enough to address most distributional concerns. Although many challenging questions remain, either version of a subtraction-method VAT provides a viable structural framework within which a broad-based consumption tax replacement of the current income tax could be designed.[151]

With this brief background, let us return to Congressman Archer. Despite his determination to replace the income tax with a broad-based consumption tax, Archer effectively blocked the most likely vehicle to achieve that end by opposing House Majority Leader Dick Armey's proposal of the Hall-Rabushka flat tax.[152] As Archer speculated after retiring from Congress, President Clinton would probably have vetoed any flat tax proposal coming from Congress and Congress might not have been able to override that veto.[153] Still, that sequence of events would have

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150. *See supra* notes 147-48. The subtraction-method VAT is also flexible at the business level as the cost of inputs could be deducted incrementally rather than immediately expensed. *See* BRADFORD, WORLD ECONOMY, *supra* note 148, at 28-30; David F. Bradford, *Transition to and Tax Rate Flexibility in a Cash-Flow Type Tax, in* TAX POLICY AND THE ECONOMY 151, 157-59 (James M. Poterba ed., 1998). The granting of a credit under a credit-invoice VAT is the equivalent to a requirement of expensing.

151. One of the recommendations of President Bush's Tax Reform Panel is to replace the income tax with a "Growth and Investment Tax Plan," which is a modified version of a subtraction-method VAT. *See* TAX REFORM PANEL, *supra* note 6, at 151-90. For some recent analysis of implementation issues raised by either a Hall-Rabushka or Bradford version of a subtraction-method VAT, see Joseph Bankman & Michael Schler, *Tax Planning Under the Flat Tax/X-Tax* (Sept. 12, 2005) (describing tax planning and tax avoidance possibilities under a flat tax or an X-tax), *available at* http://www.americantaxpolicyinstitute.org/pdf/FallConference2005/NYCorp_2532993_3.pdf; Daniel Shaviro, *Replacing the Income Tax with a Progressive Consumption Tax*, 103 TAX NOTES 91 (2004) (describing issues under the X-tax); Weisbach, *X-Tax*, *supra* note 149 (same); Weisbach, *Flat Tax*, *supra* note 144 (describing issues under the flat tax). Daniel Shaviro has recently extended this analysis by considering potential political compromises that might be made if the Bradford X-Tax were enacted. Daniel Shaviro, Simplifying Assumptions: How Might the Politics of Consumption Tax Reform Affect (Impair) the End Product? (Apr. 11, 2006) (unpublished manuscript, *available at* http://bakerinstitute.org/Pubs/conference/2006_tax_008.pdf). For an earlier discussion of the feasibility of a subtraction-method VAT as modified to take into account distributional concerns, see Charles E. McLure, Jr., *The 1986 Act: Tax Reform's Finest Hour or Death Throes of the Income Tax?*, 41 NAT'L TAX J. 303, 309-13 (1988) [hereinafter McLure, *1986 Act*] (discussing the "Simplified Alternative Tax").

152. *See supra* note 5 and accompanying text.

153. *See* Stamper, *supra* note 1, at 651.

represented much more progress toward his goal than what Archer in fact was able to achieve. Why, then, was he so opposed to the Armey proposal?

One possible explanation is that he was confused about the nature of the proposal, which he continually referred to as an "income tax."[154] Although the term "flat tax" *could* refer to an income tax—the flatness of a tax rate structure of course does not signify anything specific about the nature of the tax base that would be subject to the tax—it is clear that the Armey proposal was a consumption tax. Indeed, as we have seen, the design of the Hall-Rabushka flat tax is intended to reach the same basic tax base as a subtraction-method VAT and a retail sales tax.[155] Labels aside, any of those taxes could have achieved Archer's policy objective to have the replacement tax system "[g]ive the greatest possible incentive to savings."[156]

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154. *See 1995 W&M Hearings*, *supra* note 3, at 92 (referring to the proposal as a "flat income tax"), 553 (indicating that the flat tax "still is income-based"), 588 ("I . . . have not completely decided what form of consumption tax I believe would be the best, but I do worry that those who wish to continue some form of the income tax, albeit restructured, perhaps with a reduced rate, whether you call it flat or semiflat or whatever else, is simply déjà vu."); *see also* Archer, *supra* note 4, at 5-7 (contrasting a "flat tax" from a "consumption tax" and attributing income tax characteristics to the flat tax).

155. *See 1995 W&M Hearings*, *supra* note 3, at 511 (statement of Rep. Dick Armey), 593 (testimony of Robert E. Hall); JCT-1995 PAMPHLET, *supra* note 27, at 31 n.40, 33-34; Hall & Rabushka, *in* FRONTIERS OF TAX REFORM, *supra* note 4, at 29-30. The key difference is that the exemption amount in the flat tax provides in effect a tax exemption for a minimum amount of household consumption.

156. *See* Archer, *supra* note 4, at 4. To be sure, experts sometimes refer to consumption taxes as "income taxes." *See* HALL & RABUSHKA, *supra* note 45, at 52, 54, 63, 71 (describing their flat tax proposal as, alternatively, a tax on a "comprehensive definition of income," a tax "operat[ing] on the consumption tax principle," and "precisely a consumption tax"); *cf.* Lawrence Zelenak, *Radical Tax Reform, The Constitution, and the Conscientious Legislator*, 99 COLUM. L. REV. 833, 850-54 (1999). For example, in a very brief exchange with David Bradford that unfortunately occurred just prior to Bradford's required departure from a Ways and Means Committee hearing, Archer asked whether the Hall-Rabushka flat tax proposal is "just a modified way to tax income" and Bradford responded "[y]es" without further elaboration. *1995 W&M Hearings*, *supra* note 3, at 91. Bradford, of course, fully understood the consumption tax nature of the flat tax; in his written submission, he explicitly referred to the flat tax, along with a retail sales tax and a VAT, as "shift[ing] the U.S. tax system to a consumption base." *Id.* at 80; *see also* Bradford, *What Are Consumption Taxes?*, *supra* note 56, at 385. What Bradford may have been trying to convey is that a consumption tax *is* a "modified way to tax income" since all income is either consumed (and taxed under a consumption tax), saved for later consumption (and taxed at that later time under a consumption tax), or given away (and taxed under a consumption tax at the time of the donee's consumption). Thus, a consumption tax can be thought of as taxing income by focusing on the *uses* of income, whereas an income tax typically taxes income by focusing on the *sources* of income. *See* BRADFORD, UNTANGLING, *supra* note 148, at 15-21. But of course, in this same way, the retail sales tax supported by Archer is also "just a modified way to tax income," and I suspect Bradford would also have responded in the affirmative had Archer's question been directed to that tax. More

Alternatively, Archer may have thought that one or more of his other key tax policy objectives would not be satisfied by the Armey proposal. In addition to desiring a tax system that would treat savings more favorably, Archer indicated that any viable replacement tax system would have to be more successful than the income tax in reaching the underground economy, helping to promote U.S. trade competitiveness, and "get[ting] the IRS completely out of our individual lives."[157] As to the first two goals, it is not clear that there is much difference between a retail sales tax and the Armey proposal. Indeed, as noted, a retail sales tax is generally viewed as more vulnerable to noncompliance than a VAT. In addition, although there is a technical argument that a destination-based flat tax or subtraction-method VAT might not be permissible under existing trade laws, most economists do not believe the destination- or origin-based nature of a tax system has any significant effect on trade.[158]

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importantly, from the standpoint of Archer's policy objective to enact a broad-based consumption tax that would increase savings incentives, there was no reason for him to distinguish between a retail sales tax and the Hall-Rabushka flat tax.

Any lingering confusion should have been clarified by the following colloquy between Archer and Les Samuels, Assistant Treasury Secretary for Tax Policy, that occurred later at the same hearing:

> Chairman Archer: . . . I will say that we are not just considering consumption taxes. We are considering a flat tax. The proposal that Congressman Armey has made . . . .
>
> Mr. Samuels: . . . I would add, the Armey flat tax proposal is a consumption tax. When you talk to the economists through your hearings, if you ask them, they will tell you it is a consumption tax proposal.

1995 W&M Hearings, *supra* note 3, at 246.

157. *See 1995 W&M Hearings*, *supra* note 3, at 4-5; Archer, *supra* note 4, at 3-4.

158. *See Tax Reform: Hearing Before the H. Comm. on Ways and Means*, 109th Cong., 14-15, 49 (2005) (statement of Alan Auerbach); *1995 W&M Hearings*, *supra* note 3, at 236-37 (statement of Leslie Samuels, Assistant Treasury Secretary for Tax Policy), 616-17 (testimony of Robert E. Hall); STAFF OF J. COMM. ON TAXATION, 104TH CONG., IMPACT ON INTERNATIONAL COMPETITIVENESS OF REPLACING THE FEDERAL INCOME TAX 95-98 (Comm. Print 1996); JCT-1995 PAMPHLET, *supra* note 27, at 68-71; Martin Feldstein & Paul Krugman, *International Trade Effects of Value-Added Taxation*, *in* TAXATION IN THE GLOBAL ECONOMY 263 (Assaf Razin & Joel Slemrod, eds., 1990); MCLURE, VAT, *supra* note 112, at 39-42. Archer sharply criticized the trade impact of the flat tax because of his view that the tax "can[not] be removed from the price of our products at the border . . . . [and] [c]an[not] . . . be charged to incoming foreign products so that they pay a fair share of the cost of our government." Archer, *supra* note 4, at 6; *see also 1995 W&M Hearings*, *supra* note 3, at 245 (explaining that under the "Archer rule of common sense," a border-adjustable consumption tax will have a positive effect on trade because "if you can remove the price of government as an expense of a product and thereby reduce its price in the world marketplace, you are going to sell more American products, which in turn is going to give you a lower trade deficit . . . ."). Archer's criticism of a flat tax may be further evidence of his confusing

A flat tax would certainly require the continued presence of a tax agency, like the IRS, to administer the tax, as both businesses and households under a flat tax would have tax reporting responsibilities.[159] In that regard, it would be different from a retail sales tax, which would require tax filings by retail businesses but relieve most households of that duty.[160] But under a pure form of a flat tax, the reporting requirement by households would not be particularly onerous. Households would need to report only the amount of their compensation income, typically one of the easier determinations of an income tax, and pay tax on that income at a flat rate.[161]

Archer recognized the importance of addressing the potentially regressive impact of any replacement tax system.[162] But there are only a limited number of ways of accomplishing that policy objective. One possibility, as illustrated by the flat tax, is to build an exemption amount into the tax system. Another possibility, as illustrated by H.R. 25, is to provide a rebate system after the tax has been collected. Both techniques, however, require some type of filing by households.[163] Indeed, it is not

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it with an income tax, which is typically implemented on an origin basis without the border adjustments he described. Or it may reflect his sensitivity to a possible trade law challenge to a flat tax implemented with border adjustments. It is plain that although the Hall-Rabushka proposal was for an origin-based system without border adjustments, *see* HALL & RABUSHKA, *supra* note 45, at 76, the flat tax *can* be implemented on a destination basis, with the proceeds of export sales being excluded from business receipts and no deduction being allowed to business for the cost of imports. *Cf.* TAX PANEL REPORT, *supra* note 6, at 167-68 (recommending that the "Growth and Investment Tax Plan," a modified form of the flat tax, be implemented on a destination basis). More importantly, as noted, the existence of border adjustments is not generally viewed as having any significant trade impact.

159. According to Rep. Tauzin (R-La.), a supporter of a national retail sales tax, the existence of continued tax reporting by households under the flat tax meant that it would "still [be] an income tax." *1995 W&M Hearings*, *supra* note 3, at 574.

160. Some households would need to self-report their consumption transactions, such as goods and services purchased outside the United States but consumed (or deemed consumed) within it. Also, many businesses not ordinarily considered "retail businesses" would likely have some tax reporting responsibilities due to some retail transactions.

161. The pure form of a flat tax is often described as requiring tax filings by households that could fit on a postcard. *See* HALL & RABUSHKA, *supra* note 45, at 58-60. While that assertion is an exaggeration, most household filings would be considerably simpler under a pure flat tax than under the current income tax system. In addition, a flat rate structure would simplify or eliminate certain issues present under current law.

162. *See 1995 W&M Hearings*, *supra* note 3, at 589; Archer, *supra* note 4, at 9.

163. A third method, permitting the purchase of certain "necessities" to be tax exempt, would avoid a household filing requirement, but, as previously noted, this method is generally a crude and inefficient way to achieve distributional goals. *See supra* note 135 and accompanying text. A recent proposal would provide eligible low-income persons with "smart" cards which would allow them to make sales tax exempt purchases at the point of sale. *See* Richard Thompson Ainsworth, Biometrics: Solving the Regressivity of VATs and RSTs with "Smart Card" Technology, (Boston Univ. School of Law, Law and Economics Working Paper No. 06-20, 2006), *available at* http://www.bu.edu/ law/faculty/

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clear that the household-level reporting required by a pure flat tax would be much more difficult than the required annual filing under H.R. 25 to qualify for the family cash grants. From the tax administrator's standpoint, administering the household tax under a pure flat tax might actually be simpler than administering the cash grants.[164]

But this would be true only if the purity of the flat tax system were preserved. At bottom, Archer's reservation about a flat tax may have been due to skepticism that he and his colleagues (and their successors) would be able to keep their hands off of the system, and let it remain pure. Quite clearly, a flat tax would retain the basic structure of an income tax, with business and household tax filings, and Archer may have believed that political exigencies would inevitably intrude to make the new system no different than current law.[165] Thus, Archer may have viewed the flexibility of a subtraction-method VAT as a vice, and not a virtue.[166]

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scholarship/workingpapers/documents/AinsworthR080706.pdf. The proposal thus would attempt to overcome the crude nature of current tax exemptions for "necessities" that are universally available to all consumers. Assuming that this technology can be made widely available to eligible consumers and businesses, there would still need to be some sort of filing by the consumer to establish eligibility for use of the card. Moreover, if eligibility status is affected by the composition of the consumer's family or household and the consumer's marital status and income level, there would need to be periodic updates of such status to ensure the cards are not used improperly. In addition, there would remain the practical problem of establishing the income levels of persons in a world without an income tax. Finally, there may be concern that any effort to monitor and prevent the erroneous use of such cards would likely arise only after the card has been used and the tax benefit obtained, and therefore would be ineffective.

164. As under current law, a tax administrator could rely upon the help of employers to administer the household tax under a pure flat tax. Indeed, many households might be relieved of any filing requirement altogether through the use of withholding and a return-free system, which would seem feasible for many households under a pure flat tax. It might be more difficult to have employers or others in the private sector assist with the distribution of the cash grants.

165. Archer criticized the flat tax as "leav[ing] the roots of the income tax in the ground" and asserted that "it will only be a matter of a few years before the flat tax begins to grow into the type of [income tax] that we have today on the books." Archer, *supra* note 4, at 7; *see also The Impact on Individuals and Families of Replacing the Federal Income Tax: Hearings Before the H. Comm. on Ways and Means*, 105th Cong. 12-13 (1997) (supporting the position that a pure flat tax not be "dolled up" with additional deductions and other modifications); *1995 W&M Hearings*, *supra* note 3, at 588 (stating that "[w]e know what human nature does to that kind of a system" (referring to a flat tax)).

166. At the 1995 Ways and Means hearing on proposals to replace the income tax, Congressman Bill Thomas (R-Cal.) wryly noted that the erosion process had already begun with respect to the household tax portion of a flat tax proposal sponsored by Sen. Arlen Specter (R-Pa.) which permitted limited household deductions for home mortgage interest and charitable contributions. *See 1995 W&M Hearing*, *supra* note 3, at 477-78, 489-91. Other witnesses observed that the business tax portion of a flat tax is also susceptible to political compromise and complication. *Id.* at 306-08 (testimony of Sijbren Cnossen), 329-30 (testimony of Alan Schenk). One of President Bush's Tax Reform Panel's recommendations is a modified flat tax proposal which reflects additional, politically motivated compromises. *See* TAX PANEL REPORT, *supra* note

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What is odd about this possible explanation is not that Archer, as a knowledgeable and experienced legislator, would have developed a healthy skepticism about the quality of the product generated by the legislative process.[167] Rather, it is surprising that if this were his underlying concern, he did not appreciate its equal applicability to enactment of a national retail sales tax or any other alternative tax system. For example, experience has amply demonstrated the many compromises wrought by the political system upon enactment of a retail sales tax or a credit-invoice VAT.[168] In addition, politically inspired legislators might surely be expected to modify and complicate the family cash grants that are part of H.R. 25 to carry out many possible policy objectives. Finally, the relative inflexibility of a retail sales tax, even with the family cash grants, and its inability to raise large amounts of revenue, would not necessarily constrain a politically driven legislature. Any number of additional tax and subsidy provisions might be enacted to overcome the perceived "inadequacies" of a retail sales tax.[169]

6, at 151-90 (regarding the recommended "Growth and Investment Tax Plan" with a progressive rate household tax on labor income, special household tax provisions for health insurance, home mortgage interest, and charitable contributions, and a tax on certain household capital income).

167. The members of Congress have on occasion created rules and procedures, such as those relating to the Congressional Budget Act, that in effect tie their own hands because of their perception that, if left more free, they would be unable to produce desired legislative outcomes. *See infra* note 217 and accompanying text.

168. For an overview of the type of sales tax exemptions commonly found in the states, see HELLERSTEIN & HELLERSTEIN, *supra* note 49, at ¶¶ 12.04, 12.05, 13.01 – .10. Some exemptions are structural parts of the tax in an effort to exclude transactions such as business purchases, but other exemptions are more a product of political exigencies. For an overview of typical exemptions and special rules and rates included in VAT systems used abroad, see ORG. FOR ECON. COOP. AND DEV., CONSUMPTION TAX TRENDS: VAT/GST, EXCISE AND ENVIRONMENTAL TAXES 12-13, 16-24 tbls. 3.5, 3.6, 3.7, 3.8 (2001). When he was chair of the House Ways and Means Committee, Congressman Dan Rostenkowski (D-Ill.) predicted the likely appearance of a VAT or sales tax once the Congress got its hands on it:

> I am enough of a politician to predict that, at best, a true VAT proposal would emerge from Congress looking like a lace doily. If you think today's relatively progressive income tax system is full of holes and inequities, imagine the alterations awaiting a national sales tax. Exemptions for food, shelter, medical treatment, and education are just openers. The long line of appeal begins to stretch down Capitol Hill from there.

Dan Rostenkowski, *A View from the Ways and Means Committee*, *in* THE CONSUMPTION TAX: A BETTER ALTERNATIVE? 25, 27 (Charls E. Walker & Mark A. Bloomfield eds., 1987).

169. To be sure, Archer sought a *complete* replacement for the income tax but even if one were initially enacted, there would have been no assurance that a future legislature would have felt bound to this decision. For example, because of the limited amount of revenue that a national retail sales tax can produce, it would seem that an enactment of such a tax would much more likely end up being a mere supplement to the income tax than enactment of a more flexible and robust form of

In short, if Archer's pessimism about fixing the current income tax, and rejection of a possible replacement of the income tax with something like the flat tax, were due to concerns about the legislative process, then this worry should have led him to be pessimistic about making any change whatsoever. Quite understandably, as incoming chair to arguably the most powerful committee in Congress, he may not have wanted to follow his logic to that extent. As described in Part III, however, there may be more truth to this concern than we might like to believe and hence, much cause for pessimism about the present enactment of any real tax reform.

III. LEGISLATIVE PROCESS OBSTACLES TO TAX REFORM

This Part describes two evolving features of the legislative process. One, an increasingly "top-down" organizational structure, has largely resulted from changes internal to the Congress, whereas the other, a greater fracturing and external focus of the legislative body, has been primarily caused by forces external to the Congress. Taken together, these two trends may make the passage of a real tax reform bill more daunting than ever.

A. *"Top-Down" Organizational Structure*

Congress is principally organized around its committees and the political parties. Over the last thirty years, there has been a gradual strengthening of the party system and the leaders of the majority party within Congress, and a gradual weakening of the committees and their chairs, with the result that there is more of a top-down organizational structure. This trend is more evident in the House than in the Senate, for the greater number of House members has generally fostered a more hierarchical organizational structure designed to permit the House majority to have its way. But to some extent, the trend has been true in the Senate as well.

During the mid-1970s, with the influx of the large post-Watergate group of liberal Democrats, the House adopted a number of reforms which had the effect of weakening the committees and their chairs and strengthening House leadership. One important change was an end to the automatic seniority system for the selection of the committee chair. This made committee chairs more answerable to the majority party leadership. Another change was to curtail the chair's power within the committee. In addition, the House removed from the Democratic members of the Committee on Ways and Means the important responsibility of making committee assignments for the House Democrats, and gave that power to

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consumption tax, such as a subtraction-method VAT as modified by Hall-Rabushka or Bradford.

a new Policy and Steering Committee controlled by party leaders. Reformers, however, did not want simply to replace one power center in Congress (the committees and their chairs) with another (party leadership). Thus, certain decentralizing changes, such as the empowerment of subcommittees, caucuses, and individual House members, were also adopted in an effort to make sure party leadership remained responsive to the wishes of the rank and file. Overall, the chairs of the standing committees were the major losers in the reforms.[170]

Fast-forward to the mid-1990s with the Republican takeover of the House. The House Republicans adopted a number of changes which further strengthened the House leadership at the expense of the committees and their chairs. These changes included the adoption of a six-year term limit for committee chairs, a further weakening of seniority in the selection of the chair, a reduction in the size of committee staffs, and the greater involvement of House leadership in the selection of chairs and committee assignments.[171] Taken altogether, the changes "produc[ed] the most centralized majority leadership since the 1910 revolt against [former Speaker of the House Joe] Cannon."[172]

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170. *See* John H. Aldrich & David W. Rohde, *Congressional Committees in a Partisan Era*, *in* CONGRESS RECONSIDERED 249, 252 (Lawrence C. Dodd & Bruce I. Oppenheimer eds., 8th ed. 2005); NELSON W. POLSBY, HOW CONGRESS EVOLVES: SOCIAL BASES OF INSTITUTIONAL CHANGE 65-74, 149 (2004); JULIAN ZELIZER, ON CAPITOL HILL: THE STRUGGLE TO REFORM CONGRESS AND ITS CONSEQUENCES, 1948-2000, at 8-10, 125-26, 156-71, 199-200 (2004); DAVID W. ROHDE, PARTIES AND LEADERS IN THE POSTREFORM HOUSE 164-66 (1991). Groundwork for the changes had been laid during the early 1970s but the 1974 Congressional election and other specific events, such as the ethical problems of House Ways and Means Committee Chairman Wilbur Mills in 1974, facilitated the major reforms.

171. *See* Aldrich & Rohde, *supra* note 170, at 254-56; ZELIZER, *supra* note 170, at 256-57; John E. Owens, *The Return of Party Government in the U.S. House of Representatives: Central Leadership—Committee Relations in the 104th Congress*, 27 BRIT. J. POL. SCI. 247, 249-53 (1997). Because of term limits, Congressman Archer was forced to surrender his chairmanship of the House Ways and Means Committee in 2000 and he retired from the Congress at the end of that year. Similarly, Congressman Bill Thomas (R-Cal.) has announced his retirement from the Congress at the end of 2006 when he will be required to step down as chair of the same committee. *See* Wesley Elmore, *Ways and Means Chair Thomas Announces Decision to Retire*, 110 TAX NOTES 1134 (2006). As a result of term limits,

> By his or her fifth year a committee chair is already a lame duck, watching more junior members lobbying for the top spot. In this climate it's hard for the chair to intimidate fellow members or to rally support from the outside lobbying community, who could help counter pressure from the leadership.

JULIET EILPERIN, FIGHT CLUB POLITICS: HOW PARTISANSHIP IS POISONING THE HOUSE OF REPRESENTATIVES 84 (2006).

172. THOMAS E. MANN & NORMAN J. ORNSTEIN, THE BROKEN BRANCH: HOW CONGRESS IS FAILING AMERICA AND HOW TO GET IT BACK ON TRACK 104 (2006) [hereinafter MANN &

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Richard Fenno has described why Speaker Gingrich and the House Republican leadership were able to succeed in carrying out such far-reaching changes to the organizational structure of the House:

> [Gingrich's] goal was to further centralize power. And his plans focused on the increased subordination of committee power to the power of majority party leadership. But the underlying institutional condition that made further party centralization possible was this: the party had been out of power for so many years. As his predecessor, Speaker Tom Foley, explained, "I don't think any Democratic Speaker would be in quite the same situation as Speaker Gingrich. . . . There have been no Republican committee chairmen for over 40 years. . . . So he's had a *blank slate* on which to write and that has given him a great deal of influence.
>
> . . . The end product was an American version of a prime minister in a system of party government and a legislative process with a lot less of the deliberative and incremental pacing that a committee-centered system can provide.[173]

In addition to these rule changes, Republican House leadership began taking a more active role in shaping the legislation produced by the committees or in bypassing the committees altogether.[174] One notable example occurred in 1997 in the Committee on Ways and Means when Chairman Archer, a long-time opponent of the ethanol tax subsidy, managed to gain narrow committee approval of a controversial proposal to repeal the subsidy.[175] Speaker Gingrich removed this committee-approved provision before the bill was considered on the House floor.[176]

ORNSTEIN, BROKEN BRANCH].

173. RICHARD F. FENNO JR., LEARNING TO GOVERN: AN INSTITUTIONAL VIEW OF THE 104TH CONGRESS 31 (1997) (footnotes omitted and emphasis in original); *see also* Owens, *supra* note 171, at 263.

174. *See* MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 131 (describing how the government reorganization bill creating the new Department of Homeland Security was considered by an ad hoc committee chaired by House party leadership rather than the House standing committee with jurisdiction); Aldrich & Rohde, *supra* note 170, at 256-59.

175. *See* DANIEL J. PALAZZOLO, DONE DEAL? THE POLITICS OF THE 1997 BUDGET AGREEMENT 153-54, 161 (1999).

176. *See id.* Another example of the House leadership's active role in the tax area was Speaker Gingrich's insistence in 1995 that the proposed child tax credit be available to families with incomes up to $200,000, despite interest in a lower threshold on the part of Ways and Means Committee Republicans and the House Republican rank and file. *See* JAMES G. GIMPEL, LEGISLATING THE REVOLUTION: THE CONTRACT WITH AMERICA IN ITS FIRST 100 DAYS 109-10 (1996); Randall Strahan & Daniel J. Palazzolo, *The Gingrich Effect*, 119 POL. SCI. Q. 89, 106-07 (2004). A very recent example was the unilateral action undertaken by House and Senate leadership with respect to a pension/research credit/estate tax/minimum wage bill despite the opposition of the

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According to Thomas Mann and Norman Ornstein, "[t]aking legislative draftsmanship away from committees and centralizing it in leadership offices would become a common practice on controversial legislation by the Republican majority, one that diminished the quality of deliberation."[177]

Although Republicans also strengthened their party's role in the Senate upon taking control of that body in 1994 and imposed a six-year limit on the terms of their committee chairs, the Senate has generally not made the same changes as the House.[178] For example, in 1995, when Senate Majority Leader Bob Dole (R-Kan.) wanted to keep Sen. Phil Gramm (R-Tex.), his rival for the 1996 Republican presidential nomination, off of the Senate Finance Committee, Dole had to try to identify a more senior Republican who could take the slot, thereby demonstrating the continuing importance of seniority in the determination of committee assignments in the Senate.[179] More generally, Senate governance procedures, described as "the most permissive rules of any legislature in the world,"[180] have operated to defy strong centralized authority on the part of either the committees or party leaders in that body.[181]

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three Senate chairmen whose committees had jurisdiction over the legislation. *See* David Rogers, *House Republicans Move to Tie Wage Increase to Estate-Tax Cut*, WALL ST. J., July 29, 2006, at A4; Jonathan Weisman, *Minimum Wage Hike Passed by House; GOP Bill Also Cuts Estate Tax*, WASH. POST, July 29, 2006, at A1. A non-tax example occurred in 2003 in connection with the Medicare prescription drug legislation when House Speaker Hastert and Senate Majority Leader Frist negotiated policy compromises contrary to the position of Conference Committee and Ways and Means Committee Chairman Bill Thomas (R-Ca.). *See* Aldrich & Rohde, *supra* note 170, at 266; Carl Hulse, *Fight to Pass Medicare Measure Raised House Speaker's Profile*, N.Y. TIMES, Dec. 6, 2003, at A1; Jill Zuckman, *GOP's Go-to Leader on Capitol Hill*, CHI. TRIB., Nov. 21, 2003, at p. 8.

177. MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 104; *see also* Lawrence C. Dodd & Bruce I. Oppenheimer, *A Decade of Republican Control: The House of Representatives, 1995-2005*, *in* CONGRESS RECONSIDERED, *supra* note 170, at 27 (2005) [hereinafter Dodd & Oppenheimer, *Decade of Republican Control*] (describing committees as doing little more than rubber stamping legislation drafted by party leadership).

178. *See* ZELIZER, *supra* note 170, at 258; ROGER H. DAVIDSON & WALTER J. OLESZEK, CONGRESS AND ITS MEMBERS 212 (7th ed. 2000). Senate Democrats also made more modest Congressional reforms than the House during the mid-1970s. One important change was to reduce the size of the vote required to invoke cloture (thereby terminating a filibuster) from two-thirds of the Senators present and voting to three-fifths of the full Senate. *See* MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 82; ZELIZER, *supra* note 170, at 172-75.

179. *See* FORREST MALTZMAN, COMPETING PRINCIPALS: COMMITTEES, PARTIES, AND THE ORGANIZATION OF CONGRESS 132 (1997). Dole failed in his effort and Gramm became a member of the Committee. *Id.*

180. Barbara Sinclair, *The New World of U.S. Senators*, *in* CONGRESS RECONSIDERED, *supra* note 170, at 1.

181. The principal tools have included the use of filibusters, "holds," and objections to unanimous consent requests to proceed with much of the Senate's business. According to Barbara

But Congressional budget procedures, first adopted with the 1974 passage of the Congressional Budget Act and modified in the 1980s and 1990s, have had a greater impact in the Senate than in the House in shifting power from committees with substantive subject-matter jurisdiction, such as the Finance Committee, to the Budget Committee and Senate leadership. The reason is the procedural protection given to budget reconciliation bills in the Senate in order to prevent filibusters and the consideration of non-germane amendments on the Senate floor. Thus, reconciliation protections have strengthened the Finance Committee's hand on the Senate floor in resisting amendments offered by individual senators. At the same time, use of reconciliation and the entire budget structure has increased the involvement of the Senate Budget Committee and Senate leadership in formulating tax and spending policy. The budget process has provided the majority party, working through its Congressional leaders and the Budget Committees, with a "tool to centralize decisions"[182] and, in the process, created constraints on the independence of the tax-writing and appropriations committees.[183] Former Senate Finance Committee chair Bob Dole "said that the budget process made him feel like the chairman of a subcommittee of the Budget Committee, not the chairman of [the] usually powerful Finance Committee."[184]

Electoral changes have also contributed to greater centralization of decision making by increasing the intra-party homogeneity and inter-party polarization in Congress. Over roughly the last twenty-five years, there has been a decline in the number of moderates in each party represented in Congress as a result, in part, of a shift in each party's regional orientation.

Sinclair, about half of major Senate legislation susceptible to a filibuster between 1993 and 1998 encountered a filibuster-related problem. *See id.* at 6-13; *see also* Aldrich and Rohde, *supra* note 170, at 263-65; C. Lawrence Evans & Daniel Lipinski, *Obstruction and Leadership in the U.S. Senate*, *in* CONGRESS RECONSIDERED, *supra* note 170, at 227-48.

182. ZELIZER, *supra* note 170, at 237.

183. *See* ZELIZER, *supra* note 170, at 236-37; JOHN B. GILMOUR, RECONCILABLE DIFFERENCES? CONGRESS, THE BUDGET PROCESS, AND THE DEFICIT 139 (1990); RANDALL STRAHAN, NEW WAYS AND MEANS: REFORM AND CHANGE IN A CONGRESSIONAL COMMITTEE 46-52 (1990); Elizabeth Garrett, *The Congressional Budget Process: Strengthening the Party-in-Government*, 100 COLUM. L. REV. 702, 707-09, 714-15 (2000). The original design was for the budget process *not* to intrude too strongly into the jurisdiction of the tax and spending committees, but over time it has. *See* GILMOUR, *supra* at 63-64, 85, 138-39, 145-46.

In the House, in addition to the Budget Committee, the Rules Committee has played an important role in carrying out the objectives of party leadership. *See* EILPERIN, *supra* note 171, at 51-56; GILMOUR, *supra* at 186; MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 8; ZELIZER, *supra* note 170, at 237; JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM 162 (1987).

184. GILMOUR, *supra* note 183, at 148.

In general, Republicans have strengthened their electoral representation in western and southern states and Democrats have improved their representation in northern states.[185] These changes have been influenced by Congressional redistricting practices (which have tended to solidify the partisan orientation of the districts), the primary process (which has helped to promote the most partisan candidates of each party), and other factors.[186] The sharper party distinctions in Congress as well as other changes have increased the partisanship of the institution, the importance of party policy positions, and the role of party leaders.[187]

One final, important example of the increasingly top-down organizational structure in the legislative process has occurred within the executive branch. For at least the last dozen years or so, encompassing both Democratic and Republican administrations, there has been a significant change in the manner in which the executive branch's tax policy proposals are formulated. Political staffers within the White House have taken a more dominant role, with the Treasury Department and the IRS assuming lesser positions. The facts that the 2005 Social Security reform effort reportedly was run out of the White House and not the Treasury Department, and that for more than two-and-a-half years, the two top tax policy positions within the Treasury have not been permanently filled are just two notable, recent indications of this trend.[188]

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185. *See* MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 11-12; Lawrence C. Dodd & Bruce I. Oppenheimer, *Prologue: Perspectives on the 2004 Congressional Elections*, *in* CONGRESS RECONSIDERED, *supra* note 170, at xxv-xxvi; Dodd & Oppenheimer, *Decade of Republican Control*, *supra* note 177, at 41-42; ZELIZER, *supra* note 170, at 235, 255-56; ROHDE, *supra* note 170, at 167.

186. *See* Bruce I. Oppenheimer, *Deep Red and Blue Congressional Districts: The Causes and Consequences of Declining Party Competitiveness*, *in* CONGRESS RECONSIDERED, *supra* note 170, at 141-45, 149-52; Daryl J. Levinson & Richard H. Pildes, *Separation of Parties, Not Powers*, 119 HARV. L. REV. 2311, 2324 (2006); John Cochran, *A Government Out of Touch*, 63 CQ WKLY. 1804, 1807 (2005).

187. *See* Sinclair, *supra* note 180, at 3-4; Oppenheimer, *supra* note 186, at 154-55; Aldrich & Rohde, *supra* note 170, at 251; ROHDE, *supra* note 170, at 167-68; Carl M. Cannon, *State of Our Disunion*, NAT'L J., Jan. 21, 2006, at 18 (focusing on effect of polarization on U.S. politics).

188. *See* BRUCE BARTLETT, IMPOSTER: HOW GEORGE W. BUSH BANKRUPTED AMERICA AND BETRAYED THE REAGAN LEGACY 32 (2006); Jill Barshay, *Machinery Not in Place for Tax Code Overhaul*, 63 CQ WKLY. 3301, 3301 (2005). The position of Assistant Secretary of the Treasury for Tax Policy has not been permanently filled since February, 2004, when Pam Olson's resignation was effective. Press Release, U.S. Dep't of the Treasury, Treasury Sec'y Snow Praises Assistant Sec'y Pam Olson for Leadership and Accomplishments While Serving in Bush Admin. (Dec. 10, 2003) *available at* www.ustreas.gov/press/releases/jslosl.htm; United States Department of the Treasury, Treasury Officials, *available at* http://www.treas.gov/organization/officials.html (last visited Sept. 11, 2006). Bartlett attributes the Treasury vacancies in part to the weak position of former Treasury Secretary John Snow, although confirmation issues have also played a role. BARTLETT, *supra*, at 32, 39. Bartlett traces the greater White House involvement in tax policy to the Clinton Administration's creation of the National Economic Council in 1993, *id.* at 23-25, but

B. *Fracturing and External Focus of the Legislative Body*

At the same time that its organizational structure has become more top-down, the legislative body has become more fractured, with individual legislators increasingly taking stronger cues from sources external to the Congress rather than internal ones, such as their committees and committee chairs. This trend is captured by the term, "the permanent campaign," the title of a collection of essays edited by Norman Ornstein and Thomas Mann.[189] The book describes the manner in which the process of governance *by* Congress has merged into, and lost its distinctiveness from, the process of campaigning *for* Congress. As a result, members of Congress increasingly have a short-term, narrow-interest, external focus, and adversarial relationships with one another, as opposed to working as a deliberative and collaborative body for the long-term benefit of the general public.[190]

The changing economics of campaigning is a principal cause of this trend. Lawmakers must engage in virtually nonstop fundraising activities to satisfy both their own campaign needs and those of other members.[191] This imperative dictates almost all aspects of their lives, from who they meet, to where they travel, to how much time they are able to spend legislating in Washington. For example, because the monetary campaign needs of legislators often exceed the resources available from their home states or districts, lawmakers find it necessary to seek out campaign contributions from "national" sources of support and to obtain assistance from representatives of interest groups with ties to those sources.[192]

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it is possible to identify earlier origins; *see* BIRNBAUM & MURRAY, *supra*, at 262-63 (describing the shift of former White House staffers James Baker and Richard Darman to head the Treasury Department in 1985); Panel, *The Role of Tax Policy in the Development of Tax Legislation: Larry Woodworth's Era and Now*, 32 OHIO N. U. L. REV. 1, 10-13 (2006) [hereinafter *Larry Woodworth's Era*] (reporting comments of Bob Shapiro dating the change to the beginning of the Reagan Administration). Pam Olson, former Assistant Secretary of the Treasury for Tax Policy, has disputed Treasury's loss of influence, yet she also acknowledged her office's inability to advance certain tax simplification recommendations due to opposition from the OMB. *See* Larry Woodworth's Era, *supra*, at 15. For a description of how Treasury/White House disagreements were resolved in an earlier era, see THOMAS J. REESE, THE POLITICS OF TAXATION 26-34 (1980).

189. THE PERMANENT CAMPAIGN AND ITS FUTURE (Norman J. Ornstein & Thomas E. Mann, eds., 2000) [hereinafter ORNSTEIN & MANN, PERMANENT CAMPAIGN]. The term was used earlier by Sydney Blumenthal during the Reagan Administration to refer to the use of governing to achieve electoral advantages. *See* SYDNEY BLUMENTHAL, THE PERMANENT CAMPAIGN (1982); *see also* Hugo Heclo, *Campaigning and Governing: A Conspectus*, *in* ORNSTEIN & MANN, PERMANENT CAMPAIGN, *supra*, at 1-2.

190. *See* Heclo, *supra* note 189, at 4-15.

191. *See id.* at 26-27; Anthony Corrado, *Running Backward: The Congressional Money Chase*, *in* THE PERMANENT CAMPAIGN AND ITS FUTURE, *supra* note 189, at 75-76.

192. *See* Corrado, *supra* note 191, at 88; DAVIDSON & OLESZEK, *supra* note 178, at 343-44;

Former Democratic Sen. Fritz Hollings, who represented South Carolina, has described his continually "hustling" for money in New York, Boston, Chicago, Florida, California, Texas, and elsewhere, and reported that when he was in Washington or back home in South Carolina, his mind "was still on money."[193]

In terms of Congressional scheduling, it is not uncommon for votes to be held from only Tuesday evening to Thursday evening each week in order to accommodate fundraising activities outside of the District.[194] Congressional recess periods are also plentiful, with one analysis of the House's 2006 schedule showing a total of only eighty-four days out of the year when votes are scheduled to take place, or twenty-six fewer days than those of the Congress President Truman labeled in 1948 as "do-nothing."[195]

The growth and diversity of electronic media, including C-Span, CNN, other 24-hour cable television news outlets, and information sites available over the internet, have contributed to the fracturing of the legislative body and the increasingly external focus of lawmakers. The cost of media advertising is the single largest expense of campaigning.[196] In addition, the number and range of media outlets provide all legislators with both easy opportunity to express their views and ready access to information, thereby reducing a member's dependence upon Congress and its

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Lobbying Boom: Should the Influence Industry be Regulated More Closely?, 15 CQ RESEARCHER 613, 613 (2005), *available at* http://library.cqpress.com/cqresearcher/cqresrre2005072200 (describing lobbyists' role in obtaining campaign contributions); Robert Novak, Editorial, *The Lobby Door is Still Wide Open*, CHI. SUN-TIMES, Feb. 23, 2006, at 39 (describing "extraordinary" recent reception hosted by Sen. Ted Stevens (R-Alaska) of a wide range of lobbyists designed to raise funds from outside of Alaska for the Senator's leadership PAC, with funds to be distributed to other Republican candidates to enhance the Senator's reputation).

193. Ernest F. Hollings, Editorial, *Stop the Money Chase*, WASH. POST, Feb. 19, 2006, at B7.

194. *See id.*

195. *See* Jonathan Weisman & Charles Babington, *Estate Tax, Wage Hike Teetering in Senate*, WASH. POST, July 30, 2006, at A-1; *see also* MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 169-70 (stating that for 2006 Congress is expected to have at most ninety-seven voting days). Congress, however, often extends the period it is in session beyond the schedule laid out at the beginning of the year. For example, despite a target adjournment date of September 30, 2005, the first session of the 109th Congress did not adjourn until December 22, 2005. *Congressional Calendar: Start Planning Now*, 62 CQ WKLY. 2899 (2004); Office of the Clerk of the House, Session Dates of Congress, http://clerk.house.gov/histHigh/Congressional_History/Session_Dates/100tocur.html (last visited Sept. 18, 2006). A similar pattern occurred in 2003, *Editor's Notebook: Mark Your Calendars*, 61 CQ WKLY. 2056 (2003), and 2004 included an unscheduled lame-duck session after the election. Office of the Clerk of the House, Session Dates of Congress, *supra*.

196. *See* PAUL S. HERRNSON, CONGRESSIONAL ELECTIONS: CAMPAIGNING AT HOME AND IN WASHINGTON 82-85 (4th ed. 2004) (cost of television ads represented almost 22% of average campaign expenses for 2002 House seats and about one-third of average expenses for 2002 Senate seats, the single largest category of expense for both types of campaigns).

institutions to achieve such ends.[197] For some members, being able to speak individually through the media may reduce the significance of accomplishing collective goals within the legislature through deliberation and compromise.

Certain changes in governance rules and practices within the Congress also have contributed to this trend. For example, "sunshine" rules designed to open up committee deliberations to scrutiny by the entire chamber have also exposed the committee activity to interests outside of the Congress, thereby reducing the amount and quality of the deliberations.[198] There has also been an increase in the number of junior or electorally vulnerable members of Congress selected to serve on key policy committees such as the Committee on Ways and Means.[199] While this practice may provide an electoral boost to such members and thereby help to protect the majority party in Congress, it has also weakened the authority of the committee chair and increased the likelihood that the committee's decision-making will have an external orientation.[200]

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197. *See* ZELIZER, *supra* note 170, at 207, 216-17.

198. *See* Heclo, *supra* note 189, at 20-21; David Brady & Morris Fiorina, *Congress in the Era of the Permanent Campaign*, *in* THE PERMANENT CAMPAIGN AND ITS FUTURE, *supra* note 189, at 140-42; MALTZMAN, *supra* note 179, at 159; STRAHAN, *supra* note 183, at 143-45 (describing how the return to closed sessions in the Ways and Means Committee in 1982 decreased lobbyist influence and allowed committee members to "take a broader view of the issues at stake in recent tax legislations"); Charles E. McLure, Jr., *The Budget Process and Tax Simplification/Complication*, 45 TAX L. REV. 25, 70-74 (1989). Other Congressional reforms may also have backfired. For example, the purpose of the six-year term limit for committee chairs was to prevent the entrenchment of special interests affiliated with the chair. *See* GIMPEL, *supra* note 176, at 40. But representatives of interest groups are not term-limited. Thus, as chairs (and their staffs) turn over more frequently, interest group representatives gradually gain experience and informational advantages over committee chairs and their staffs which may prove critical in negotiations relating to the formation of legislation.

199. *See* GARY W. COX & MATHEW D. MCCUBBINS, LEGISLATIVE LEVIATHAN: PARTY GOVERNMENT IN THE HOUSE 55-56 (2d ed. 2006) (draft), *available at* http://mccubbins.ucsd.edu/leglev2nd.pdf; PALAZZOLO, *supra* note 175, at 144. According to one study, the twenty-three Democratic members elected to Ways and Means during the 86th through 93rd Congresses (1959-72) "served an average of nearly nine years before their election to the committee. No freshman was appointed [during that time], and only two [were selected] with as little as a single term of service." KENNETH A. SHEPSLE, THE GIANT JIGSAW PUZZLE: DEMOCRATIC COMMITTEE ASSIGNMENTS IN THE MODERN HOUSE 138-39 (1978). In addition, only two received 55% or less of the vote in the general election prior to appointment. *Id.* at 140-41. In contrast, as set forth in the Appendix, the twenty-seven Republican members selected to serve on Ways and Means during the 104th through 109th Congresses (1995-2006) served an average of just over three years prior to going on the committee. Five freshmen were appointed and ten others were selected who had just one prior term of service (or portion thereof). Ten received 55% or less of the vote in the general election immediately prior to appointment, and five actually received 50% or less in that election. *See infra*, Appendix.

200. *See* SCOTT A. FRISCH & SEAN Q. KELLY, COMMITTEE ASSIGNMENT POLITICS IN THE U.S. HOUSE OF REPRESENATATIVES 190-91 (2006) (describing how freshman member of Appropriations

The greater fracturing and external focus of the legislative body might seem to be somewhat contradictory to the trend toward increased centralization of power in Congress. But the two changes may be complementary to one another. In an eerily prescient passage written almost thirty years ago, Lawrence Dodd describes how these two trends might naturally coincide. In his essay, Dodd contrasts the inward-looking Congress that he claimed existed at the time, where members were primarily interested in accumulating power within the institution, with a more outward-looking body principally interested in securing reelection:

> Were members solely preoccupied with reelection, we would expect them to spend little time in Washington and devote their personal efforts to constituent speeches and district casework. One would expect Congress to be run by a centralized, efficient staff who, in league with policy-oriented interest groups, would draft legislation, investigate the issues, frame palatable solutions, and present the members with the least controversial bills possible. Members of Congress would give little attention to committee work, and then only to committees that clearly served reelection interests. The primary activity of congresspeople in Congress, rather, would be extended, televised floor debates and symbolic roll call votes, all for show. Such a system would allow the appearance of work while providing ample opportunity for the mending of home fences. . . . [O]ne might expect a centralized system with a few leaders exercising power and all others spending their time on personal or electoral matters.[201]

Other than failing to anticipate the tremendous changes in the economics of campaigning over the last thirty years and the consequent growth in influence and involvement of interest group representatives in all aspects of the legislative process, including the drafting of legislation, Dodd's articulation of an alternative, hypothetical Congress seems closely descriptive of the one we have today.

As Dodd predicted, the increasingly external focus of Congress has gradually changed the nature of its work. One commentator has summarized the change in the following way:

Committee was a "hindrance" to the committee chair); PALAZZOLO, *supra* note 175, at 144; STRAHAN, *supra* note 183, at 65, 68.

201. Lawrence C. Dodd, *Congress and the Quest for Power*, *in* CONGRESS RECONSIDERED 269, 271-72 (Lawrence C. Dodd & Bruce I. Oppenheimer eds., 1st ed. 1977).

> What is clear is that such permanent campaigning is diminishing the quality of representation in Washington. Legislators are spending excessive amounts of time on fund-raising and electioneering. Their focus on campaigning comes at the expense of the legislative craft; if they are spending more time raising money, they are spending less time learning legislative practice, understanding the details of major policy debates, or becoming acquainted with their professional colleagues.[202]

C. *Impact on Tax Reform*

What do these trends signify for legislative consideration of tax reform? The increasingly external focus of legislators is not conducive to undertaking a task as mammoth and difficult as tax reform. As a practical matter, legislators may simply not have enough time to spend on such legislation to understand the policy implications and tradeoffs of various options, let alone to craft constructive compromises. The introduction each year of a "Tax Code Termination" bill, under which the entire Tax Code is repealed as of a particular date in the future, to be followed by an unspecified replacement tax system that is "simple and fair" to all, may be illustrative of the level of seriousness and understanding some members of Congress have about the tax system.[203]

Moreover, a defining characteristic of real tax reform is the reduction or curtailment of tax provisions that benefit only parochial interests.[204] Yet because of their external focus, legislators may find it increasingly difficult to turn away from the many, narrow interest groups that constantly surround them.[205] During the recent Senate debate concerning the possible repeal of the estate tax, Assistant Senate Minority Leader Dick Durbin (D-Ill.) candidly described this political reality:

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202. Corrado, *supra* note 191, at 104; *see also* Brady & Fiorina, *supra* note 198, at 148-49; Hollings, *supra* note 193. For a description of how personal relationships among the members have changed in the House, see EILPERIN, *supra* note 171, at Ch. 2.

203. *See* Tax Code Termination Act, H.R. 4725, 109th Cong. (2d Sess. 2006) (including over 80 cosponsors). Earlier versions of this legislation were approved by the House in 1998 and 2000. *See* Date Certain Tax Code Replacement Act, H.R. 4199, 106th Cong. (2d Sess. 2000); Tax Code Termination Act, H.R. 3097, 105th Cong. (2d Sess. 1998).

204. *See, e.g.*, TAX PANEL REPORT, *supra* note 6, at 83; 1 OFFICE OF THE SECRETARY, DEPARTMENT OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH viii–x (1984).

205. *See* DAVIDSON & OLESZEK, *supra* note 178, at 353.

> We also have to reflect on another reality as to why [estate tax repeal] is before us. . . . I say this with some understanding that it is an indictment of our political system, of which I am a part. Why is it that we are so focused on helping the wealthiest people in America . . . ? The explanation is sad but true. We spend a lot of our time as Members of the Senate and House of Representatives in the company of very wealthy people. We run across them in the ordinary course of Senate business, but there is another part of our lives as well. We are out raising money for political campaigns that cost millions of dollars. People who can afford to help us are often very wealthy themselves. . . . [W]e spend a lot of time in their lifestyle seeing where they live, how they spend their time, understanding their hobbies and their lifestyles and naturally developing a friendship and empathy with the wealthiest people in America.
>
> Our campaign financing system draws us into these situations. It is understandable that with this empathy comes an understanding that some of them are going to face taxes when they die for all the money and the wealth they have accumulated. Their pleas have not fallen on deaf ears in the Senate. Their pleas to repeal the estate tax have resulted in this bill before us now.[206]

The external focus of legislators also undermines confidence in the long-term stability of any tax reform legislation that Congress somehow manages to pass. Stability is a key goal of tax reformers, including proponents of the FairTax.[207] Yet the current state of the legislative process might lead a cynic to conclude that any tax reform legislation passed by Congress is merely another step in the endless cycling of pro- and anti-reform changes to the Tax Code, with the only beneficiaries being those who advocate for such changes and those whose campaign coffers are thereby augmented.[208] During consideration of the bill leading to the 1986

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206. 152 CONG. REC. S5590 (daily ed. June 7, 2006). Senate procedural rules that empower individual members may also tend to promote parochial interests over the general interest. *See* Evans & Lipinski, *supra* note 181, at 243.

207. *See* FAIRTAX, *supra* note 12, at 115-16; *see also* TAX PANEL REPORT, *supra* note 6, at 4-5 (decrying lack of stability in tax law).

208. *See* Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913 (1987) (suggesting that increased frequency of tax reform changes results from legislators' desire to reward private interests and to be rewarded in turn); Richard L. Doernberg & Fred S. McChesney, *Doing Good or Doing Well? Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891 (1987) (same); Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159 (2006) (arguing that Congress uses its taxing power to create or perpetuate special interest groups which are then targeted for campaign contributions); Milton Friedman, *Tax*

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Tax Reform Act, one tax-writing committee member reportedly whispered, upon termination of a tax-exempt bond provision he favored, "'I don't mind this. We'll just get it back next year.'"[209]

Increased intra-party unity and inter-party polarization in Congress, and the resulting greater difficulty in developing bipartisan compromise, is also not conducive to enactment of meaningful tax reform.[210] As a practical matter, the absence of bipartisan compromise may effectively block the progress of such legislation because of supermajority rules in the Senate that in many instances provide the minority party in that body with a veto. Moreover, the reduction or elimination of government benefits that is characteristic of reform legislation creates opportunities for party demagoguery without some degree of bipartisan agreement. Thus it may not be coincidental that the three tax acts that have garnered the "tax reform" label have all occurred during periods of divided government when bipartisan compromise was necessary.[211] The Tax Reform Act of

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Reform Lets Politicians Look for New Donors, WALL ST. J., July 7, 1986, at 12. Congressional staff may also benefit by "cashing in" on their connections following passage of a major tax reform or revision bill by Congress. *See* JEFFREY H. BIRNBAUM, THE LOBBYISTS: HOW INFLUENCE PEDDLERS GET THEIR WAY IN WASHINGTON 126-28 (1992) (describing number of tax staff aides who left Capitol Hill for lobbying positions following enactment of Tax Reform Act of 1986).

209. *See* TIMOTHY J. CONLAN, MARGARET T. WRIGHTSON, & DAVID R. BEAM, TAXING CHOICES: THE POLITICS OF TAX REFORM 108 n.5 (1990). Mere consideration of a proposal as wide-ranging as tax reform generates increased fees to lobbyists and campaign contributions. *See id.* at 88-99, 139; BIRNBAUM & MURRAY, *supra* note 183, at 137, 177-83 (describing 1986 Act as "Lobbyists' Relief Act of 1986").

210. In an interesting study, Sarah Binder attempted to measure the degree of polarization between the parties during different periods and found that greater polarization increases the likelihood of legislative stalemate and is "counterproductive to fostering major policy change." SARAH A. BINDER, STALEMATE: CAUSES AND CONSEQUENCES OF LEGISLATIVE GRIDLOCK 68 (2003). Her conclusions are consistent with the intuitive sense that polarization has markedly increased over the last twenty years. *Id.* at 65-66.

211. *See* CONLAN, WRIGHTSON & BEAM, *supra* note 209, at 237-38 (describing advantage of divided government in advancing tax reform effort). Of course, whether the Acts *deserved* the "reform" moniker is a matter of some dispute. Some liberals were so unhappy with the substance of the Tax Reform Act of 1976 that they proposed that the word, "reform," be removed from the title of the Act. *See id.* at 30; JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 194 (1985). The Tax Reform Act of 1986 has also had its critics. *See generally* Michael J. Graetz, *The Truth about Tax Reform*, 40 FLA. L. REV. 617 (1988) (rejecting the idea that the 1986 Act would reduce poverty, help families, and create jobs); McLure, *1986 Act*, *supra* note 151 (criticizing the 1986 Act as "horribly complex"); Charles E. McLure, Jr. & George R. Zodrow, *Treasury I and the Tax Reform Act of 1986: The Economics and Politics of Tax Reform*, 1 J. ECON. PERSP. 37, 57 (1987) (arguing the 1986 Act failed to follow the recommendations of the Department of Treasury's report to President Reagan). For a cynical definition of "tax reform," see 122 CONG. REC. S18553 (1976) (Sen. Long (D-La.)) ("[T]ax reform is a change in the tax law that I favor, or if it is the other man defining tax reform, it is a change in the tax law that he favors . . . .").

Outside of the tax area, recent efforts to enact important reforms dealing with health care and

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1969 was enacted during the Republican Nixon administration, which drew heavily upon proposals prepared by the previous Democratic Treasury Department and worked with a Congress controlled by Democrats.[212] The Tax Reform Act of 1976 was enacted during the Republican Ford administration, again working with a Congress controlled by Democrats. Finally, the Tax Reform Act of 1986 was a product of the Republican Reagan administration, a House controlled by Democrats, and a Senate controlled by Republicans.[213]

Social Security during periods of one-party control of the executive and legislative branches were unsuccessful, while welfare reform passed when control of government was divided. *See* Alex Wayne, *2005 Legislative Summary: Social Security Overhaul*, 64 CQ WKLY. 50 (2006) (describing failure of Social Security reform effort in 2005); Donna Cassata, *Finale Expected to Be Short, But Not Necessarily Sweet*, 54 CQ WKLY. 2418 (1996) (describing enactment of welfare reform in 1996); David S. Cloud, *Health Care's Painful Demise Cast Pall on Clinton Agenda*, 52 CQ WKLY. 3142 (1994) (describing failure of health care reform effort during 103rd Congress). In addition to the one-party/divided government difference, party polarization was greater during the failed health care and Social Security reform efforts than during the periods of the earlier tax reform legislation. *See* BINDER, *supra* note 210, at 65-66. Daniel Shaviro has argued, however, that major reform is easiest when one party controls government. *See* DANIEL SHAVIRO, DO DEFICIT$ MATTER? 298-99 (1997) ("Reforming entitlement programs ... is easiest when one party controls the government. In a genuine two-party situation, each party is tempted to play chicken, leaving to the other the onus of arguing for painful but necessary spending cuts.").

212. WITTE, *supra* note 211, at 172; *Larry Woodworth's Era*, *supra* note 188, at 11.

213. Due to divided government, there was meaningful party competition during the period leading to the 1986 Act and such competition proved to be an important impetus at various stages of the process. Party leaders first vied to claim credit for proposing tax reform, and later strategized to avoid blame for killing it. *See* CONLAN, WRIGHTSON, & BEAM, *supra* note 209, at 46, 48, 70, 89, 104, 111-12, 174, 237-39; BIRNBAUM & MURRAY, *supra* note 183, at 39-41, 57-58, 100-01, 121, 223. Although enactment of the 1986 Act was ultimately marked by bipartisan compromise at the very highest levels of government, there was ample partisan disagreement in the development of the legislation. For example, House Republicans were completely shut out of important portions of the process leading up to that Act. *See* CONLAN, WRIGHTSON, & BEAM, *supra* note 209, at 118-19, 122, 125, 129-30, 209-10; BIRNBAUM & MURRAY, *supra* note 183, at 141, 156, 280-81.

There is a debate among political scientists regarding whether important legislation is more likely to be enacted during periods of one-party government or divided government. *See, e.g.*, DAVID R. MAYHEW, DIVIDED WE GOVERN: PARTY CONTROL, LAWMAKING, AND INVESTIGATIONS 1946-2002 (2d ed. 2005) (concluding that periods of unified government have not been legislatively more productive than periods of divided government); BINDER, *supra* note 210 (discussing the causes and consequences of legislative stalemate, especially in relation to polarization within Congress); John J. Coleman, *Unified Government, Divided Government, and Party Responsiveness*, 93 AM. POL. SCI. REV. 821 (1999) (challenging Mayhew's assessment); George C. Edwards, III et al., *The Legislative Impact of Divided Government*, 41 AM. J. POL. SCI. 545 (1997) (concluding that important legislation is more likely to fail under divided government); Sean Q. Kelly, *Divided We Govern? A Reassessment*, 25 POLITY 475 (1993) (arguing that divided government does have a negative impact on innovative legislation); James L. Sundquist, *Needed: A Political Theory for the New Era of Coalition Government in the United States*, 103 POL. SCI. Q. 613 (1988). These studies generally have not focused on potentially important details about the specific legislative proposals being evaluated, such as the manner in which the costs of the legislation would be

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The potential impact on tax reform of the greater top-down organizational structure in Congress is a little more ambiguous. Greater centralization of decision-making authority can be a useful means to overcome collective action problems arising in the Congress. For example, a "tax" committee with jurisdiction over all tax matters, and a "spending" committee with jurisdiction over the amount and allocation of all government expenditures, if left to their own devices, might well produce legislation which in combination is disfavored by the members of each committee as well as the legislature at large. The division of responsibility would enable each committee to support the politically popular position—tax cuts for the tax committee and spending increases for the spending committee—without having to confront the overall budget consequence of their action. Each committee could rationalize its action as being consistent with sound fiscal policy so long as the *other* committee exercised an appropriate level of "spending restraint" or "tax restraint."[214]

This type of dilemma, where individual members (or committees) acting independently and rationally end up producing a joint result that is disfavored by all, can potentially be overcome by empowering some

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financed. Consider, for example, a proposed major expansion of an entitlement program, such as an increase in Social Security benefits to lower-income retirees. One bill may accomplish this outcome by debt financing, thereby shifting the costs to future generations. Another "reform" bill may accomplish the same end through other changes to Social Security, such as an increase in the eligibility age of beneficiaries. Because the former bill does not appear to curtail the benefits of any current or future Social Security beneficiaries, it may be easier to pass than the reform bill during periods of one-party government and despite high intra-party homogeneity and inter-party polarization. The principal controversy of the first bill may be one of policy direction more than politics, an issue more easily resolved if one party speaks with one voice and controls all of pertinent levers of government. In part for this reason, Bruce Bartlett has urged the return of "gridlock." *See* BARTLETT, *supra* note 188, at 127-28, 134, 198 (attributing slow growth in spending and emergence of surpluses during 1994-2000 period to divided government and gridlock). Bartlett has also observed that legislation enacted during periods of divided government may prove to be more durable because of the need to compromise. *See id.* at 198.

214. *See* JOHN F. COGAN, TIMOTHY J. MURIS, & ALLEN SCHICK, THE BUDGET PUZZLE: UNDERSTANDING FEDERAL SPENDING 26-27 (1994); GILMOUR, *supra* note 183, at 20-21, 53, 100-07. The committees may instead try to externalize the cost of their actions to future generations by simply allowing budget deficits to grow rather than imposing either spending or tax restraint. In that case, there would be even greater diffusion of political responsibility. In my example, I have assumed that there is consensus among the members of the committees and the legislature as a whole as to the size of the politically acceptable surplus or deficit but even in that case, without a sufficient coordination device, the committees will not produce legislation consistent with that agreement.

Prior to 1974, the budget process was so uncoordinated that Congress regularly approved *both* individual committee proposals to increase spending *and* an overall spending ceiling lower than the total cost of the individual spending bills already approved. In effect, by taking these inconsistent actions, Congress surrendered its budget responsibility to the executive branch. *See* GILMOUR, *supra* note 183, at 19, 39-46.

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central authority to coordinate the efforts of the otherwise independent actors. For example, party leaders in Congress, or members of a third committee (such as a "budget" committee) with no direct jurisdiction over the tax and spending decisions, might be delegated to set forth guidelines in advance of each committee's action that limit their options, or to revise their legislative products ex-post to conform to some overall budgetary goal before they are considered by the legislative body as a whole.[215] Through this type of coordination device, the members of the majority party, including the members of the individual committees affected, would in effect precommit to supporting whatever the majority of their party wants, as determined by their party leaders.[216] The coordination results in greater centralization of decision-making, with constraints placed on the autonomy of the committees with substantive subject-matter jurisdiction. In important ways, the congressional budget process has been designed to provide this type of coordination device.[217] More generally, greater centralization of decision-making in congressional party leaders may more efficiently and effectively promote the party agenda.

The risk of a more centralized structure, however, is the potential loss of the specialization benefits provided by committees and their chairs, including their increased subject-matter expertise. This potential loss may be felt most acutely in connection with more involved legislative efforts, such as fundamental reform initiatives, which are likely to raise many interrelated issues for legislative consideration and decision making. Particularly for this type of legislation, the chair of the committee, who is typically the person in Congress most familiar with the substantive issues raised by the legislative product, would seem to be in a better position than party leaders to resolve conflicts in a manner most consistent with the theory of the reform objective. A chair whose authority has been diminished may have difficulty making and holding compromises, as individual members seek out alternative sources of support for their policy positions. At the same time, without the subject-matter expertise, party leaders may be unable to develop sensible compromises. As Julian Zelizer has described, during the pre-reform era, committee chairs "were adept at

215. *Cf.* COX & MCCUBBINS, *supra* note 199, at 112 (suggesting development of party leaders in Congress to overcome collective action problems); D. RODERICK KIEWIET & MATHEW D. MCCUBBINS, THE LOGIC OF DELEGATION: CONGRESSIONAL PARTIES AND THE APPROPRIATIONS PROCESS 43 (1991) (same).

216. Members might surrender a portion of their autonomy in this way in order to help guarantee that their party remains in the majority in Congress, a status providing collateral benefits to all of them. *See* COX & MCCUBBINS, *supra* note 199, at 161.

217. ALLEN SCHICK, THE FEDERAL BUDGET: POLITICS, POLICY, PROCESS 107 (revised ed. 2000); GILMOUR, *supra* note 183, at 94-95; Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 U. KAN. L.REV. 1113, 1133 (1997).

producing compromise" whereas during the post-reform period, party leaders "created conditions that stifled legislative negotiation."[218]

Although the history of the Tax Reform Act of 1986 is not the only model by which tax reform might be enacted, a review of that history reveals the critical role the chairs of each tax-writing committee played in overcoming the strategic behavior and collection action problems arising within the committee.[219] Conversely, in the current legislative environment, committee chairs have suffered some loss of authority as a result of both the greater top-down organizational structure that has evolved in Congress and the greater fracturing and external focus of the legislative body, which has reduced the influence of the chairs over the members of their committees.

A further concern relates to the importance of information in developing the legislative product. A fundamental reform effort is more likely to involve policy innovation than other legislation, and successful innovation in turn places a premium on having good information. As outlined in Part II of this article, there are a number of ways in which the income tax might be replaced by a broad-based consumption tax, but the feasibility and merits of each approach are not the same. To make a sound decision, a legislature needs to have sufficient information to appreciate

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218. ZELIZER, *supra* note 170, at 240. Although any legislative initiative potentially presents conflict, it may be particularly difficult to gain approval of fundamental reform legislation. For example, unlike the formation of a tax cut bill in which conflict may be limited to determining the priority of individual provisions to be included in the bill, legislation with a tax reform objective might dictate the repeal of certain existing tax provisions. Because of loss aversion, individual members may be more resistant to the repeal of favored provisions than the legislature's failure to adopt preferred new ones. *Cf.* Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q. J. ECON. 1039 (1991) (explaining concept of loss aversion). This bias may be reflected in the legislative guiding principle to first "do no direct harm." *See* GILMOUR, *supra* note 183, at 52. Repeal of existing provisions also raises transitional issues not present when a preferred new alternative is not adopted. Finally, the possible characterization of repeal of an existing provision as a "tax increase" may present a higher barrier for acceptance for members who have pre-committed to particular bright-line policy positions, such as the opposition of all "tax increases." *See* Emily Pierce, *Can Thomas Thread the Needle With FSC Bill?*, ROLL CALL, May 18, 2004 (describing how closing of loopholes still represents an unacceptable "tax increase").

219. *See* COX & MCCUBBINS, *supra* note 199, at 121 (discussing role of Chairman Rostenkowski); CONLAN, WRIGHTSON, & BEAM, *supra* note 209, at 84, 102, 132 (describing role of Rostenkowski), 136 (describing role of Chairman Packwood), 189, 252-54 (discussing role of both men); STRAHAN, *supra* note 183, at 147-50 (discussing role of Rostenkowski); BIRNBAUM & MURRAY, *supra* note 183, at 128, 132-34, 136, 145-46, 149-50 (describing role of Rostenkowski), 204-33 (describing role of Packwood). These efforts were obviously in addition to the central role played by President Reagan in first putting tax reform on the nation's agenda. *See* Ronald Reagan, *Address Before a Joint Session of the Congress on the State of the Union 1983*, 1 PUB. PAPERS 102, 105-06 (1984); Ronald Reagan, *Address Before a Joint Session of the Congress on the State of the Union 1984*, 1 PUB. PAPERS 87, 89-90 (1986).

the important distinctions in the different policy approaches.

Typically, the chair of a committee controls all key staff and therefore is in the best position to determine the type and amount of information gathered by the committee and made available to the rest of the legislature. For example, the chair decides not simply the number of hearings to be held but also how extensive and balanced they will be. A chair and committee whose authority have been reduced may have less incentive to bear the cost of obtaining good and complete information, to the detriment of the entire legislature.[220] According to Mann and Ornstein, the number of House committee and subcommittee meetings of an average Congress shrank from more than 5,000 in the 1960s and 1970s to 2,135 in the 108th Congress (2003-04).[221]

The potential loss of good information for a tax reform effort is especially noteworthy when one considers the parallel change that has evolved within the executive branch. The Treasury Department has the most expertise in the executive branch to develop, analyze, and understand a comprehensive tax reform proposal. Treasury also has the breadth of vision to keep the general interest in mind, at the expense of more parochial interests.[222] It is far from clear that political staff within the White House have the same level of understanding and maintain the same focus.[223] Thus, Treasury's loss of influence in the tax legislative process may harm the quality of information provided by the executive branch. In his book on the George W. Bush administration, conservative economist Bruce Bartlett bemoans the administration's complete lack of reliance on serious policy analysis and asserts that its White House-dominated system "places little value on substance and judges success or failure solely on the basis of short-term politics."[224]

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220. *Cf.* KIEWIET & MCCUBBINS, *supra* note 215, at 5 (arguing that committees would not invest as much time in committee work if their influence over policy was reduced); Thomas W. Gilligan & Keith Krehbiel, *Collective Decisionmaking and Standing Committees: An Informational Rationale for Restrictive Amendment Procedures*, 3 J. L. ECON. & ORG. 287, 289 (1987) (arguing that when a committee is undermined by the legislative body as a whole, the committee has less incentive to gather information). In one instance in 1995, a committee's role has been described as being reduced to that of a "'eunuch[]'" because the committee had the ability to hold hearings but not to make a legislative proposal. *See* Owens, *supra* note 171, at 261 (quoting from a Congressional Quarterly article).

221. MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 170 (footnote omitted). Another consequence of insufficient information-gathering by the committees is inadequate oversight of the executive branch. *See id.* at 151-58.

222. *See* CONLAN, WRIGHTSON, & BEAM, *supra* note 209, at 53.

223. For an example of the sometimes naïve top-down strategizing of political staff who are unfamiliar with the product or process of a tax reform proposal, see BIRNBAUM & MURRAY, *supra* note 183, at 76-78 (describing initial tax reform plans of Treasury Secretary James Baker and Deputy Treasury Secretary Richard Darman shortly after they moved over from the White House).

224. *See* BARTLETT, *supra* note 188, at 30. It appears that President Bush's Tax Reform Panel

The continued interest in completely replacing current taxes with a national sales tax, and the current tax reform stalemate, may be a reflection of the top-down organizational structure within the legislative and executive branches. Reportedly, individuals at the highest levels of government maintain an interest in this idea even though "bottom-up" analysts of both liberal and conservative persuasion who have examined the details of the proposal, which I hope now includes every reader of this Article, have recognized its obvious failings.[225]

There is of course risk that too much authority granted to a committee and its chair will allow them to behave opportunistically in contravention of the wishes of the majority party and the majority in the legislature.[226] "Tax reform" legislation, for example, may mysteriously morph into "tax cut" legislation once the committee gets its hands on it.[227] What this worry suggests is that although a strong chair may be a necessary ingredient for a successful tax reform effort, that alone is insufficient. Further mechanisms must be devised to help ensure that the committee's interests are properly aligned with those of the rest of the legislature.

Let me end this Article where I began it by returning to the period following the 1994 congressional elections, to review briefly the evidence as it relates to the issues raised in this Part. In hindsight, we know that the flat tax proposal favored by House Majority Leader Armey was never taken up by the Committe on Ways and Means during the six years that Congressman Archer chaired the committee. There is evidence that Armey was frustrated by the committee's inaction and sought without success to

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was subject to greater political constraints than was the Treasury Department under President Reagan in the initial development of tax reform proposals. *Compare* Ackerman & Altshuler, *supra* note 64, at 173-75 (identifying constraints on the Tax Reform Panel), *with* McLure & Zodrow, *supra* note 211, at 38, 46 (describing the process under which Treasury I was formulated).

225. *See* TAX PANEL REPORT, *supra* note 6, at 207 (rejecting complete replacement of federal income tax with retail sales tax); Gale, *supra* note 66, at 900; John Buckley & Diane Lim Rogers, *Is a National Retail Sales Tax in Our Future?*, 104 TAX NOTES 1277, 1287 (2004); Bartlett, *supra* note 47, at 1003; Richard W. Stevenson, *Bush Prepares for Changes in Programs and Cabinet*, N.Y. TIMES, Nov. 7, 2004, at A34; Richard W. Stevenson, *Big Tax Plans, Big Tax Risks*, N.Y. TIMES, Nov. 8, 2004, at A1 (describing interest of Vice-President Cheney in, among other things, replacing current taxes with national sales tax).

226. This was the state of affairs prior to the mid-1970s changes, where the committees were viewed as thwarting the will of the majority party in Congress. *See* ROHDE, *supra* note 170, at 163-64. Julian Zelizer has described this time as a "period when Congress gained an unfavorable reputation . . . . Congress seemed to be a relic from an earlier century, a decentralized body in which authority was scattered among committee chairs and where policymaking took a long time." JULIAN E. ZELIZER, THE AMERICAN CONGRESS: THE BUILDING OF DEMOCRACY 312 (Julian E. Zelizer ed., 2004).

227. *See* WITTE, *supra* note 211, at 160-65 (describing elimination of reform elements of Kennedy Administration tax proposals by congressional tax-writing committees and addition of new tax cut provisions).

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bypass the committee.[228] What we don't know is whose position—Archer's, Armey's, or perhaps some third view altogether—was most consistent with the position of the other party leaders in the House as well as the Republican rank and file. Thus, we don't know to what extent the failure to take up the Armey proposal was a sign of strength on the part of the committee and its chair.[229]

Between 1995 and 1997, the Committee on Ways and Means held a series of hearings on proposals to replace the current income tax. The hearings lasted approximately forty-six hours spread over ten days and 120 witnesses were called to testify.[230] These bare facts, however, do not reveal the quality of the information produced by the hearings. By focusing exclusively on proposals to "replace" the income tax, the committee ruled out at the outset an entire range of possible tax reforms. In addition, the Treasury Department refused to proffer any specific reform proposals of its own, despite vigorous prodding by Chairman Archer.[231]

Finally, it is unclear how informative the hearings were to Archer and the other members of the committee.[232] Usually, the chair of the committee is the most well-informed member at a hearing because of the chair's involvement in the planning for the hearing and the level of support and briefings received from staff. Despite this, as we have seen, Archer may have remained confused on certain key issues raised at the hearings.[233] One can only speculate about the level of understanding on the part of the other members. This last uncertainty serves as a useful reminder that in addition to being influenced by the factors discussed in this article, the quality of legislation is also a function of the people serving in the legislature.[234]

IV. CONCLUSION

This Article has examined two aspects of former House Ways and Means Committee Chairman Bill Archer's famous vow following the 1994 Congressional elections to completely replace the income tax with a

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228. *See* MANN & ORNSTEIN, BROKEN BRANCH, *supra* note 172, at 104.

229. *Cf.* Tim Groseclose & David C. King, *Committee Theories Reconsidered*, *in* CONGRESS RECONSIDERED 191, 209 (Lawrence C. Dodd & Bruce I. Oppenheimer eds., 7th ed. 2001) (suggesting test of committee's gatekeeping power is whether it can prevent a bill from becoming law despite floor's preference for the bill).

230. In addition, the committee received 158 submissions for the record. The committee reports for all of the hearings total about 2,200 pages.

231. *See 1995 W&M Hearings*, *supra* note 3, at 245-48.

232. Twenty-nine of the thirty-six committee members posed questions at some point during the three days of hearings in 1995. Participation was somewhat lower during the 1996 and 1997 hearings.

233. *See supra* notes 154-59 and accompanying text; text accompanying notes 168-70.

234. *Cf.* Strahan & Palazzolo, *supra* note 176, at 113-14 (describing Gingrich Speakership as an example where "individual leader effects" were important).

broad-based consumption tax, such as a national retail sales tax, because the income tax is "too broken to be fixed." Part I of the Article first shows that Archer's preferred substitute, a retail sales tax, would not be a viable complete replacement tax. Its reliance on just one type of transaction—a retail sale of a good or service by a business to a household—as the single event prompting tax liability constrains the permissible base and rate of the tax so that it could not provide an adequate amount of revenue for this country.

The Article then considers whether Archer was nevertheless correct in claiming that the current tax system is effectively beyond reform. Part II describes other possible ways to replace the income tax with a broad-based tax on consumption and concludes that a proposal specifically rejected by Archer, the Hall-Rabushka flat tax, provides a viable structural framework within which a replacement tax system could be designed. It then speculates on why Archer nevertheless rejected this option and suggests that pessimism about the tax legislative process may have played a role.

Part III discusses the legislative process. It identifies two trends—a greater top-down organizational structure and an increasingly fractured and externally focused legislative body—that may justify pessimism about the successful passage of real tax reform by Congress. In short, there may be more truth than we might like to believe in Archer's assertion that the current tax system is presently beyond reform.

APPENDIX

Republicans Selected to Serve on Ways and Means Committee, 1995-2006

							% vote obtained in general election		
First Name	Last Name	State	District Number	Year appointed	Year First Elected to Congress	# years service prior to appointment	most recent prior to appointment	2nd most recent prior to appointment	3rd most recent prior to appointment
Jon	Christensen	Nebraska	2	1995	1994	0.0	50%	-	-
Mac	Collins	Georgia	8	1995	1992	2.0	66%	55%	-
Jennifer	Dunn	Washington	8	1995	1992	2.0	76%	60%	-
Philip	English	Pennsylvania	3	1995	1994	0.0	49%	-	-
John	Ensign	Nevada	1	1995	1994	0.0	48%	-	-
Sam	Johnson	Texas	3	1995	1991^^	3.5	91%	86%	53%
Jim	Nussle	Iowa	1	1995	1990	4.0	56%	50%	50%
Rob	Portman	Ohio	2	1995	1993**	1.5	77%	70%	-
Jim	Ramstad	Minnesota	3	1995	1990	4.0	73%	64%	67%
Dick	Zimmer	New Jersey	12	1995	1990	4.0	68%	64%	64%
Jimmy	Hayes	Louisiana	7	1996	1986^	9.0	53%	73%	58%
J.D.	Hayworth	Arizona	5	1997	1994	2.0	48%	55%	-
Kenny	Hulshof	Missouri	9	1997	1996	0.0	49%	-	-
Wes	Watkins	Oklahoma	3	1997	1996	0.0	51%	-	-
Jerry	Weller	Illinois	11	1997	1994	2.0	52%	61%	-
Mark	Foley	Florida	16	1999	1994	4.0	100%	64%	58%
Ron	Lewis	Kentucky	2	1999	1994*	4.5	64%	58%	60%
Scott	McInnis	Colorado	3	1999	1992	6.0	66%	69%	70%
Kevin	Brady	Texas	8	2001	1996	4.0	92%	93%	59%
Paul	Ryan	Wisconsin	1	2001	1998	2.0	67%	57%	-
Eric	Cantor	Virginia	7	2003	2000	2.0	69%	67%	-

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							% vote obtained in general election		
First Name	Last Name	State	District Number	Year appointed	Year First Elected to Congress	# years service prior to appointment	most recent prior to appointment	2nd most recent prior to appointment	3rd most recent prior to appointment
Bob	Beauprez	Colorado	7	2005	2002	2.0	55%	47%	-
Chris	Chocola	Indiana	2	2005	2002	2.0	54%	50%	-
Melissa	Hart	Pennsylvania	4	2005	2000	4.0	63%	65%	59%
John	Linder	Georgia	7	2005	1992	12.0	100%	79%	100%
Devin	Nunes	California	21	2005	2002	2.0	73%	70%	-
Tom	Reynolds	New York	26	2005	1998	6.0	56%	74%	69%
					total	84.5			
					average	3.13			

* Elected in May 1994

^ Hayes was elected as a Democrat, but switched parties in late 1995

** Elected March 1993, so most recent election was 1994, second most recent was March 1993

^^ Elected in May 1991, so third most recent election was May 1991

Source: National Journal, Almanac of American Politics, 1996, 1998, 2000, 2002, 2004, 2006.

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