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NOTE

REFRAMING THE FLAT TAX DEBATE: THREE NOT-SO-EASY STEPS FOR EVALUATING RADICAL TAX REFORM PROPOSALS

*M. Scotland Morris**

I. INTRODUCTION

"[T]he power to tax involves the power to destroy. . . ."

—Chief Justice Marshall (1819)[1]

* This Note is dedicated to the love of my life, my wife, Kay.

1. McCulloch v. Maryland, 17 U.S. (1 Wheat.) 316, 431 (1819).

The United States' tax system is destroying the American dream.[2] That seems to be the rallying cry of a growing movement to abolish the federal tax code as we know it and replace it with a flat-rate system, or flat tax.[3] Several recent high-profile proposals for the enactment of a flat tax,[4] combined with growing taxpayer discontent,[5] have energized a national tax reform debate among politicians and voters of both political parties.[6]

Politicians and media commentators who support flat tax proposals argue that a flat tax would be superior in many ways to our current federal income tax system. Their opponents also base their (counter) arguments on the current tax system. Scholars, meanwhile, usually analyze flat tax systems by applying theoretical, aspirational standards of tax policy. Thus, flat tax reform is generally approached in two different ways: the popular press presents the debate by comparing flat tax reform proposals to the current system (I call this the "popular" debate); scholars, on the other hand, explore flat tax reform using more abstract constructs (I call this the "scholarly" debate).

This Note explores both of these debates and suggests an alternate framework for analyzing flat tax reform. Part II provides a brief background for the study of flat tax systems. Part III analyzes the leading flat tax proposals. Part IV presents the flat tax debate in its popular and scholarly forms. Part V exposes the shortcomings inherent in both of these approaches. Part V then reframes the flat tax debate by identifying the fundamental issues that must be addressed when evaluating the desirability of enacting a flat tax. This Note concludes that the flat tax debate should be reframed to focus on three fundamental issues: (1) determining the appropriate tax base (i.e., deciding whether we should tax income or consumption); (2) adopting an appropriate analytical frame of reference for evaluating radical tax reform proposals; and (3) selecting and prioritizing our tax policy objectives.

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2. See, for example, the remarks of Congressman Richard Armey at 141 CONG. REC. E1461, 1461 (daily ed. July 19, 1995) (extension of remarks accompanying introduction of the Freedom and Fairness Restoration Act). Congressman Armey, in a section entitled "American Dream in Danger," states: "Our government is too big, and it spends, taxes, and regulates too much. This is the central crisis facing America today." *Id.*

3. Louis S. Richman, *The Flat Tax: It's Hot It's Now It Could Change the Way You Live*, FORTUNE, June 12, 1995, at 36 (noting that the idea of replacing the current tax code with something radically different, such as a flat tax, has become "a broad political movement, gaining in popularity the way a hurricane gathers force as it heads for land").

4. *Id.* at 36-38; Ann Reilly Dowd, *Why a True Flat Tax Could Flatten You*, MONEY, Jan. 1, 1996, at 84.

5. Rachel Wildavsky, *How Fair Are Our Taxes?*, WALL ST. J., Jan. 10, 1996, at A12.

6. Dowd, *supra* note 4, at 84; *see also Taxation Progressives*, WALL ST. J., Dec. 7, 1995, at A14.

II. A FLAT TAX PRIMER

A. *The Need for Tax Reform*

> " 'Simplicity in modern taxation is a problem of basic architectural design. Present legislation is insufferably complicated and nearly unintelligible. If it is not simplified, half of the population may have to become tax lawyers and tax accountants.' "
>
> —Henry C. Simons (1950)[7]

Tax reform is nothing new.[8] Efforts to change and improve our tax system have been a staple of American politics since the inception of the first income tax law in 1913.[9] However, widespread support for a flat tax is a fairly recent phenomenon.[10] Furthermore, as we will see later in this Note, most flat tax proposals present a dramatic departure from our current income tax system. What is behind the recent calls for such drastic reform? Proponents of a flat tax system argue that a flat tax would increase simplicity, economic growth, and fairness, and would eliminate loopholes and tax preferences for special interest constituencies.[11] Opponents disagree about the likelihood of achieving these

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7. HENRY C. SIMONS, FEDERAL TAX REFORM (1950), *quoted in* Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusion of Tax Simplification*, 2 GEO. MASON INDEPENDENT L. REV. 319, 319 (1994).

8. For example, proposals to enact a national consumption tax have been mooted since 1921. *See* William L. Raby & Burgess J. Raby, *Will There Be Tax Practitioners After the Flat Tax?*, 96 TAX NOTES TODAY 37-79 (Feb. 22, 1996).

9. *See* Pollack, *supra* note 7, at 322.

10. *See* 141 CONG. REC. S10320, S10322 (daily ed. July 19, 1995) (statement of Senator Shelby introducing the Freedom and Fairness Restoration Act) ("Two years ago, the flat tax was not even considered as an alternative in the tax reform debate."). *But see* Milton Friedman, *A 1962 Flat-Tax Proposal Revisited*, WALL ST. J., Feb. 9, 1996, at A14 (revisiting the case economist Friedman made for a flat tax in 1962).

11. *See, e.g.*, 141 CONG. REC. E1461 (daily ed. July 19, 1995) (extension of remarks by Congressman Richard K. Armey accompanying introduction of the Freedom and Fairness Restoration Act) (citing simplicity, fairness, economic growth, and the elimination of loopholes and anti-family penalties as the primary reasons Congressman Armey introduced his flat tax proposal). *See also* ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX 2-3 (2d ed. 1995). Hall and Rabushka, the fathers of the modern flat tax, argue:

> The federal income tax is a complete mess. It's not efficient. It's not fair. It's not simple. It's not comprehensible. . . . It costs the economy billions of dollars in lost output of goods and services from investments being made for tax rather than for economic purposes. It involves tens of thousands of lawyers and lobbyists

objectives, as well as the relative importance that should be placed on them. In the midst of this debate, however, there are two points on which most participants agree: our current tax system is overly complex, and reform efforts should seek to simplify reporting requirements for mainstream taxpayers.

There seems to be nearly universal dissatisfaction with the level of complexity in our present tax system.[12] Congressman Richard Armey, sponsor of one of the leading flat tax proposals, recently declared that, due to its complexity, our tax system is "[p]erhaps the greatest ball-and-chain on America's freedom and prosperity. . . ."[13] While this statement is certainly hyperbole, it is not unfounded. Taxpayers spend an estimated five billion hours a year filling out tax forms.[14] Taxpayers use 480 tax forms for reporting and paying taxes and another 280 forms to assist in the completion of these tax forms.[15] In order to administer the tax system, the IRS has ballooned to twice the size of the CIA and five times the size of the FBI.[16] One tax economist has estimated that complying with the rules of the current federal tax system costs the nation $140 billion a year.[17]

In recent years, the complexity of the federal tax system has reached staggering proportions.[18] The Internal Revenue Code is now thousands

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getting tax benefits for their clients instead of performing productive work.

Id. at 2. Hall and Rabushka's solution is "a low, simple flat tax." *Id.* at 3.

12. *See, e.g.,* Charles E. McLure, Jr., *The Budget Process and Tax Simplification/Complication*, 45 TAX L. REV. 25, 26-27 (1989) ("There is . . . substantial agreement that [the recent] increase in complexity [in the U.S. tax system] is undesirable.").

13. 141 CONG. REC. E1461 (daily ed. July 19, 1995) (extension of remarks by Congressman Richard K. Armey accompanying introduction of the Freedom and Fairness Restoration Act).

14. David Gergen, *The Flat Tax Diversion*, U.S. NEWS & WORLD REP., Feb. 5, 1996, at 80; *see also* 141 CONG. REC. S15515, S15516 (daily ed. Oct. 24, 1995) (remarks of Senator Arlen Specter) ("It is reliably estimated that some 5.4 billion hours annually are spent by Americans on tax compliance.").

15. Hall & Rabushka, *supra* note 11, at 5; *see also* John C. Goodman, *Principles of the Flat Tax*, 96 TAX NOTES TODAY 31-37 (Feb. 13, 1996).

16. Gergen, *supra* note 14, at 80.

17. *Tax Reform: Tax Reform Proposals Could Cut Costs of Tax Compliance for Millions, Hall Says*, 1996 DAILY TAX REP. 9, at d6 (Jan. 16, 1996) (reporting on the findings of Tax Foundation economist Arthur P. Hall that federal tax compliance costs the United States $140 billion annually); *cf.* 141 CONG. REC. S15515, S15516 (daily ed. Oct. 24, 1995) (remarks of Senator Arlen Specter) ("Our current Internal Revenue System is a mammoth bureaucracy requiring Americans to spend . . . hundreds of billions of dollars in compliance, estimated as high as $595 billion by Fortune magazine.").

18. *See* McLure, *supra* note 12, at 26 ("There seems to be little disagreement that the U.S. tax system has become much more complicated in recent years.").

of pages long.[19] The Code, in turn, is supported by an intricate patchwork of regulations, revenue rulings, and other Treasury pronouncements.[20] In fact, income tax regulations alone comprise over 6400 pages of fine print.[21]

These unsettling statistics have led some to conclude that excessive complexity alone is reason enough to abandon our current tax system for something simpler and more efficient. Indeed, one tax scholar has bluntly stated that, because of its intractable complexity and inefficiency, "the current [income tax] system is a hopeless mess, not worthy of resurrection."[22] Furthermore, inefficiency and taxpayer exasperation are not the only products of a complex tax system. One author points out the subtle, but pervasive and very real effects that excessive complexity produces:

> "A law that can be understood (if at all) by only a tiny priesthood of lawyers and accountants is naturally subject to popular suspicion. By undermining popular support, complexity erodes the self-assessment on which economical compliance depends. Making taxpayers record and report information that is inherently difficult to audit places an often prohibitive tax on honesty. Furthermore, dealing with the law's arcane provisions requires rare talents that might be better applied to other tasks in the economic system."[23]

Thus, there is a strong case for dramatic tax reform. Undeniably, the present level of complexity in our tax system is undesirable, and efforts to reduce this complexity should be welcomed. But even the simplest and most efficient tax system would be widely and loudly condemned if it was considered unfair or if it stymied economic growth. Therefore, tax reform proposals must be evaluated for more than their ability to reduce complexity—other issues must be considered. After examining our current tax system and contrasting it with the leading flat tax proposals, we will be better able to analyze the full range of issues surrounding flat tax reform.

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19. Richard L. Doernberg, *A Workable Flat Rate Consumption Tax*, 70 IOWA L. REV. 425, 425 (1985). West Publishing Company published the 1994 Code in two volumes containing almost 1400 pages. HALL & RABUSHKA, *supra* note 11, at 5.

20. *See* 141 CONG. REC. S16014, S16015 (daily ed. Oct. 27, 1995) (statements of Sen. Specter) ("The current Internal Revenue Code, with its myriad deductions, credits and schedules, [is supported by] over 12,000 pages of rules and regulations. . . .").

21. HALL & RABUSHKA, *supra* note 11, at 5.

22. Doernberg, *supra* note 19, at 426.

23. McLure, *supra* note 12, at 27 (quoting DAVID BRADFORD, UNTANGLING THE INCOME TAX 266 (1986)).

B. *An Introduction to the Federal Tax System*

Under the current federal tax system, individuals are subject to taxation on "all income from whatever source derived."[24] This broad definition of income for tax purposes, referred to as "gross income," encompasses wages and other compensation, income from certain businesses, interest, dividends, rents, alimony, pensions, and capital gains (i.e., the appreciation in value of certain property over time), among other things.[25] Gross income is adjusted by numerous deductions and exemptions in order to arrive at "taxable income."[26] Tax rates ranging from 15% to 39.6% are then applied to taxable income.[27] The resulting tax may be reduced by any "credits" (e.g., the earned income credit)[28] the taxpayer qualifies for in order to arrive at the amount of income tax payable.[29]

In addition to levying an individual income tax on a broad range of income producing activities, the federal government also imposes payroll taxes on wages (i.e., Social Security and Medicare payroll deductions).[30] Payroll taxes effectively take 15.3% of most workers'

24. I.R.C. § 61(a) (1996).

25. *Id.* For an enlightening discussion of tax "income," see J. MARTIN BURKE & MICHAEL K. FRIEL, TAXATION OF INDIVIDUAL INCOME 24-33 (1994).

26. I.R.C. §§ 62-63 (1996). Gross income is reduced by certain deductions in order to arrive at "adjusted gross income." *Id.* § 62. From adjusted gross income, taxpayers may deduct either a "standard deduction" or the sum of certain allowed "itemized deductions." *Id.* § 63. Adjusted gross income is further reduced by "personal exemptions" in order to arrive at taxable income. *Id.* § 151. For 1995, the combined standard deduction, personal exemptions, and dependent deductions for a family of four was $16,550. I.R.S. Publication 17 (1995).

27. I.R.C. § 1. This multi-tiered rate structure, which taxes higher levels of income at higher rates, is partially responsible for making our tax system "progressive." A progressive tax system requires high income taxpayers to pay a larger fraction of their income in taxes than low income taxpayers. BURKE & FRIEL, *supra* note 25, at 4. Progressivity in taxation accomplishes one of the basic functions of tax policy: to allocate the cost of government on an ability-to-pay basis. *Id.* However, graduated tax rates are only one element of our tax system which produces progressivity. Tax credits for the working poor, standard deductions, and deduction phase-outs for upper income taxpayers also contribute to the progressivity of our current tax system. For an informative analysis of progressivity under a flat tax, see Charles R. O'Kelley, Jr., *Tax Policy for Post-Liberal Society: A Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax*, 58 S. CAL. L. REV. 727 (1985).

28. I.R.C. § 32(c).

29. Note that income tax can actually be a "negative" amount where an individual's tax credits exceed his tax from taxable income (i.e., the government may owe the taxpayer a refund for the amount of the net tax credit).

30. Thomas G. Donlan, *The Worst Tax*, BARRON'S, Feb. 5, 1996, at 58, 58.

wages.[31] Corporations also are subject to federal taxation on their taxable income.[32] Corporate tax rates range from 15% to 35%.[33]

Under our current tax system, investments in corporate stock are taxed twice: once at the corporate level through corporate income taxes, and again at the individual level, as individuals must include stock dividends and capital gains in gross income.[34] Human labor also is taxed twice under the current tax system: once through payroll taxes, and a second time through individual income taxes[35] because gross income includes *gross* wages.[36] In fact, due to this double taxation of labor, most working Americans give up more than 30% of their earnings to the federal government, and some pay more than 60%.[37]

Because both investments and labor are double taxed, individual taxpayers' earnings may become subject to three or four layers of taxation, as savings and investments are often made from "after-tax" income (i.e., wages net of payroll and income taxes).[38] For example, if a wage earner puts part of his paycheck into a savings account, he will be subject to three layers of taxation on the amount saved (i.e., payroll taxes, income taxes on his wages, and income taxes on the interest earned from saving).[39] If a worker decides to invest in corporate stock, he endures four layers of taxation because the corporation is taxed before it distributes any dividends to him.[40] The reduction or elimination of multiple layers of taxation on savings and investments is one of the primary goals of flat tax supporters.[41]

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31. *Id.* The payroll tax claims 7.65% directly from workers, and another 7.65% nominally paid by employers, on wages up to approximately $61,000. *Id.* After this cutoff, the payroll tax continues to claim 1.45% from workers and a matching amount from employers. *Id.*

32. I.R.C. § 11(a). Generally speaking, a corporation's taxable income is roughly equivalent to its net income. However, there can be significant differences between a corporation's taxable income and its net income for accounting purposes in any given year.

33. I.R.C. § 11(b).

34. *See generally* Rebecca S. Schaefer, *How the Flat Tax Ends Double Taxation*, 96 TAX NOTES TODAY 33 (Feb. 16, 1996).

35. Donlan, *supra* note 30, at 58.

36. *See* I.R.C. § 61.

37. Donlan, *supra* note 30, at 58.

38. *See* Doernberg, *supra* note 19, at 435 ("Interest and dividends currently are taxable to the recipients even though the income used to make those payments also is taxed when earned by the user of the funds.").

39. *See* I.R.C. § 61; *see also* Donlan, *supra* note 30, at 58.

40. *See* I.R.C. § 11(a).

41. *See, e.g.*, Brian S. Wesbury, *Letters to the Editor: Some Round Figures on the Flat Tax*, WALL ST. J., May 18, 1995, at A17 ("[T]he flat tax would eliminate the double and triple taxation of business incomes.").

III. ANALYSIS OF LEADING FLAT TAX PROPOSALS

A. *The Academic Approach: The Hall-Rabushka Flat Tax*

In 1981, two senior fellows at Stanford's Hoover Institution, Robert Hall and Alvin Rabushka, inspired a modest national debate with their proposal to "replace the federal income tax system with a 'flat tax.' "[42] Although the Hall-Rabushka plan did not achieve a critical mass of popular or political support when first introduced, it has become the model upon which many prominent modern flat tax proposals have been crafted.[43] As such, a rudimentary examination of the Hall-Rabushka plan provides a profitable introduction to the key principles of flat tax systems, as well as a useful reference point for comparing variations on the flat tax theme.

Under the Hall-Rabushka plan, the voluminous Internal Revenue Code would be replaced with a four-page document.[44] In place of the hundreds of tax forms currently used by the IRS, only two would be needed: one for individuals and another for businesses.[45] Either tax return would fit on a postcard-sized document.[46] In order to achieve such breathtaking simplicity, the plan would replace the myriad income tax provisions covering individuals, corporations, partnerships, trusts and estates, pension plans, etc., with two easily calculated taxes.[47] Both the individual and the business tax would use a single-rate structure[48] and would apply the same 19% tax rate to their respective tax bases,[49] thus, the moniker "flat tax."

The Hall-Rabushka flat tax plan would tax individuals solely on compensation (i.e., wages, salaries, and payments from private pensions).[50] Interest, dividends, and capital gains would not be subject to

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42. Robert Eisner, *Make Taxes Fair, Not Flat*, WALL ST. J., Apr. 11, 1995, at A20. On December 10, 1981, Hall and Rabushka published their flat tax proposal in the Wall Street Journal. *Id.* Later, in 1983, Hall and Rabushka published an expanded book version of their flat tax proposal in LOW TAX, SIMPLE TAX, FLAT TAX. Doernberg, *supra* note 19, at 485 n.2. Hall and Rabushka's most recent book on the subject is *The Flat Tax.*

43. *See* Eisner, *supra* note 42, at A20. The Hall-Rabushka prototype serves as the foundation for flat tax proposals by Richard Armey, Steve Forbes, and Arlen Specter. *See infra* pt. III.B.

44. Doernberg, *supra* note 19, at 425.

45. Richman, *supra* note 3, at 36; *see also* HALL & RABUSHKA, *supra* note 11, at 52-82.

46. HALL & RABUSHKA, *supra* note 11, at 55.

47. Doernberg, *supra* note 19, at 425; *see also* HALL & RABUSHKA, *supra* note 11, at 52-82.

48. Technically, there are two tax rates: 19% and 0% (on amounts below the "personal allowance," discussed *infra* note 53 and accompanying text).

49. HALL & RABUSHKA, *supra* note 11, at 55-64.

50. *Id.* at 58-60. Contributions by employers to pension plans and other fringe benefits

tax.[51] Furthermore, individuals would not need to report or pay taxes on payments that are "unaccompanied by the production of income," such as gifts and alimony.[52] The only deduction allowed would be a "personal allowance,"[53] resembling a combination of the current standard deduction and personal exemption. The allowance for a family of four would be $25,500 and would be indexed for inflation.[54] Itemized deductions, including the home mortgage interest deduction and the charitable gift deduction, would be eliminated.[55] Credits against income tax, such as the earned income credit and the child and dependent care credit, would also be eliminated.[56]

The Hall-Rabushka plan would tax *all* businesses at the *entity level*.[57] Thus, so-called "pass-through" entities, such as partnerships and S-corporations, would calculate and pay taxes directly instead of passing taxable income on to their owners to be taxed at the individual level, as is the current practice. Another stark change under the Hall-Rabushka plan is the treatment of capital assets.[58] Currently, the cost of significant, durable business assets is deductible over time through depreciation deductions.[59] Under the Hall-Rabushka plan, the complexities of accounting for depreciation would be eliminated through immediate deduction of the acquisition cost of all assets.[60] There would also be significant changes in the deductibility of business expenses.[61]

Hall and Rabushka state that they have designed their flat tax to be revenue neutral, that is, to bring in as much tax revenue as the current

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would be excluded from compensation. *Id.* at 58.

51. *Id.* at 59-60.

52. Doernberg, *supra* note 19, at 431.

53. HALL & RABUSHKA, *supra* note 11, at 59.

54. *Id.* The total "personal allowance" would be calculated in the following manner: married couples filing jointly would begin with an allowance of $16,500; single taxpayers would start with an allowance of $9,500; persons claiming head of household status would start with an allowance of $14,000; in addition to these amounts, taxpayers would receive a $4,500 allowance for each dependent. *Id.* at 59 fig. 3.1.

55. *Id.* at 59-60.

56. *See id.* at 58-60 (Figure 3.1, Hall and Rabushka's "Individual Wage Tax Form," does not include any credits in the computation of tax); *see also id.* at 114-15 (eliminating child and dependent care credit under Hall-Rabushka plan).

57. *See id.* at 60-64.

58. Doernberg, *supra* note 11, at 62-64.

59. *See* I.R.C. § 167.

60. Doernberg, *supra* note 19, at 440; *see* HALL & RABUSHKA, *supra* note 11, at 70-72.

61. *See* HALL & RABUSHKA, *supra* note 11, at 62-64 ("Many deductions allowed to businesses under current laws are eliminated in our plan, including interest payments and fringe benefits."); *see also* Doernberg, *supra* note 19, at 438 ("No deduction would be permitted for fringe benefits, local taxes, or pension contributions. There would be no investment tax credit, no jobs credit, and no interest deduction.").

system.[62] However, they admit that their calculations may be "a little optimistic."[63] Indeed, their calculations are based on an estimated national tax base that does not take into account income that escapes tax reporting (i.e., the so-called "underground economy").[64] Hall and Rabushka contend that other factors make up for this overestimate of the national tax base.[65] For example, while Hall and Rabushka project that their flat tax will result in an increase in economic growth of six percent over seven years,[66] they do not factor this growth into their revenue calculations.[67] Nevertheless, their claim of revenue neutrality, while credible, is speculative. Accordingly, their 19% tax rate and personal allowance amounts are both subject to debate, even by flat tax supporters.

B. *Political Approaches: Leading Flat-Tax-Inspired Tax Reform Proposals*

Politicians, seizing upon growing taxpayer frustration, have recently unveiled a number of radical tax reform plans employing flat tax concepts.[68] Three of the leading proposals, the Armey plan, the Forbes plan, and the Specter plan, are Hall-Rabushka style flat tax plans.[69] The so-called "USA Tax," sponsored by Senators Nunn and Domenici, shares some of the attributes of a flat tax.[70] Senator Lugar has also attracted attention with his proposed national sales tax, a sort of distant cousin of the flat tax.[71]

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62. HALL & RABUSHKA, *supra* note 11, at 55-59.

63. *Id.* at 58.

64. *See id.*; *see also* Doernberg, *supra* note 19, at 444 ("[T]o the extent that the underground economy remains, the [Hall-Rabushka] proposal may [overestimate] the tax base.").

65. HALL & RABUSHKA, *supra* note 11, at 58.

66. *Id.* at 89. Hall and Rabushka "project a three percent increase in [economic] output from increased total work in the U.S. economy and an additional increment to total output of three percent from added capital formation and dramatically improved entrepreneurial incentives . . . after the economy has had seven years to assimilate the changed economic conditions brought about by [their] flat tax." *Id.* They claim that "[b]oth the amount and the timing [of the economic growth] are conservative." *Id.*

67. *Id.* at 58.

68. *See supra* notes 3-6 and accompanying text.

69. The "Armey plan" is sponsored by Congressman Richard Armey and Senator Richard Shelby. *See* 141 CONG. REC. E1461 (daily ed. July 19, 1995). The "Forbes plan" is promoted by former presidential candidate Steve Forbes. The "Specter plan" is sponsored by Senator Arlen Specter. *See* 141 CONG. REC. S3390, S3416 (daily ed. Mar. 2, 1995) (statement of Sen. Specter). For convenience, I refer to these initiatives by the last name of the primary sponsor of each proposal.

70. For a detailed explanation of the Unlimited Savings Allowance (USA) Tax, see 141 CONG. REC. S5664, S5664 (daily ed. Apr. 25, 1995) (statement of Sen. Domenici).

71. *See* Richman, *supra* note 3, at 37-38. A national sales tax is akin to a flat tax in that

Though the Armey, Forbes, and Specter plans are based squarely on the Hall-Rabushka plan,[72] these plans all differ in various ways from that prototype. The Armey plan calls for an initial flat tax rate of 20%; after a two year phase-in period, the rate would be lowered permanently to 17%.[73] Additionally, the Armey plan provides a personal allowance of $33,300 for a family of four.[74] Thus, the Armey plan differs modestly from the Hall-Rabushka plan by using a lower tax rate (17% vs. 19%) and a higher personal allowance ($33,300 vs. $25,500 for a family of four).[75] Armey's relative largess is primarily a result of the congressman's belief that his flat tax system "will spur economic growth and thus expand revenue to the Treasury."[76] The Armey plan guards against future congressional tinkering through a provision requiring a 60% supermajority of the House and Senate to raise the tax rate, create multiple tax rates, lower personal allowances, or create loopholes.[77]

The Forbes plan also closely follows the flat tax principles of Hall and Rabushka. Like the Armey plan, however, the Forbes flat tax differs slightly from the Hall-Rabushka plan by using a lower tax rate and a higher personal allowance. The Forbes plan calls for a 17% tax rate and a personal allowances of $36,800 for a family of four.[78] Thus, the Forbes plan, like the Armey plan, depends on anticipated economic growth in order to remain revenue neutral.[79] Forbes also echoes Hall

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they are both considered "consumption" taxes. In fact, the national sales tax is often regarded as "[t]he purest form of consumption tax." *Id.* at 38. For a brief discussion of consumption taxes see *infra* notes 103-05 and accompanying text.

72. *See* HALL & RABUSHKA, *supra* note 11, at viii (thanking Congressman Armey for "introduc[ing] a variation of our flat tax" and Steve Forbes for "remain[ing] a staunch supporter of our flat tax for many years"); 141 CONG. REC. S15515, S15517 (daily ed. Oct. 24, 1995) (remarks of Sen. Specter) ("My flat tax is based on the analyses done over a period of years by highly respected economic professors, Robert Hall and Alvin Rabushka, of Stanford's Hoover Institute.").

73. 141 CONG. REC. E1461, E1462 (daily ed. July 19, 1995) (statement of Rep. Armey). Like the Hall-Rabushka plan, the Armey plan would impose an individual wage tax and a business tax using the same tax rate. *Id.* at E1461.

74. *See id.* at E1461. Allowance amounts under the Armey plan would be $11,350 per taxpayer (i.e., $11,350 for a single person and $22,700 for a married couple filing jointly), and $5,300 for each dependent. *Id.* All of these amounts would be indexed for inflation. *Id.*

75. For comparison between the Armey plan and the Hall-Rabushka plan, see *id.*; *see also* HALL & RABUSHKA, *supra* note 11, at 59 fig. 3.1.

76. 141 CONG. REC. E1461, E1462 (daily ed. July 19, 1995). Armey's bill also includes cuts in federal spending in an effort to achieve revenue neutrality. *Id.*

77. *Id.*

78. *See* Dowd, *supra* note 4, at 84. Under the Forbes plan, allowances would be $13,100 per taxpayer (i.e., $26,200 for a married couple filing jointly), plus $5,300 per dependent. *Id.*

79. *See generally* Alan Murray, *GOP Adherents Study Merits of a Flat Tax*, WALL ST. J.,

and Rabushka's call to eliminate taxes on wealth transfers (i.e., estate and gift taxes).[80]

The Specter plan resembles the Hall-Rabushka flat tax, but departs from it more significantly than the Armey and Forbes plans. In addition to a personal allowance of $25,500 for a family of four,[81] the Specter plan permits limited deductions for charitable contributions and interest on home mortgages.[82] To compensate for these additional deductions, the Specter plan uses a 20% flat tax rate.[83]

The Nunn-Domenici USA Tax is not really a flat tax. Indeed, the USA Tax is based predominantly on the current income tax system.[84] Although the USA Tax is not based on the Hall-Rabushka flat tax, it borrows two central ideas from that plan. "USA" stands for Unlimited Savings Allowance.[85] Accordingly, after measuring an individual's income in much the same manner as the current system,[86] the USA Tax provides a deduction for the amount of income the individual saved and invested during the tax year.[87] Thus, like the Hall-Rabushka plan, the USA Tax favors savings.[88] Unlike the Hall-Rabushka plan, however, the USA Tax does not exempt all income and gains (i.e., capital gains) generated from saving and investing; instead, the USA Tax provides a deduction only for "net new savings [and investments]."[89]

Like the Hall-Rabushka plan, the USA Tax system "consists of a single, integrated tax in two parts," one part being "a low, flat rate tax on all businesses."[90] However, unlike the Hall-Rabushka plan, the USA Tax on individuals uses three graduated rates.[91] Furthermore, the USA

Jan. 29, 1996, at A1.

80. *See* Dowd, *supra* note 4, at 85; HALL & RABUSHKA, *supra* note 11, at 26-27.

81. *See* 141 CONG. REC. S3390, S3417 (daily ed. Mar. 2, 1995) (statements of Sen. Specter). The Specter plan uses the same personal allowance amounts as the Hall-Rabushka plan. *See id.*

82. *Id.* Deductions for charitable contributions would be limited to $2,500, while deductions for home mortgage interest would be capped at $100,000 in borrowing. *Id.*

83. *Id.* at S3416.

84. *See* 141 CONG. REC. S5664, S5670 (daily ed. Apr. 25, 1995) (statements of Sen. Nunn) ("In a way, the USA Tax System could be described as simply taking the current tax system and adding a deduction for savings.").

85. *Id.* at S5666.

86. *Id.* at S5667.

87. *Id.*

88. *See id.* at S5666 ("[W]e [the sponsors of the USA Tax] believe the central goal of any reform of our tax system should be to raise the level of national savings."); *see also supra* notes 36-41, 50-51 and accompanying text; *infra* notes 103-05 and accompanying text.

89. 141 CONG. REC. S5664, S5667 (daily ed. Apr. 25, 1995).

90. *Id.* The tax rate on all business income would be 11%. Richman, *supra* note 3, at 39.

91. 141 CONG. REC. S5664, S5668 (daily ed. Apr. 25, 1995) ("We [the sponsors of the USA Tax] are proposing a progressive system, not a flat tax."). The top personal tax rate would

Tax on individuals retains the current tax system's approach whereby numerous deductions, exemptions, and allowances are netted against a broadly defined measure of income in order to arrive at the tax base.[92]

The USA Tax also contains two new deductions that are not currently allowed to individuals. The first is a deduction for tuition expenses for post-secondary education.[93] The second is a deduction for the employee share of payroll taxes.[94] In order to pay for these new deductions and the unlimited savings allowance while remaining revenue neutral,[95] the USA Tax would impose a top individual tax rate of 40%.[96] Given its high tax rates and retention of the current system's complexity, the USA Tax seems unlikely to inspire much enthusiasm from ardent tax reformers.

The national sales tax plan advocated by Senator Lugar is by far the most radical of the tax reform plans currently being discussed. Under his plan, individual and corporate income taxes, as well as estate taxes, would be eliminated; instead, merchants and businesses would collect a 17% sales tax on consumer goods and services and remit it to the federal government.[97] Senator Lugar contends that since his plan would free individuals and businesses from reporting taxable income, the IRS could be eliminated.[98] Undeniably, this is taxation at its flattest and simplest. However, a national sales tax would be highly regressive. That

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be 40%. Richman, *supra* note 3, at 39.

92. 141 CONG. REC. S5664, S5667 (Apr. 25, 1995).

93. *Id.* at S5668. Post-secondary education includes "college, trade or vocational school, or remedial education." *Id.*

94. *Id.*

95. Senator Nunn has stated that although the USA Tax has not undergone "official revenue analysis[,] . . . [i]t is our intention that this system . . . be revenue neutral compared to the current system." *Id.* at S5669.

96. *See* Richman, *supra* note 3, at 39. Note, however, that the USA Tax would allow taxpayers to deduct a standard "family living allowance" *in addition to* itemized deductions to determine taxable income:

> [T]he USA proposal contains a family living allowance that is similar to the current standard deduction except that it is in addition to any itemized deductions, not an alternative to itemized deductions. . . . A family of four filing a joint return would have its first $17,600 of income exempt from taxation by adding this family living allowance to its four personal exemptions.

141 CONG. REC. S5664, S5667 (daily ed. Apr. 25, 1995).

97. *See* 1995 Daily Tax Rep. (BNA) 66, at d3 (Apr. 6, 1995); Richman, *supra* note 3, at 38. Senator Lugar's proposed rate of 17% is designed to be revenue neutral. *See* 1995 Daily Tax Rep. (BNA) 66, at d3 (Apr. 6, 1995).

98. *See* 1995 Daily Tax Rep. (BNA) 66, at d3 (Apr. 6, 1995); Richman, *supra* note 3, at 38.

is, it would have a disproportionate impact on the poor and elderly since they spend a larger percentage of their income on goods and services than other taxpayers.[99] While this regressivity could be partially mitigated by exempting certain necessities (Senator Lugar, for example, suggests food and medicine),[100] the sales tax rate would have to be increased beyond 17% in order to remain revenue neutral. Furthermore, even with exemptions for necessities, a national sales tax likely would be more regressive than a flat tax, because all major flat tax proposals offer substantial personal allowances[101] that effectively exempt the poor and (most) elderly from paying taxes altogether. Further still, states are likely to strongly protest any trespass on their sales tax turf. Thus, a national sales tax is probably too "flat" to be palatable.

C. *A Flat Tax vs. Our Current System*

As one tax scholar has observed, any resemblance between our current tax system and a flat tax system based on the Hall-Rabushka prototype is "illusory."[102] Our current system operates as an *income* tax. That is, it taxes both personal consumption and savings—the two components of income under the classic equation used by tax scholars and economists: income = consumption + savings.[103] A flat tax, meanwhile, is really a type of *consumption* tax.[104] That is, it taxes only personal consumption, not savings.[105] Furthermore, our current tax system uses five tax rates for individual taxpayers[106] and four rates for corporate taxpayers.[107] A flat tax uses one uniform rate for all taxpayers.[108] Thus, there are two fundamental structural differences between

99. *See* 1995 Daily Tax Rep. (BNA) 66, at d3 (Apr. 6, 1995); Richman, *supra* note 3, at 38. Middle-class and affluent taxpayers save and invest a larger percentage of their income than the poor and elderly. For a brief discussion of the relationship between income, consumption, and savings, see *infra* notes 103-05 and accompanying text.

100. *See* 1995 Daily Tax Rep. (BNA) 66, at d3 (Apr. 6, 1995).

101. *See supra* notes 54, 74, 78, 81 and accompanying text.

102. Doernberg, *supra* note 19, at 435.

103. *See* Joseph Bankman & Thomas Griffith, *Is the Debate Between an Income Tax and a Consumption Tax a Debate About Risk? Does It Matter?*, 47 TAX L. REV. 377, 378 (1992) ("Under the so-called [classic] Haig-Simons definition, income is defined as the sum of personal consumption and year-end accretion to wealth [i.e. savings].").

104. *See* Doernberg, *supra* note 19, at 426. The Hall-Rabushka flat tax would be considered a "yield exemption consumption tax." *See* Bankman & Griffith, *supra* note 103, at 379.

105. *See* Bankman & Griffith, *supra* note 103, at 379; *see also* HALL & RABUSHKA, *supra* note 11, at 55. For an overview of the categories of consumption taxes, see Leslie B. Samuels, *Remarks of Leslie B. Samuels*, 1995-SPG FED. B. ASS'N SEC. TAX'N REP. 11 (1995).

106. I.R.C. § 1.

107. I.R.C. § 11.

108. *See* HALL & RABUSHKA, *supra* note 11, at 55-56.

the current federal income tax system and a Hall-Rabushka type of flat tax: tax base and rate structure.[109]

These dramatic structural differences are the product of Hall and Rabushka's "four tenets" of flat taxation:[110]

> 1. Income should be taxed only once, as close as possible to its source.[111]
> 2. All types of income should be taxed at the same low rate.[112]
> 3. The poor should pay no tax at all, and the fraction of income that is paid as tax should rise with income.[113]
> 4. Tax returns should be simple enough to fit on a postcard.[114]

The first tenet (avoiding multiple layers of taxation) reflects two maxims. First, incentives to save are diminished by multiple layers of taxation on savings and investment, and a low rate of national savings can retard economic growth and inflate interest rates.[115] Second, *people* ultimately pay all forms of taxation, even taxes that are nominally levied on businesses.[116] Thus, the owners of a business entity should be taxed only once on the income generated by the business.[117]

The second tenet (using a low, unified rate) reflects the belief that allowing taxpayers to keep a high percentage of every dollar earned will maximize incentives to work and increase economic growth.[118] Further, a low, unified tax rate reduces opportunities and incentives for tax avoidance.[119] The third tenet reflects the belief that taxes should be progressive.[120] The fourth tenet reflects the belief that complexity

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109. *See* Doernberg, *supra* note 19, at 427-30.
110. *See id.* at 430-31.
111. HALL & RABUSHKA, *supra* note 11, at 52.
112. *Id.* at 52-53.
113. *Id.* at 53.
114. *Id.* at 52, 54.
115. *See id.* at 70-72, 84-89.
116. *Id.* at 60; *see also* Doernberg, *supra* note 19, at 431.
117. HALL & RABUSHKA, *supra* note 11, at 60.
118. *See The Flat Tax: Why Not?*, WALL ST. J., Jan. 30, 1996, at A18 (advocating a flat tax as one way to achieve low "marginal" rates "if the government lets everyone keep more of the next dollar he or she earns, this will maximize incentives and spur economic growth").
119. *See* HALL & RABUSHKA, *supra* note 11, at 16-17; *see also* Brian S. Wesbury, *Letters to the Editor: Some Round Figures On the Flat Tax*, WALL ST. J., May 18, 1995, at A17 ("A flat tax will eliminate distortions in economic decisions currently made solely to minimize taxation.").
120. See *supra* note 28 for an explanation of progressivity.

should be reduced to an absolute minimum so that compliance can be as simple as possible.

IV. THE FLAT TAX DEBATE(S)

A. *The Popular Flat Tax Debate*

> "[R]eal tax relief cannot come from tinkering at the margins, by adding a new break here or a new loophole there. Breaks and loopholes are part of the problem, not the solution."
>
> —Senator Arlen Specter (1995)[121]

> "The complexity of our code in the main is not there because of some mischief[.] Most of it is there in the effort to do more perfect justice."
>
> —Senator Russell Long (1986)[122]

Politicians and media commentators have advanced numerous arguments both for and against a flat tax. What follows is a roundup of the major arguments in the flat tax debate as commonly framed by the popular press (i.e., the "popular" debate).

Proponents of a flat tax generally present the following issues as the crucial considerations for tax reform:

Simplicity. *Pro*: A flat tax would be much simpler to administer and comply with than our current system.[123] *Con*: Three-fourths of individual taxpayers do not itemize deductions;[124] thus, many taxpayers' returns are already fairly easy to prepare. Two-thirds of individual taxpayers currently pay a "flat" 15% tax rate.[125]

Efficiency. *Pro*: The savings to both government and taxpayers in reduced administrative costs under a flat tax system would be enor-

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121. 141 CONG. REC. S15515, S15516 (daily ed. Oct. 24, 1995).

122. TIMOTHY J. CONLAN ET AL., TAXING CHOICES 141 (1990) (quoting Senator Russell Long, Former Chairman of the Senate Finance Committee, *quoted in Senate Finance Comm. Hearings on Tax Reform Proposals*, 99th Cong., 2d Sess. 53 (1986)).

123. *See Is a Flat Tax the Right Cure?*, U.S. NEWS & WORLD REP., Jan. 15, 1996, at 38; *see also supra* notes 12-25, 44-49 and accompanying text.

124. *Statement of Margaret M. Richardson, Commissioner of Internal Revenue, Before the House Committee on Small Business*, 95 TAX NOTES TODAY 209-48 (Oct. 25, 1995).

125. *Id.* Many taxpayers are only subject to a single tax rate; that is, all of their taxable income falls within the lowest (15%) "bracket."

mous.[126] *Con*: The transition to a flat tax system would be difficult and could have a negative short-term impact on the economy.[127]

Savings and investment. *Pro*: Since income from savings and investments would not be taxed at the individual level, there would be greater incentive for people to save.[128] This would increase personal economic security, as well as the national savings rate. Further, investment decisions would not be skewed by tax considerations. *Con*: Since wealthy taxpayers are able to save a greater percentage of their income than poorer taxpayers, the wealthy would benefit disproportionately from tax-free saving and investing.

Economic growth. *Pro*: A higher national savings rate would make capital available at lower interest rates, thus spurring business investment, with resulting gains in economic growth.[129] Further, since all business entities would be subject to the same tax rate, business decisions would not be complicated by arcane tax considerations.[130] *Con*: Projections of economic growth from flat tax effects are speculative, and the actual benefits would probably be more modest than some flat tax proponents suggest.[131] Further, economists project that some of the current flat tax proposals being debated would increase the federal budget deficit if enacted at the tax rates propounded by their sponsors.[132]

Opponents of a flat tax generally focus debate on the following issues:

Fairness. *Con*: The idle wealthy, living off inherited wealth, would pay no taxes.[133] Thus, a flat tax would be a "sop to the rich."[134] Wealthy taxpayers would pay less in taxes under a flat tax than the

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126. *See* Donlan, *supra* note 30, at 58; *see also Tax Reform: Tax Reform Proposals Could Cut Costs of Tax Compliance for Millions, Hall Says*, 1996 DAILY TAX REP. 9, at d6 (Jan. 16, 1996) (reporting on the findings of Tax Foundation economist Arthur P. Hall that "potential savings in compliance costs under three major tax reform proposals could be massive": compliance cost could decrease 94% under the Armey plan; 76% under the USA Tax; and 92% under Senator Lugar's national sales tax).

127. *Is a Flat Tax the Right Cure?*, *supra* note 123, at 38.

128. *Id.*

129. *See The Flat Tax: Why Not?*, WALL ST. J., Jan. 30, 1996, at A18.

130. *See Is a Flat Tax the Right Cure?*, *supra* note 123, at 38.

131. Alan Murray, *GOP Adherents Study Merits of a Flat Tax*, WALL ST. J., Jan. 29, 1996, at A1.

132. *See, e.g., id.* (referring to a Treasury estimate that the Forbes plan would cut tax revenues by up to $200 billion annually). *But see Very Close*, WALL ST. J., Jan. 15, 1996, at A12 (arguing that the Treasury's projection that the Armey plan will widen the budget deficit by $138 billion "suffers . . . from the usual static analysis").

133. *See The Flat Tax: Why Not?*, *supra* note 129, at A18.

134. *Contra Very Close*, *supra* note 132, at A12.

current system, while the tax burden on the middle-class would increase.[135] Our current multiple rate structure is more progressive than a flat tax. *Pro*: A larger group of "poor" taxpayers would pay no taxes under a flat tax.[136] Effective tax rates would be progressive, especially at lower income levels, due to generous personal allowances.[137] Under some flat tax plans, payroll taxes would be deductible, eliminating double taxation on wage earners.[138] "Fairness" is treating everyone the same.[139] "What could be fairer than taxing income only once?"[140]

Real estate. *Con*: Elimination of the mortgage interest deduction could cause a significant decline in real estate values.[141] *Pro*: Interest rates should fall due to the elimination of interest from the tax base, thus making home purchases more affordable and refinancing more attractive.[142] The mortgage interest deduction benefits only a fraction of taxpayers.[143] The deductibility of mortgage interest has not been proven to have any effect on home ownership rates.[144] Homeowners will benefit under a flat tax because they will pay no capital gains taxes when they sell their homes.[145]

Donations to charities. *Con*: Elimination of the deduction for charitable contributions may reduce donations to charities.[146] *Pro*: " 'As incomes rise under a flat tax (as a result of increased economic growth, saving and investment), so too will donations to America's charities.' "[147]

Social and economic policy. *Con*: A flat tax would eliminate the ability to enact social and economic policy through the tax system. *Pro*: A flat tax would eliminate special preferences and reduce economic

135. *Is a Flat Tax the Right Cure?*, *supra* note 123, at 38.

136. *Id.*

137. *See The Flat Tax: Why Not?*, *supra* note 129, at A18.

138. *See, e.g.*, Amity Shlaes, *Wage Reform: Kemp Tax Team Rewards Labor*, WALL ST. J., Jan. 9, 1996, at A14 (describing the Kemp Commission's proposal to "[a]llow full deductibility of the payroll tax for working men and women"); *supra* note 94 and accompanying text (payroll taxes deductible under USA Tax).

139. *The Flat Tax: Why Not?*, *supra* note 129, at A18 (paraphrasing a statement by the Kemp Commission).

140. Wesbury, *supra* note 119, at A17.

141. *See* Bruce R. Bartlett, *Will the Flat Tax KO Housing?*, WALL ST. J., Aug. 2, 1995, at A10 (citing a widely publicized study by DRI/McGraw-Hill that predicts a 15% decline in housing prices if the mortgage interest deduction is eliminated).

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Is a Flat Tax the Right Cure?*, *supra* note 123, at 38.

147. *Taxleads*, 1996 Daily Tax Rep. (BNA) 23, at d16 (Feb. 5, 1996) (quoting a statement by Congressman Richard Armey issued on Jan. 29, 1996).

distortions caused by enacting social and economic policy through the tax system.[148]

Clearly, the popular debate is characterized by division and contradiction. Politicians and media commentators are sharply divided as to the relative importance of the issues in the flat tax debate. Further, both sides advance contradictory predictions of the impact of a flat tax on each of these issues. Thus, the popular debate has likely produced more confusion than resolution in the minds of many taxpayers. However, despite this (perhaps predictable) failure, the popular press has succeeded in directing the public's attention to the debate over radical tax reform and the issues surrounding the flat tax debate.

B. *The Scholarly Flat Tax Debate*

> "For what reason is there, that he which laboreth much, and sparing the fruits of his labor, consumeth little, should be charged, more then he that living idley, getteth little, and spendeth all he gets; seeing the one hath no more protection from the Commonwealth then the other?"
>
> —Thomas Hobbes (1651)[149]

> "Complexity does not enter the tax code so much out of malevolence as through misguided reform efforts and excessive demands made on tax laws as the vehicle for implementing public policy."
>
> —Prof. Sheldon D. Pollack (1994)[150]

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148. *See* Milton Friedman, *Why a Flat Tax Is Not Politically Feasible*, WALL ST. J., Mar. 30, 1995, at A14.

> The political function of the [individual and corporate] income taxes, which is served by their being complex, is to provide a means whereby the members of Congress who have anything whatsoever to do with taxation can raise campaign funds. That is what supports the army of lobbyists in Washington who are seeking to produce changes in the income tax, to introduce special privileges or exemptions for their clients, or to have what they regard as special burdens on their clients removed. A [flat tax] would [thwart these objectives] since the structure of the tax is so simple and straightforward.

Id.

149. Pollack, *supra* note 7, at 353-54 n.126 (quoting THOMAS HOBBES, LEVIATHAN PART II ch. 30 (1651)).

150. *Id.* at 321.

For well over a decade, scholars have vigorously debated the merits of enacting a flat tax.[151] However, instead of relying chiefly on comparisons with our current tax system, scholarly debate generally focuses on evaluating flat tax proposals against theoretical, aspirational principles of tax policy. Under such an approach, the choice of the tax principles used to evaluate a tax proposal becomes extremely important to the outcome of the debate. Thus, the key to understanding scholarly debate over flat tax proposals is often to identify which principles of tax policy a given author is using to evaluate a given proposal. Scholars have advanced a wide variety of views on what the fundamental objectives of tax policy should be.

Over 200 years ago, in *The Wealth of Nations*, Adam Smith advanced four aspirational goals for all tax systems: equality, economy in collection, certainty, and convenience of payment.[152] Thus, Smith's tax policy goals might be restated as: fairness, efficiency, and simplicity. Interestingly, Leslie B. Samuels, Assistant Treasury Secretary for Tax Policy, recently declared these three goals to be "fundamental tax policy objectives."[153]

The "traditional theoretical approach" to tax policy identifies seven "general purposes" that a tax system should serve: revenue-raising; administerability; stability; horizontal equity; vertical equity; neutrality; and political order.[154] These purposes have been restated as requiring an analysis of whether a tax system: raises adequate revenue, in an equitable manner, without undue complexity, and without undue interference with the economy.[155] Thus, the modern "traditional" approach shares concern for fairness and simplicity with the Smith and Samuels approaches, and adds revenue-raising and economic neutrality as key objectives. Indeed, according to some scholars, economic neutrality has recently become "the dominant characteristic of tax policy debate."[156]

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151. *See supra* notes 10 & 42.

152. *See How to Evaluate Tax Reform*, BUS. WEEK, Jan. 8, 1996, at 122 (referring to ADAM SMITH, THE WEALTH OF NATIONS (1937)).

153. Leslie B. Samuels, *Remarks of Leslie B. Samuels*, 1995-SPG FED. B. ASS'N SEC. TAX'N REP. 11 (1995).

154. *See* Nancy E. Shurtz, *A Critical View of Traditional Tax Policy Theory: A Pragmatic Alternative*, 31 VILL. L. REV. 1665, 1667 (1986).

155. Martin J. McHahon, Jr., *Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself*, 50 WASH. & LEE L. REV. 459, 461 (1993).

156. *Id.*; *see also A Better Way to Pay*, THE ECONOMIST, Jan. 13, 1996, at 32. "One compelling objective of tax policy . . . is to make taxes as neutral as possible: rather than punish some productive activities a lot, punish them all a little." *Id.*

Tax scholars also have identified four functions that our current federal income tax system serves: raising revenue to operate the government; allocating the cost of government on an ability-to-pay basis; serving as a tool of social policy; and implementing economic policy.[157] Thus, our current tax system, which embraces taxation as a means of implementing social and economic policy, seems to be in conflict with the modern trend in tax policy toward economic neutrality. This modern preference for economic neutrality over policy implementation may explain, at least in part, the apparent rise in scholarly and political support for a flat tax.[158]

In summary, there are two distinct approaches to the flat tax debate and, indeed, to tax reform in general. Scholars generally evaluate tax reform proposals in relation to an ideal tax system, as defined by theoretical, aspirational tax policy objectives.[159] Therefore, the conclusions reached by scholars are highly dependent on the tax policy objectives selected to embody the ideal tax system. Scholars generally choose some combination of the following objectives: revenue-raising; fairness; efficiency; simplicity; economic neutrality; enactment of social policy; and implementation of economic policy. Since some of these objectives can be conflicting (e.g., fairness and simplicity), and others are mutually exclusive (e.g., economic neutrality and implementation of social or economic policy), scholars inevitably disagree as to which tax policy objectives should be used to shape the ideal tax system. Thus, because scholars cannot even agree about the formula for the ideal tax system, they are doomed to disagree about whether any particular tax

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157. BURKE & FRIEL, *supra* note 25, at 4-5.

158. *See, e.g.*, 141 CONG. REC S10320-04, S10321 (daily ed. July 17, 1995), on the introduction of the "Armey-Shelby" flat tax bill. Senator Shelbey stated:

> When considering any proposal for tax reform, one has to ask the question, "Should the Federal Government coerce free individuals by means of tax policy?" I believe the answer is a clear and resounding "No." In other words, tax policy should neither encourage nor discourage the personal decisions of free individuals in America. If one accepts this premise, one has to conclude the best alternative for tax reform is the flat tax. No other tax proposal, not [even] the sales tax, . . . has the attribute of neutrality.

Id.

159. *See, e.g.*, Charles R. O'Kelley, Jr., *Tax Policy for Post-Liberal Society: A Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax*, 58 S. CAL. L. REV. 727, 739 (1985) (arguing for the enactment of a "flat rate comprehensive income tax" using, *inter alia*, a hypothetical "simple, pre-money society" called "Nirvana" to illustrate the desirability and equity of such a tax).

reform proposal represents an advance toward or a retreat from such an ideal.

Politicians and media commentators approach tax reform by comparing proposals like the flat tax to the existing tax system. Thus, although the popular debate touches upon many of the same issues found in the scholarly debate (e.g., simplicity, fairness, economic growth, policy enactment), the focus is quite different. Overwhelmingly, the popular debate centers on whether a particular tax reform proposal will be "better" or "worse" for different taxpayer constituencies.[160] Thus, while scholars generally engage in the flat tax debate as part of the ongoing search for the "perfect" tax system, the popular press presents the debate as a political choice.

V. REFRAMING THE FLAT TAX DEBATE

A. *Limitations of the Popular and Scholarly Debates*

The popular and the scholarly debates are both worthwhile in that they present two different approaches to the issues involved in the flat tax debate. Further, they have produced volumes of relevant information, analysis, and informed opinion on the subject. It is, however, my opinion that neither debate affords the average taxpayer an appropriate basis for making an intelligent decision about whether to support the enactment of a flat tax. I believe that this failure is due largely to the way these two debates are framed.

The popular flat tax debate is inherently limited in its usefulness because it is one-dimensional: it relies on the current tax system as its sole frame of reference for evaluating flat tax proposals. Nearly all of the arguments advanced by politicians and media commentators, both pro and con, have one thing in common: they are based on comparing flat tax proposals to our current tax system.[161]

This frame of reference is problematic for at least three reasons. First, it is counterproductive to use a tax system that is widely loathed and disparaged as the benchmark for evaluating tax reform proposals. How many companies or individuals would evaluate their performance and seek to improve it by comparing themselves to an underachieving peer? Such an approach is hardly conducive to achieving dramatic improvement. By relying on our current tax system as its solitary benchmark for tax reform, the popular debate limits itself to answering, at best, the question of whether a flat tax would be better than the status

160. *See supra* notes 129-31.

161. *See supra* notes 123-48 and accompanying text.

quo. Given the increasing level of taxpayer dissatisfaction with our present tax system (and this despite numerous recent "reforms"), a *better* system hardly seems good enough. The objective of real tax reform should be to develop and implement the *best* tax system that is achievable. Similarly, the debate surrounding tax reform should have as its goal to identify the *best* system(s) from the many competing alternatives.

The second problem with the popular debate's approach is that contrasting flat tax systems with the current system makes for an "apples and oranges" comparison. A flat tax system would depart radically from our current system, and would have substantial, incalculable effects at the national and individual level. Any conclusions about the relative superiority of one system over the other will be speculative or highly generalized or both. Thus, the popular debate affords, at best, a marginal basis for projecting whether a flat tax *might* be better by some measures than the present system. This is hardly a reassuring basis upon which to decide whether to enact a flat tax, given the dramatic change inherent in such reform.

I do not wish to suggest that there is no merit in using our current tax system as a benchmark in the flat tax debate. Certainly, it is profitable to compare any tax reform proposal to our current tax system. The status quo provides a natural and relevant reference point for evaluating change. In fact, the status quo serves as a good benchmark for evaluating minor changes to a system. But when the changes are as dramatic as those contemplated by switching from an income tax to a flat tax, the status quo does not serve as an adequate benchmark, at least not by itself.

The third deficit of the popular debate is that it has been infected (some might argue molded) by politics. By pitting flat tax systems against the current system and focusing on the relative "winners" and "losers" under a flat tax, the popular debate has largely degenerated into a quarrel between various political constituencies. In fact, it seems that the popular "debate" is more often characterized by political rhetoric and one-sided arguments than by objective analysis and thoughtful deliberation. This political orientation is divisive rather than consensus-building, and substantially diminishes the usefulness of the popular debate as a basis for rational decisionmaking.

The scholarly flat tax debate is also problematic. Scholars generally rely on abstract, theoretical principles as their primary frame of reference for evaluating flat tax proposals. The main problem with this approach is that outcomes are determined largely by the tax policy objectives chosen to evaluate tax reform proposals. And, since there is substantial disagreement over the priority that various tax policy objectives should enjoy, scholars can reach different conclusions from their colleagues simply because they employ different "starting points" for their analyses. In other words, the same tax reform proposal can look quite different in the hands of one scholar versus another based solely on differences in the two scholars' beliefs about tax policy. As a result, the scholarly debate is not as detached and objective as one might imagine.

In fact, if a scholar were interested in promoting a particular side in the flat tax debate, that scholar could readily "back into" the desired conclusion through careful selection or prioritization of the tax policy objectives to be used in the scholar's analysis. For example, a discussion which focused heavily on the implementation of social and economic policy would almost certainly conclude that flat tax reform efforts are misguided (or worse). On the other hand, a dissertation which focused on simplification, efficiency, and economic neutrality would likely conclude in favor of a flat tax.

While scholars are certainly less likely than politicians and media pundits to blatantly pursue political purposes at the expense of research and analysis, biases and individual preferences undoubtedly creep into even the best scholarly work, especially work centered on policy. Thus, despite a considerably higher level of analysis than that found in the popular debate, the scholarly debate is not immune from "politics." Accordingly, the conclusions of scholars engaged in the flat tax debate must be scrutinized for bias.

The scholarly debate also is limited in its usefulness to the average reader because scholars tend to focus on the "trees" in the flat tax debate, sometimes at the expense of the "forest." That is, scholars often engage in lengthy debate over narrow, complex tax and economic issues in order to defend and develop their theories and observations.[162] Likely, all but a "tiny priesthood"[163] of tax experts are left befuddled by these dissertations.

B. *Three Not-So-Easy Steps: The Fundamental Issues of Flat Tax Reform*

Given that neither the popular debate nor the scholarly debate provide an ideal frame of reference for non-experts to evaluate flat tax proposals, how should one approach the flat tax debate? I suggest that there are three fundamental issues which every taxpayer should consider when deciding if he or she supports enacting a flat tax. Briefly, they

162. Of course, the pursuit of narrow, complex issues is perfectly appropriate for scholars. Nonetheless, it still limits its usefulness to the non-expert.

163. *See supra* note 23 and accompanying text.

may be stated as: (1) determining the appropriate tax base; (2) adopting an appropriate analytical frame of reference; and (3) selecting and prioritizing our tax policy objectives.

The first fundamental tax reform issue that must be addressed involves determining what tax base to use. That is, we must decide whether to tax income or consumption. Recall that flat tax systems differ from income tax systems in two fundamental structural aspects: tax base and rate structure.[164] Of these two, the more radical departure from our current system is unquestionably the narrower tax base employed in a flat tax system.[165] Merely flattening the existing rate structure would be easy.[166] More importantly, it would not amount to major tax reform; the tax system would retain all of its current, objectionable features (complexity, inefficiency, multiple layers of taxation, etc.). Rather, it is the change in the tax base which is the hallmark of flat tax reform; it is the change from taxing income to taxing consumption which holds the potential to eliminate or reduce the ills the flat tax is designed to cure, and perhaps to accomplish its designers' loftier goals of increasing savings and economic growth.[167] Plainly stated, deciding whether to tax income or consumption is the most profound choice we must make about tax reform.

Proponents of a flat tax argue that the main benefit of taxing consumption rather than income lies in increasing economic growth through increasing the rate of savings by exempting savings and investment from taxation.[168] As we have seen, this claim is subject to dispute.[169] Furthermore, we must ask whether this potential benefit is worth the unsettling vision of removing idle millionaires, living off inherited wealth, from the federal tax rolls? Consider, however, that before wealth can be inherited it must be earned, and thus would be subject to tax at least once under a flat tax. Further, some flat tax plans retain wealth transfer taxes (i.e., estate and gift taxes). Additionally,

164. *See supra* note 109 and accompanying text.

165. *See* David Wessel, *What Should Be Taxed Will Be the Key Issue*, WALL ST. J., May 1, 1995, at A1 ("The truly radical feature of [the Armey plan] isn't the flat rate. . . . What makes Mr. Armey's plan provocative is that he proposes to eliminate every existing tax deduction . . . and to exempt all interest, dividends and capital gains from the personal income tax. [Thus,] the tax would apply to a narrower base. . . .").

166. *See id.* ("Congress could retain the current income tax code with all its complexities and deduction and raise as much money with roughly a 21% flat rate. . . .").

167. *See* HALL & RABUSHKA, *supra* note 11, at 55 ("Here is the logic of our system, stripped to basics: We want to tax consumption.").

168. *See id.* at 84.

169. *See supra* notes 129-32 and accompanying text.

taxing consumption allows for greater simplicity and efficiency than taxing all sources of income—a benefit for taxpayers of all classes.

Still, many will be understandably troubled by the idle millionaire scenario, especially if federal estate and gift taxes are eliminated in conjunction with the enactment of a flat tax. One compromise is to impose a special tax (in addition to a "regular" flat tax) on large amounts of wealth—perhaps in the form of a federal ad valorem tax. While such a tax system would be more complicated and less "flat" than a "regular" flat tax, it might satisfy those who object to a flat tax based solely on the specter of idle millionaires paying no taxes.

The second fundamental tax reform issue that must be addressed involves selecting the appropriate analytical frame of reference for evaluating radical tax reform proposals. That is, we must consider whether flat tax proposals and other reform efforts should be compared to our current system (the popular approach), or to theoretical, aspirational principles of tax policy (the scholarly approach), or to some other measure. The scholarly approach has the merit of being conceptually superior because it strives to find the best tax system rather than just a better system. However, the popular debate is certainly much more accessible and understandable for the non-expert. I have previously argued that the popular and scholarly frames of reference are both useful, however, both have inherent limitations. Accordingly, I would like to suggest a third, supplementary frame of reference: Lon Fuller's celebrated "principles of legality."[170]

It seems to me that Fuller's aspirational principles for the creation of "good" law afford an excellent basis for evaluating tax reform proposals. Such an undertaking could provide an objective (i.e., policy-free) analysis of whether a reform proposal was "good" law by classic jurisprudential standards.[171] Further, our current tax system could be analyzed under these same principles and the results compared. Admittedly, analysis under Fuller's principles of legality would be

170. *See* LON L. FULLER, THE MORALITY OF LAW 33-94 (rev. ed. 1969). Fuller's eight principles of legality flow from his concept of the "inner" or "internal" morality of law. *See id.* The principles of legality are aspirational in nature, comprising "eight kinds of legal excellence toward which a system of rules may strive." *Id.* at 41. These principles may be summarized as: generality (there must be rules); promulgation (laws must be available to those whom they govern); prospectivity (laws should not be retroactive); clarity (laws should be clear); non-contradictoriness (laws should not contradict one another); possibility of performance (laws should not require the impossible); stability (laws should not change too frequently); and congruence between official action (i.e., enforcement) and declared law. *See id.* at 46-91.

171. Fuller's principles of legality embody only the "internal" morality of law (loosely defined as the efficacy or jurisprudential "goodness" of law), as distinguished from law's "external" morality (i.e., policy judgments about the content of law). *See generally* FULLER, *supra* note 170. Thus, the principles of legality are inherently free from policy bias.

somewhat esoteric and would not resolve important questions about tax policy. However, in a debate as fraught with politics and policy disagreements as the flat tax debate, it would certainly be refreshing and enlightening to see how various tax systems rate and compare in terms of their efficacy as law.

The third fundamental tax reform issue that must be addressed involves selecting and prioritizing the many competing and diverse objectives of tax policy. In other words, what should our tax system focus on? Or, put differently, what should tax *reform* focus on? Revenue-raising? Economic growth? Fairness? Efficiency? Simplicity? Economic neutrality? Enactment of social policy? Implementation of economic policy? On this issue I merely offer three observations. First, the answer cannot be "all of the above," since some of these policy objectives are either conflicting or mutually exclusive.[172] Second, the priorities we assign to these competing tax policy objectives will have a profound impact on the type of tax reform we pursue. Third, while decisions about tax policy are difficult and contentious, they are too important to be left in the hands of politicians, media pundits, or even scholars; "average" taxpayers should carefully consider what policies *their* ideal tax system would pursue, then voice their views.

I do not wish to suggest that the three fundamental tax reform issues discussed above have not been addressed at all in the popular and scholarly debates. Certainly they are present in both debates in various fashions and with varying levels of clarity and development. However, I believe that, overall, these three fundamental issues have become obscured and their central importance diminished. These three issues underlie every argument advanced for or against a flat tax. They are foundational and fundamental. Yet the popular press and the academic community have, in my opinion, failed to convey the importance of addressing these fundamental issues before related and derivative issues can be properly debated. Thus, in my view, the central deficiency of both the popular and scholarly approaches to the flat tax debate is not so much the content of the debate, but the manner in which the fundamental issues of the debate have been treated.

VI. CONCLUSION

The flat tax debate should be reframed to focus on three fundamental issues: (1) determining the appropriate tax base, (2) adopting an appropriate analytical frame of reference for evaluating radical tax

172. For example, fairness and simplicity are generally conflicting, while economic neutrality and implementation of social or economic policy are mutually exclusive.

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reform proposals, and (3) selecting and prioritizing our tax policy objectives. Deciding these issues will be difficult and contentious; tradeoffs are inherent. But unless these fundamental issues are squarely addressed, tax reform efforts are unlikely to yield equitable, satisfying results. Hopefully, the three-step process developed in this note provides a useful framework for approaching the flat tax debate and making rational decisions about whether to enact a flat tax. If politicians were to follow this three-step process in a conscientious and non-partisan manner, they might be able to resolve the flat tax debate through thoughtful deliberation and compromise. If, however, politicians follow their usual course and engage in partisan rhetoric and political gamesmanship, the likely result will be more tinkering with the existing tax code. This will only prolong the debate; taxpayers' growing thirst for tax reform will not be quenched with anything less than real reform. To accomplish real reform of our tax system, the fundamental issues presented by the flat tax debate must be faced and resolved directly and honestly.