Volume 2 | Issue 1 Article 9

Spring 1999

The Missing Links in Tax Reform

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A funny thing happened on the way to fundamental tax reform: Nothing. Just a few short years ago, it looked as if we might have another great American tax revolt, akin to the one that started this country over 200 years ago. Ronald Reagan had gotten the modern bandwagon started, first in California in the 1970s and later, from the White House, in the 1980s.[1] Politicians—like football coaches, investment advisors, and most of the rest of us—are apt to keep trying the same old thing until it has proven beyond a shadow of a doubt to work no longer. Thus the antitax talk continued full force into the 1990s.

George Bush's quivering lips probably cost him the 1992 presidential election, and only further proved how deadly serious antitax talk had become.[2] The *Contract with America*, which fueled the sweeping Republican electoral victories in the mid-term elections of 1994, was full of fire and brimstone talk of tax.[3] Steve Forbes nearly made the 1996 presidential election a referendum on the flat tax, even as Jack Kemp was more effective at personally cashing in on the idea.[4] The fire still burned bright after Bill

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1 *See, e.g.*, GARRY WILLS, REAGAN'S AMERICA (1987); Kenneth Cooper, *GOP Offers a "Contract" to Revive Reagan Years*, WASH. POST, Sept. 28, 1994, at A1. Of course, Reagan stood in a long line of American tax cutters, haters, and protesters. *See generally* CHARLES ADAMS, THOSE DIRTY ROTTEN TAXES (1998) (chronicling history of taxes and tax protests in America).

2 *See* Alan Murray & Jackie Calmes, *The Great Debate: How the Democrats, with Real Cunning, Won the Budget War*, WALL ST. J., Nov. 5, 1990, at A1; John E. Yang, *Budget Deal Appears at Hand*, WASH. POST, Oct. 25, 1990, at A1; Thomas Patterson, *Bad News, Bad Governance*, 546 ANNALS AM. ACAD. POL. & SOC. SCI. 97, 104 (1996).

3 *See* CONTRACT WITH AMERICA: THE BOLD PLAN BY REP. NEWT GINGRICH, REP. DICK ARMEY, AND THE HOUSE REPUBLICANS TO CHANGE THE NATION (Ed Gillepsie & Bob Schellas eds., 1994) [hereinafter CONTRACT]. *See also* CONTRACT WITH THE AMERICAN FAMILY: A BOLD PLAN BY CHRISTIAN COALITION TO STRENGTHEN THE FAMILY AND RESTORE COMMONSENSE VALUES (1995) [hereinafter CONTRACT II]. I discuss the two Contracts and their talk of tax in Edward J. McCaffery, *Tax's Empire*, 85 GEO. L.J. 71, 128-37 (1996). *See also* EDWARD J. MCCAFFERY, TAXING WOMEN 202-25 (1997).

4 *See* Jackie Calmes, *Forbes's Flat-Tax Plan Will Be a Tough Sell*, WALL ST. J., Feb. 5, 1996, at A1; Jack Kemp, *Lower Taxes, Higher Revenues*, N.Y. TIMES, Feb. 11, 1996, § 4,

Clinton had defeated Bob Dole—perhaps the only major Republican candidate *without* a radical tax overhaul plan.[5] By 1997, Representatives Dick Armey and Billy Tauzin were touring the country putting on a "Scrap the Tax Code Tour," a kind of Lincoln-Douglas debate for the 1990s, with taxes replacing slavery as the topic du jour.[6] Calls for a national sales or value-added tax to replace the income tax gained steam. Republicans took to calling the gift and estate tax the "death tax" and made popular, if not quite populist, calls for its repeal.[7] The "marriage tax" became a front page issue in major newspapers, and Congress was full of proposals to kill it.[8] In a kind of crowning glory to all this talk of tax, Republicans initiated the Tax Code Termination Act, calling for the utter abolition of the income tax as we have come to know it by the dawn of the next millennium.[9]

But, lo and behold, actual tax policy and legislation of the 1990s has looked suspiciously like its predecessors in, say, the 1960s or 1970s—lacking even the radicalness of Ronald Reagan's 1980s. The Omnibus Budget and Reconciliation Act of 1993,[10] the Taxpayer Relief Act of 1997,[11] and the IRS Restructuring and Reform Act of 1998,[12] to name three quick examples, all featured typically *ad hoc* and incremental changes: tinkering among the deck chairs of the Titanic. Among the key provisions of these laws were a nonrefundable $500 per child credit, an expansion of the earned-income tax credit, the creation of new individual retirement accounts (IRAs), reductions in the capital gains rates, and an increase in the unified credit under the estate and gift tax. These changes are hardly the stuff of revolution.

at 15; Rob Norton, *The Wrong Way to Sell a New Idea: The Flat Tax Has Emerged as the Single Biggest Issue in the 1996 Presidential Race. Can It Succeed in Spite of its Supporters?*, FORTUNE, Feb. 19, 1996, at 41.

5 *See* Thomas Powers, *The Last Hurrah*, N.Y. REVIEW OF BOOKS, Feb. 15, 1996, at 3 (discussing Dole and his positions on tax reform); *Dole Calls for "Flat" Tax Rate*, N.Y. TIMES, Jul. 5, 1982, at A17; Lawrence Kudlow, *Cut Taxes, Starve the Beast*, WALL ST. J., Sept. 30, 1996, at A18; Marvin Chirelstein, *Taxes and Public Understanding*, 29 CONN. L. REV. 9, 14 (1996).

6 *See* Agnes Roletti, *Republicans Urging Radical Change in IRS Cheered Here*, SAN DIEGO UNION TRIB., Feb. 22, 1998, at B1.

7 *See* Greg Hitt, *GOP Targets Estate Taxes, Capital Gains*, WALL ST. J., June 10, 1997, at A3; *Estate Tax Elimination: A Family Relief Act* (Editorial), ARIZONA REP., Sept. 11, 1998, at B6. *See also* Joel Dobris, *A Brief for the Abolition of All Transfer Taxes*, 35 SYRACUSE L. REV. 1215, 1225 (1985).

8 *See, e.g.*, Janet Hook, *Appeal Grows for Bid to End "Marriage Tax,"* L.A. TIMES, Oct. 20, 1997, at A1. The so-called marriage tax was a major theme in MCCAFFERY, TAXING WOMEN, *supra* note 3.

9 *See Grandstanding on Taxes*, N.Y. TIMES, June 24, 1998, at A24 (editorial).

10 Omnibus Budget and Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993).

11 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

12 IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998).

So much sound and fury thus signified so much nothing. Even as a large federal surplus made the kind of radical reform called for in the early part of the decade—and called irresponsible by liberals—possible, Democrats, led by President Clinton, continued to advocate a panoply of small *ad hoc* changes, while even Republicans seemed to be abandoning the radical tax reform ship.[13] What happened?

In this essay I want to answer that question by looking at three related missing links in tax reform: the people, principle, and policy. First, however, let us take a deeper look at the rhetoric and reality of tax today.

I. The Rhetoric and Reality of Reform

This Part summarizes the dominant themes in the tax debates over the last quarter-century, and then looks at actual tax reform in the 1990s. It concludes by looking at some structural reasons why the reality of tax reform has not lived up to the fiery promise of its rhetoric.

A. Talk of Tax

The modern antitax movement can usefully, if a bit simplistically, be laid at the feet of Ronald Reagan. Reagan's America featured a vision of a downsized government off of the people's backs, taxing and doing less. Reagan participated in the great tax-limitation movements in California in the 1970s,[14] and he rode this antitax rhetoric into the White House.

Reagan delivered, partially. The two great tax acts of his presidency, the Economic Recovery Tax Act of 1981 (ERTA)[15] and the Tax Reform Act of 1986 (TRA 1986),[16] certainly changed the face of the Internal Revenue Code. The highest marginal tax rate when Reagan took office was 70%, as it had been ever since the Kennedy administration.[17] ERTA lowered this to 50%, and the TRA 1986 brought it down further, to 28% or 33%, depending on how one considers the notorious "bubble."[18] The 1986 Act also eliminated any preference for capital gains, and, notwithstanding

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13 *See State of the Union: Clinton Outlines His Vision for Nation's Transition to the 21st Century*, N.Y. Times, Jan. 20, 1999, at A22; Eric Pianin and Ferge Hager, *With Black Ink, Clinton Draws a Line*, Wash. Post., Jan. 21, 1999, at 6; *Clinton, Republicans Each Pitch Own Tax, Budget Plans*, L.A. Times, Jan. 24, 1999, at A16.

14 *See* David Kyrig, *Refining or Resisting Modern Government? The Balanced Budget Amendment to the U.S. Constitution*, 28 Akron L. Rev. 97, 105 (1995). *See also* Wills, *supra* note 1.

15 Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981).

16 Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

17 I.R.C. § 2001(c) (1976) (amended 1981).

18 *See* Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. Rev. 1861, 1989-99 (1994).

bickering among many practitioners and academics, fairly significantly simplified the Code.[19] Among other things, by raising the standard exemption levels and by indexing the marginal rate brackets for inflation, TRA 1986 got millions of lower and lower-middle income Americans off the tax rolls to stay.[20] By any measure, this was radical tax reform.

Of course, as we well know by now, these tax reductions only captured part of the story. Under Reagan there was in fact, a large shift to payroll and corporate taxes, while the total tax burden stayed more or less the same. Giving credit where credit is due, however, we can at least see the 1980s as a time of significant tax reform.

Tax reform rhetoric continued full force into the 1990s. Indeed, picking up on the success of Reagan, the rhetoric intensified. The *Contract with America* illustrates this trend well. This skilled political tract ingeniously mixed antigovernment, antitax, and pro-family talk. The *Contract* called for a reduction in the capital gains rate and a $500 per child credit, an idea that had originated with the Christian Coalition as an infra-marginal way to get tax relief to all families, without altering the disincentives facing working wives in two-earner ones.[21] These technical provisions were part of a bigger agenda. The *Contract* made clear throughout, with its calls for term limits, supra-majority voting requirements, and a line-item veto, that none other than the federal government, now seen as the arch-enemy to family values, was its prey.[22] Tax had become the government's life-blood; any blow against taxes was a blow against the beast itself. Tax reduction, government downsizing, and morality were all, in the end, one and the same thing.

Going beyond the *Contract*, which perhaps hinged too narrowly on its social conservative underpinnings, talk of tax reform continued to expand and become more specific while retaining its radical taint. In the late 1990s, we have witnessed attacks on the income tax, the "marriage tax," and the "death tax."[23] Advocates of fundamental reform have been recommending a flat tax, national sales tax, VAT tax, MAX tax, just about any tax but what we now have.[24] A defining moment in this antitax fever was the

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19 *See id.* at 1920-23, and sources cited therein.

20 *See* Marjorie Kornhauser, *The Morality of Money: American Attitudes Toward Wealth and the Income Tax*, 70 IND. L.J. 119, 159 (1993); McCaffery, *supra* note 18, at 1894.

21 *See* MCCAFFERY, TAXING WOMEN. *supra* note 3.

22 *See* CONTRACT, *supra* note 3.

23 *See* William Gale, *Tax Reform in the Real World,* 15 YALE J. ON REG. 387 (1998) (book review).

24 *See* Alan Schenk, *The Plethora of Consumption Tax Proposals: Putting the Value Added Tax, Retail Sales Tax and USA Tax Into Perspective*, 33 SAN DIEGO L. REV. 1281, 1283 (1996).

proposal of the Tax Code Termination Act to eliminate the Internal Revenue Code as we have come to know it as of the dawn of the millennium.[25]

B. The Facts of Tax in the 1990s

With so much talk of tax, one would think that something was in fact being done. Since the monumental TRA 1986, however, tax legislation has been characterized by *ad hoc* tinkering within the basic confines of an income-plus-estate tax. Consider, for example, the principal provisions of three major pieces of 1990s tax legislation.

The Omnibus Budget Reconciliation Act of 1993 raised marginal rates a bit, reopened the preference for capital gains that TRA 1986 had briefly shut down, expanded the earned-income tax credit, increased the income taxation of social security benefits, and limited the corporate tax deduction for executive pay.[26]

The Taxpayer Relief Act of 1997 primarily accepted the principal recommendations of the *Contract* by further lowering the tax rates on capital gains and adding a $500 per child credit. It went on to essentially eliminate the taxation of gain on the sale of personal residences, increase the unified credit under the gift and estate tax to $1,000,000 over time, add a bonus for qualified family-owned businesses under the estate tax, modify the treatment of IRAs, and continue a Clinton-era theme of creating special savings provisions for health and education.[27]

The IRS Restructuring and Reform Act of 1998 added scores of relatively minor substantive provisions to its principal themes, which were the administrative overhaul of the IRS and revisions to the procedures for the collection and enforcement of taxes. Among these changes were additional lowering of the capital gains rates and more tinkering with IRAs and savings accounts.[28]

All of these changes did not add up to very much. There was no major change to the structure of the income or "death" taxes, nor was a death blow dealt to the marriage tax. No steps were taken in the direction of simplification. Within days of its passage, for example, the Taxpayer Relief Act was being dubbed the *Tax Preparer's* Relief Act.[29] The 1998 law may only have been worse. As the millennium drew to a close, politicians showed every sign of continued tinkering to come. The more things failed to change, the more they stayed the same.

25 *See supra* note 9.
26 *See supra* note 10.
27 *See supra* note 11.
28 *See supra* note 12.
29 *See, e.g.*, Jacqueline Albus, Comment: *The Deduction for Interest on Student Loans: Relief is on the Way*, 42 ST. LOUIS U. L.J. 591, 610 (1998).

C. Barriers to Reform: The Tyranny of the Practical

Why has so little been done? There are several deep-seated structural barriers to real reform, rooted in both our politics and in our habits of heart and mind. Fundamental change in a system as large, coercive, and important as tax requires the support of the people, which in turn requires the articulation of simple, consistent principles as guides to tax reform. President Reagan was able to use both simplification and an assault on the absurdly high marginal tax rates under the income tax as his principal tools for galvanizing public opinion. Since Reagan, the Great Communicator, we have lacked an articulate and popularly accessible sense of where to go with tax reform. Everybody hates the status quo, it seems, but it is hard to build a positive agenda on negative sentiment alone. Absent some general consensus on the ideal, actual tax reform has fallen prey to what I have called the "tyranny of the practical."[30] Consider three related aspects of this.

First, tax policy, as Michael Graetz among others has pointed out,[31] seems to have become enslaved to the lure of distributive tables. Policymakers in Washington prepare charts of "winners" and "losers" from any proposed tax reform. This characterization has a quite specific meaning. "Winners" are those whose taxes will go down under a proposed change, *ceteris paribus*, and "losers" are those whose taxes will go up. The distributive tables get picked up in the popular press and consciousness. They then stand as an obstacle to further dialogue or ultimate change. Once one has seen oneself stamped as a "loser," typically on the front page of the local newspaper, it is hard to get enthusiastically on board behind any particular tax reform. Nobody likes to lose—most especially not money.

There are some unfortunate things about this political and intellectual habit. Consequences matter, of course, and distribution is one of the most important elements of tax policy. There is, for example, very good reason to believe that the flat tax is unattractive on the grounds of traditional liberal theories of distributive justice *and* in the popular consciousness. Reformers should listen to both dimensions of the case against this idea. There is no reason that the upper class should be the systematic "winner," and the middle class the systematic "loser," under fundamental tax reform. The distributive tables, painted in big broad strokes, are often telling us something important.

The questions of the distributive tables, however, are not *all* that there is to the case for tax reform. There are also problems of

30 *See* McCaffery, *Tax's Empire*, *supra* note 3, at 90-91.

31 *See* Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609 (1995).

measurement, such as whether or not one uses "dynamic" or "static" "scoring,"[32] but this really is the least of it. Our current tax system is very badly flawed—it is in many ways immoral—and yet we seem stuck in it, forever, because we are blinded by a narrow vision of dollars and cents. The distributive tables and the attendant focus on winners and losers lead us away from focusing on the bigger picture of the ideal shape of our tax system.

An alternative way to proceed would be to put the numbers aside and get the principles down right first. After all, questions of a tax's base, the "what" of taxation, are logically distinct from questions of the tax's rate structure, or the "how much" question. We can and should decide on the broad structure of the tax system first, and then design a rate structure such that we can all live with the "winners" and "losers" produced by the ensuing distributive tables. In plain terms, the tail shouldn't be wagging the dog.

Second, there has been, at times, an excessive focus on the problems of transition.[33] Once an idea for fundamental reform is floated, however tentatively, think-tanks and academics produce detailed analyses of all the headaches involved in getting from here to there. This focus on the downside of reform buttresses our natural aversion to change of any sort, and seems to consign us, forever, to the status quo. Of course change is hard. Taxes are a big part of our lives, and so changing the tax system will, no doubt, pose many difficulties, both seen and unseen. This anxiety about change is part of the reason why old taxes are good taxes, by and large, all things being equal.[34]

But all things are not equal. Things are very bad indeed. I don't think our current, complex, hybrid tax system scores particularly well on any criteria of sensible tax policy: equity, efficiency, or administrability.[35] It is a fairly simple matter for the wealthy and well-advised property-owning class to avoid paying taxes al-

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32 *See, e.g.*, *id.* at 668-72.

33 An excellent general discussion of various tax systems and the problems of transition in getting to them can be found in AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, CHANGING AMERICA'S TAX SYSTEM: A GUIDE TO THE DEBATE (1996) [hereinafter AICPA]. *See also* JOEL SLEMROD AND JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE GREAT DEBATE OVER TAX REFORM (1996). For a classic statement of problems in making the transition to a consumption tax, *see* Michael J. Graetz, *Implementing A Progressive Consumption Tax*, 92 HARV. L. REV. 1575 (1979).

34 The saying that "old taxes are good taxes," or the variant that "the only good tax is an old tax," is generally attributed to Adam Smith. *See, e.g.*, J. Mark Ramseyer & Minoru Nakazato, *Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow*, 75 VA. L. REV. 1155, 1157 n.7 (1989); ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 873 (E. Cannan ed. 1937) (new taxes meet opposition from the populace).

35 *See generally* Edward J. McCaffery, *Tax Policy under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145 (1992) [hereinafter *Hybrid*]. I return to and expand on this theme in my current book project, EDWARD J. MCCAFFERY, THE NEXT GREAT AMERICAN TAX REVOLT (forthcoming 2000—manuscript on file with *Chapman Law Review*).

together, on both first- and later-generation wealth.[36] Meanwhile, the middle and lower-middle classes are hit hard by what is increasingly a wage tax system, looking at both the "income" tax per se, and the large and important payroll tax system. Two-earner families, and especially the working mothers within them, are hard hit,[37] and other problems of justice and fairness abound. When we look at the current tax system from the standpoint of principle, almost anything seems better—no matter how hard and long the route from here to there might be.

We ought not to let practical details preclude better theoretical thinking. Without first focusing on some attractive light at the end of the tunnel, we may never start the journey toward tax reform. The tail is now wagging the dog to sleep.

Third, aside from the general habits of mind that have us looking to distributive tables and questions of transition as ways of cutting off the revolution at its roots, there are a host of more particular reasons—political, intellectual, psychological—that keep us wedded to the way things are. Consider, for one very large example, how our practical bipartisan politics have played out—a story that might be most simply described as "Gridlock Happens."

Republicans, starting with Ronald Reagan, got on the antitax bandwagon and found it to be wildly successful, but they also loaded up this wagon with a good deal of baggage. Tax reform in the hands of Republicans has been linked throughout to the logically independent case against government itself or has been used in the service of supporting a narrow, socially conservative, "family values" agenda.[38] Republicans married what I take to be, and what I shall argue below to be, a sensible policy answer to the question of the ideal tax base, or the "what" of taxes—the case for consumption taxes—to a position on the appropriate rate structure, or the "how much" question. As others at this Symposium have discussed, we now have a plethora of flat-tax consumption plans floating about,[39] but there is no reason sounding in logic, policy, or principle why consumption taxes need be "flat."

36 *See* MCCAFFERY, THE NEXT GREAT AMERICAN TAX REVOLT, *supra* note 35.

37 *See* MCCAFFERY, TAXING WOMEN, *supra* note 3.

38 *See generally* CONTRACT, *supra* note 3; CONTRACT II, *supra* note 3; both discussed in McCaffery, *Tax's Empire*, *supra* note 3. *See also* Christine Klein, *A Requiem for the Rollover Rule: Capital Gains, Farmland Loss, and the Law of Unintended Consequences*, 55 WASH. & LEE L. REV. 403, 409 (1998).

39 Lawrence Zelenak, *The Selling of the Flat Tax: The Dubious Link Between Rate and Base*, 2 CHAP. L. REV. 197 (1999); Alan Schenk, *Radical Tax Reform in the 21st Century: The Role for a Consumption Tax*, 2 CHAP. L. REV. 133 (1999); Barbara H. Fried, *The Puzzling Case for Proportionate Taxation*, 2 CHAP. L. REV. 157 (1999). *See also* AICPA, *supra* note 33 and SLEMROD & BAKIJA, *supra* note 33.

Democrats, meanwhile, ever distrustful of Republicans, paid little or no attention to tax. They confused the preferred Republican endpoint of smaller, less redistributive taxes and spending programs with one of its institutional means, tax reform. President Clinton seems to have grown especially fond of small, targeted, nonrefundable tax credits.[40] Looked at closely, this predilection, like the fondness for substantive positions such as the one favoring school uniforms, consists more of rhetoric than reality. The nonrefundable nature of the credits means that they cannot possibly benefit the 40% or so of adult Americans too poor to pay positive income tax, while their various caps and ceilings ensure that they cannot benefit the wealthiest Americans who are most likely to act on tax law incentives.[41] We are left with small, technical provisions that cost little and sound nice—serving worthy goals such as helping adoptive families or the disabled—but that do next to nothing.

In this climate, no one is advocating what is an obvious, sensible compromise. We should concede the base issue to the Republicans and the rate issue to the Democrats. This compromise would leave us with a progressive consumption-without-estate tax, a system with attractive normative properties that seems to resonate well with contemporary democratic values.[42] Yet, except for the brief moment that the Nunn-Domenici USA Tax had in the sun, no one has worked very hard to advance this sensible idea.[43]

II. The Missing Links

Rhetoric has left us with the same old dreary reality. What is to be done? In this part, I cash in on the promise of this essay's title and discuss the missing links in tax reform.

A. The People

Missing link number one is the people. The American tax system is big, coercive, and important; nearly $3 trillion, roughly one-third of our gross domestic product, gets churned through the tax

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40 *See, e.g.*, Heidi Glenn & Daniel Tyson, *Clinton Throws Out First Tax Cut Chip*, 82 Tax Notes 159 (1999). *See generally* Amity Shlaes, The Greedy Hand: How Taxes Drive Americans Crazy and What To Do About It (1999).

41 *See, e.g.*, Jane Bryant Quinn, *The Downside of a Tax Credit for Caregivers*, Wash. Post., Jan. 24, 1999, at H2. *See also* McCaffery, Taxing Women, *supra* note 3, at 148-49.

42 I develop these arguments further in Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 Yale L.J. 283 (1994) [hereinafter *Uneasy Case*]; Edward J. McCaffery, *The Political Liberal Case against the Estate Tax*, 23 Philos. & Pub. Aff. 281 (1994); Edward J. McCaffery, *Being the Best We Can Be (A Reply to Critics)*, 51 Tax L. Rev. 615 (1996); and McCaffery, *Tax's Empire*, *supra* note 3.

43 *See generally* Laurence S. Seidman, The USA Tax: A Progressive Consumption Tax (1997).

system each year.[44] It is simply unthinkable that we could change such a massive and massively important system without popular support, input, and understanding. Tax stands at the center of our practical political lives. It often dominates our presidential politics. The people care, passionately, about tax, yet we have very little public understanding of the real facts and possibilities of tax, and very few attempts to get more.

The people themselves can hardly be blamed fully for this sorry state of affairs. Tax is complex and it hits close to the bone. Modern life is complicated enough without expecting people to educate themselves in the nuances of public finance and policy alternatives. The passions of tax make it even harder to think clearly about it.[45] A further problem is that the people are not getting any help in their obvious hunger to replace the current disaster of a tax system with something more sensible, efficient, and fair.

One set of culprits is the politicos, the "inside the beltway" crowd, who have proven time and time again to be out of step with the American people, most recently in the extended saga of President Clinton's impeachment.[46] Insiders talk of tax in terms of "dynamic scoring" and narrow pragmatics. Talk of tax, as we have seen above, gets wrapped up and lost in other agendas, such as the Republicans' for downsizing government or the Democrats' for preserving spending programs. There is even reason to be cynical about the ultimate political will to change tax. A certain sociological tendency of bureaucracy makes tax, an already complicated subject, more and more distant from the language and concerns of everyday people.[47] At the same time, the fact that the taxing power and the threat of its exercise provides a major impetus behind campaign contributions leads one to doubt how much Washington insiders genuinely desire any radical change.[48] A similar pattern of heated rhetoric followed by icy inaction has characterized one of the other great areas of modern inertia: campaign fi-

44 *See* BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1998, at 307 tbl.499, 456 tbl.721 (118th ed. 1998).

45 Consider for example Hume's observation: "As violent passion hinders men from seeing directly the interest they have in equitable behavior towards others; so it hinders them from seeing that equity itself, and gives them a remarkable partiality in their own favours." DAVID HUME, A TREATISE OF HUMAN NATURE 538 (Lewis A. Selby-Bigge & P.H. Nidditch eds., 2d ed. 1978) (1740).

46 *See* Howard Kurtz, *Americans Wait for the Punch Line on Impeachment as the Senate Trial Proceeds, Comedians Deliver the News*, WASH. POST, Jan. 26, 1999, at A1.

47 *See, e.g.*, Bayless Manning, *Hyperlexis and the Law of Conservation of Ambiguity: Thoughts on Section 385*, 36 TAX LAW. 9 (1982).

48 *See generally* Richard L. Doernberg and Fred S. McChesney, *Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891 (1987); Richard L. Doernberg and Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913 (1987) (both articles suggesting and amply demonstrating that campaign contributions drive tax lawmaking and reform).

nance reform.[49] Tax as usual is part of business as usual. Those who are in power have won under the rules, and seem hesitant to change them.

In this climate, the academy, including lawyers, accountants, and economists, has only proven to be a second culprit. Scholars who have the time and talent to understand this kind of thing could be helping to reach out to the people, to speak of tax and tax reform in plain terms. Trapped in narrow debates among themselves, however, and concerned about appearing too "popular" or "political," the academy has been turning inward, not reaching outward.[50] Although the situation has been changing of late, with symposia such as this one being an important example of a new promise, too much tax scholarship is still too devoted to the concerns of too few people.

All of this is unfortunate, for the people seem clearly ready and willing to change—if they can be helped to see a way. Looking at general attitudes, we see that the current tax system is widely disdained. If this anger against the status quo can be translated into a popular and understandable program, then the people can get behind tax reform. We need them.

B. Principle

Missing link number two is principle. I mean "principle" in a rather precise sense, picking up on the jurisprudential ideas of Ronald Dworkin.[51] Dworkin distinguishes between concerns of "policy," where matters can be left to a net balancing of social interests—he cites as an example the decision to pursue some project in national defense, or questions about which military bases to close—and concerns of "principle," where questions of right, fairness, and justice trump any narrowly framed calculus of indi-

49 For the interesting idea that Congress often tries to delay in order to do nothing—to "strike while the iron is cold"—*see* Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. LEG. STUD. 747 (1990).

50 A somewhat contrary tendency has appeared in a new movement of tax scholarship, to which I have often been linked, loosely called "critical tax theory." To the extent that adherents of this self-identified movement take a critical questioning and normative stance in relation to tax law, doctrine, and policy, I think that the movement is salutary and long overdue. At times, however, perhaps inevitably, critical tax theorists have also turned inward and been as trapped within their own intellectual debates as the older generation of tax law scholars of whom they are often critical. Critical tax theory itself has also become bogged down in a debate over its meanings and possibilities. *See, e.g.*, Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521 (1998) and the several responses to it in the same issue. For the record, I tend to think that such academic pursuits are important and valuable, but that tax *also* needs for scholars to reach out and explain things better to the people affected by it all.

51 RONALD DWORKIN, LAW'S EMPIRE (1986); RONALD DWORKIN, A MATTER OF PRINCIPLE (1985). *See also* Edward J. McCaffery, *Ronald Dworkin, Inside-Out*, 85 CAL. L. REV. 1043 (1997); Larry Alexander & Ken Kress, *Against Legal Principles*, 82 IOWA L. REV. 739, 745 (1997).

vidual interests.[52] "Equality" is a principle, for example, and when it is seen to come into play, its dictates must be followed. Thus, in an example that I think should strike home for tax reformers today, the right to equal concern and respect, to equal opportunity, that propelled the Supreme Court to overrule the "separate but equal" rule of *Plessy v. Ferguson*[53] in *Brown v. Board of Education*,[54] was a matter of principle. The fact that the transition to desegregated schools was difficult and costly, as well as the fact that this change no doubt had its "losers," did not count as arguments against the principle. Rights "trump" interests, narrowly conceived.

Now clearly tax is quite often a matter of policy—of horse trades and dollars and cents. But it is more than that. The failure to articulate a domain of principle for tax underlies and informs the current gap between rhetoric and reality. Narrow questions of distribution and transition are indeed fair game, and can often be decisive, in a narrowly policy regime, but a huge and coercive system like tax cries out for something else, and more. Democratic legitimacy demands that the state's exercise of coercive power through its tax system be principled. Tax matters.

There are two connected reasons for this commitment to principle in tax. First, there is a principle behind the need for principle. Tax is large and coercive and it affects far-reaching aspects of our social lives: the kinds of people we are and might reasonably hope to become, to paraphrase John Rawls.[55] It is a fundamental part of a reasonable conception of democratic legitimacy that power be exercised with principle.

Second, just as there is a principle of requiring principle, the case for more principle in tax draws support from pragmatic politics. In short, principle sells. There is nothing bad or disingenuous about this truth. The people cannot understand intricate debates about tax, but they can understand the core principles and commitments of alternative tax regimes. We ought to have that out, to get a chance to arrive at principles that can serve as going-forward guides to debate and reform.

We can understand these abstractions with reference to contemporary practice. The current income-plus-estate tax system rests on a principle that tax burdens should be borne according to one's "ability to pay."[56] This principle suggests an income tax,

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52 *See* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY, ch. 2 (1977).

53 Plessy v. Ferguson, 163 U.S. 537 (1896).

54 Brown v. Board of Educ., 347 U.S. 483 (1954).

55 See John Rawls, *Kantian Constructivism in Moral Theory*, 77 J. PHIL. 515 (1980); JOHN RAWLS, POLITICAL LIBERALISM 269-71 (1993 & 1996).

56 For a seminal statement of the "ability to pay" norm, see Richard Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44, 45-46 (1967).

which differs from a consumption tax only in its inclusion of savings within the base.[57] Since savings add to a taxpayer's ability to pay, traditional tax theorists insist on including them within the tax base.

As an *a priori* matter, "ability to pay" is a perfectly compelling principle. The problem—and it is a factual problem—is that nearly a century of experience has taught us that American society is not committed to taxing savings. Thus, we have the realization requirement, supplemented with the nontaxation of most retirement savings, insurance, home equity, and human capital.[58] The practical and political inability consistently to tax the yield to capital has left us with a hybrid income-consumption tax that is badly flawed in practice and altogether ungrounded in theory. As a practical matter, the current hybrid tax is no tax at all for the rich and well-advised, especially if they presently have capital and an inclination to spend it all on themselves. That situation is a disgrace, or it ought to be, and it leaves us with no compelling principle to take to the people in arguing for any particular tax reform.

C. Policy

Missing link number three is policy, in a specific, practical sense. The previous section argued that the people cannot get involved in practical tax reform politics without some coherent principle that they can understand and endorse. We need principle. At the same time, however, principle needs policy—in the concrete, particular sense of a specific plan or proposal to carry and illustrate it. Abstractions only go so far in America. "Equality," for example, has long been a widely accepted principle, but the case of *Brown v. Board of Education* was necessary to suggest that the principle required desegregation of public schools.

In the case of tax, this all might seem hopeless. There is so much talk of tax and so little agreement. Where are the common principles, other than that everyone wants to tax someone else? There seems to be neither principle nor policy to cling to in tax. Fortunately, however, it all comes together when we step back a bit and take a calm, dispassionate look at the current lay of the land.

Let's start with two simple facts of tax logic. One, as I have mentioned above, is the recognition that questions of a tax's base are logically separate from questions about its rates. We can talk

57 *See generally Hybrid, supra* note 35.

58 I discuss these deviations from an income concept in *Hybrid, id.*, and I return to them in chapter 4 of MCCAFFERY, THE NEXT GREAT AMERICAN TAX REVOLT, *supra* note 35.

about them separately. Let's put the more contentious rate issue aside, and focus on the base.

Two, in understanding the tax base, we have the familiar Haig-Simons definition of income to guide us. In simplified terms, this definition states that:

Income = Consumption + Savings,[59]

which tells us no more and no less than that all money is either spent or not.

Nonetheless, we can rearrange the Haig-Simons definition to see the very important point that, since

Consumption = Income − Savings,

a consumption tax is any tax that does not tax savings.[60]

These simple insights allow us to see the practical missing link in talk of tax today. Briefly and simply put:

It's Consumption, Stupid.

It turns out, on closer inspection, that all popular reform proposals feature some variant of a consumption tax. This is true of the national sales tax, the VAT tax, all popular proposals for "flat" taxes, and the Nunn-Domenici USA Tax.[61] Even more striking, the theme of consumption taxation is present in almost all "*income*" tax reform in the 1990s. Movements to lower the tax rate on capital gains, exempt the gain from the sale of homes from tax, and expand IRAs or other savings account vehicles are all the stuff of *consumption* taxation, because they retreat from an income tax's theoretical commitment to taxing savings. Our so-called income tax is already well on its way towards being a "consumption" tax in fact, and it is getting closer and closer with each and every major act of tax legislation in the 1990s.[62]

The movement towards consumption taxation is not just of practical interest. A consumption tax is appealing to both independent, abstract, moral and political theory and commonsensi-

59 *See generally* HENRY SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY (1938) and HENRY SIMONS, FEDERAL TAX REFORM (1950). *See also* Robert M. Haig, *The Concept of Income—Economic and Legal Aspects, in* THE FEDERAL INCOME TAX 1, 7 (Robert M. Haig ed., 1921), *reprinted in* READINGS IN THE ECONOMICS OF TAXATION 54 (Richard A. Musgrave & Carl S. Shoup eds., 1959). *See also Hybrid, supra* note 35.

60 *See Hybrid, supra* note 35; William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974); NICOLAS KALDOR, AN EXPENDITURE TAX (1955).

61 *See, e.g.,* Schenk, *supra* note 24; SLEMROD & BAKIJA, *supra* note 33; AICPA, *supra* note 33.

62 *See generally Hybrid, supra* note 35.

cal popular morality, because a consumption tax rests on a principle that we can indeed endorse and take to the people:

> We should consistently tax spending, not work or savings.

This simple principle goes a surprisingly long way in crafting practical tax reform proposals. It not only suggests a more systematic exemption for savings than our present hybrid income-consumption tax features, but it also has relevance for such contemporary debates as that over "death" taxes. Specifically, the principle of taxing spending, and spending alone, suggests that we should indeed abolish the estate and gift tax for one simple reason: Dead men don't spend.

An estate tax falls only on savings, or nonconsumed wealth.[63] As such, it encourages and rewards consumption; it encourages the wealthy elderly to spend down their wealth in one grand final binge, and discourages and penalizes savings, especially, and indeed only, long-term, inter-generational savings. It is an anticonsumption tax. Further, under the consistent principle of a consumption tax, no death tax is needed, even in the cause of fairness or justice. A consistent consumption tax can tax the *heirs*, when and as they spend the wealth, as current law systematically fails to do.

The careful reader will have noticed that I have not yet said anything of substance about the appropriate tax rates. This omission is by design, following the first fact of tax. The consistent principle we have thus far developed is about the "what" of taxes. Now, however, having agreed on a consumption tax base, there are compelling reasons to advocate maintaining the historic American commitment to progressive effective tax rates.

Once again looking at the practical proposals—since part of the idea, after all, is to pay respectful attention to the people[64]—all of these turn out not to be "flat" taxes at all, but rather to be two-rate plans, with some kind of rebate or zero bracket for the lower income or consumption levels.[65] Under a consistent consumption tax, and under a general tax system now committed to the principle of being principled, accommodation for the first dollars of a family's spending can be seen to rest on another compelling principle:

> Spending on life's necessities should bear a lower rate of tax than spending on life's ordinary matters.

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63 I elaborate on all these arguments at much greater length in *Uneasy Case*, *supra* note 42.

64 This is my central argument in McCaffery, *Being the Best We Can Be*, *supra* note 42.

65 *See* Zelenak, *supra* note 39.

This same principle can support reasonable exclusions under a consumption tax base, such as for medical or education expenses. What we would have, which we now lack, is a consistent principle against which to measure these "special" provisions.[66]

Having said that, there is no reason to pull up short and stop the argument for progression at the lower and middle classes. In point of fact, the experience of practical politics suggests that while the flat tax plans are initially attractive, the bloom soon fades from the rose.[67] Once the distributive tables are trotted out showing that all popular flat-rate tax plans, which tend to feature something like a 20% marginal rate, would in fact involve a tax *increase* on the middle classes to pay for a tax *decrease* for the rich, the appeal of this radical tax plan fades. And why shouldn't it? What's fair about making the middle classes, who have suffered enough under the current disaster of a tax system, pay a dollar price for its improvement, while the rich get richer?

Now, once again, we are committed to principle. Stating these attitudes in principled fashion leads to the following:

> Spending on life's luxuries should bear a higher rate of tax than spending on life's ordinaries, which should bear a higher rate of tax than spending on life's necessities.

And, voilà, we are done. We have made the case for a progressive consumption-without-estate tax. Note that, just as the consumption and anti-estate tax elements were grounded in both current popular democratic norms and some sense of ideal political theory, so too with the progressive element. Americans have consistently shown support for at least moderate progressivity in the tax system.[68] This arrangement strikes us as fair; liberal political theory supports it; and we can see it in the current political winds, most importantly in the ultimate disillusionment with the flat tax.

D. A Modest Proposal

We have developed important governing principles for tax, looking both to popular attitudes and moral theory. All that remains to be done is to wrap these principles into a coherent policy proposal, one that the people can understand and endorse. Then our missing links will have been supplied.

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66 *See generally* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972); Thomas D. Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343 (1989).

67 *See* Zelenak, *supra* note 39.

68 *See* Marjorie Kornhauser, *supra* note 20; Peggy A. Hite and Michael L. Roberts, *An Experimental Investigation of Taxpayer Judgments on Rate Structure in the Individual Income Tax System,* 13 J. AM. TAX. ASS'N 47 (1991).

It is not all that difficult to implement our principles. Practical proposals exist, such as the Nunn-Domenici USA Tax Plan,[69] which get pretty close to doing just that. Starting with current law, we would have to take just three or four basic steps:

(1) allow unlimited IRAs or other savings accounts;

(2) repeal the gift and estate tax and allow IRAs or other tax-free savings accounts to be transferred with zero basis;[70]

(3) include debt in the tax base, to prevent arbitrage;[71] and,

(4) if we wanted to, we could even raise the progressive marginal rates at the high end, so that we would have, in essence, a general luxury tax in place.

What is most important about this modest proposal is that principle has been its guide. Officials must make reforms with core commonsensical beliefs in mind. This would help us to have a tax system open to public scrutiny and accountability—properties highly and independently attractive to ideal political theory.

To keep the conversation going, consider some simplifying moves. Imagine this. We put in place a national sales tax at, say, a 15% rate. There are technical reasons to prefer a value-added tax to a literal sales one, but this comes out to much the same place for our purposes.[72]

To create a "zero bracket," we give a rebate to consumers, say for spending of up to $5000 per person. There are several ways to do this, including by allowing an exemption from Social Security contributions. Although the typical American family of four would pay $3000 in sales taxes on its first $20,000 of consumer purchases, they would get this money back via the rebate, effectively netting out at a 0% tax rate over this initial range of spending.

To create a higher bracket for high-end consumption, we next set up an individual consumption tax, such as the one proposed by then-Senators Nunn and Domenici in the mid-1990s.[73] By allowing unlimited deductions for savings, such a tax isolates out

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69 *See* SEIDMAN, *supra* note 43; SLEMROD & BAKIJA, *supra* note 33; AICPA, *supra* note 33.

70 Note, importantly, that this proposal does not mean that heirs are getting off the hook. They would pay tax when and as they spent their inheritance, in withdrawing from the accounts. This situation is as it should be under a consistent consumption tax.

71 *See generally* Alan J. Auerbach, *Should Interest Deductions Be Limited*, *in* UNEASY COMPROMISE: PROBLEMS OF A HYBRID INCOME-CONSUMPTION TAX (Henry J. Aaron et. al. eds., 1988). If this strikes us as too radical—even though a sales tax, the most commonly understood form of consumption tax, similarly reaches out to include spending out of debt—we might have an even more systematic interest deduction limitation than current law now has. I.R.C. § 163 (1994 & Supp. III 1997).

72 *See generally* AICPA, supra note 33, for a discussion of the value added tax versus sales tax.

73 *See generally* SEIDMAN, *supra* note 43.

consumption. Because everyone would already be paying tax under the 15% national sales tax, we could have a large exemption level from this so-called Supplemental Consumption Tax.

Imagine, for example, that we exempted the first $100,000 that a family of four spent. Only those Americans spending more than this high level need to be concerned with the supplemental tax. This step would remove tens of millions of Americans from the annual tax rolls. The supplemental tax could be levied at a flat rate, again say 15%. Then, spending over $100,000 would bear the regular 15% sales tax, plus the 15% supplemental tax, for a combined marginal tax rate of 30%.

Voilà. We are done. We now have a tax system economically equivalent to a progressive national sales tax, with a rate structure that looks as follows:

TABLE 1: TAX RATES UNDER A PROGRESSIVE NATIONAL SALES TAX

SPENDING	TAX RATE
$0 to $20,000	0%
$20,000 to $100,000	15%
over $100,000	30%

The progressive national sales tax would relieve most Americans from the burden of filling out annual tax forms. It would systematically exempt savings from tax, and thus in one stroke greatly simplify the law. Yet, it would also maintain our historic commitment to some progression in tax rates and avoid the absurdity of raising taxes on the middle classes to lower them on the upper classes. We could easily maintain the most popular and important features of the present tax system, such as home mortgage interest deductions, charitable contribution and extraordinary medical expense deductions, and additional exemptions for children and other personal dependents.[74]

The call for a progressive national sales tax actually isn't too crazy. It is similar to proposals independently put forth by former Representative Sam Gibbons, a Democrat from Florida,[75] and Professor Michael Graetz of Yale Law School.[76] Both Gibbons and Graetz would have a broad-based national sales or value-added tax, supplemented with a continuation of the current income tax

74 *See* I.R.C. §§ 163(h) (home mortgage interest deduction), 170 (charitable contribution deductions), 213 (extraordinary medical expense deduction), and 151 (personal dependency exemptions) (1994 & Supp. III 1997).

75 *See* H.R. 4050, 104th Cong. (1996).

76 *See* MICHAEL J. GRAETZ, THE DECLINE (AND FALL?) OF THE INCOME TAX (1997).

for high earners. Because I consider the actual income tax to be a failure, and the very idea of taxing savings to be misguided, my proposal instead keeps a consistent focus on consumption. Indeed, under a progressive national sales tax, we can even eliminate the gift and estate, or so-called "death," taxes, because a consistent consumption tax would fall on anyone who spends, parent, child, or heir, when and as she spends. Under the progressive national sales tax, there is no need for the costly, confusing, inefficient and unpopular death tax.

The important thing, however, is not the smallest of specifics. The devil may be in the details, but we ought, at least, to look for angels first. The modest proposal is a consistent and progressive consumption tax, and that's a practical policy proposal that the American people can understand and endorse. It's also a long way from where we are today.

III. Conclusion: Where There's a Way?

As we stand at the dawn of the millennium, the state of tax is a state of disgrace. Our major federal tax, the nominal income-plus-estate tax, is complicated, costly, inefficient, and unfair. The rich and clever can avoid paying taxes altogether, while the middle classes continue to toil under what has become, with the increasingly important social security system factored in, an onerous wage tax system. The people have noticed, and the income tax and its administrators are among the most loathed of our public institutions. Yet they are also among the most important. We cannot get around the central fact of modernity that tax is big, coercive, and wide-ranging in its effects. In short and in sum, tax stinks. And as long as it does, our great democracy is hindered from reaching its full potential.

The people's anger alone is not sufficient to effect change. This is the lesson that the last decade of radical antitax talk has taught us. The people need some sense of where to go. They need help in seeing some light—any light—at the end of what might seem to be more a bottomless pit than a tunnel. If the people are our first missing link in tax reform, principle is our second, for the people need some set of ideals to rally around.

Fortunately, with a little bit of intellectual work, it is indeed possible to discern principles in the cacophony of antitax talk. A principled reading of democratic values and norms gives us reason to hope that a progressive consumption tax may one day arrive. Using what we know and have learned about tax, it is possible to package these principles in an attractive policy proposal, for what is, in essence, a progressive national sales tax. Such a plan effects a Grand Compromise between Republicans calling for a consumption tax base and Democrats wishing to maintain at least a moderate degree of progressivity in our laws. It is a good, fair, efficient, and sensible thing to do. With any luck at all, we just might do it.

Until that day, we can at least aspire to abide by the Hippocratic oath: do no harm. Rather than continue to tinker with our tax system, we ought to let principle be our guide in the small, as well as in the large. We should strive in each and every tax act to get a fairer, simpler, more sensible law, by taking even more systematic steps in the direction of a consumption tax and maintaining progressive rates on spending, even as we eliminate taxes on savings altogether. We should keep trying to get lower and middle-class Americans off the tax rolls, for filling out an annual tax form has become one of modern life's worst horrors. One day, just maybe, we will get to a better place in our most important system of social and economic control. Until that day, let's not make things worse.