

IMAGINING A PROGRESSIVE AND COMPREHENSIVE CONSUMPTION TAX

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INTRODUCTION

“If you love those who love you, what reward will you get? Are not even the tax collectors doing that?”¹ Tax collection is no stranger to enmity.² Imagining tax systems plagued by corruption, extortion, and the imposition of exorbitant rates could explain this historic unpopularity. But one would have a difficult time establishing either extortion or the imposition of exorbitant rates within the American income tax system. In fact, one would be hard-pressed to show that the tax rates imposed under the American income tax system are seriously unfair. Yet, discontent with

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¹ *Matthew* 5:46; *Luke* 6:32-36.

² If nothing else, the Biblical references are evidence of an historic loathing for tax collection: “While Jesus was having dinner at Matthew’s house, many tax collectors and sinners came and ate with him and his disciples. When the Pharisees saw this, they asked his disciples, ‘Why does your teacher eat with tax collectors and sinners?’ On hearing this, Jesus said, ‘It is not the healthy who need a doctor, but the sick. Go and learn what this means: ‘I desire mercy, not sacrifice.’ For I have come to call not the righteous, but sinners.” *Matthew* 9:10-13; *Mark* 2:13-17; *Luke* 5:27-32. See also *Matthew* 21:31-32; *Mark* 3:15. Calumniations notwithstanding, in perhaps one of the more famous passages of the New Testament, Jesus diplomatically instructs his followers to pay their taxes nonetheless: “Give to Caesar what is Caesar’s, and to God what is God’s.” *Matthew* 22:21; *Mark* 12:13-17; *Luke* 20:20-26.

the system continues to grow.³ Since there is no extortion, and since the rates are not exorbitant, the question is whether American taxpayers have a compelling reason to loathe tax collection. It appears they do.

The odiousness of the American income tax system is not caused entirely by a fight over money. Of course, it is true that most taxpayers believe the income tax system asks too much of them⁴ and that they are not getting much in return.⁵ But, while taxpayers are understandably hesitant about paying more taxes,⁶ the real problem with the income tax system is not the tax itself; it is how the tax is collected. Indeed, taxpayers overwhelmingly agree that the income tax system's collection mechanism is

³ Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261, 272 (2002) ("From the period immediately following World War II until 1972, the American people viewed the income tax as the fairest tax in the nation. Since 1980, they have consistently viewed it as the least fair.").

⁴ According to the 2006 Tax Foundation's Annual Survey of U.S. Attitudes on Tax and Wealth (Q645), fifty-nine percent of those surveyed believed that the amount of federal income tax they pay is "too high." This figure rose four percent from the prior year. The 2006 survey is *available at* http://www.taxfoundation.org/files/survey_topline-20060405.pdf (last visited June 2, 2006). *See also* Special Report No. 141, *available at* <http://www.taxfoundation.org/files/sr141.pdf> (reporting and interpreting the survey results) (last visited June 12, 2006).

⁵ In the 2006 Tax Foundation survey (Q635), sixty-six percent of those surveyed believed that the personal value they receive from paying taxes is only fair or poor; twenty-four percent of those surveyed believed the value received was "pretty good" while only two percent considered it "excellent."

⁶ According to the 2005 Tax Foundation Annual Survey on U.S. Attitudes on Taxes and Wealth (Q640), sixty-four percent of those surveyed believed the government should decrease services and taxes or keep taxes and services the same. Only thirteen percent of those surveyed believed the government should increase services and raise taxes. The 2005 survey is *available at* <http://www.taxfoundation.org/files/topline-20050414.pdf> (last visited June 2, 2006). Moreover, in the 2006 survey (Q727 & Q729), seventy-nine percent indicated they would not be willing to pay an additional \$2,470 in federal taxes to eliminate the deficit and sixty-three percent believed, if forced to pay the additional \$2,470, Congress would only increase spending and not pay off the deficit. Twenty percent believed Congress would pay off the debt but increase spending nonetheless (Q729).

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now far too complicated either to understand or implement.⁷

Taxpayers are unhappy because the method of collection under the American income tax system places the filing burden on them.⁸ While the burden associated with filing taxes may escape condemnation as involuntary servitude,⁹ it is arguably unfair and almost certainly unwise.¹⁰ Admittedly, if no other practical means of securing governmental revenue exists, perhaps requiring individuals to calculate and file their own taxes,

⁷ In the 2006 Tax Foundation Annual Survey (Q685), eighty percent of those surveyed found the current federal income tax either very complicated or somewhat complicated. Only nine percent of those surveyed believed the system was “not too complex” and only one percent found it “not complex at all.” Many scholars also believe the income tax is unnecessarily complicated. “Studies of the federal income tax code consistently find that the current system is excessively complex. This study concurs, quantifying the code’s complexity in a way that makes it clear how unnecessary much of it is. If the high cost of complying with the federal income tax were a necessary price to pay for a fair and effective tax system, there would be little room for complaint. But in fact, most complaints are justified.” J. Scott Moody et al., *The Rising Cost of Complying with the Federal Income Tax*, Tax Foundation Special Report No. 138 at 2 (Dec. 2005).

⁸ The 2005 Tax Foundation Annual Survey (Q680) found seventy percent of those surveyed either disliked or hated working on their income taxes.

⁹ Although the rationale behind the precedent is largely unexplained, the precedent itself is fairly clear. *See, e.g.*, *LaRue v. United States*, 959 F. Supp. 957, 959 (C.D. Ill. 1997) (finding plaintiff’s unsupported claim that the income tax violated the Thirteenth Amendment was “absurd”); *Trohimovich v. Dep’t of Labor & Indus.*, 869 P.2d 95, 98 (Wash. Ct. App. 1994) (“Trohimovich also claims that the payment of taxes is a violation of the Thirteenth Amendment prohibiting slavery. He is wrong. Payment of taxes does not constitute a violation of the Thirteenth Amendment against involuntary servitude.”); *Kasey v. Comm’r of Internal Revenue*, 457 F.2d 369, 370 (9th Cir. 1972) (holding that a claim that the income tax filing burden amounted to involuntary servitude as “without merit”); *Abney v. Campbell*, 206 F.2d 836, 841 (5th Cir. 1953) (finding a claim that the income tax violated the Thirteenth Amendment’s prohibition against involuntary servitude was “far-fetched”).

¹⁰ It is safe to say filing burdens have reached unhealthy levels. And, while the advent of e-filing may or may not relieve some of the burden, it does not eliminate it entirely. *See* Mary Dalrymple, San Jose Mercury News, *GE Files Tax Return That’s 24,000 Pages: Would Have Been Eight Feet Tall* (June 1, 2006) (“[General Electric] filed a 24,000-page tax return to the Internal Revenue Service this month. If it were paper, it would stack up 8 feet high. But instead of sending boxes to the tax collectors, GE filed its return electronically – all 237 megabytes of it.”), *available at* <http://www.mercurynews.com/mld/mercurynews/business/14714255.htm> (last visited June

and the responsibilities and penalties that go along with that it, may make the burden seem reasonable. But, if a practical alternative exists that would remove that burden from the individual taxpayer while generating progressively comparable revenue amounts, failing to make the transition would instead seem reasonably unfair.

This article proposes the graduated consumption tax model may be such an alternative.¹¹ Designed primarily to relieve the individual taxpayer's filing burdens while progressively generating sufficient governmental revenue at comparable rates, the graduated consumption tax model imposes differential tax rates on the consumption of all goods and services, both at the production and retail levels. The rate attached to each good or service would depend on the item's character – whether it was a “necessity” or a “luxury.” The items characterized as most necessary would be assessed at the lowest tax rates while those characterized as most luxurious would be assessed at the highest. All other consumables would be taxed at a rate somewhere in between.

2, 2006).

¹¹ While focusing principally on tax policy, it is essential to note that this article is largely, if not entirely, heuristic. This article is an unrestrained experiment in thought; it is not intended to be taken as quantitative, technical proof that any of its suggestions, arguments, hypotheses, or assumptions is true. Admittedly, the graduated consumption tax model raises far more pragmatic questions and concerns than it answers. But there is a method to the madness. By approaching these questions from an outsider's perspective, this article offers a radical alternative to force an honest evaluation of the shortcomings of the present income tax system, the circumstances where the proposed alternative could actually work, and the policies that could serve as the inspiration for replacing the income tax or finally enacting some meaningful change.

This article consists of six parts. The first part introduces and outlines the graduated consumption tax proposal. Part II explores the major proposed alternatives to the income tax, including some of the leading scholarship, and compares some of the major features of these models against the main features of the graduated consumption tax. This section is not intended to serve as an exhaustive analysis or critique of the alternative tax models. Rather, it is designed only to illustrate the major shortcomings of the other tax alternatives that, among other things, fail ultimately to free the individual taxpayer from the burden of tax collection, fail to generate progressively sufficient revenue, or fail to do both.

Part III provides an illustrative model and the underlying theory of the graduated consumption tax system and how it might be implemented. Based on an expansion of Hobbesian foundational tax theory, the illustrative model provides a six-tiered graduation ranging from items of “Fundamental Necessity” to items of “Consummate Luxury.” Each tier is assigned a specific number of internal steps assessed incrementally at progressive tax rates. Characterization of items placed within each tier would be determined as objectively as possible, employing a ranking system based on a number of different quantitative and qualitative factors.

Part IV identifies and examines some of the potential benefits of the graduated consumption tax model, including greater perception of fairness;

the encouragement of responsible spending and savings; greater taxpayer participation; decreased tax evasion and avoidance; greater capital surplus; and lower interest rates, among several others. Conversely, Part V identifies and examines some of its potential weaknesses, including the theoretical and factual problems inherent with item characterization, as well as concerns with the model's potential administration, equity, and economic efficiency. This part concludes that each of these concerns must be tested successfully before implementation of the model becomes possible.

Finally, Part VI considers briefly the constitutional implications of replacing the existing income tax system with a graduated consumption tax model. Although there may be some direct tax implications related to possible transition relief, this part concludes that the graduated consumption tax would be constitutional because it is, essentially, a classic indirect sales tax.

I. OVERVIEW OF THE GRADUATED CONSUMPTION TAX PROPOSAL

The graduated consumption tax imposes differential tax rates on the consumption of all goods and services at the production and retail levels.¹² Although the design of the graduated consumption tax is intended primarily to relieve the individual taxpayer's filing burdens, the design also addresses

¹² The graduated consumption tax model is debuted in this article as the offspring of the author's imagination.

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the three legs of traditional tax policy. Administrative efficiency is served because a tax on consumption would relieve the filing burden from the individual taxpayer. Equity is preserved because differential rates would avoid regressivity. Finally, economic efficiency is facilitated because the comprehensive tax base would ensure the generation of revenue amounts comparable to the income tax system.

Nevertheless, proposing an income tax alternative is nothing new. In fact, numerous alternative tax models, some of which are quite popular, already exist. Yet, none of them proposes to remove the taxpayer's filing burden while progressively generating tax revenue in amounts comparable to the present income tax system. The graduated consumption tax model is the only one to propose broad-based consumption at multiple or differential tax rates at the production and retail levels.

Although other models seem to disfavor the use of differential tax rates,¹³ multiple rates are at the heart of the graduated consumption tax model. While more administratively complicated than the single-rate alternatives, differential tax rates are critical for the graduated consumption tax model because they are necessary to free completely individual taxpayers from the burdens of tax filing, while simultaneously preserving tax progressivity.¹⁴

¹³ See, e.g., *infra* notes 166-68 and accompanying text.

¹⁴ The graduated consumption tax model is designed primarily to achieve three

Under the graduated consumption tax model, the differential tax rates would vary according to the degree of necessity or luxury of the item consumed. The less necessary – or more luxurious – an item is, the higher the rate of tax would be placed on that item.¹⁵ The various rates of tax would be compiled in an index of tax schedules that separates consumables into a number of different categories based on their degree of necessity or luxury. The rate represented in the schedule would not be a fixed dollar amount but, rather, a percentage attached to the price of the item at the time of purchase.¹⁶

Determining the degree of necessity or luxury of a given item, or its character, would be a difficult task that would require some degree of value judgment.¹⁷ Accurate characterization would be fundamental to the fair application of a graduated consumption tax.¹⁸ Accurate characterization

purposes: (1) to remove individual taxpayer filing burdens; (2) to preserve tax progressivity; and (3) to generate sufficient amounts of revenue at reasonable tax rates. Incidentally, the author believes a “fair” tax is defined by these three principles. *Cf. infra* note 40 and accompanying text.

¹⁵ Since the price of an item may vary by state or seller, the degree of necessity or luxury ascribed to an item should not be purely a function of the market price of an item, but a function of a number of different factors taken together. *See infra* note 19 and accompanying text.

¹⁶ This method makes the graduated consumption tax uniformly applied throughout the country, regardless of the possible variation in price of an item being sold in two or more different states. Since the tax would be a percentage of the final purchase price, the same proportionate amount of tax would apply.

¹⁷ Establishing an administrative agency competent to make transparently objective determinations as to product character would be a vital component of a legitimate graduated consumption tax model.

¹⁸ Legitimacy of the characterization process depends primarily on objectivity. The characterization process may be susceptible to undue outside influence and political pressure, all of which must be carefully monitored and controlled. *See infra* notes 112-13

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would require an objective examination of a number of different factors,
likely including the basic utility of the product; the price of the product
compared with the average market price of categorically similar items; the
degree of market finality of the product; the degree of market access and
demand; the degree of public benefit derived from the product; the novelty
of the product; and others.¹⁹

Although the graduated consumption tax model is designed to tax
consumption, as opposed to taxing income and savings, the primary purpose
of implementing a graduated consumption tax is to remove the burden of
computation and the liability of miscalculation from the individual
taxpayer. Under the graduated consumption tax model, individual
taxpayers would not be required to compute or file anything when paying
their taxes. As with an ordinary sales tax, the tax they owe would be
computed directly and immediately into the sale of the products they
purchase.

The graduated consumption tax model thus employs an

and accompanying text.

¹⁹ These factors are recommended and non-exhaustive. Some of the factors listed are self-explanatory. Others might need some clarification. The degree of finality of the product refers to a product's placement within the stream of manufacturing. This factor attempts to account for a component of the character of items sold by business entities that are not producing the final version of the product ultimately consumed by the market at large. For example, a product may pass through many different levels of manufacturing before sold finally on the open market.

The novelty of the product encompasses two distinct concepts. First, whether the item is new or used and, second, whether the item is one that is new to the market in general or one that is a more familiar item. Such factors may be important factors to consider in the

administrative framework similar to the credit-invoice value-added tax, as sellers along the entire chain of production and distribution would be required to keep accurate transaction records to make sure they are charging and collecting the appropriate tax on each item they sell.²⁰ And, since the individual taxpayer would not file any paperwork, the only audits performed by the government would be of the sellers.²¹

Although the filing burden of the individual taxpayer would be removed, the graduated consumption tax model would not shift the overall tax liability. Currently, the income tax system is itself progressive, placing a greater tax burden on the wealthiest taxpayers.²² Since the design of the graduated consumption tax is also progressive, it would achieve the same results. Necessary items, such as food, clothing, housing, and medicine, would be subject to little to no tax at all. All people, whether wealthy or poor, are in equal need of a certain degree of these basic items.²³ Conversely, luxury items such as yachts and private jets would be assessed

determination of an item's character.

²⁰ See *infra* notes 54-60 and accompanying text.

²¹ The exception, of course, would be the informal or "backyard" seller, who would be required to declare the sale on the appropriate form and file it with the agency which, in turn, would assess the appropriate tax on the item and issue the bill to the purchasing taxpayer for payment. See *infra* notes 116-17, 128 and accompanying text.

²² DOUGLAS A. KAHN, FEDERAL INCOME TAX § 1.1000 at 3-4 (Foundation Press 4th ed. 1999); *The Effects of Replacing Most Federal Taxes with a National Sales Tax: A State-by-State Distributional Analysis*, Institute on Taxation and Economic Policy ("ITEP"), at 3 (Sept. 2005).

²³ Practically speaking, degree may be a function of character. For example, staple food items that one might find at most ordinary grocery stores should be subject to zero tax liability. Meanwhile, gourmet items less necessary would be assessed appropriately at the higher rates.

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properly at the highest tax rates.²⁴

The graduated consumption tax system would impose an amount of federal sales tax computed according to a sliding scale. The algorithm that defines the scale might be summed up with one phrase: the greater the luxury, the greater the tax. Thus, every consumable item would be placed somewhere along this continuum according to its character and taxed accordingly. And, since every consumable product or service would be taxable, the graduated consumption tax would draw its revenue from a virtually unrestricted tax base.²⁵ Thus, unlike the other alternative tax models, the large tax base would ensure progressive revenue generation comparable to the income tax system without imposing unpalatably high tax rates.²⁶

The graduated consumption tax might be less complicated than the income tax system. Even if the system proves more administratively complicated, those burdens would not be imposed on individual taxpayers

²⁴ One of the fundamental challenges of the graduated consumption tax system would be designating the relative necessity and the degree of luxury of any given item. In some cases, the assessment should be relatively simple. For example, few could reasonably argue that a 250-foot yacht or a Gulfstream V jet are items necessary to sustain only the most basic level of human comfort. There are other situations, however, where assessment would prove more difficult to determine. For example, it may be difficult to draw factual or otherwise principled distinctions between items of the same general description. For example, while shoes are clearly a necessity, Manolo Blahniks clearly are not. Likewise, while houses may be necessary, mansions are not. While the foregoing examples may be easy to distinguish, drawing close lines between different types of clothes, automobiles, or homes, for example, may prove quite challenging. Navigating these dark waters would be a necessary challenge of the graduated consumption tax system.

²⁵ See *infra* notes 140-42 and accompanying text.

²⁶ See *infra* notes 144-49 and accompanying text. Cf. *infra* note 75 and accompanying

as they are presently under the income tax system. Individual taxpayers would not be responsible for knowing the tens of thousands of pages of rules or be required to fill out any paperwork based on those rules. Instead, as with any sales tax, the taxes they owe would be calculated at the time of purchase and attached to the bill of sale. The only thing the individual taxpayers would be required to do is pay that bill.²⁷

II. FRAMING THE GRADUATED CONSUMPTION TAX PROPOSAL

Calculating income tax liability is not a simple task. The income tax system encumbers all taxpayers with the responsibility of sifting through the tens of thousands of pages of tax codes and filing instructions, computing tax liability based on equations and tables that are not always easy to understand, filling out and filing all the proper forms and schedules correctly, and making the appropriate payments.²⁸ As if calculating tax liability were not challenging enough, the government may impose

text.

²⁷ Of course, taxpayers would have access to the character index and schedules of tax rates. In addition, merchants would be required to post the applicable tax rate to the items they were selling, giving notice to the buyer of the tax rate attached to the sale price.

²⁸ These responsibilities, which this article refers to as the taxpayer's "filing burdens," are quite significant. In fact, the IRS estimates the average taxpayer, using a tax software program, takes about forty hours to figure out her taxes. David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens*, NTU Policy Paper 120 (Apr. 17, 2006). The number of hours doubles to over eighty if the taxpayer is self-employed. *Id.* A Tax Foundation study estimated that "[i]n 2005 individuals, business and non-profits [spent] an estimated 6 billion hours complying with the federal income tax code, with an estimated compliance cost of over \$265.1 billion." Moody, *supra* note 7, at 1. For a comprehensive discussion of the other various forms of income tax burdens, see JAMES L. PAYNE, *COSTLY RETURNS: THE BURDENS OF THE U.S. TAX SYSTEM* (1993) (pointing out,

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potentially severe penalties for failing to compute or file taxes correctly.²⁹
Requiring flawless income tax computation requires a significant amount of
skill that even tax experts have difficulty achieving.³⁰ Yet, the government
assumes that each taxpayer has the ability and the means to do the job.

Shouldering the monumental responsibility of “getting it right”
effectively requires the taxpayer to become relatively well-versed in tax
law. But, it seems unreasonable to assume that most taxpayers have
mastered the over 60,000 pages of tax code and over 500 forms.³¹ Not

among other things, that it costs about \$65 to raise \$100 under the income tax system)

²⁹ See, e.g., I.R.C. §§ 6651, 6662, 6702 (2005). In criminal tax cases, the prosecution must prove that the tax evasion was willful. *Cheek v. United States*, 498 U.S. 192, 201 (1991) (“Willfulness, as construed by our prior decisions in criminal tax cases, requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty. . . . In such a case, if the Government proves actual knowledge of the pertinent legal duty, the prosecution, without more, has satisfied the knowledge component of the willfulness requirement. But carrying this burden requires negating a defendant’s claim of ignorance of the law or a claim that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any of the provisions of the tax laws.”).

³⁰ The United States Government Accountability Office found that virtually all the chain tax preparers it studied made significant errors in tax filing and calculation. U.S. Gen. Accounting Office, *Paid Tax Return Preparers, In a Limited Study, Chain Preparers Made Serious Errors* 14, (GAO-06-563T, Apr. 2006) (“All 19 of our visits to tax return preparers affiliated with chains showed problems. Nearly all of the returns prepared for us were incorrect to some degree, and several of the preparers gave us very bad tax advice While some errors had fairly small tax consequences, others had very large tax consequences. Incorrectly reported refunds ranged from refunds overclaimed by nearly \$2,000 to underclaims of over \$1,700.”). See also David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens*, NTU Policy Paper 120 (Apr. 17, 2006). (“The Tax Code is so convoluted that no one inside or outside of the IRS understands it. For many years *Money* magazine’s annual test of tax preparers for a hypothetical household proved that paid professionals often make huge mistakes. In 1998, the last year *Money* administered the test, all 46 tested tax professionals got a different answer, and not one got it right. The pro who directed the test admitted ‘that his computation is not the only possible correct answer’ since the tax law is so murky. The tax computed by these pros ‘ranged from \$34,240 to \$68,912.’ The closest answer still erred in the government’s favor by \$610.”).

³¹ Absurdly, taxpayers are expected to know more about the over 7 million words of

surprisingly, many taxpayers delegate that responsibility to paid income tax professionals.³² Meanwhile, immediate and significant inequities reverberate as the government continues to force taxpayers to calculate their own tax liabilities.³³

As a result of its own unyielding complication, the income tax system often creates unnecessary and unintended tax breaks, or “loopholes.”³⁴ Of course, in order to take advantage of a loophole, a taxpayer must first know how to find one and properly utilize it. Naturally, then, the benefits of these loopholes are enjoyed almost exclusively by the

tax rules than those who are paid to give tax advice at the IRS assistance centers. John Semmens, *Tax Filing Burden Continues to Grow*, The Heartland Institute (Apr. 8, 2005) (“In 2002, government auditors found IRS taxpayer assistance centers give the wrong advice for filling out forms a distressingly large 50 percent of the time. Taxpayers’ distress is intensified by the IRS’s refusal to stand by the advice it gives out. Taxpayers are not relieved of any penalties they may face for errors on their tax forms resulting from following the advice given by the IRS assistance centers.”).

³² According to the 2006 Tax Foundation Survey of U.S. Attitudes on Taxes and Wealth (Q735), thirty-six percent of those surveyed indicated they paid an outside tax professional to prepare their income taxes. This figure may be largely understated according to a National Taxpayers Union policy paper written by David Keating that, citing to the revised March 17, 2006 Taxpayer Usage Report of the IRS, indicates over sixty percent of tax returns have been signed by paid preparers since 2004. David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens*, NTU Policy Paper 120 (Apr. 17, 2006). That figure jumps to an astounding ninety percent when counting computer-prepared returns. *Id.* The policy paper also indicated that the average fee charged by H&R Block in 2006 for income tax preparation was around \$150. *Id.*

³³ The brunt of these inequities falls on the backs of the poor. “When examined by income level, compliance cost is found to be highly regressive, taking a larger toll on low-income taxpayers as a percentage of income than high-income taxpayers. On the low end, taxpayers with adjusted gross income (AGI) under \$20,000 incur a compliance cost equal to 5.9 percent of income while the compliance cost incurred by taxpayers with AGI over \$200,000 amounts to just 0.5 percent of income.” Moody, *supra* note 7, at 1.

³⁴ For example, a recent clarification in tax law intended to benefit the poor inadvertently created a tax loophole for the rich. Mary Beth Franklin, *Behold, A Tax Loophole*, Kiplinger.com article (Jan. 6, 2006) (“Thanks to a recent tax simplification law designed to clarify who can claim a child as a dependent, some upper-income families with both younger children and older “boomerang” kids living at home could benefit from an

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well-off or the well-advised.³⁵ Successfully utilizing these loopholes,³⁶
those with the greatest tax burdens are able to shirk the full extent of their
intended tax liability, thereby shifting a greater proportionate burden onto
the backs of the less-than-wealthy. Unfortunately, taming the current
income tax system has proven a Sisyphean task, as attempts to close
loopholes often result in the generation of others eager to take their place.³⁷

A. *The Usual Suspects: Major Income Tax Alternatives*

The fundamental principles of tax policy are regarded as virtually
universal.³⁸ Most agree that a “fair” tax should generate sufficient
governmental revenue while imposing acceptably minimum burdens on the
taxpayer.³⁹ The form that best achieves those functions, however, enjoys

unintended loophole.”).

³⁵ The irony is that many loopholes are the result of tax law designed to benefit the poor, who are neither well-off nor can afford to be well-advised. *See, e.g., supra* note 34 and accompanying text.

³⁶ Loophole generation may be the result of earnest attempts to immortalize an outdated income taxation system that is far beyond its natural life expectancy. Although tax rules and exceptions were created originally to achieve fairness, they have transformed initially common-sense income tax principles into a nonsensical, dizzying mess. *See infra* notes 38-44 and accompanying text.

³⁷ *See supra* notes 34-36 and accompanying text.

³⁸ Graetz, *supra* note 3, at 273 (“The tax system can, and should, be fixed without such a shift in the nation's tax burdens. As the conservative New York Times columnist William Safire, who called the flat tax ‘draconian,’ has said, ‘Most of us accept as ‘fair’ this principle: The poor should pay nothing, the middlers something, the rich the highest percentage.’”).

³⁹ William G. Gale, *Tax Reform in the Real World*, 15 *Yale J. on Reg.* 387, 391 (1998) (*reviewing* MICHEAL J. GRAETZ, *THE DECLINE (AND FALL?) OF THE INCOME TAX* (1997)) (“There is broad agreement, in principle at least, on the characteristics of a good tax: It should raise sufficient revenue to finance government and it should be simple, fair, and economically efficient.”).

significantly less consensus.⁴⁰ Indeed, disagreement existed even at the beginning of the twentieth century, when the income tax system was finally and formally adopted in the United States.⁴¹

However the income tax may be characterized presently, it was not designed to be draconian. Nor was it perceived as such – well, at least not until more recently.⁴² But, present frustration may have been unavoidable. The country’s expanding sophistication eventually outgrew the capabilities of the income tax system’s original design. To keep pace, the tax code also grew, increasing in complexity to accommodate the changing needs of society. Cannibalized by its own reforms, about six decades later, the income tax code is now a hopeless, quixotic mess.⁴³ Sadly, the mess is an unintended consequence of obdurate efforts to mend a broken system and the unwillingness to admit that it is beyond repair.⁴⁴

The solutions presented to address the problems of the income tax

⁴⁰ *Id.* (“In practice, there is probably less agreement on what some of these principles mean; fairness, for example, is generally in the ‘eyes of the beholder.’ In addition, extreme disagreement exists about the relative value of each of these characteristics and about how they should be traded off one another.”).

⁴¹ See generally Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1 (1999) (tracing the history of the direct tax clauses and the enactment of the Sixteenth Amendment).

⁴² Michael Graetz has studied and written extensively about this shift in public perception. “From the period immediately following World War II until 1972, the American people viewed the income tax as the fairest tax in the nation. Since 1980, they have consistently viewed it as the least fair.” Graetz, *supra* note 3, at 272.

⁴³ Or, in the words of Michael Graetz, the tax code is a “horrible mess.” *Id.* at 282.

⁴⁴ Almost tragically, even altruistic gestures of the government appear to have the opposite effect. For example, the Paperwork Reduction Act of 1995 actually generated more paperwork than existed before its implementation. See *infra* note 46 and accompanying text.

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system are as numerous as the problems themselves.⁴⁵ The most widely
recognized solutions suggest either broad reform of the extant income tax
system or scrapping the system altogether and starting from scratch.⁴⁶
Regardless of whether the income tax places unconstitutional burdens on
the backs of the taxpayers, the idea of scrapping the current income tax
system, and the countless provisions of the Internal Revenue Code along
with it, has tantalized taxpayers and economists for some time.⁴⁷ The most
seriously considered income tax alternatives include the value-added tax,
the flat tax, the personal consumption tax, and the national retail sales tax.⁴⁸

1. The Value-Added Tax

The value-added tax (hereinafter the “VAT”) has essentially two

⁴⁵ They may also be as numerous as the people who thought them up, as each taxpayer seems to have her or his own preference of what to do with the income tax system. Indeed, this article may be evidence only of the same.

⁴⁶ “Simplifying” the income tax system was not the answer. Congress tried it twice before – once in 1980 and again in 1995 – but the income tax system’s interminable complexity proved too great a juggernaut. David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens*, NTU Policy Paper 120 (April 17, 2006) (“In an attempt to bring the paperwork burden under control, Congress passed the Paperwork Reduction Act of 1995 [T]he law has been a failure, largely due to the increasing burdens at the IRS.”) This article presumes the current income tax system may be incapable of any meaningful reform. See *supra* notes 34-37 and accompanying text.

⁴⁷ See, e.g., Barbara H. Fried, *Fairness and the Consumption Tax*, 44 STAN. L. REV. 961, 961 (1992) (“For over a century, tax scholars and economists have debated the merits of replacing the existing income tax with a tax on consumption.”).

⁴⁸ See generally U.S. Gen. Accounting Office (“GAO”), Tax Administration, Potential Impact of Alternative Taxes on Taxpayers and Administrators 55-188 (GAO/GGD-98-37, Jan. 1998) (presenting analysis on the national sales tax model), available at <http://www.gao.gov/archive/1998/gg98037.pdf> (last visited June 30, 2006).

forms, the credit-invoice VAT and the subtraction VAT.⁴⁹ Both forms of the VAT are designed to tax the value a business adds to a product at the time of sale.⁵⁰ What distinguishes the two forms is the method of calculating the tax liability. Under the credit-invoice method, the tax is calculated on each individual transaction at the time of sale.⁵¹ Under the subtraction method, by comparison, the tax is calculated by subtracting the business's aggregate purchases of goods and services from other businesses from the aggregate sales of its own goods and services.⁵²

Tax liability is easier to verify under the credit-invoice VAT because individual transactions can be traced and authenticated by comparing the receipts and records of the businesses and individuals involved at any point in the production chain, including the retail level.⁵³ Because of this inherent verifiability, the credit-invoice VAT could impose tax at multiple rates.⁵⁴ Conversely, tax liability under the subtraction VAT is difficult to verify because it would be based solely upon the business's

⁴⁹ *Id.* at 127.

⁵⁰ The value added to a product by a business equals the difference between the amount a business spent purchasing the product and the amount for which the same business sold that product. *Id.*

⁵¹ *Id.* at 127, 133.

⁵² *Id.* at 127, 145.

⁵³ *Id.* at 136, 146. See also U.S. Gen. Accounting Office, Tax Policy, Choosing Among Consumption Taxes 13 (GAO/GGD-86-91, Aug. 1986) ("The invoice method allows for a readily administrable verification of tax liability because each business must keep accurate records of total tax paid and charged, with supporting invoices. The trail of invoices also allows cross-checking for accuracy should the business be selected for audit."), available at <http://archive.gao.gov/d4t4/131062.pdf> (last visited July 18, 2006).

⁵⁴ The GAO notes that a single rate would be administratively more desirable. GAO, *supra* note 48, at 134.

own records, which cannot be cross-referenced against the records of other businesses to verify their accuracy.⁵⁵ Accordingly, to minimize underreporting, the subtraction VAT should be assessed only at a single rate.⁵⁶

Both forms of the VAT eliminate the individual taxpayer filing burdens.⁵⁷ Rather than place the filing burden on the individual taxpayer, the VAT places that burden on businesses, which would be required to remit the difference between the taxes paid on its purchases of goods and services and the taxes received on the sales of its own goods and services.⁵⁸ Even though the burden of remitting taxes would be placed on businesses, the burden of ultimately paying the taxes would be passed on entirely to the individual taxpayer.⁵⁹ And, while the credit-invoice VAT is commonly

⁵⁵ *Id.* at 146.

⁵⁶ *Id.*

⁵⁷ *Id.* at 127.

⁵⁸ *Id.*

⁵⁹ Businesses do initially remit some portion of the taxes, but they eventually receive a credit for the amount they pay. “Under [the credit-invoice VAT], for every sale within the production and distribution system, a tax is calculated, added to the price of the product, and shown on the invoice that sellers in these countries normally are required to furnish to purchasers. At the end of each tax period, a business subtracts the sum of the taxes that it paid on its purchases from the taxes that it collected on its sales. The difference is its net tax liability, which it remits to the government. . . .

“An example may help to clarify how the invoice method works. This example is of a value-added tax of 20 percent applied to the production and distribution of baseball bats. A tree farmer harvests an ash tree and sells it to a lumber yard for \$5 per unit. This represents the value added to the ash seedling by the farmer. The farmer adds \$1 of tax to his price (20 percent of \$5) and collects a total of \$6 from the lumber yard. He remits \$1 of tax to the government. The lumber yard takes the \$5 unit of ash, cuts it into rectangular prisms, and sells them to the bat maker for \$10 (another \$5 being added in value by cutting the wood). In addition to the \$10, the bat maker pays \$2 of tax. The lumber yard remits to the government the difference between the total amount of tax it collected (\$2) from the sale of its product and the total amount of tax it paid (\$1) for raw materials. If audited, the lumber

employed by many industrialized countries,⁶⁰ it is often supplemented with some form of income tax because the system is unable to generate sufficient revenue on its own because of its limited tax base.⁶¹

2. The Flat Tax

The flat tax would attach a single rate of tax to the wages of all

yard must be able to produce the invoice from the tree farmer showing the \$1 tax paid to support its claim for the \$1 tax credit.

“The same procedures are followed by the wholesaler and retailer. The wholesaler buys the bats for \$20 plus \$4 of tax and sells them to the retailer for \$25 plus \$6 of tax. Eventually, the consumer buys the finished baseball bats from the retailer for \$36 – \$30 for the bats and \$6 for the value-added tax.

“A retail sales tax of 20 percent would generate the same tax revenue (\$6), but the responsibility for collecting the tax and remitting it to the government would belong to the retailer alone. Under the value-added method, four businesses remit 1 dollar and one business, the bat maker, remits 2 dollars of tax.” U.S. Gen. Accounting Office, Tax Policy, Choosing Among Consumption Taxes, *supra* note 53, at 13-14 (footnote omitted).

As the above example illustrates, the VAT system simply spreads the burden of remitting the taxes among the businesses linked within the production and distribution chains. *Id.* In the end, since each business would receive its credit, the retail consumer would ultimately pay the entire amount of tax liability. *Id.*

⁶⁰ GAO, *supra* note 48, at 133. See also *id.* at 131 (“In 1996, the standard VAT rates in most of the world’s industrialized countries ranged between 15 and 25 percent. Most of these countries had different rates for necessities and/or luxuries. Most of these countries also relied on an income tax, as well as the credit VAT, for their revenues.”) (footnote omitted).

⁶¹ *Id.* at 131, 133. The tax base is limited because businesses end up passing the tax burden onto the individual taxpayer. See *supra* note 59 and accompanying text. The graduated consumption tax model, by comparison, requires both individuals and businesses to contribute to the tax base at the retail and production levels, respectively. See *infra* note 123 and accompanying text. Furthermore, given its constraints, “[i]f a credit VAT, collected at the various stages of production and distribution (including retail), replaced the income and employment taxes, the rate could be as high or higher than the common rates of 15 to 25 percent currently in effect in industrialized countries.” *Id.* at 139 (citation omitted). Given the comprehensive tax base of the graduated consumption tax, the average mean tax rate could be as low as thirteen percent. See *infra* notes 140-48 and accompanying text.

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individuals and businesses, regardless of income level.⁶² Since it would tax only the accumulation of unsaved income, the flat tax is technically considered a consumption tax.⁶³ Technicalities aside, however, the flat tax would be administratively similar to the income tax because it would impose upon taxpayers analogous burdens of tax computation and filing. For example, to counterbalance the inherent regressivity of the main feature of the flat tax – its fixed rate – the General Accounting Office (hereinafter “GAO”) concluded that “[i]ndividuals would be required to make the calculations to determine deductions, and thus, properly claiming dependents, which has proven troublesome in the current system, would continue as a problem area.”⁶⁴

3. The Personal Consumption Tax

The personal consumption tax is not designed to lighten the individual taxpayer’s filing burdens. The personal consumption tax is similar to the present income tax, except that it would impose tax upon total taxpayer consumption rather than income.⁶⁵ Unlike the flat tax, the

⁶² The GAO’s analysis focused specifically on the Hall and Rabushka version of the flat tax. GAO, *supra* note 48, at 157 (citing Robert E. Hall and Alvin Rabushka, *The Flat Tax*, 2nd ed. (1995)).

⁶³ *Id.*

⁶⁴ *Id.* at 157, 162.

⁶⁵ *Id.* at 174 (“In general, under a personal consumption tax, taxpayers add up all the funds they have received during the year and then deduct the amount they saved. The remaining amount is a measure of the taxpayer’s spending on goods and services for consumption over the year, and this amount is subject to tax.”).

personal consumption tax would tax consumption at graduated rates based on income status.⁶⁶ But, like the flat tax, the personal consumption tax would not remove the individual taxpayer's filing burdens. In fact, it would increase those filing burdens because it would require the taxpayer to add their income and deduct their savings to compute their tax liability.⁶⁷ Under this tax model, taxpayers would not only have to calculate their total income accurately, they would also have to save all their receipts and calculate their expenses with equal precision.⁶⁸

4. The National Sales Tax

On January 4, 2005, Congress introduced the latest version of a national sales tax program.⁶⁹ The bill was designed to replace the income tax system with a national sales tax at a single, fixed rate.⁷⁰ The national sales tax model was both novel and controversial. Although the legislation advertised an initial fixed tax rate of twenty-three percent,⁷¹ upon review, the Institute on Taxation and Economic Policy concluded that the national sales tax program would actually require a single, fixed tax-exclusive rate

⁶⁶ *Id.*

⁶⁷ *Id.* at 174.

⁶⁸ GAO, *supra* note 48, at 178, 180.

⁶⁹ The Fair Tax Act of 2005, H.R. 25, 109th Cong. (1st Sess. 2005).

⁷⁰ H.R. 25 §§ 101, 201.

⁷¹ H.R. 25 § 201, ch. 1, § 101(b)(1). Note, the twenty-three percent rate is tax-inclusive. William G. Gale, *A Note on the Required Tax Rate in a National Retail Sales Tax: Preliminary Estimates for 2005-2014*, The Brookings Institution (Aug. 12, 2004), available at <http://www.brookings.edu/views/papers/gale/20040812.htm> (last visited June

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somewhere between forty-five and sixty percent.⁷² In addition to the high
rate of taxation, the Institute found that a fixed-rate national sales tax would
shift the tax burden disproportionately to the low and middle-income
households:⁷³ “As a result, replacing most federal taxes with a national
sales tax would mean very large tax increases on most Americans and very
large tax cuts for the wealthy.”⁷⁴

The national sales tax model presented several other potential
problems. One such problem is that it purported to draw its revenue from a
reduced tax base.⁷⁵ For example, under the national sales tax, business-to-
business transactions would be exempted from taxation for fear of
cascading tax upon tax.⁷⁶ Another significant problem with the national
sales tax model is due to its refunds and credit programs, which could

2, 2006).

⁷² ITEP, *supra* note 22, at 2 (citing William G. Gale, *A Note on the Required Tax Rate in a National Retail Sales Tax: Preliminary Estimates for 2005-2014*, The Brookings Institution (Aug. 12, 2004)).

⁷³ *Id.* at 3.

⁷⁴ *Id.*

⁷⁵ The anemic tax base explains the exorbitant tax rates under the national sales tax model. Revenue-neutral tax rates (when compared to the income tax system) are possible under the graduated consumption tax because of its significantly broader tax base. *See infra* notes 140-48 and accompanying text. Perhaps the credit-invoice VAT or the national retail sales tax might work better if their respective tax bases were simply broadened to tax consumption along the entire production and distribution chains using the “consumption events theory,” or something similar. Nevertheless, the theoretical considerations involved in increasing the tax base under either of those models may result in a tax model very similar to the graduated consumption tax.

⁷⁶ H.R. 25 § 201, ch. 2. *See also* William G. Gale, *The Required Tax Rate in a National Retail Sales Tax*, 52 NAT’L TAX JOURNAL 443, 445 (Sept. 1999) (“In a pure retail sales tax, business-to-business transactions would not be included either, because the purchase is used as an input, not as household consumption. . . . Thus, business purchases would not enter the net tax base, . . .”). But, note, the graduated consumption tax base is configured under a different theory of consumption. *See infra* note 123 and accompanying

facilitate increased tax avoidance and evasion.⁷⁷ Finally, and significantly, while the national sales tax model would reduce the individual taxpayer filing burden, it would not eliminate it. Indeed, some taxpayer work would still be required, especially for the poor who would still be required to file forms to qualify for tax refunds or credits.⁷⁸

B. The Other Players: Income Tax Alternatives Proposed by Scholars

Although the graduated consumption tax is novel, it is not the first scholastic attempt to reform the income tax system. In fact, several scholars have already proposed noteworthy income tax alternatives. One such scholar, Professor Michael Graetz, has proposed a sophisticated alternative tax model that also seeks to remove the filing burdens from the majority of individual taxpayers by combining essentially a single-rate VAT-style consumption tax with reduced income taxes, payroll tax withholdings, and corporate taxes.⁷⁹ The Graetz model, however, would not eliminate entirely

text.

⁷⁷ Gale, *supra* note 76, at 451 (warning that individuals might attempt to register as business entities to take advantage of the tax credits).

⁷⁸ For example, under the Fair Tax Act of 2005, taxpayers must apply for exemptions and credits. *See, e.g.*, H.R. 25 § 201, ch. 3 § 304. By comparison, the graduated consumption tax model does not require the ordinary taxpayer to request or provide any paperwork. From the consumer's point of view, the transaction would function no differently than the sales taxes most states currently employ. Unlike the Fair Tax Act of 2005, the individual taxpayer has no tax computation burdens under the graduated consumption tax model because the exemptions and refunds would be built into the tax rate calculations themselves

⁷⁹ Graetz, *supra* note 3, at 285-99.

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the individual taxpayer filing burdens.⁸⁰ Moreover, administrative concerns
aside, the graduated consumption tax presents a less complicated overall
design than the sophisticated Graetz model, which fuses several different
tax structures into a single patchwork.⁸¹

Also noteworthy is the “X-Tax.” Designed by Professor David
Bradford, the X-Tax is another sophisticated tax model alternative that
essentially couples a business tax with a graduated tax on employment
compensation.⁸² Because of its complicated design, and since the X-tax is a
form of subtraction VAT, administration of the tax may prove
challenging.⁸³ Most significantly, however, the X-Tax would not relieve
individual taxpayer filing burdens, as it is contemplated to work in
conjunction with the present income tax system.⁸⁴

Offering perhaps the most practical solution to address the growing
problem of individual income taxpayer filing burdens, Professor Joseph
Bankman introduced a pilot program called “ReadyReturn.”⁸⁵ The program
would require California’s Franchise Tax Board to complete the taxpayer’s

⁸⁰ *Id.* at 295 (explaining that, under his plan, “only about 25 million income tax returns
would be filed each year”).

⁸¹ *See id.* at 285-99.

⁸² David F. Bradford, *What are Consumption Taxes and Who Pays Them?*, Tax Notes,
Apr. 18, 1988, at 384, available at LEXIS 39 Tax Notes 383.

⁸³ *See id.* at 387; *cf. supra* notes 55-56 and accompanying text.

⁸⁴ Bradford, *supra* note 82, at 385 (“The X-Tax could be administered in conjunction
with the existing income tax.”).

⁸⁵ Joseph Bankman, *Simplifying the Tax System for Average Citizens: the California
“ReadyReturn,”* Tax Notes (forthcoming), available at
<http://www.law.stanford.edu/faculty/bankman/> (last visited Aug. 3, 2006).

state income tax return using the wage data it already receives from employers.⁸⁶ Upon review, the taxpayer can accept the government's work, make changes to it, or fill out and file a new return entirely on their own.⁸⁷

While the "ReadyReturn" program is a thoughtful and efficient approach to relieving the individual taxpayer's filing burdens,⁸⁸ it presents its own shortcomings. As an initial matter, the "ReadyReturn" program appears to be based on the ideal notion that there is one correct way, or at least one "most" correct way, for taxpayer's to calculate their individual tax liabilities.⁸⁹ Unfortunately, the reality is that the income tax's overwhelming complexity now allows for significant computational variance within individual tax returns.⁹⁰ Perhaps anticipating this problem, the "ReadyReturn" would be offered only to those who ordinarily file the simplest returns, leaving the overwhelming majority of the taxpaying population – including those with the most complicated returns and, in turn, the most onerous filing burdens – no better off than they were before.⁹¹

⁸⁶ *Id.* at 3.

⁸⁷ *Id.*

⁸⁸ To its credit, the "ReadyReturn" program achieves the same primary purpose of the graduated consumption tax model without requiring a complete change of the extant income tax system.

⁸⁹ "The ReadyReturns stated the wage income reported to the State, and the tentative tax liability produced by that wage income." *Id.* at 3. The inference drawn from this statement, as well as the impetus behind the program itself, is that the filing burden is simply a matter of math, work, and time. But, as any taxpayer might attest, filing taxes is never that simple. *See supra* note 7 and accompanying text.

⁹⁰ *See supra* notes 30-31 and accompanying text.

⁹¹ "The California Franchise Tax Board, or FTB, has come up with a plan that would greatly simplify tax return filing for over 3 million Californians. These citizens have only wage income, and do not itemize deductions." Joseph Bankman, *ReadyReturn: A Brief*

Moreover, there is a good chance that the taxpayers who would actually benefit from the program might be overcharged by the government, as even tax experts seem incapable of taming the tax code's complexity.⁹² As a result, and quite understandably, Professor Bankman speculates that some taxpayers would nevertheless prefer to double-check the government's work by doing it themselves, using a software program, or even submitting their returns to their tax preparer.⁹³

So, as thoughtful and efficient as the "ReadyReturn" program appears, it can hardly be considered a comprehensive solution when it seems that over ninety percent of taxpayers will be excluded from the program,⁹⁴ and when some of the taxpayers who actually participate would do the work the "ReadyReturn" program was designed to eliminate anyway.⁹⁵ And, even if the "ReadyReturn" program eliminated the filing burden to an extent comparable to the graduated consumption tax model, it would do so without the model's added administrative benefits since, like

Explanation, The California ReadyReturn Project, at 1, available at <http://www.law.stanford.edu/faculty/bankman/> (last visited Aug. 3, 2006). According to the latest census information, which estimated California's population in 2005 at 36,132,147, the "ReadyReturn" program would appear to help less than ten percent of Californians. U.S. Census Bureau, State and County Quick Facts, California State Quick Facts Table, available at <http://quickfacts.census.gov/qfd/states/06000.html> (last visited Aug. 3, 2006).

⁹² See *supra* notes 30-31 and accompanying text.

⁹³ "Some taxpayers would be thrilled to simply have a return to sign; others would want to show the Ready Return to their preparer, run the return through Turbo Tax or other software, or 'manually' double-check the State's numbers." Joseph Bankman, *ReadyReturn: A Brief Explanation, The California ReadyReturn Project*, at 1, available at <http://www.law.stanford.edu/faculty/bankman/> (last visited Aug. 3, 2006).

⁹⁴ See *supra* note 91 and accompanying text.

the credit-invoice VAT, fewer entities would be responsible for filing taxes under the graduated consumption tax model.⁹⁶ Indeed, Professor Bankman and Professor David A. Weisbach have previously argued, quite persuasively in fact, that an ideal consumption tax should be preferred over an ideal income tax for a host of reasons.⁹⁷ Thus, if the graduated consumption tax can achieve the goals of the “ReadyReturn” program with equal or better administration, equity, and economic efficiency, then perhaps it too should be preferred.

III. THE GRADUATED CONSUMPTION TAX MODEL

While the graduated consumption tax is envisioned as a complete replacement to the income tax system, it could also function as an income tax supplement. In fact, the European VATs, as well as many other proposed income tax alternatives, are designed to supplement and not to

⁹⁵ See *supra* note 93 and accompanying text.

⁹⁶ Under a credit-invoice VAT, only sellers – not consumers – would be responsible for filing taxes. See *supra* notes 57-59 and accompanying text.

⁹⁷ Professors Bankman and Weisbach provide many persuasive reasons for resetting some of the traditional notions that favor an income tax over a consumption tax. Joseph Bankman & David A. Weisbach, *The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax* 58 STAN. L. REV. 1413 (2006), also available at <http://www.law.stanford.edu/faculty/bankman/TheSuperiority.pdf> (last visited Aug. 4, 2006). Among those reasons, unlike the income tax, a consumption tax would not distort savings decisions. *Id.* at 1422. In addition, a consumption tax would generate greater efficiency. *Id.* at 1455; *cf. infra* notes 184-94. Professors Bankman and Weisbach based their study on the assumption that a consumption tax should be neutral, or that it taxes all consumption at the same rate. *Id.* at 1414. Obviously, the graduated consumption tax does not follow the same assumption.

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replace the income tax.⁹⁸ But, the graduated consumption tax model does not contain the same design limitations as the European VATs. Unlike the European VATs, the graduated consumption tax would not need supplementation because it would generate sufficient amounts of revenue on its own.⁹⁹ Moreover, given the mess associated with any degree of income tax filing, the graduated consumption tax must completely replace the present income tax if it is to accomplish its primary goal of removing all the individual taxpayer's filing burdens. Thus, there would be no need or reason to endure the administrative or economic headaches associated with keeping the income tax, even if reduced to some supplementary form.

Accordingly, like the Fair Tax Act of 2005,¹⁰⁰ the graduated consumption tax model would replace completely not only the income tax, but also the payroll and estate and gift taxes.¹⁰¹ In addition, the repeal of the 16th Amendment would be appropriate. Excise taxes, however, should remain unchanged, as their continued presence would have no effect on the individual taxpayer except to increase the tax base and, in turn, decrease the

⁹⁸ See GAO, *supra* note 48, at 133; Graetz, *supra* note 3, at 285-99.

⁹⁹ See *infra* notes 140-51 and accompanying text.

¹⁰⁰ The Fair Tax Act of 2005 was introduced in the House of Representatives on January 4, 2005, by Mr. Linder on behalf of himself and Mr. DeLay, Mr. Brady of Texas, Mr. Culberson, Mr. Deal of Georgia, Mr. Flake, Mr. Gutknecht, Mr. King of Iowa, Mr. Kingston, Mr. Westmoreland, and Mr. Price of Georgia. H.R. 25.

¹⁰¹ *Cf.* H.R. 25 § 101-03. In addition, the graduated consumption tax model may adopt the Congressional Findings related to the income, payroll, estate and gift taxes as well. See H.R. §§ 2(a) – (c).

tax rates.¹⁰²

Functionally, the graduated consumption tax would operate like a national sales tax at both the production and retail levels.¹⁰³ While the design of the graduated consumption tax model is similar to that of the Fair Tax Act, it differs significantly from the Act in that the tax rates under the graduated consumption tax model vary progressively in relation to the character of the specific item being consumed. Accordingly, under the graduated consumption tax model, credit, refunds, and allowances would be unnecessary because they would be built into the progressive nature of the tax rates themselves.¹⁰⁴ And, since there would be no exceptions or exemptions, all spending generated within the United States would be subject to taxation under the appropriate classification,¹⁰⁵ including interstate and international purchases.¹⁰⁶

¹⁰² *Cf.* H.R. 25 § 104.

¹⁰³ The graduated consumption tax model may incorporate some or all of Congress's findings relating to an administration of a national sales tax with the exception, of course, that the national sales tax rates should be graduated according to the character of necessity or luxury associated with each particular item taxed and should include a broader tax base. *See* H.R. 25 §§ 2(d) & (e).

¹⁰⁴ *Cf.* H.R. 25 § 201, chs. 2 & 3.

¹⁰⁵ All items consumed shall be subject to tax. While the purchase of homes would be subject to tax at the appropriate rate corresponding to the characterization of the home, an interesting question is whether rent should also be taxed. Technically, the act of paying rent is a form of consumption; accordingly, it seems logical to conclude that rent should be subject to tax. While the transaction would be subject to tax assessment, the tax rate associated with the rent would likely be *de minimis*, as the majority of rent would probably be characterized as a necessity. Naturally, the character of rent payments would correspond largely to the character of the item upon which the rent would be based.

¹⁰⁶ This policy would eliminate some of the benefits of off-shore accounts. Since there would be no income tax advantage to holding assets outside of the United States, many of those assets may find their way back home into the U.S. Furthermore, since all

A. The Characterization Model

Like the income tax system,¹⁰⁷ the graduated consumption tax model is progressively designed.¹⁰⁸ Under the graduated consumption tax model, tax rates may be organized into graduated tiers. The tax rates would increase progressively from one tier to the next. An illustration of the tax rates¹⁰⁹ under a graduated consumption tax model is provided below:

<u>Tax Tier</u>	<u>Tax Range</u>
Fundamental Necessity	0% Sales Tax
Moderate Necessity	0-4% Sales Tax
Marginal Necessity	5-9% Sales Tax

consumption within the United States would be subject to tax – even the consumption of international goods and services – there would be no tax benefit to purchasing products from off-shore entities.

¹⁰⁷ KAHN, *supra* note 22, § 1.1000 at 3-4.

¹⁰⁸ The term “progressive” is used carefully here. In the income tax sense, “progressive” means the tax burden increases along with income, ensuring a greater tax burden supported by the wealthy. For the graduated consumption tax model, the term “progressive” must have a technically different meaning, even if its impact is practically the same. Under the graduated consumption tax model, the tax burden would increase along with consumption. Thus, the greatest tax burden would be supported by the most excessive, lavish, and decadent consumers. In virtually all cases, the most decadent consumers are also those with the greatest spending power. Thus, while the “progressive” nature of the consumption tax technically targets excessive consumption, like the income tax system, the greatest tax burden, practically speaking, would also be borne by the most wealthy.

¹⁰⁹ Here, the tax rates were intended to be tax-exclusive. Whether the graduated consumption tax model ultimately utilizes tax-inclusive or tax-exclusive percentages is largely an irrelevant matter of semantics. Nevertheless, to avoid any possible confusion, the graduated consumption tax model should utilize only one or the other and broadcast its choice clearly to the public.

Marginal Luxury	10-25% Sales Tax
Moderate Luxury	33-67% Sales Tax
Consummate Luxury	67%-100% Sales Tax

Under this model, every consumable item would be taxed according to the rate that corresponds to the item’s character. Each tier could be further subdivided into a specific number of steps. Items could then be classified according to their tier and their respective step within each tier. Once classified, the appropriate tax rate would apply.

<u>Tier</u>	<u>Degree</u>	<u>Tax Rate</u>
First Tier: Fundamental Necessity	(No subdivision)	0% Sales Tax
Second Tier: Moderate Necessity (1% Steps)	First Step	1% Sales Tax
	Second Step	2% Sales Tax
	Third Step	3% Sales Tax
	Fourth Step	4% Sales Tax
Third Tier: Marginal Necessity (1% Steps)	First Step	5% Sales Tax
	Second Step	6% Sales Tax
	Third Step	7% Sales Tax
	Fourth Step	8% Sales Tax
	Fifth Step	9% Sales Tax

Fourth Tier: Marginal Luxury (Three 1% Steps, Three 5% Steps)	First Step	10% Sales Tax
	Second Step	11% Sales Tax
	Third Step	12% Sales Tax
	Fourth Step	17% Sales Tax
	Fifth Step	22% Sales Tax
	Sixth Step	27% Sales Tax
Fifth Tier: Moderate Luxury (7% Steps)	First Step	32% Sales Tax
	Second Step	39% Sales Tax
	Third Step	46% Sales Tax
	Fourth Step	53% Sales Tax
	Fifth Step	60% Sales Tax
Sixth Tier: Commensurate Luxury (11% Steps)	First Step	67% Sales Tax
	Second Step	78% Sales Tax
	Third Step	89% Sales Tax
	Fourth Step	100% Sales Tax

Due to the progressive nature of the graduated consumption tax model, the rates between each step increase incrementally, with the slowest increases in rate reserved for items characterized as more necessary and the steepest increases in rate reserved for the items considered most luxurious. For example, if the character of an item is classified within the fourth step

of the tier of moderate luxury, then the item would be taxed at a rate of fifty-three percent for the sale. Of course, the number of tiers, steps, and rates – even the category labels – are intended to be illustrative only. The actual number of tiers, steps, and rates must be calculated in a far less arbitrary way.¹¹⁰

Determining the character of an item – its degree of necessity or luxury – obviously requires the government to make certain value judgments. These value judgments, however, can and must be made as objectively as possible. The legitimacy of the graduated consumption tax model, therefore, depends largely on a classification system that is absolutely transparent. The transparency of the classification system would help guarantee against arbitrary assignments or political influence, which could quickly and easily discredit the system entirely.¹¹¹

¹¹⁰ Given the low mean tax rates – a natural consequence of the comprehensive tax base – the differential tax rates could conceivably cover a substantially smaller range than provided in the above illustration. *See infra* notes 140-48 and accompanying text. Moreover, a two or three-tiered system that distinguishes only between necessities and luxuries, for example, could achieve the same goals of the graduated consumption tax system, *see supra* note 13 and accompanying text, while posing simpler tax administration issues than the six-tiered model. In fact, similar models have already proven administratively possible, as most of the countries that employ a VAT system of taxation do so utilizing differential tax rates. GAO, *supra* note 48, at 131 (“Most of the[] countries [using the VAT] had different rates for necessities and/or luxuries.”). For the sake of clarity, however, the more complicated six-tiered model is offered here only for the sake of theoretical completeness.

¹¹¹ A potential weakness inherent in the graduated consumption tax model is that businesses would likely mount overwhelming lobbying efforts in an attempt to influence the characterization of their products and, hopefully, secure a lower tax rate. Of course, political gerrymandering already affects the present tax code to some extent. Nevertheless, transparency in this regard would be critical to preserving the fair application and legitimacy of the graduated consumption tax model. Possible solutions may include

No radical solution would be required to maintain transparency and legitimacy; our current system of checks and balances is equipped to handle the challenge. Hence, like many other governmental programs, under Congressional authority, the Executive Branch could create an independent agency like the “State and Federal Cooperative Tax Administration” identified in the Fair Tax Act,¹¹² which would compile the various indexes, classification tables, and corresponding tax schedules. Predictably, the work conducted by that agency, or any others, would be answerable to all three branches of government.

While the model attempts to preserve fairly the progressive nature of the current income tax system, the consumption tax model reflects a different philosophy than the income tax system. Rather than tax income progressively, which some may characterize as a system that “punishes” hard work, the graduated consumption tax model is designed to tax spending progressively.¹¹³ The policy behind the graduated consumption tax model is not to tax income or savings but to tax all consumption at both the production and retail levels.

Under this policy, individuals and entities alike would be subject to

prohibiting or restricting lobbying efforts or enacting an administrative agency whose sole charge would be to regulate and scrutinize the legitimacy of the characterization processes.

¹¹² See H.R. 25 § 201, ch. 4.

¹¹³ Some might characterize the graduated consumption tax model as one that “punishes” spending. Due to its progressive nature, however, it would seem more accurate to characterize the model as one that “punishes” excessive and extravagant spending rather

the same tax rates. The amount of taxes either would pay, therefore, would depend entirely on how much the taxpayer consumes and the character of the items consumed. For example, although a manufacturer's consumption of raw materials would be subject to taxation, the level of taxation would depend on the tax classification of raw materials consumed. In the case of food manufacturers, for instance, aside from the tax rate attached to other business consumption, the rate of tax that would apply either to the purchase of raw materials or the sale of the finished food item would either be zero or some percentage close to it. Similarly, in the case of the manufacturer of luxury items, raw materials would be taxed at a rate significantly lower than the rate attached to the sale of the final product manufactured using those raw materials.¹¹⁴

Since the graduated consumption tax would tax all consumption, the tax would apply to the purchase of all items. An all-inclusive consumption tax base, however, raises interesting questions, such as whether the policy should apply a tax to the consumption of used products. The policy behind implementing a graduated consumption tax does not necessarily need to

than spending in general.

¹¹⁴ Characterization – the degree of “necessity” or “luxury” associated with an item – is not measured subjectively in terms of the necessity of using any particular raw material for production or consumption. Rather, “necessity” is measured more objectively in terms of whether the item being consumed, in abstraction, is something characteristically luxurious or necessary when compared to similar or like-kind materials, goods, or services.

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distinguish between new and used products.¹¹⁵ In fact, the market automatically corrects for any discrepancies in value and, since the tax rate would be a percentage of the value, the actual amount of the tax would be reduced in direct proportion to the discounted value, if any, of the used item.¹¹⁶

Still, under this policy, one may contend reasonably that no consumption tax should attach to the sale of an unmodified,¹¹⁷ used product because it has not changed character and the tax assessed on it, presumably, has already been paid by the seller. In other words, once consumed, the same item should not be taxed again. Ultimately, and as this introductory question illustrates, developing a sound theoretical basis for the graduated consumption tax is critical to its successful implementation.¹¹⁸

B. The Consumption Events Theory

As a matter of theory, consumption is sometimes considered to occur exclusively outside the production cycle.¹¹⁹ Many tax models, such

¹¹⁵ As a matter of enforcement, it might prove practically useful to distinguish between the commercial seller of used goods and the one-time backyard seller, as backyard sales are typically hard to track. *Cf. supra* note 127 and accompanying text.

¹¹⁶ As a default, the character of the used item would be identical to when it was new. Merchants, or backyard sellers, may request character re-evaluations by the appropriate federal agency, however, to compensate for age, wear-and-tear, and similar considerations.

¹¹⁷ Theoretically, the example requires the product to be unmodified because the character of an item must be reevaluated once modified.

¹¹⁸ *See infra* note 123 and accompanying text.

¹¹⁹ Some scholars note, however, the line between consumption and production is not always clear. *See* Robin Cooper Feldman, *Consumption Taxes and the Theory of General*

as the VAT, operate under a version of this theory of consumption.¹²⁰

Under this definition, if a tax on consumption were imposed at each step in the stream of commerce, from manufacturer to distributor to retailer, and if the end-market consumer were paying a tax on an item that represents one-hundred percent of the consumed value of the product, then the graduated consumption tax model would impose a total tax on consumption that would exceed the total consumed value of the product.

Viewing consumption as occurring exclusively outside the production cycle, however, creates an overly broad distinction between producers and consumers.¹²¹ Under a consumption tax that taxes only consumers, the implication is that only consumers consume. Hence, the theory infers, producers should not pay a consumption tax because they do not consume. The inference, of course, is incorrect: producers also consume.¹²² The distinction, therefore, should not be drawn between producers and consumers as a class but, rather, between the individual events of production and consumption regardless of class.

and Individual Taxation, 21 VA. TAX REV. 293, 360 n.65 (2002) (“The definition of consumption, however, views individual consumption in isolation from the production cycle. It suggests that an individual's consumption has no productive element at all. This implication is misleading in two respects. First, production and consumption are part of the same economic cycle. . . . Second, it is artificial to suggest that an individual exhausts resources solely for personal reasons and not in any way for the purpose of production. . . . Individual consumption, however, cannot be neatly separated from the production cycle.”) (citations omitted).

¹²⁰ For an example of how this theory applies in the credit-invoice VAT context, *see supra* note 59 and accompanying text.

¹²¹ *See* Feldman, *supra* note 119, at 360 n.65.

Unlike the traditional theory of consumption, which assigns consumption tax liability to a broad class of market-end consumers, the “consumption events theory” instead views individual events to determine when the consumption tax should apply. Taxing consumption at all levels – whether production, distribution, or retail – the consumption events theory distinguishes only between production and consumption events, taxing only the latter. And, once identified, each consumption event is treated as an isolated and complete consumption event.¹²³

At the beginning of the stream of commerce, the manufacturer is removing natural resources and transforming them into something novel. This transformative event is theoretically and operationally tax significant.¹²⁴ Once consumed, the old transforms into the new, and the finished product becomes something separate and distinct from the raw

¹²² *See id.*

¹²³ The “consumption events theory” is the author’s comprehensive expansion of Hobbesian foundational tax theory tailored specifically to the characterization theories of the graduated consumption tax model. *See* THOMAS HOBBS, *LEVIATHAN* 266-67 (Clarendon Press 1958) (1651) (“[T]he Equality of Imposition consisteth rather in the Equality of that which is consumed, than of the riches of the persons that consume the same. For what reason is there, that he which laboureth much, and sparing the fruits of his labour, consumeth little, should be more charged, than he that living idly, getteth little, and spendeth all he gets; seeing the one hath no more protection from the Common-wealth, than the other?”). For a discussion on the Hobbesian foundational tax theory, *see* Fried *supra* note 47, at 962, 996, 1006-07, 1016. “Under the Hobbesian view, a ‘fair tax’ is defined simply as a tax that applies only to personal consumption.” *Id.* at 996.

¹²⁴ A bright-line transformative event test would avoid over-complication of the characterization models. Only significant changes in the physical structure or overall design of the good or service should qualify for re-characterization. For example, if a retailer assembles a box of parts into a functioning bicycle, a significant change has occurred and re-characterization would be appropriate. By contrast, if a retailer simply inserts a reflector in the spokes of a pre-assembled bicycle, a significant change has not

materials used to create it. The characterization of the new product is a reflection of that transformation. So, in this example, the tax assessed to the consumption of raw materials under the consumption events theory would represent 100 percent consumption of those materials. Under this theory, once the new product assumes its new character, it would then be ready for its own separate and complete consumption event.¹²⁵

Returning to the introductory question,¹²⁶ the consumption of used items is treated no differently. If the used item is modified, its character has changed, and it is ready for a subsequent sale that is an independent, separate, and complete consumption event. The sale of the unmodified, used item, however, requires more complicated considerations that could follow one of two different approaches. The difference between the two approaches depends on whether the original sale is regarded as a complete or incomplete consumption event.

Under the first approach, the sale of the unmodified, used item

occurred and re-characterization would not be inappropriate. For a brief consideration of the effect on middle-merchants, *see infra* note 133 and accompanying text.

¹²⁵ The consumption events theory is similar conceptually to the biological food chain. Once an item was consumed, the theory assumes it was completely removed from the market, in essence, absorbed or digested by the consumer. Although any product consumed subsequently may, in fact, be composed in part or entirely of the prior item consumed, it would be treated as though something completely separate and independent was consumed. All items sold are viewed similarly under the consumption events theory, whether sold by one manufacturer to another for the purpose of completing an unfinished product or sold by one consumer to another for the purpose of selling a used item.

¹²⁶ The introductory question is whether the consumption events theory should apply to the sale of used products. *See supra* notes 115-18 and accompanying text.

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would generate no tax liability because its original consumption was considered complete and, since it was unmodified, the item's character did not change. The second approach, conversely, views a subsequent sale as an indication that its original consumption was incomplete. Accordingly, the item would be subject to a subsequent consumption event because its sale would indicate some consumable value in the product that was not exhausted by its original purchase. Thus, under this view, the consumption tax on the discounted price of the unmodified, used item may be justified theoretically as the tax on consumption of that previously unrecognized value.¹²⁷

Regardless of which approach is adopted, the consumption events theory would not cascade tax-upon-tax for the manufacturers and distributors. By definition, cascading tax would not be possible under the theory because each transaction along the chain of production would be viewed as a separate, distinct, and complete consumption event.¹²⁸ Moreover, the character of the item, and its corresponding tax rate, would depend on where the product is found in the manufacturing process.¹²⁹

¹²⁷ Ultimately, the approach that is adopted should not have a significant impact on revenue generation either way, as the sale of the unmodified, used item would occur almost exclusively by the informal or "backyard" seller who, incidentally, probably does not claim such sales as income under the present tax system. For the sake of simplicity and consistent application among all sellers, both private and commercial, the latter approach may be preferred.

¹²⁸ *See supra* note 123 and accompanying text.

¹²⁹ Since the character of an item would change at each step in the manufacturing process, the unmodified, used item-scenario would not apply to manufacturers. *See supra*

Manufacturing profitability, therefore, would be preserved because the earlier a product would be found in the manufacturing process, the more necessary its character would be assessed at the time of consumption. Hence, a manufacturer consuming raw materials would pay little tax while the final consumer would pay the highest tax assessed respectively on that product.¹³⁰

Of course, cascading tax upon tax may be a larger problem for the retailer or distributor who is simply reselling an otherwise finished product.¹³¹ In this situation, the business entity makes an inaccessible product readily available to the market. In addition to the degree of product finality, market availability would be an inherent component of the finished product.¹³² A product that is not readily available to the market is not in its final, market-ready form until the moment when the market readily has access to it. Accordingly, the finished character of the product should

notes 124-25 and accompanying text. The consumption events theory assumes that tax rates may be assessed in a way that does not significantly encourage business entities to vertically consolidate to avoid business-to-business consumption tax. In addition, this theory of consumption assumes that the final market is that which the public at large readily has access to, and that the tax rates may be assessed in a way that does not significantly encourage end-market consumers to prefer the purchase of unfinished products over finished products.

¹³⁰ “Respectively highest tax assessed on that product” because the final, highest tax assessed on that product would ultimately depend on that finished product’s final character. Moreover, this analysis ignores price increases along the chain of production, which would further insulate manufacturing profitability.

¹³¹ Some business entities may sell services in addition to products or services only. Like tangible products, services are also consumable items subject to characterization and the corresponding tax assessment.

¹³² See *supra* note 19 and accompanying text.

reflect this value added by the retailer or distributor.¹³³

IV. BENEFITS OF THE GRADUATED CONSUMPTION TAX MODEL

Assuming it can be implemented reasonably and generate sufficient amounts of revenue, the benefits of the graduated consumption tax model are exciting to imagine. The primary benefit of the graduated consumption tax is that individual taxpayers would no longer be burdened with the responsibility of calculating their own tax liabilities.¹³⁴ Regardless of whether the individual taxpayer's burden of tax calculation is constitutional, removing that burden – if possible – seems only fair.¹³⁵

¹³³ Incidentally, middle-merchants who simply pass wares already available on the market without also providing services may add little, if any added value. In those situations, it would be difficult if not impossible for such businesses to remain profitable assuming, of course, that they were otherwise unable to increase the price of the item for sale. Nonetheless, such middle-merchants subsist presently only at the needless expense of the consumer. Keeping prices competitive would provide those previously exploited consumers with more money to spend on other products. This inherent prophylactic consequence of the graduated consumption tax model may thus represent a benefit to consumers, their spending power, and the economy.

¹³⁴ See *supra* notes 20, 27 and accompanying text.

¹³⁵ The government bears the burden of calculating the appropriate tax rates. Like the VAT, however, the burden of applying the appropriate rate and remitting taxes would also fall on the backs of businesses under the graduated consumption tax since the two models are based upon similar administrative frameworks. See *supra* note 20 and accompanying text. Unfortunately, this burden is unavoidable, but businesses would be better suited to bear this responsibility than would individual taxpayers.

Out of concern for the potentially disproportionate burden on small businesses, “[m]ost European VATS were established with small business exemptions. Typically, in countries with these VATS, small businesses do not have to file returns or remit tax if their gross receipts are low, for example, less than \$25,000 per year.” GAO, *supra* note 48, at 130. Exempting small businesses may also be a consideration for the graduated consumption tax model, but only if granting the exemption would not significantly affect the tax base. See *infra* notes 140-51 and accompanying text. Like the hypothetical U.S. VAT, the treatment of small businesses under the graduated consumption tax model should

Eliminating the income tax system would also reduce the large drain on the economy attributed to the costs of filing and paying large lump-sum amounts to the government every April 15.¹³⁶ The graduated consumption tax model would not only calculate tax liability and broadcast the exact amount owed, but it would also allow taxpayers to spread their liability by spending throughout the year. Without the drain caused by the excision of lump sum payments and filing deadlines, taxpayers would be able to manage their spending and saving more effectively.

Another benefit of the graduated consumption tax system would be significantly greater participation from all consumers.¹³⁷ On February 14, 2006, the IRS announced that it estimated a \$345 billion tax gap for the 2001 tax year.¹³⁸ As compared with the income tax, under the graduated

not be problem either way. *Id.* at 136 (“For example . . . 96 percent of income year 1993 corporate revenues came from only 2 percent of corporations. However, because most small businesses at the retail level in the United States are familiar with remitting state and local [retail sales taxes], small businesses may not need special treatment under a U.S. VAT.”).

¹³⁶ While the costs of compliance with the federal income tax are already exorbitant, they are only increasing. A Tax Foundation study found that the estimated cost of complying with the federal income tax code in 2005 totaled over \$265.1 billion for individuals, businesses, and non-profits. Moody, *supra* note 7, at 1. A similar study had previously found that “the estimated cost of [federal income tax] compliance in 1999 was over \$125 billion.” J. Scott Moody, *The Cost of Complying with the U.S. Federal Income Tax*, Tax Foundation Background Paper No. 35 at 9 (Nov. 2000), available at <http://www.taxfoundation.org/files/7eb3ef27926cd164a33e6bf5a46372c8.pdf> (last visited June 1, 2006). “Projections show that by 2015 the compliance cost will grow to \$482.7 billion.” Moody, *supra* note 7, at 1.

¹³⁷ Of course, tax evasion is a significant concern. Even so, participation under the graduated consumption tax model should exceed the level currently enjoyed under the income tax system. See *infra* notes 195-207 and accompanying text.

¹³⁸ Press Release: *IRS Updates Tax Gap Estimates* (Feb. 14, 2006) (“The updated estimate of the overall gross tax gap for Tax Year 2001 – the difference between what taxpayers should have paid and what they actually paid on a timely basis – comes to \$345

consumption tax model, taxpayers would be less capable of hiding from their tax burdens. Every person and entity must consume to survive, and every consuming person or entity would pay their fair share of the taxes at the same time.¹³⁹

Under the graduated consumption tax model, all consumption events would be taxable.¹⁴⁰ The effective tax base, thus, would consist of personal consumption expenditures and government¹⁴¹ and corporate expenditures, including employment compensation.¹⁴² Greater taxpayer participation,¹⁴³

billion.”), *available at* <http://www.irs.ustreas.gov/newsroom/article/0,,id=154496,00.html> (last visited June 2, 2006).

¹³⁹ Like the credit-invoice VAT, the trail of invoices found along the production and distribution chains would make tax liability difficult to avoid or evade under the graduated consumption tax model. *See infra* notes 195-207 and accompanying text. Of course, since everyone must pay the tax on the items they consume, foreigners or undocumented workers spending time and money in the United States may also be required to pay consumption taxes. Like everyone else, the share of consumption taxes paid by such persons would be a function of the resources and governmental services enjoyed by that person in an amount proportionate to the time spent and amount consumed while in this country.

¹⁴⁰ *See supra* note 123 and accompanying text.

¹⁴¹ Government spending would also be subject to tax to promote consistency and simplicity in the application of the tax, which limits alternate routes for avoidance and evasion, and also to promote government accountability. Like the ordinary consumer, theoretically, forcing the government to pay taxes on its consumption may encourage it to spend within its means.

¹⁴² Under the consumption events theory, employers are consuming the labor of their employees. Accordingly, the salaries paid in exchange would be taxable to the employer as consumption events. Rates would probably be low, however, as the consumption of most labor would likely be characterized under independent schedules as more necessary than luxurious. Note that employers already pay taxes on payroll under Subtitle C of the Internal Revenue Code. The labor tax rate schedules under a graduated consumption tax could be designed to impose no greater tax burden than already exists.

¹⁴³ Under the graduated consumption tax model, taxpayer participation includes undocumented workers and foreign visitors that consume resources within the United States. An interesting question this article does not address, however, is whether the consumption tax should be placed on items consumed in the United States from purchasers abroad. For the sake of theoretical consistency, simplicity, and the protection against tax avoidance, the tax should apply to the consumption of any and all items consumed in the United States. Although various trade and economic concerns should also be considered, a

which is inherent in a large tax base, would allow the government to generate amounts of tax revenue under the graduated consumption tax model that would be comparable to the income tax system without prohibitively increasing tax rates. As an example, compare the graduated consumption tax model to the income tax system for the 2003 tax year.¹⁴⁴

The income tax system generated approximately \$1.953 trillion in total revenue for the 2003 tax year.¹⁴⁵ For 2003, the graduated consumption tax base would have equaled about \$17.895 trillion.¹⁴⁶ In order to generate the same amount of revenue as the income tax for that year, the mean tax-exclusive rate under the graduated consumption tax model would have had to equal about 10.6 percent.¹⁴⁷ Even assuming twenty percent avoidance, evasion, and erosion of the tax base, the mean tax-exclusive rate would

related question is whether purchases of products manufactured and sold by United States companies outside of the United States should nevertheless be subject to the consumption tax.

¹⁴⁴ The 2003 tax year is used as an example only because that year provided the most accessible date points.

¹⁴⁵ The figure drops to approximately \$1.9 trillion after subtracting the \$52.8 billion in the revenue generated from excise taxes. IRS, 2005 Fiscal Year Data Table, *available at* <http://www.irs.ustreas.gov/taxstats/compliancestats/article/0,,id=97168,00.html> (last visited June 2, 2006).

¹⁴⁶ The tax base was calculated by adding the figures for 2003 listed in the National Income and Products Accounts (“NIPA”) Tables, provided by the Bureau of Economic Analysis. All of the tables relied upon for these calculations are *available at* <http://www.bea.gov/bea/dn/nipaweb/SelectTable.asp?Selected=N> (last visited June 2, 2006). According to NIPA table 2.4.5, line 1, personal consumption expenditures totaled \$7.71 trillion in 2003. Government receipts totaled \$1.89 trillion and government expenditures totaled \$ 2.316 trillion in 2003, according to NIPA table 3.2, lines 36 and 39, respectively. Corporate consumption of fixed capital plus adjustments totaled \$1.548 trillion in 2003, according to NIPA tables 7.5 & 7.6, line 1, and total compensation of employees private and public totaled \$6.321 trillion in 2003, according to NIPA table 6.2D. Accordingly, \$7.71 + \$2.316 + \$1.548 + \$6.321 = \$17.895 trillion.

¹⁴⁷ The figure was calculated in the following manner: \$1.9 trillion ÷ \$17.895 trillion =

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remain relatively low at about 13.3 percent.¹⁴⁸ By comparison, under the
income tax system, the average tax rate for the individual taxpayer was also
about thirteen percent in 2003.¹⁴⁹ Thus, unlike the national sales tax,¹⁵⁰ the
average tax rate would not significantly increase under the graduated
consumption tax model.¹⁵¹

The graduated consumption tax model could also significantly

10.6%.

¹⁴⁸ The figure was calculated in the following manner: $\$17.895 \times .8 = \14.316 trillion;
 $\$1.9 \text{ trillion} \div \$14.316 \text{ trillion} = 13.3\%$.

¹⁴⁹ Internal Revenue Service website, *Individual Tax Rates and Shares*, available at
<http://www.irs.gov/pub/irs-soi/03inrate.pdf> (last visited June 2, 2006).

¹⁵⁰ Cf. *supra* note 75 and accompanying text. See also William G. Gale, *The National
Retail Sales Tax: What Would the Rate Have to Be?*, TAX NOTES 890, 898-899 (May 16,
2005), available at <http://www.brookings.edu/views/articles/gale/20050516.pdf> (last
visited June 2, 2006). "For example, if evasion occurred at the same rate in the sales tax as
in the income tax and if the sales tax did not cover interest payments such as mortgages and
credit card payments, 20 percent of the consumption base would be lost. In that case, even
with no avoidance and with all other consumption (including health, housing, and food)
fully taxed, the required 10-year rate would rise to 39 percent tax-inclusive (65 percent tax-
exclusive). If, in addition, state and local purchases were omitted from the federal sales tax,
the 10-year revenue-neutral federal sales tax rate would rise to 45 percent tax-inclusive (82
percent tax-exclusive). To replace just the personal income tax and corporate income taxes
with a sales tax would require a tax inclusive rate about 60 percent as large as the rates
quoted above. Thus, if 20 percent of the proposed consumption base were not taxed and
state and local governments were not taxed, replacing the personal and corporate income
taxes would require a 27 percent tax inclusive (36 percent tax-exclusive) rate over the next
decade." *Id.* at 890.

¹⁵¹ Please note the formula is not intended as a proof, but as an indication that the
graduated consumption tax might be economically plausible. Naturally, a more rigorous
and economically proficient review should follow. Some scholars, for example, have
suggested that "[a] broad, but realistic, consumption tax base . . . is about forty percent of
gross domestic product." Graetz, *supra* note 3, at 287 n.121. The forty percent figure,
however, may be a more realistic tax base for the VAT. See *id.* (noting the forty percent
figure in the context of an alternative single-rate VAT). Operating under the consumption
events theory, the graduated consumption tax demands a more comprehensive consumption
tax base. See *supra* notes 123 & 140-50 and accompanying text.

Note also that the term 'mean tax rate' is intended to reflect an average of all the
various tax rates implemented during consumption over the course of the year. Actual tax
rates would vary according to tier, step, and character. Furthermore, individuals and
entities concerned they would lose the benefit of their deductions under the graduated
consumption tax model should wait to compare their total tax liabilities under each system.

reduce enforcement costs. Under the graduated consumption tax system, the government would not have to chase and prosecute as many taxpayers as it does now because combined taxpayer avoidance and evasion should occur less frequently under a graduated consumption tax model than under the current income tax system.¹⁵² Accordingly, it seems likely that enforcement costs under the graduated consumption tax model would probably be less than under the present income tax regime, especially if the cost associated with enforcing any other sales tax were a relevant indicator.¹⁵³

The graduated consumption tax would not shift the overall tax liability. As in the contemporary graduated income tax system, the wealthy, who would continue to consume more luxurious items,¹⁵⁴ would continue to shoulder most of the tax burden. Conversely, the poor would enjoy a

¹⁵² See *infra* notes 195-207 and accompanying text.

¹⁵³ Some experts have suggested that “while compliance with the retail sales tax is quite good (aside from the mail order sales problem and the growing electronic commerce problem), a primary reason is that current tax rates are modest, giving rise to only modest incentives for evasion and avoidance.” Matthew N. Murray, *Would Tax Evasion and Tax Avoidance Undermine a National Retail Sales Tax?*, 50 NAT’L TAX JOURNAL 167, 168 (Mar. 1997). Finishing the thought, attempts at evasion would rise in proportion to the increase in relative tax rate. Such a prediction would clearly be plausible and perhaps even probable. While the incentive for evasion under the graduated consumption tax model may be relatively similar to the present income tax system, evading income taxes seems easier to accomplish by simply not filing income taxes. Logically, the number of attempted evasions would be less under a system more difficult to cheat. Moreover, a similar enforcement structure accompanied with joint liability for both parties to the transaction along with stiff penalties, such as fines, liens, and prison time, seem an appropriate and significant disincentive for evasion to both seller and buyer alike. Furthermore, combined taxpayer avoidance and evasion should occur less than under the present income tax system. See *infra* notes 195-207 and accompanying text.

¹⁵⁴ See *infra* note 196 and accompanying text.

relatively tax-free lifestyle. Those who would be able to afford little more than that which is necessary to sustain themselves or their families would pay little, if any, tax at all.

The graduated consumption tax system would also make debt easier to avoid by attaching price tags to luxury items that would force taxpayers to spend within their means. Taxpayers, particularly the self-employed, would no longer make errors by underestimating their tax liabilities when calculating their spending capital. Since taxpayers would keep all their income, and since tax liability would be built into the price of each item, they would know exactly how much they can afford to spend.¹⁵⁵ Thus, debt may be easier to avoid because the graduated consumption tax model encourages saving and responsible spending.¹⁵⁶

In addition, since consumption tax would be factored into the price

¹⁵⁵ At least taxpayers would no longer be able to blame debt on underestimated income tax liability. While debt may still be a problem under the graduated consumption tax model, it would make it easier for the responsible consumer to avoid.

¹⁵⁶ Alan Greenspan remarked recently that “many economists believe a consumption tax would be best from the perspective of promoting economic growth – particularly if one were designing a tax system from scratch – because a consumption tax is likely to encourage saving and capital formation.” Fox News article entitled Greenspan: Consumption Tax Could Help Economy (Mar. 3, 2005). At the very least, a consumption tax would not punish those who save rather than spend their money. See Bradford, *supra* note 82, at 390 (“The most obvious way in which a consumption tax differs from an income tax is in the variation of burdens among people with different tastes or necessities to save. In the context of the assumption that people with the same lifetime resources as defined above have access to the same consumption possibilities (‘perfect capital markets’), a consumption tax that satisfies the second property (no tax on savings) is neutral among equally endowed individuals. By contrast, an income tax places a relatively heavy burden on those who save, or rather on those whose lifetime resources are paid to them relatively early and on those whose tastes favor later consumption.”). Encouraging savings and responsible spending, however, does not mean that the graduated consumption

of every item, taxpayers would be effectively empowered with the ability to choose when and where to spend or save their money. In this way, taxpayers would receive a symbolic benefit from paying taxes that is not apparent under the income tax model.¹⁵⁷ Income taxpayers are required simply to pay taxes without information or indication as to how their taxes would be spent. Rather than simply paying taxes in abstraction, each tax payment under the graduated consumption tax model would produce an immediately tangible benefit in the item purchased. Since the graduated consumption tax would tax consumption like a sales tax, paying taxes would serve more than a purely intangible role, as taxpayers would regard taxes as the price of consumption.

V. EXAMINING THE WEAKNESSES OF THE GRADUATED CONSUMPTION TAX MODEL

The graduated consumption tax raises many questions, all of which must be answered before such a system may be implemented responsibly. Perhaps the most important question is whether it would be possible, as a matter of fact or theory, to ascribe fair value judgments as to the necessity or luxury of different items. The answer depends on whether there is some

tax model would try to exert control over consumer spending. *See infra* notes 184-91 and accompanying text.

¹⁵⁷ Studies have indicated that taxpayers perceive little value from the government in exchange for their tax payments. *See supra* note 5 and accompanying text.

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 economic model that can be implemented reliably to draw these distinctions
 in inherent value.

The character of an item may be a function of a number of different factors, likely including the basic utility of the product, the average market price of categorically similar items, and the degree of public benefit derived from the product.¹⁵⁸ These factors may be weighted as variables in a mathematical equation formulated to derive a standardized ranking. The item's standardized rank could then be used to numerically categorize that item's degree of necessity or luxury.

For example, under the illustrative six-tiered graduated consumption tax model, each respective step within a tier would be assigned to a range of numerical rankings. Once the standardized ranking of an item was calculated, the character, tier, and step of that item would correspond to the appropriate range. Consider the following table and example for illustrative purposes:

<u>Tier</u>	<u>Degree</u>	<u>Numerical Rank (Range)</u>
First Tier: Fundamental Necessity	(No subdivision)	0 through 80
Second Tier: Moderate Necessity (1% Steps)	First Step	81 through 207
	Second Step	208 through 472

¹⁵⁸ See *supra* note 19 and accompanying text.

	Third Step	473 through 784
	Fourth Step	785 through 1224 and so on . . .

Using the table,¹⁵⁹ an item calculated with a standardized ranking of 562 would fall within the third step of the second tier. Using the tax rates from the previous table,¹⁶⁰ the tax on that item would equal three percent. Under this system, products would be grouped into a multitude of different categories that contained practically similar or nearly identical items. All the items in each category would be assigned the same standardized rank.¹⁶¹

The ability to identify the character of an item would be powerful. Placing that power exclusively into the hands of the government could be unwise.¹⁶² Placing that power into the hands of an independent agency with government and public oversight, however, may seem like the safer bet. The independent agency should consist of a non-partisan panel of tax professionals, economics experts, and other specialists who would conduct transparent sessions and would be accountable to the government and the

¹⁵⁹ Once again, the table and its contents and included for illustrative purposes only.

¹⁶⁰ *See supra* note 109 and accompanying text and tables.

¹⁶¹ Manufacturers and retailers would be required to publish the rank of each item on the item itself, as a label or within the product's bar code.

¹⁶² Of course, many state and local governments have already been making these value judgments in the application of their respective sales taxes without significant objection or problem for quite some time. For instance, many sales taxes exempt necessary items like certain types of food and medicine. *See, e.g.*, Cal. Rev. & Tax. Code § 6369 (Deering 2006) (exempting certain medicines from sales tax).

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public.¹⁶³ Government and public oversight and accountability would ensure that such experts would be applying accurately the appropriate equations to objectively calculate the right tax rates and item characterization.¹⁶⁴

A. Administrative Concerns of the Graduated Consumption Tax Model

Even if item characterization were possible, government reports imply that the graduated consumption tax model would be administratively unsound. In 1998, the General Accounting Office released a study in which it presented analysis on major tax alternatives.¹⁶⁵ Regardless of which alternative tax methodology it studied, the GAO repeated one theme very clearly: whatever the system, multiple tax rates should be avoided because they would be more difficult to administer reliably.¹⁶⁶ A 1984 Treasury

¹⁶³ Members may be appointed to the independent agency through Congressional committees, much like federal judicial appointments. In fact, the transparency and legitimacy of the system might be well preserved by creating a special tax court whereby taxpayers may sue to challenge the characterization of any particular item.

¹⁶⁴ Under this scenario, the legislation might outline a procedure like the following: The independent agency would draft a tax proposal and submit it for a certain period of time for public review. Through the appropriate procedures, likely through their own representatives, taxpayers may voice concerns or comments about the proposal for review ultimately by Congress which, under public hearings, would ultimately ratify the proposal, reject it, or return it to the agency for revision. If sent back to the agency for revision, once revised, the proposal would travel through the same procedure again until it was finally ratified by Congress and enacted into law.

¹⁶⁵ GAO, *supra* note 48, at 55-188.

¹⁶⁶ For instance, when analyzing the subtraction VAT, the GAO made the following recommendation: "To be administrable, a subtraction VAT should have only one rate. Although multiple rates add complexity to a credit VAT, with a subtraction VAT businesses simply could not keep track of the rates paid at the intermediate production stages. If more than one rate applied, the net difference between sales and purchases could

Report (hereinafter the “Report”) echoed an identical sentiment.¹⁶⁷

Since the graduated consumption tax is structurally similar to the VAT or a national sales tax, it has similar administrative benefits.¹⁶⁸ When considering the VAT or a national sales tax, however, the Report stated that “there should be only one rate of tax, and it should be applied to a comprehensive tax base.”¹⁶⁹ In support of its conclusion, the Report suggested that the administration of a system utilizing multiple rates would be “greatly complicated” and overburden retailers, such as grocery clerks, with the “necessity to know which rate to apply to any given item and the obligation to make the proper distinction as sales are made.”¹⁷⁰

Undoubtedly, the administration of multiple or differential tax rates would be more complicated than administering a single tax rate. But the increase in complexity associated with the application of differential tax rates under the graduated consumption tax model should not be enough to automatically foreclose its consideration. In fact, discounting alternative tax models that implement differential rates as administratively impractical

not be the basis for calculating the tax. Further, if multiple rates were used with a subtraction VAT, the tax agency administering the tax would have no reliable way to confirm a business’ claims for the volume of goods sold at lower rates, since the business, itself, would furnish the audit information.” *Id.* at 146.

¹⁶⁷ “To avoid unintended distortions in consumer behavior, a sales tax should constitute a uniform percentage of all consumption expenditures.” Dept. of the Treasury Report, Report to the President, Tax Reform for Fairness, Simplicity, and Economic Growth 216 (Nov. 1984), *available at* <http://www.treas.gov/offices/tax-policy/library/tax-reform/> (last visited June 30, 2006).

¹⁶⁸ *See supra* notes 20-21 and accompanying text.

¹⁶⁹ *Id.* at 217.

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may be paradoxical given that the income tax system does it already.¹⁷¹ In addition, such a dismissal may send the strange message that the ordinary taxpayer would be better equipped to handle the challenge of mastering the multiple tax rates and exceptions than the governmental agencies charged with their administration.

Furthermore, the Report provides no conclusive findings that administration of differential rates would be prohibitive. The Report instead takes the anecdotal example of the grocery store clerk who would be forced to know that orange juice is taxed at a different rate than orange soda and apply the differential tax rates appropriately.¹⁷² Yet, this seems no more complicated than knowing which price tag to attach to each product.¹⁷³ Still, the Report concludes that “[d]istinctions of this type also greatly complicate tax administration, since it is necessary for auditors to verify the rates reported on various sales.”¹⁷⁴

While tax administration would be more challenging under a tax system utilizing differential tax rates, the extent to which it would complicate tax administration remains unknown. For example, present technological advances could reveal that the administrative complexities are

¹⁷⁰ *Id.*

¹⁷¹ The exception is, of course, that the income tax places the filing onus on the individual taxpayer. The graduated consumption tax model proposes to remove that burden.

¹⁷² Dept. of the Treasury Report, *supra* note 167, at 217.

¹⁷³ Evidently, this is what grocery stores do already.

more manageable than considered originally in 1984.¹⁷⁵ Nevertheless, the Report lists economic reasons for disfavoring the use of differential tax rates. For example, the Report predicted that differential tax rates would “interfere[] with tax neutrality by distorting consumer choices away from highly taxed items and toward lightly taxed ones.”¹⁷⁶ Like administrative complexity, the potentially paternalistic economic impact of the graduated consumption tax system is a legitimate concern.

B. Equity Concerns of the Graduated Consumption Tax Model

As a threshold matter, there is some question whether it is fairer to tax income or consumption. One reason to prefer taxing income progressively is to help offset disparities in wealth. The graduated consumption tax model operates under the policy that income, no matter how large, should not be taxed if the money does nothing or if it is spent doing nothing society deems “bad.” To put it another way, money used to do something society regards as “good” should not be penalized. The policies of the income tax system implicitly agree with this reasoning, as evidenced by the deductions allowed for charitable giving.¹⁷⁷

¹⁷⁴ *Id.*

¹⁷⁵ In fact, there is evidence that administering a consumption tax at differential rates is already possible. *See supra* notes 60, 110 and accompanying text.

¹⁷⁶ In addition, the Report discourages assessing higher tax rates on luxuries than necessities. Dept. of the Treasury Report, *supra* note 167, at 217.

¹⁷⁷ *See* I.R.C. § 170 (2006).

Pushing the policy to its logical conclusion, money and wealth are “bad” for society only when they are used “badly.” Assuming this policy is true, it makes little sense to tax income without reference to how the money was actually spent.¹⁷⁸ By comparison, if we were to apply income tax policy to criminal law, society would punish those who it determines have the largest predisposition for committing crimes without regard to whether or not they actually committed one. Of course, adopting such a policy in the criminal law context would be absurd. Yet, adopting the same policy in the income tax context does not seem any better. Accordingly, the graduated consumption tax operates under the policy that it is fairer to tax consumption than unspent income because taxing the former allows the rates to correspond with how the money is used.¹⁷⁹

The graduated consumption tax model also operates under the premise that it is fair to attach higher tax rates to more lavish consumption. Admittedly, attaching higher tax rates to the consumption of more luxurious items may not seem equitable at first glance. For instance, take the example of the modest consumer who saves her money by economizing on groceries so she can afford to purchase the luxurious item she always wanted. Would

¹⁷⁸ Unless one wishes to contend that money not spent is used “badly.” The graduated consumption tax operates under the premise that savings should be encouraged over consumption.

¹⁷⁹ In some ways, an income tax and a consumption tax are similar: they both impose a tax on labor earnings. See Bankman & Weisbach, *supra* note 97, at 1417-18. Income tax applies progressive rates according to the amount of earnings, while the graduated

it be fair to impose the highest rate of tax on that person's purchase?

Before we can answer that question, we must first determine how to reliably test fairness in taxation. On this point, recent scholarship suggests that the most accurate way to test the inherent equity of a tax system may be to compare the theoretical effects of similarly-situated taxpayers.¹⁸⁰ Or, to put it another way, perhaps fairness is best measured by balancing the theoretical consequences of each alternative tax policy as experienced by the same hypothetical taxpaying individual. Consequently, the inherent equity of the graduated consumption tax model may be evaluated best using the following example of the average wage-earning consumer:

Assume the average wage-earning consumer may be taxed under either a progressive income tax system or a progressive consumption tax system. Under the income tax system, the more money the individual makes, the higher the rate of tax the person pays. But, the typical wage-earner can make more money only through more work, whether in the form

consumption tax model applies progressive rates according to their use.

¹⁸⁰ Professors Bankman and Weisbach, for instance, utilize intra-class comparisons when discussing comparative consumption tax and income tax net redistribution. Bankman & Weisbach, *supra* note 97, at 1440 (“[Under an ideal consumption tax], there is no net redistribution from one wage class to another. We do find intraclass redistribution: the burden of the \$400,000-per-year wage eager who spends rises relative to the \$400,000-per-year wage earner who saves; the burden of the \$20,000-per-year wagger [sic] earner who spends rises relative to [sic] burden of the \$20,000-per-year wage earner who saves.”).

The authors make another important point in this section. “[C]onsumption tax is often opposed on the grounds that, by not taxing the return to investment, it ignores the morally relevant difference between winners and losers: investments that pay off and investments that do not. . . . Whatever the merits of treating winners and losers differently, they have no bearing on the choice between an income tax and a consumption tax. . . . [because] both taxes treat returns to risk the same way. . . [and i]f it is desirable to tax risk using graduated

of overtime, promotions, or additional employment. Under a consumption tax system, by comparison, an individual pays a higher rate of tax only when he or she chooses to consume a more luxurious item.

Ultimately, in this consideration, equity boils down to a simple choice: whether to attach higher tax rates to the choice to work more or to attach higher tax rates to the choice to consume more lavishly. In both situations, personal liberty is at stake to some extent, whether in the form of the freedom in the choice of consumption or the freedom in the choice of labor.¹⁸¹ Conventional wisdom might find the thought of attaching higher tax rates to a consumer's decision to buy a more luxurious item to be counterintuitive. But, attaching a higher rate of tax to the fruits of that person's decision to work more seems equally inappropriate.¹⁸² The graduated consumption tax operates under the premise that it is fair – perhaps even virtuous – to encourage productivity while discouraging

rates, both income and consumption taxes can do so." *Id.* at 1440-41.

¹⁸¹ This example assumes an average wage-earner who is not seriously in debt. Coincidentally, consumers seriously in debt may need some incentive to reexamine their spending preferences.

¹⁸² Some scholars have concluded that the income tax distorts both work effort and savings while a consumption tax would distort only work effort. Bankman & Weisbach, *supra* note 97, at 1422-28. If the consumption tax distorts work effort at all, the distortion seems an indirect effect only. *See id.* at 1437 ("A retail sales tax is not imposed when wages are earned. Instead, sales taxes are imposed only when the individual purchases consumption goods, often many years after the wages are earned. One might say loosely that a wage tax is *ex ante* while a retail sales tax is *ex post*. In fact, most consumption taxes are largely *ex post* - they are imposed when consumption goods are purchased."). While the ordinary wage-earner may or may not have to work harder to earn enough money to afford the luxury item – and pay the higher tax – the wage-earner does not automatically subject herself to a higher tax rate simply because she chose to work harder, as is the case under the income tax model. Instead, the individual is subject to the higher tax rate only

unnecessary consumption. Thus, attaching a higher tax rate onto an individual's lavish consumption is more equitable than attaching a higher tax rate onto the sweat of that person's brow.¹⁸³

C. Economic Efficiency under the Graduated Consumption Tax Model

Some scholars have concluded that a consumption tax would promote economic efficiency when compared to an income tax.¹⁸⁴ Yet, given its use of differential rates, an unintended consequence of the graduated consumption tax model might be that it inadvertently encourages consumer spending trends that reflect the characterization determinations made by the government. Assigning a significantly higher tax rate on a BMW 3-series than on a Toyota Prius, for instance, might send a message to consumers that they should buy the Prius. Although the graduated consumption tax model might have some influence on consumer spending, tax laws – like all other laws – inevitably, are largely a reflection of societal values and governmental processes.¹⁸⁵

when that person chooses to consume a more luxurious item.

¹⁸³ Admittedly, the graduated consumption tax model reflects a conservationist attitude.

¹⁸⁴ Bankman & Weisbach, *supra* note 97, at 1455 (finding that an ideal consumption tax “[would] generate efficiency gains”).

¹⁸⁵ See Leah Witcher Jackson, *Won the Legal Battle, but at What Tax Cost to Your Client: Tax Consequences of Contingency Fee Arrangements Leading up to and After Commissioner v. Banks*, 57 BAYLOR L. REV. 47, 56-57 (2005) (“Through tax laws, Congress creates incentives for citizens to privately spend money on, or invest in, activities deemed beneficial to society and, therefore, in need of our private support. Programs and activities that citizens and businesses support voluntarily do not need as much, or any,

Perhaps more significant is whether the graduated consumption tax model might exaggerate class stratification. In the last example, encouraging the consumer to buy the Prius may impact the economy positively if it encourages the taxpayer to spend within her or his own means. At the same time, however, forcing taxpayers to spend within their own means would make it more difficult for low-to-middle income persons to afford luxury items. Class stratification, therefore, would become exaggerated if only the wealthy could afford items of luxury.

By attaching higher tax rates to the consumption of more luxurious items, the graduated consumption tax model should encourage consumers to spend within their means. A higher tax rate attached to the more luxurious item would be an appropriate cost of luxury that, by some definitions, is unnecessary and arguably, in some cases, detrimental to social welfare. The high tax rate attached to the price tag may indeed be shocking for some individuals, but perhaps the shock would bring some consumers to their senses about the realistic expectations they should have about their standard of living.

support from the government. The federal income tax system also discourages various types of spending and provides punitive monetary measures for activities not favored in society. Moreover, the tax laws influences the economy by affecting a multitude of routine and major life choices, such as the type of housing people live in, the manner in which they save for retirement, the structure of a new business, and the arrangement of debt. However, some of the special rules in the Internal Revenue Code cannot be explained or justified by the noble goal of influencing our behavior for the betterment of our society. Sometimes the explanation for a provision is the clout of a political party or the persuasiveness of special interest lobbies.”).

Encouraging consumers to spend within their means may seem paternalistic, but the influence might actually be good for the economy because, among other things, it may have the tendency to reduce debt.¹⁸⁶ Moreover, debt may become more manageable for the responsible consumer who will no longer have to account accurately for large lump-sum tax payments ever year.¹⁸⁷ Nevertheless, successfully reducing debt and encouraging consumer resourcefulness presupposes objective item characterization.¹⁸⁸ And, since it exists already under the income tax system, class stratification might have to do with something other than tax rates.

But, even if the graduated consumption tax model has a net positive economic impact, another concern is whether tax policy should influence consumer spending at all. Any influence over spending, even an arguably positive one, may thus be regarded as an unwelcome intrusion upon the economic free will of the consumer. After all, it is not the government's

¹⁸⁶ The high price tags attached to luxurious items under the graduated consumption tax model may reduce irresponsible spending and debt in some cases, but it may have less impact on irresponsible spending and debt when caused by the bad decisions and poor spending habits of the individual consumer. *See supra* note 155 and accompanying text.

¹⁸⁷ Under the income tax system, in any given year, the relatively responsible consumer may suddenly find themselves seriously in debt as a result of under calculating their tax liability. Under the graduated consumption tax model, by comparison, tax liability will no longer be an unknown. In this way, the graduated consumption tax model makes it easier for the responsible consumer to avoid debt.

¹⁸⁸ Encouraging consumers to spend within their means, as well as class stratification, might also bolster the economy by providing greater incentive for taxpayers to build wealth through education, work, and investment so they can afford to purchase luxurious items taxed at higher rates.

place to dictate how its citizens should live.¹⁸⁹ Yet, to some extent, these concerns already exist given present interest rates and the income tax system.¹⁹⁰ Assuming the graduated consumption tax would be administrable, it should have no significant impact on responsible spending other than, perhaps, to encourage more of it.¹⁹¹

Manufacturers, particularly those that manufacture high-end luxury items, would undoubtedly oppose a shift to a graduated consumption tax model. Indeed, they may even detest the suggestion. Manufacturers might argue that the graduated consumption tax model amounts to a disincentive to produce high-end, luxury goods because a high tax rate attached to the price tag of a high-end luxury item may shock an otherwise willing consumer away from the purchase. In turn, the widespread disincentive to buy would result in a depressed economy.

A shift to a graduated consumption tax may have a significant dampening effect on the sales of high-end luxury items, at least temporarily if not permanently. Still, those concerned that the graduated consumption tax model might stifle economic prosperity must also account for the

¹⁸⁹ For example, consider the low-income individual who wanted to save up to buy a luxury item. The paternalism concerns are whether the consumption tax model would attempt to control low-income consumer spending by attaching high tax rates to the price tags of luxury items. While the graduated consumption tax might ultimately have some paternalistic impact on spending, it is not intended to serve as a system of control. On the contrary, the graduated consumption tax is designed to eliminate the individual taxpayer filing burden while preserving tax progressivity. *See supra* note 13 and accompanying text.

¹⁹⁰ *See supra* note 185 and accompanying text.

evisceration of the income tax system. The absence of income tax would create sizable increases in disposable income that would be immediately perceptible because taxpayers would now be pocketing all their respective pay checks.¹⁹² The significant increase in taxpayer take-home income could be enough to offset the disincentive to buy luxurious items that would be created by the higher tax rates.

Moreover, those truly wealthy enough to afford luxury items should not be hindered by the added consumption tax, especially since they would no longer be paying an annual income tax. In fact, the high tax rate would build an added element of exclusivity into the price of a luxury item. Exclusivity is, essentially, the message the luxury conveys and what many wealthy consumers are purchasing. Thus, making an item more exclusive may make the luxurious item even more desirable and, hence, worth the added cost. By re-incentivizing luxurious consumption and helping to reduce debt, a graduated consumption tax model that encourages taxpayers to save their money and spend within their means could, theoretically speaking, promote economy efficiency.¹⁹³

Although excellent research has already been done on the efficiency

¹⁹¹ See *supra* note 186 and accompanying text.

¹⁹² Although this work focuses on a federal graduated consumption tax model, if the model proves successful, states with an income tax system may also adopt it. States adding their own graduated consumption tax on top of the federal tax should not stifle their economies any more than they did through their state income tax systems.

¹⁹³ See *supra* notes 184-86 and accompanying text.

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gains of a consumption tax over an income tax,¹⁹⁴ further research is necessary to better predict the extent to which differential tax rates under a graduated consumption tax will effect overall economic efficiency. Certainly, a reliable prediction will depend on the actual tax rates, steps, and characterization models finally adopted by the graduated consumption tax model.

D. Tax Avoidance and Evasion under the Graduated Consumption Tax Model

Tax avoidance and evasion may occur less frequently under the graduated consumption tax model. Indeed, given the broad tax base, overwhelming tax participation seems unavoidable, as consumption is necessary for survival.¹⁹⁵ Still, tax avoidance would be possible. While the

¹⁹⁴ See Bankman & Weisbach, *supra* note 97, at 1455 (“Supporters of an income tax have argued that any efficiency gains realized from switching to a consumption tax are overstated. They argue that eliminating the tax on savings will require higher taxes on wages and that any efficiency gains from eliminating the first tax will be reduced or offset by the efficiency loss from increasing the latter tax. . . . We show that none of these arguments is correct.”).

¹⁹⁵ See *supra* note 139 and accompanying text. While evasion and efficiency under a comprehensive tax base may generate unresolved empirical questions, there is evidence that a comprehensive tax base “should reduce the opportunity of tax avoidance since it reduces differential treatment of items.” James R. Repetti, *The Uneasy Case for a Comprehensive Tax Base* 18 (Boston College Law School, Legal Studies Research Paper No. 99, 2006). Although Professor Repetti’s paper discusses evasion and efficiency under a comprehensive income tax base, his conclusion that tax avoidance would be reduced under a comprehensive income tax base may also apply to the comprehensive tax base of the graduated consumption tax model. See *id.* Professor Repetti concludes that tax avoidance should be reduced because a comprehensive tax base, which allows lower marginal tax rates, “reduces differential treatment of items.” *Id.* Although the graduated consumption tax utilizes differential tax rates, differential treatment of items would be eliminated under the graduated consumption tax model because all items would be subject to tax and similar items consumed would be subject to the same tax. Accordingly, one

graduated consumption tax model may encourage responsible spending and savings, the wealthy may be able to avoid tax liability simply by reducing their consumption of luxuries. Of course, while the rich can choose to live poorly, it is not likely.¹⁹⁶ Even if some wealthy consumers do live modestly, the graduated consumption tax model is premised upon the theory that an individual should be taxed according to how lavishly that person *actually* consumes and not on the amount of that person's unspent income.¹⁹⁷ So, under a policy designed to tax lavish consumption, even a wealthy person should enjoy the tax benefits of a conscious decision to consume less.¹⁹⁸ Indeed, such behavior should be encouraged, especially for those individuals or entities with an otherwise unchecked affinity or unlimited ability to consume lavishly without hesitation or restriction.

Tangentially, however, it is conceivable that a wealthy person could consume excessive amounts of items characterized ordinarily as necessary without enduring adverse tax consequences. For example, a wealthy person

could avoid the tax only if one did not consume. Furthermore, since the character and resultant tax rate would be predetermined, there would be no opportunity to "avoid" the tax by re-classification except, of course, by fraud. Fraudulent or otherwise illegal attempts to minimize or eliminate tax liability are not tax avoidance, but tax evasion. *Id.* at 1 n.1. *See also infra* notes 200-207 and accompanying text.

¹⁹⁶ In fact, the Department of Labor reported that, in 2003, consumer units earning \$150,000 or more "spent more for every item examined than did the less-than-\$70,000 group." U.S. Bureau of Labor Statistics, *Issues in Labor Statistics*, Summary 06-02 (Jan. 2006), available at <http://www.bls.gov/opub/ils/pdf/opbils54.pdf> (last visited June 2, 2006).

¹⁹⁷ *See supra* notes 113, 123 and accompanying text.

¹⁹⁸ Such a policy may indeed be Hobbesian. *See supra* note 123 and accompanying text. Regardless, a tax policy that encourages savings – or, at least, one that does not punish savings – should be preferred to one that discourages it. *See supra* note 156 and

could decide to host lavish events every night, buying food and drink for multitudes of people while paying a minimum amount of tax. The graduated consumption tax model, however, anticipates such events. While food in general may be characterized as “necessary,” different types of food would be characterized very differently. Most likely, the wealthy host would offer a different character of food and drink than lower-income taxpayers would provide for their families. Accordingly, while food may be generally characterized as necessary, certain food items – like Champagne and caviar for instance – would be characterized as more luxurious and, as such, assessed at significantly higher tax rates.¹⁹⁹

Although tax avoidance concerns may be minimal, tax evasion may be a more significant concern under the graduated consumption tax model.²⁰⁰ Although regulating sellers to ensure the proper application of

accompanying text.

¹⁹⁹ Admittedly, the wealthy host could consume excessive amounts of food characterized as necessary without incurring significant tax liability. Yet, the thought of someone like Hugh Hefner or Donald Trump serving only fish sticks and tater tots to the celebrity guests of their extravagant events seems almost laughably improbable.

²⁰⁰ Professor Repetti concludes that tax evasion is an unresolved empirical question under a comprehensive income tax model. Repetti, *supra* note 195, at 17. Although his conclusion might also apply to the graduated consumption tax model, his analysis must accommodate the theoretical fact that most forms of tax evasion under the graduated consumption tax model would be more complicated, and perhaps more difficult, tasks than simply failing to file a tax return. For instance, tax evasion might have to look something like the following: Manufacturer makes a deal with seller that seller would mislabel a product purchased from manufacturer in order to qualify for a lower tax rate. Seller would then sell the product to buyer, either at market price or at a calculated discount enough to make a larger profit due to the lowered tax rate. Alternatively, manufacturer makes a deal with seller that seller would mislabel a product purchased from the manufacturer in order to qualify for a lower tax rate but, instead of selling the product at market price, seller instead sells it at a rate that would produce a significant profit only upon a high volume of sales.

the tax program seems like a relatively straightforward task, in his analysis of the national sales tax, William G. Gale expressed some concerns about tax evasion.²⁰¹ While most of those concerns are particular to the national sales tax model only,²⁰² some could apply to the graduated consumption tax model as well.²⁰³

For example, Gale envisions that “[i]t will [] prove very difficult to collect high-rate sales taxes from a number of small-scale service industries – taxi cab drivers, plumbers, handy men, painters, maids, etc. are classic examples.”²⁰⁴ This problem is significant under the national sales tax model because the sales tax imposed would be a fixed percentage and, while the scale is small, the volume of sales in these industries is high. Accordingly, tax evasion in this situation could have a significant adverse affect upon revenue generation.

Tax evasion in the high-rate sales from small-scale service industries may be less of a problem under the graduated consumption tax model.

The latter scheme would allow the seller, effectively, to sell an otherwise characteristically luxurious item at a lower price therein undercutting the competition.

The exception is that businesses could also evade taxes by simply failing to report sales. While periodically auditing the inventories of such businesses could help solve this problem for the sales of goods, the failure to report the sales of services, or the underreporting of such sales, could pose a challenging problem. *See* GAO, *supra* note 48, at 143 (noting a Canadian study that reported “the potential for ‘skimming’ (underreporting) or nonreporting of legitimate business receipts with the Canadian VAT is greatest in the service sector, similar to the U.S. income tax”).

²⁰¹ Gale, *supra* note 76, at 451-53.

²⁰² Exploitation of the \$2,000 off-shore credit under the national sale tax, for example. *Id.* at 452.

²⁰³ *See id.* at 452-53.

²⁰⁴ *Id.* at 452.

Most of the small-scale services described would probably be assessed at marginal tax rates due to the necessary character of these services, e.g., transportation, housing maintenance, etc. Under contemporary evasion theory, a moderate tax rate would generate only moderate incentives for evasion.²⁰⁵ Furthermore, depending on the moderation of the assessed rate, the effect on revenue may be as insignificant as the undeclared cash wages and tips under the present income tax system.

Furthermore, the graduated consumption tax would incorporate the same security mechanisms as the credit-invoice VAT. Under the national sales tax model, by comparison, fraud is a more serious concern because, unlike the income tax system, there would be no required third-party reporting.²⁰⁶ Without third-party reporting, commerce would be under the “honor system” where it would be far easier to cheat. Third-party reporting, however, would exist under the graduated consumption tax model because,

²⁰⁵ See *supra* note 153 and accompanying text.

²⁰⁶ Gale, *supra* note 76, at 452 (“More generally, the two parties to a sale will have incentives to report lower-than-accurate transaction prices to the government coupled with side payments. The true transaction price and the side payments could easily be shielded via complex financial arrangements. . . . For income where taxes are withheld and reported to the government by a third-party, the evasion rate is about one percent. This is predominantly withholding of taxes on wages. At the other extreme, for income where taxes are not withheld and there is no reporting, the evasion rate is 30 percent or more. In contrast, the pure retail sales tax would be collected only from businesses that make retail sales, and there would be no withholding or reporting by anyone other than the business itself. That is, the entity reporting the tax payment would also be the entity legally responsible for the tax liability. Because the pure retail sales tax would feature no third-party withholding or reporting, the possibility of high rates of evasion needs to be taken quite seriously.”). Of course, a system that requires more complicated mechanisms to successfully evade tax liability is a system that is more difficult to cheat and, therefore, a system where evasion would occur less. See *supra* note 153 and accompanying text.

like the credit-invoice VAT, the authenticity of all transactions and the resultant tax can be verified by comparing the invoices of the businesses and individuals involved at any point in the production, distribution, and retail chains.²⁰⁷

Reduced evasion incentives generated by a low average tax rate combined with the regular auditing along all levels of the stream of commerce and the imposition of stiff penalties and fines against the offenders may result in decreased tax evasion under the graduated consumption tax model. Even assuming evasion rates were comparable to the income tax system, given the significant decrease in tax avoidance, the combination of revenue lost under both avoidance and evasion may likely be less than the combined avoidance and evasion that occurs presently under the income tax system.

E. Mortgage Interest, Investments, and Health Care under the Graduated Consumption Tax Model

The current income tax system provides deductions that encourage home-ownership.²⁰⁸ Perhaps the most significant among them is the deduction for mortgage interest.²⁰⁹ Mortgage payments would be taxable

²⁰⁷ See *supra* notes 53-54. Like the credit-invoice VAT, the largest evasion challenge for the graduated consumption tax may be the failure to report the sales of services. See *supra* note 200 and accompanying text.

²⁰⁸ I.R.C. § 163 (2005).

²⁰⁹ See *id.*

under the graduated consumption tax model. Like anything else, borrowed money would be taxable once it was consumed. A lender loans money to a borrower so the borrower can purchase an item of significant value that the borrower otherwise could not afford to purchase on her or his own.²¹⁰ The borrower uses the money loaned to make the large purchase.²¹¹ The borrower then repays the loan incrementally at a negotiated interest rate.

The total repayment amount, which equals the sum of the principal plus interest, is the borrower's cost of purchasing the home.²¹² Accordingly, the entire repayment amount would be subject to consumption tax. Although mortgage interest would be taxable under the graduated consumption tax model, the amount of tax would likely be negligible for most taxpayers because home payments, principal and interest included, would be characterized as necessities in most cases.²¹³

Investments, such as stocks and mutual funds, would be subject to

²¹⁰ This analysis assumes a typical home owner.

²¹¹ As collateral, the lender attaches the item as security for the loan.

²¹² The lender may be ignored for consumption tax purposes because, by lending money, it is technically not consuming anything. Lending institutions, incidentally, may favor a graduated consumption tax model for this reason. This policy, however, may encourage lending institutions to loan money more generously, in turn, helping consumers achieve certain benchmarks, such as home ownership.

²¹³ Unless, of course, the home purchased is a luxurious one. Large consumable items, like homes, may be subject to more specific characterization procedures. For instance, such purchases may be characterized at the time of purchase. Characterization of homes, for example, could include an examination of local market price averages, the size, age, and condition of the home, the existence of any renovations, the size of the lot, consideration of the relevant zoning laws and surrounding areas, number of homes already owned by the purchaser, and other similar factors. Like property tax assessments, buyers and sellers could be permitted to present the assessing agency with evidence they believe was most relevant to characterization.

taxation upon the purchase of shares by the investor. The equity built or lost, however, would be subject to no tax burden or benefit. Under the graduated consumption tax theory, savings and equity or income generation would not be taxable; rather, it would be only the consumption events that trigger tax liability. So, once an item was consumed and the tax was paid, no further tax liability for the owner would attach.

Similarly, aside from an incidental sales tax,²¹⁴ most taxpayers do not presently pay taxes on health care services. Under the graduated consumption tax theory, however, the consumption of services would not be distinguishable from the consumption of tangible items. Accordingly, health care services would also be subject to taxation. Nevertheless, the amount of tax assessed on most health care services provided would probably be zero, or some percentage close to zero, because most health care services would be characterized as necessary.²¹⁵

F. Inflation and Interest Rates under the Graduated Consumption Tax Model

Inflation may increase significantly during the period of transition from the current income tax system to the graduated consumption tax

²¹⁴ Noting, of course, the common exemptions. *See, e.g.*, Cal. Rev. & Tax. Code § 6369 (Deering 2006) (exempting certain medicines from sales tax).

²¹⁵ Some health care services, such as those that fall within the category of purely cosmetic surgery, would be classified as luxurious and subject to a significantly higher tax rate.

model. Under the graduated consumption tax model, however, manufacturers and sellers would no longer expend large amounts of money on income and payroll taxes. Accordingly, since these costs would no longer need to be incorporated into the price of the items sold, the pre-tax market price of consumables might decrease.

Still, adding a sometimes significant tax on top of market prices may generate a rise in the general level of market prices. Initially, higher prices might scare consumers into reduced spending.²¹⁶ During this period, consumers may be more selective about the products and services they purchase which, in turn, may force manufacturers and retailers to compete by providing higher quality products and services until the market finally adjusts to the change. By then, however, consumer expectations may be reset and manufacturers and retailers may be required to maintain the same high level of quality and service experienced beyond the transitional period.

While inflation may increase during the transitional period, interest rates may nevertheless decline under a graduated consumption tax model. Household and business savings would grow, as they would no longer be taxed, allowing for more spending and investment. Lending institutions would likewise have more money to lend to consumers who may, in turn, seek to borrow more money, all of which may help to keep interest rates

²¹⁶ That is, until taxpayers learn to finally trust the permanency of their increased paychecks that would accompany the evisceration of the income tax.

relatively under control. Moreover, interest rates may be reduced during the transitional period due to a market surplus of previously safeguarded capital, as the need for domestic and offshore tax shelters would vanish along with the income tax.²¹⁷

G. Miscellaneous Considerations of the Graduated Consumption Tax Model

Current tax professionals might oppose a shift to the graduated consumption tax model out of fear they may lose work. The public tax professionals, such as those that work at the Internal Revenue Service, should not worry. The heart of the graduated consumption tax model is its tax indexes and rate schedules. These documents would itemize every general and specific category of consumable item, categorize it under the appropriate degree of necessity or luxury, and assess the appropriate graduated tax rate. The indexes and schedules would need to be continuously updated and modified and would require thousands of public tax professionals working in collaboration with various other public and private sector experts to study, compute, recalculate, and implement periodic consumption tax rate indexes, schedules, and tables. Such an endeavor may actually generate more work for public tax professionals than

²¹⁷ See *supra* note 106 and accompanying text.

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presently required.²¹⁸

Private tax professionals may also voice concerns about a shift to the graduated consumption tax model. Unlike the public tax professionals, the shift to a graduated consumption tax model would bring with it the obsolescence of individual income tax planning. The loss of the tax professional's individual income tax planning work, however, would be greatly outweighed by the public benefit enjoyed by removing the individual taxpayer's filing burdens and liabilities associated with tax computation. In fact, tax planning developed as a reaction to the increasing burdens of tax computation and filing. Removing the need for tax assistance would be equitable, therefore, given the purpose of the assistance was to alleviate the burden that created it. Furthermore, the tax professional's career would not be eviscerated along with the income tax system. Tax professionals may still be necessary to aid merchants and consumers with characterization assessments or re-evaluation.²¹⁹

Some taxpayers might oppose the shift to a graduated consumption tax model on the ground that it would reduce taxpayer control over

²¹⁸ Much of today's tax work is done by individual taxpayers who, unlike the public tax professionals, are not compensated for their work. The graduated consumption tax model is designed to alleviate the individual taxpayer's burden of computing their respective tax liability by shifting the responsibility of tax computation onto the government. Removing the benefit of the free labor would create a gap in work that public tax professionals would be required to fill. Shifting the labor burden onto the government could generate more jobs for public tax professional than are necessary under the current income tax system.

²¹⁹ See, e.g., *supra* note 213 and accompanying text.

computing the tax they owe.²²⁰ These taxpayers might contend that the income tax system allows for some clever tax planning that can result in some level of tax avoidance that would not be available under the graduated consumption tax model. The concern, however, is a relatively weak one because preventing unequal access to tax breaks or other loopholes would be a net social benefit of the graduated consumption tax model that greatly outweighs the individual taxpayer's benefits of tax avoidance.²²¹

In the end, while experts may support the implementation of some form of a consumption tax model, many suspect implementation of a consumption tax model may prove impracticable.²²² While the costs associated with transition should be considered, there would also be concerns about the fair treatment of taxpayers and their previous tax plans, which relied upon the existence of the present tax system.²²³ While transition concerns are clearly important, the degree of difficulty associated with transition appears a subject of present debate.²²⁴ For instance, some

²²⁰ Ironically, some taxpayers might argue that laying the burden of tax calculation and filing on the taxpayer is a good thing, at least insofar as it allows for clever tax planning that may avoid some tax liability. Naturally, this argument begs the question of whether taxpayer cleverness should play any role in determining (and avoiding) tax liability.

²²¹ See *supra* notes 34-37 and accompanying text.

²²² Alan Greenspan had indicated: "As you know, many economists believe that a consumption tax would be best from the perspective of promoting economic growth – particularly if one were designing a tax system from scratch – because consumption tax is likely to encourage savings and capital formation. However, getting from the current tax system to a consumption tax raises a challenging set of transition issues." Fox News, Greenspan: Consumption Tax Could Help Economy (Mar. 3, 2005), *available at* <http://www.foxnews.com/story/0,2933,149298,00.html> (last visited June 2, 2006)..

²²³ See *infra* notes 236-38 and accompanying text.

²²⁴ See, e.g., Americans for Fair Taxation, Response to William Gale at 9 (Mar. 16,

scholars surmise that transition problem may not be as overwhelming as originally anticipated.²²⁵ Regardless, transition issues are probably best resolved after the initial questions raised by the graduated consumption tax model are answered satisfactorily.

VI. BRIEF CONSTITUTIONAL CONSIDERATIONS OF THE GRADUATED CONSUMPTION TAX MODEL

The Constitution presents no significant obstacle for the graduated consumption tax. The Constitution provides that “[t]he Congress shall have the power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the United States”²²⁶ Congress’s virtually plenary power to tax is nevertheless subject to two important limitations.²²⁷ First, the tax must be uniformly applied throughout the states.²²⁸ Second, direct taxes must be apportioned.²²⁹ These limitations are mutually exclusive.²³⁰

1998) (“If it is fair to hold people harmless against adverse changes in the tax law, then it is equally fair to tax people on windfall gains accruing because taxes they planned to pay when the made an investment have been repealed.”), *available at* <http://www.fairtaxvolunteer.org/smart/GaleRebuttal.pdf> (last visited June 2, 2006).

²²⁵ Bankman & Weisbach, *supra* note 97, at 1438 (“[I]t is quite a different thing to believe that an income tax is desirable than to believe that a consumption tax is desirable but hindered by a serious transition problem. Research agendas would shift from determining how to perfect the income tax to how to transition out of it.”).

²²⁶ U.S. CONST. art. I, § 8, cl. 1.

²²⁷ 97 COLUM. L. REV. at 2340.

²²⁸ *Id.* (citing *Knowlton v. Moore*, 178 U.S. 41, 83-106 (1900)).

²²⁹ *Id.* at 2340-41 (citing U.S. Const. art. I, § 2, cl. 3; U.S. Const. art. I, § 9, cl. 4; U.S. CONST. amend. XIV).

²³⁰ *Id.* at 2341 (citing Nelson Lund, Comment, *The Uniformity Clause*, 51 U. CHI. L. REV. 1193, 1195 n.5 (1984) (“The Court has generally assumed that once a tax is found to

A sales tax is “a classic indirect tax” because it does not tax individuals but, rather, the goods or services they decide to buy.²³¹ Accordingly, a traditional sales tax is not subject to the apportionment limitation²³² and is generally considered a constitutional indirect tax when applied uniformly throughout the states.²³³ Since imposing a national sales tax would be constitutional, imposing a graduated consumption tax would likewise be constitutional so long as it was applied uniformly.²³⁴ Moreover, since the graduated consumption tax is not a tax on income, it would not require the authority granted under the Sixteenth Amendment.²³⁵ Thus, the Sixteenth Amendment may be appropriately repealed upon implementation of the graduated consumption tax.

Interestingly, although the graduated consumption tax may be constitutional itself, some constitutional questions might arise during the transition to its implementation from the present income tax system.²³⁶

be outside the reach of the apportionment clause, it is within the reach of the uniformity clause.”).

²³¹ *Id.* at 2405.

²³² *See id.* at 2341, 2405.

²³³ 97 COLUM. L. REV. at 2405-06 (“As long as a value-added tax (or other form of national sales tax) is uniform in its application, it should survive constitutional scrutiny. . . . [because they are both] classic indirect tax-like duties, imposts, and excises – and the founders thought that taxes on articles of consumption presented no constitutional problems.”).

²³⁴ *Id.*

²³⁵ *See* U.S. CONST. amend. XVI (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”)

²³⁶ 97 COLUM. L. REV. at 2406 (“There are two minor areas of uncertainty in this analysis; neither should change the result. One difficulty is that a consumption tax might be characterized, in some circumstances, as a tax on the ownership of property – for

Specifically, transitional relief might be required to avoid double taxation of “old capital.”²³⁷ Such relief could amount to a direct tax, which would raise different constitutional considerations.²³⁸ Ultimately, the constitutional implications of granting potential transitional relief should not adversely affect the overall constitutionality of implementing the graduated consumption tax.²³⁹

CONCLUSION

Nothing in this world is perfect. Like anything else, pointing out the problems of the income tax system is easy. The true test of creativity is not finding the perfect solution, but imagining a better one. And while imagining a graduated consumption tax model may be exciting, the true test is whether the model will unravel when confronted by reality.

The foundation of the graduated consumption tax system would depend on the creation of an objective, precise, and transparent characterization model. The characterization model, however, is

example, if the consumption is attributable to the income from real estate. . . . Of perhaps greater potential significance are the problems that would arise from a transition to a consumption tax. . . . The most commonly noted issue associated with the move to a consumption tax is how ‘old capital’ should be treated – capital that was accumulated on an after-tax basis under the current tax regime but the consumption from which would be taxed under a consumption-tax regime as well. Without transition relief, something like double taxation of the old capital could occur.”)

²³⁷ *Id.* Some scholars, however, suggest that “taxation of retiree consumption might produce efficiency gains that could be used to fund lower overall rates for everyone.” Bankman & Weisbach, *supra* note 97, at 1438.

²³⁸ *Id.* Such considerations are beyond the scope of this introductory article.

incomplete without an equally competent economic model to assess reasonable and appropriate tax rates. The model and its theory must also be tested carefully to ensure reasonable administration as well as the fair and practical application among all taxpayers. And even if all of this is successfully accomplished, a thoughtfully-tailored transitional plan must yet be engineered and executed without overwhelming difficulty.

Assuming the dream outlives this journey, its transition to reality would also demand the courage and conviction necessary to overcome fear and political inertia. But, if the graduated consumption tax model proves workable, it seems foolish not to consider implementing it. Even so, “[a] foolish consistency is the hobgoblin of little minds, adored by little statesmen, scholars, and divines,”²⁴⁰ and the graduated consumption tax’s fate may be predetermined by those too invested or too afraid to give it a chance. Perhaps appropriately, a foolish consistency is something only imagination and faith can overcome.

²³⁹ See *supra* note 236 and accompanying text.

²⁴⁰ RALPH WALDO EMERSON, *SELF-RELIANCE*, *ESSAYS, FIRST SERIES*, IN *ANTHOLOGY OF AMERICAN LITERATURE VOLUME I: COLONIAL THROUGH ROMANTIC* (7th ed., George McMichael et al. eds., Prentice Hall 2000) (1841).