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DEPARTMENTS

The Campaign for Radical Tax Reform: Round Two

by Sheldon D. Pollack

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"We must get rid of the IRS. It's a bureaucracy fraught with totalitarianism."

Rep. Sonny Bono, R-Calif.

"It's time we tell the bar associations and the IRS to shove their opinions up their cash cows."

Rep. James Traficant, D-Ohio

Now that the electorate has spoken, voting thumbs down on GOP presidential candidate Bob Dole's "new" economic and tax plan, it may be time for Republicans to regroup and reconsider the war they have waged for the past two years on the U.S. income tax. Democrats who joined the fray might also consider lowering the rhetoric a notch or two. And after several years of useful and interesting lessons from our nation's leading economists, perhaps it is now time to shelve discussions on replacing the income tax with a consumption tax and focus instead on the system at hand — meaning the income tax. After all, there was a substantial amount of tax legislation in 1996, and those of us not waiting around for the Coming of the VAT have to figure out what it means.

Ironically, it was the Dole tax plan that drew most of the attention during the fall election; the Clinton administration did little more than propose its own Democratic tits for those tats raised by the Republican challenger. The central provisions of the ill-fated Dole plan — a 15 percent across-the-board tax cut, a 50 percent cut in the tax rate for long-term capital gains, and a $500-per-child tax credit — were actually pretty mild stuff compared with the more radical tax "reforms" advanced by Republicans in the 104th Congress and elsewhere on the campaign trail. GOP presidential hopeful Steve Forbes started the trend among Republicans, promising to abolish the income tax altogether in favor of a "fair" and "simple" flat tax. By comparison, the Dole tax plan was palatable even to most GOP moderates. But notwithstanding the moderate tone of the formal plan, the Senator from Kansas spouted some hot rhetoric of his own during the campaign.

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Indeed, one of the saddest spectacles of the very tiresome presidential campaign was that of Senator Dole, long-time member and former chairman of the august Senate Finance Committee, embracing the virulent and unseemly antitax rhetoric that now permeates the Republican Party. Dole's speech last August in which he introduced the tax plan intended to resuscitate his floundering campaign included some sharp barbs aimed at the income tax and the much despised administrative agency charged with collecting it — the Internal Revenue Service. At the time, Dole characterized his plan as only the "opening salvo in a battle to repeal the current tax code" and the beginning of the "end of the IRS" as we know it. He pledged his support for "repeal of the entire tax code" and promised to "replace it with a simpler, fairer, flatter system." In doing so, Dole threw his support behind the campaign for "radical tax reform" (read: dumping the income tax) that first began brewing in the House in the wake of the Republican victory in the 1994 congressional elections.

Throughout the 104th Congress, the idea of replacing the income tax with a "flat" tax was tirelessly promoted by House Majority Leader Richard Armey, R-Texas. Likewise, Speaker Newt Gingrich, R-Ga., and the more radical House Republicans perceived significant electoral benefits from denouncing the IRS. Apparently, candidate Dole made the calculated decision to look for votes from among the same crowd that views the Bureau of Alcohol, Tobacco, and Firearms as the advance SWAT team for the New World Order. In this campaign against the IRS, Republicans found support from Democrat demagogues as well. For instance, in the House the most virulent anti-IRS rhetoric has been espoused by long-time crusader Rep. James Traficant, D-Ohio, who since he was first elected to the House in 1984 has waged a war of retribution against the IRS. Traficant was found to have evaded the tax on bribes received from mobsters during his earlier election as county sheriff. (A criminal charge for bribery was rejected by the jury, notwithstanding a prior confession by Traficant; liability in the civil fraud case was sustained on appeal.) Ever since, Traficant uses every opportunity on the campaign trail as well as on the floor of the House to denounce the IRS: "Congress should take the IRS, hand-cuff them to a chain-link fence and flog them with their own damn tax code." Because Traficant has irritated even his anti-IRS brethren in the House, he was unable to secure the committee assignment he covets most — a place on Ways and Means. Even with nine seats on the committee up for grabs in the new Congress, Traficant had no chance. But do not despair. That still leaves him C-SPAN and the TV talk-show circuit, where he has had great success peddling his venomous anti-IRS message. And with the apparent defeat of "B-1" Bob Dornan, Traficant may win the first annual Fannie Fox Award for the greatest embarrassment to the U.S. House of Representatives.

Contrary to most expectations, 1996 did not turn out to be a very good year for the forces lined up in favor of radical tax reform. First, the campaign to repeal the income tax was put on hold last spring by Republican leadership pending the outcome of the fall elections. Then with Dole's victory over Forbes in securing the GOP nomination, the flat tax became yesterday's news. Dole's subsequent defeat in the main bout was a further setback, but it did not mean the end of the crusade. With Republicans in control of the 105th Congress, radical tax reform is sure to be resurrected as a major political issue. In that battle, the heir apparent to the flat tax as the solution to all the many economic and political problems attributed (rightly and wrongly) to the income tax will be some form of a national consumption tax. Or at least that is the favored choice of influential House Republican leaders such as Rep. Bill Archer, chairman of the powerful Ways and Means Committee, who since 1971 has represented the oil-wealthy 7th Congressional District of Texas (George Bush's old seat).

If Bill Archer has his way, the intensely partisan and contentious debate in the 104th Congress over the flat tax — to which Archer remained strategically aloof — was only the warm-up. Soon after Clinton's reelection, Archer announced that he plans to move cautiously with his committee, focusing first on a capital gains tax cut and a $500-per-child tax credit. Senate Finance Committee Chair William Roth, R-Del. expressed his support for these items — along with his long-time favorite, a proposal to expand individual retirement accounts. Archer intends to work both sides of the aisle to build support for the more radical idea of replacing the income tax with a national consumption tax: "It is clear that such a massive undertaking is going to have to have broad consensus and bipartisan support within this country. That consensus is not there yet, because the information is not there yet." Archer's committee hearings will provide the ideal forum from which such "information" can be disseminated.

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In his struggle to build a consensus for a national consumption tax, Archer has lost one of his strongest allies on the Ways and Means Committee — Ranking Minority Member Sam Gibbons, who retired from the House after 34 years representing Florida's 11th Congressional District. Gibbons, who briefly served as the chairman of Ways and Means following Dan Rostenkowski's forced resignation from the House, long favored a European-style value added tax and even introduced a bill (H.R. 4050) last September to repeal the personal and corporate income taxes, as well as the social security payroll tax, and replace them with a value added tax on all goods and services. Archer will sorely miss Gibbons, as the new ranking Democrat on Ways and Means, Rep. Charles Rangel of New York, will be much less supportive. In the 103d and 104th Congresses, Rangel displayed little interest in tax reform, preferring traditional Democratic tax policies such as providing tax exemptions for low-income housing, enterprise zones, and group legal services. This is hardly the stuff that moves Bill Archer, to whom tax reform means "ripping the income tax out by the roots" and getting "the IRS completely and totally out of the lives of every individual American."

Archer and other supporters of a consumption tax have a substantial number of respected economists and important business interests standing behind their campaign. Like the Forbes campaign, they hope to tap into the undercurrent of antitax sentiment that runs strong among the Republican faithful. But the consumption tax has much stronger appeal than the flat tax within the business community. (Maybe this says something about what business thinks is the "incidence" of the tax.) Likewise, professional economists extol the virtues of a consumption tax over the income tax. But while promising to solve the many economic problems blamed on the current income tax system, the consumption tax suffers from most of the same political shortcomings as the flat tax.

A convincing case has been made by economists that a consumption tax has some clear advantages over an income tax. Economists like a consumption tax so much because it promotes savings and investment. Of course, that is in comparison with a "pure" income tax. Our hybrid model has many pro-savings features of its own — such as qualified pension plans, IRAs, and Keoghs. That so much of our savings is achieved through these tax-preferred accounts vitiates much of the argument for adopting a consumption tax. Proponents also claim that a consumption tax will be a more efficient tax. So long as politicians keep their hands off, a consumption tax will impose fewer misallocations of capital (as does the current income tax through its many "tax expenditures" granted to politically favored interests). Beyond this, advocates claim that such a tax will be easier and less costly to administer. Many of the rest of us remain skeptical.

As we all know by now, a consumption tax means one of two things: a VAT or a national sales tax. The VAT is the consumption tax most common in Europe and recently adopted by New Zealand. It is imposed on the "value added" to a particular commodity by businesses engaged in the various stages of the manufacturing process. The tax essentially collects the difference between a business's gross income from sales and services and its outlays for raw materials. Ultimately, the "cost" of the tax is borne by the final consumer of the good, as manufacturers are granted credits for the taxes they pay on the purchase of raw materials.

The other choice is a national sales tax (such as the GST recently adopted by Canada). This is a consumption tax imposed on the retail sale of consumer goods and services. The idea of a national sales tax isn't new. Back in 1993, the Clinton administration contemplated a national sales tax as a means of raising new revenue to finance the president's ill-fated health care reforms. But Republican supporters want a national sales tax to do more than simply augment the income tax; they see it as a *substitute.* This overlooks the fact that European governments use consumption taxes such as the VAT to *supplement* their property taxes and income taxes, the latter of which tends to be much less effective in raising revenue than our own. Nowhere is a VAT or sales tax used exclusively to fund a modern state with a modern military and even a modest social welfare system, and nowhere has a VAT or sales tax been used to replace an income tax as the principal source of national revenue.

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In his anemic campaign for the GOP presidential nomination, Senator Richard G. Lugar of Indiana adopted as his major issue replacing the federal income tax with a national sales tax. Lugar extolled the virtues of a flat 17 percent sales tax on all goods and services (except for food and medicine). In favoring a sales tax, Lugar is not alone among congressional Republicans. Last March, a group of exuberant Republican congressmen introduced the National Retail Sales Tax Act of 1996 (H.R. 3039). Cosponsored by Representatives Dan Schaefer, R-Colo., newly Republicanized "Billy" Tauzin of Louisiana, and Dick Chrysler, R-Mich., the bill would impose a 15 percent sales tax on all sales of consumer goods and services. In addition, the Schaefer-Tauzin bill calls for repeal of the income tax, the estate and gift tax, most federal excise taxes, and the destruction of the IRS all in one fell swoop. Under the proposed sales tax, no exemption would be provided for food and medicine, although there would be an "exemption" of sorts for low-income families (achieved through a system of credits against payroll taxes for those "working poor" below the poverty level).

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The Schaefer-Tauzin bill stalled in the Ways and Means committee in the 104th Congress. But proponents are sure to reintroduce the measure in the new Congress, and Archer's committee will conduct hearings this year to consider proposals for a national sales tax or VAT. As chairman, Archer was neutral with respect to the specifics of the Schaefer-Tauzin bill; anyway, he prefers a VAT over a sales tax. Others have been more openly enthusiastic. Last spring, the Cato Institute convened a rally in Washington for congressional supporters of a national sales tax. At the rally, Representative Sonny Bono, R-Calif., announced his support for the Schaefer-Tauzin bill and carried the attack one step further, declaring: "We must get rid of the IRS. It's a bureaucracy fraught with totalitarianism." Republican congressman Sam Johnson of Texas thereafter introduced a constitutional amendment (H.J. Res. 176) to repeal the Sixteenth Amendment and forever forbid Congress from imposing any form of direct tax on income. These guys mean business!

Yet, sales tax advocates face most of the same obstacles as their flat-tax brethren. The most significant is revenue — or the lack thereof. A 15 percent national sales tax simply won't raise enough money to fund the federal government at current levels. In a report prepared in 1995 for the Joint Economic Committee, economist Bruce Bartlett, former deputy assistant secretary for the Treasury for economic policy from 1988 to 1993 and now senior fellow with the National Center for Policy Analysis, calculated that for a sales tax to be "revenue-neutral," it would have to have a rate of at least 19 percent. In view of the much greater than predicted revenue raised by the income tax, it would now have to be closer to 21 percent. If, in the interest of equity, basic necessities such as food, medicine, clothing, and housing are exempted from the tax base (as they are under most state sales taxes), the rates would rise even higher. If food and the value of owner-occupied housing are excluded from the tax base (as would be necessary to secure support among congressional Democrats), a rate of 37.7 percent would be needed. If medicine is also exempted, the rate would soar to 49.3 percent.

So how do the sponsors of the Schaefer-Tauzin bill figure that a 15 percent rate will suffice? The answer lies in what is surely the oddest provision in the proposal. Under the bill, the sales tax would be imposed on the production of goods and services by the federal government itself. The government would charge itself (and nominally pay itself) a 15 percent tax on the wages it pays to its own workers. This bizarre provision expands the tax base and, at least in theory, provides enough extra revenue to support the low 15 percent tax rate. But it is not clear how the government can raise extra revenue by collecting and paying sales tax *to itself*.

Switching to a tax regime based solely on a sales tax would itself cause significant economic disruptions. Even if the sales tax were revenue-neutral, particular industries and businesses would be affected differently by the switch to a new tax system. As with the radical flat tax proposal, this inevitably makes for "winners" and "losers." And as with the flat tax, some of the biggest losers would be retirees, who would face "double taxation" as they consume their life savings (accumulated in after-tax dollars under the current income tax regime). Other entirely unforeseen economic outcomes could result as well. For instance, retiring Federal Reserve governor Lawrence Lindsey, himself a noted Republican supply-side economist, has expressed caution and warned that the central bank would run into difficulties in adjusting monetary policy if the income tax was replaced with a national sales tax. These are just some of the minor concerns that are lost on those who prescribe fiscal revolution.

One of the least understood results of adopting a sales tax or VAT is the impact on the tax systems of the state governments. Since many of the 44 states that have their own income taxes "piggyback" on the federal income tax base, repeal of the federal income tax would wreak havoc on state revenue systems. States also rely on federal "information reporting" (IRS Form 1099) to verify what interest and dividend income taxpayers have for the year. But under a national sales tax regime (as well as the flat tax), these sources of income would be exempt, so there would be no information reporting. This would render the states at a serious disadvantage in trying to administer their own taxes. And calls to abolish the IRS are not likely to sit well with state officials who would be charged with the unwanted task of collecting the federal government's revenue — especially in the five states that do not impose a sales tax of their own.

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Notwithstanding the considerable problems resulting from replacing the income tax with either a national sales tax or VAT, the idea is not going to fade from the political scene any time soon. Those who wish the demise of the income tax and the IRS must replace it with *something*. With a weakened Speaker and Bill Archer firmly in control of tax policy in the House, the idea of replacing the income tax with a consumption tax is sure to get an extensive and prolonged hearing. (The idea has already been aired by Archer at a January meeting with President Clinton in the White House.) Chairman Roth and moderates on the Senate Finance Committee are unlikely to resist their more radical brethren in the House. And who knows? In his second term, Bill Clinton could very well turn the tables on the GOP and embrace the VAT as *his* idea! Given his past struggles with his tax returns, perhaps the president has as intense a hatred for the IRS as does Bill Archer — not to mention Sonny Bono and James Traficant.

The *Tax Notes* Name Game: A Reply to Professor Jensen

by Sheldon I. Banoff

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I felt compelled to respond to Professor Erik M. Jensen's suggestion that *Tax Notes* be renamed, so that prospective authors with academic careers at stake can include their publications in *Tax Notes* to meet "publish or perish" requirements. (See "*Tax Notes* by Any Other Name Would Smell Sweeter," *Tax Notes*, (Feb. 3, 1997, p. 641.) I appreciate Professor Jensen's quandary, having had passing exposure to academia,[1] but I cannot agree with his suggestion that *Tax Notes* be renamed the *Harvard Tax Journal*. Oftentimes the most valuable articles appearing in *Tax Notes* are written by practitioners, not academicians, and the Marketing Partner in major law and accounting firms — the business world's equivalent to Jensen's all-powerful Dean for Research and Public Relations — would never give credit for articles appearing in such a theoretically-named publication. If we are going to de-emphasize the practical and emphasize the theoretical, why not just rename *Tax Notes* to be *The Calvin H. Johnson Tax Review*? If we are going to de-emphasize clarity and emphasize academic verbosity and citology, why not just rename it *The Banoffian Journal of Tax Notes and Footnotes*?[2]

[1]This author has been a lecturer in law at the University of Chicago Law School, whose national reputation has been enhanced by its perennial number one ranking (by those foolish enough to compile these lists) for (1) number of articles in accredited publications per faculty professor and (2) number of footnotes in accredited publications per faculty professor.

[2]For a good example of how not to do it, see, e.g., this author's most recent eruption of citations in my article at 74 *Taxes* 742, 863 (Dec. 1996) (839 footnotes).