

SEAN RAFT*

Imagining a Progressive and Comprehensive Consumption Tax

“If you love those who love you, what reward do you have? Do not even the tax collectors do the same?”¹ Tax collection is no stranger to enmity.² 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 that any of those problems exist within the American income tax system. Yet, Americans continue to

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¹ *Matthew* 5:46.

² If nothing else, the Biblical references are evidence of an historic loathing for tax collection:

[A]s [Jesus] sat at dinner in the house, many tax collectors and sinners came and were sitting with him and his disciples. When the Pharisees saw this, they said to his disciples, “Why does your teacher eat with tax collectors and sinners?” But when he heard this, he said, “Those who are well have no need of a physician, but those who are 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] the things that are [Caesar’s], and to God the things that are God’s.” *Matthew* 22:21; *Mark* 12:13–17; *Luke* 20:20–26.

loathe tax collection³ and the question is whether they have a compelling reason to do so.

A fight over money is not the sole cause of the odiousness of the American income tax system. Of course, most taxpayers believe the income tax system asks too much of them⁴ for what they get in return.⁵ But, while taxpayers understandably are hesitant about paying more taxes,⁶ the greater 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 collection mechanism is far too complicated to understand and implement.⁷

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.”) (citation omitted).

⁴ According to the Tax Foundation’s 2006 Annual Survey of U.S. Attitudes on Tax and Wealth, 59 percent of those surveyed believed that the amount of federal income tax they pay is “too high.” HARRIS INTERACTIVE, 2006 ANNUAL SURVEY OF U.S. ATTITUDES ON TAX AND WEALTH—TOP LINE RESULTS 1 (created for Tax Found., Wash. D.C., Mar. 17, 2006) [hereinafter 2006 SURVEY], available at http://www.taxfoundation.org/files/survey_topline-20060405.pdf. This figure rose 4 percent from the prior year. *Id.*; see also Andrew Chamberlain & Scott A. Hodge, *2006 Annual Survey of U.S. Attitudes on Tax and Wealth*, SPECIAL REPORT NO. 141 (Tax Found., Wash. D.C.), Apr. 2006, at 6–7 (reporting and interpreting the 2006 survey results).

⁵ In the 2006 Tax Foundation survey, 65 percent of those surveyed believed that the personal value they receive from paying taxes is only fair or poor; 24 percent of those surveyed believed the value received was “pretty good”; while only 2 percent considered it “excellent.” 2006 SURVEY, *supra* note 4, at 1.

⁶ According to the 2005 Tax Foundation survey U.S. Attitudes on Taxes and Wealth, 64 percent of those surveyed believed the government should decrease services and taxes or keep taxes and services the same. HARRIS INTERACTIVE, ATTITUDES ON TAX AND WEALTH ISSUES—TOPLINE RESULTS 3 (created for Tax Found., Wash. D.C., Apr. 6, 2005) [hereinafter 2005 SURVEY] available at <http://taxfoundation.org/files/topline-20050401.pdf>. Only 13 percent of those surveyed believed the government should increase services and raise taxes. *Id.* Moreover, in the 2006 survey, 79 percent indicated they would not be willing to pay an additional \$2470 in federal taxes to eliminate the deficit and 63 percent believed, if forced to pay the additional \$2470, Congress would mostly increase spending and not pay off part of the deficit. 2006 SURVEY, *supra* note 4, at 4. Twenty percent believed Congress would pay off part of the debt but increase spending nonetheless. *Id.*

⁷ In the 2006 Tax Foundation Annual Survey, 80 percent of those surveyed found the current federal income tax either very complicated or somewhat complicated. 2006 SURVEY, *supra* note 4, at 3. Only 9 percent of those surveyed believed the system was “not too complex” and only 1 percent found it “not complex at all.” *Id.* Many scholars also believe the income tax is unnecessarily complicated.

Taxpayers are unhappy because the method of collection under the American income tax system places the filing burden on them.⁸ The tax-filing burden is arguably unfair⁹ and almost certainly unwise.¹⁰ Admittedly, if no other practical means of securing governmental revenue existed, perhaps requiring individuals to calculate and file their own taxes, and face the accompanying responsibilities and penalties, would be reasonable burdens. But there are alternatives.

This Article proposes the graduated consumption tax model¹¹ as a practical alternative to remove the tax-filing burden from the individual taxpayer while progressively generating comparable revenue amounts.¹² The graduated consumption tax

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 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*, SPECIAL REPORT NO. 138 (Tax Found., Wash. D.C.), Dec. 2005, at 2.

⁸ The 2005 Tax Foundation Annual Survey found 70 percent of those surveyed either disliked or hated working on their income taxes. 2005 SURVEY, *supra* note 6, at 6.

⁹ Some taxpayers have gone so far as to attack the income tax as a form of involuntary servitude. Courts have rejected such claims. *See, e.g.,* 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 had "no 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"); *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.").

¹⁰ Filing burdens have reached unhealthy levels. And, while the advent of e-filing may relieve some of the burden, it does not eliminate the burden 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, at BU4 ("[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.").

¹¹ The graduated consumption tax model is debuted in this Article as the offspring of the author's imagination.

¹² While focusing principally on tax policy, this Article is largely, if not entirely, heuristic. This Article is an unrestrained experiment in thought; it is not intended

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 is 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.

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 graduated consumption tax. This section is not intended to serve as an exhaustive analysis or critique of the alternative tax models. Rather, it illustrates the major shortcomings of alternatives that ultimately fail either to free the individual taxpayer from the burden of tax collection or to generate progressively sufficient revenue, or both.

Part III provides an illustrative model of the graduated consumption tax system and its underlying theory. 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 different quantitative and qualitative factors.

Part IV identifies and examines 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.

to be quantitative, technical proof of the truth of its arguments or assumptions. 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 work, and the policies that could inspire the replacement of the income tax or the enactment of meaningful change.

Conversely, Part V identifies and examines 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.

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 essentially it is a classic indirect sales tax. Finally, the Article concludes by calling for the political will to change a broken system.

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. Although the graduated consumption tax is designed primarily to relieve the individual taxpayer's filing burdens, the model also addresses the three legs of traditional tax policy: administrative efficiency, equity, and economic efficiency. First, administrative efficiency is attained because a tax on consumption would relieve the filing burden from the individual taxpayer. Second, equity is preserved because differential rates would avoid regressivity. Finally, economic efficiency is achieved because the comprehensive tax base would ensure the generation of revenue amounts comparable to the income tax system.

Proposing an income tax alternative is nothing new. In fact, numerous alternative tax models, some of which are quite popular, already exist.¹³ Yet, none 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

¹³ See discussion *infra* Part II.A–B.

alternative to propose taxing, at multiple or differential tax rates, consumption at the production and retail levels.

Although other models disfavor the use of differential tax rates,¹⁴ 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 necessary for the graduated consumption tax model to free individual taxpayers from the burdens of tax filing, while simultaneously preserving tax progressivity.¹⁵

Under the graduated consumption tax model, the differential tax rates 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 on that item.¹⁶ The various tax rates would be compiled in an index of tax schedules separating consumables into different categories based on their degree of necessity or luxury. The rate represented in the schedule would not be a fixed dollar amount but a percentage attached to the price of the item at purchase.¹⁷

Determining the character, or degree of necessity or luxury of a given item, would be a difficult task requiring value judgment.¹⁸ Accurate characterization would be fundamental to the fair application of a graduated consumption tax.¹⁹ Accurate characterization would require an objective examination of a

¹⁴ See, e.g., *infra* notes 165–66 and accompanying text.

¹⁵ The graduated consumption tax model is designed to achieve three 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.

¹⁶ 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 20 and accompanying text.

¹⁷ This method makes the graduated consumption tax uniformly applicable nationwide, regardless of the possible variation in price of an item sold in two or more states. Since the tax would be a percentage of the final purchase price, the same proportionate rate of tax would apply.

¹⁸ Establishing an administrative agency competent to make transparently objective determinations as to product character is a vital component of the graduated consumption tax model.

¹⁹ Legitimacy of the characterization process depends primarily on objectivity. The characterization process may be susceptible to undue outside influence and political pressure, both of which must be monitored and controlled. See *infra* notes 112–13 and accompanying text.

number of different factors: 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.²⁰

Although the graduated consumption tax is designed to tax consumption rather than income and savings, its primary purpose is to remove the individual taxpayer's burden of computation and the liability of miscalculation. Under the graduated consumption tax model, individual taxpayers do not compute or file anything when paying their taxes. As with an ordinary sales tax, taxes would be computed directly and immediately upon sales.

The graduated consumption tax model thus employs an administrative framework similar to the credit-invoice value-added tax. 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.²¹ And, since the individual taxpayer would not file any paperwork, the government only would audit sellers.²²

Although the filing burden of the individual taxpayer would be removed, the graduated consumption tax would not shift overall tax liability. Currently, the income tax system is progressive, placing a greater tax burden on the wealthiest

²⁰ These factors are recommended and nonexhaustive. 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 final sale on the open market.

The novelty of the product encompasses two distinct concepts: whether the item is new or used, and whether or not the item is new to the market in general.

²¹ See *infra* notes 53–59 and accompanying text.

²² The exception 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. In turn, the agency would assess the appropriate tax on the item and issue the bill to the purchasing taxpayer for payment. See *infra* notes 117–18, 128 and accompanying text.

taxpayers.²³ 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 or no tax at all. All people, whether wealthy or poor, need these basic items.²⁴ Conversely, luxury items such as yachts and private jets would be assessed at the highest tax rates.²⁵

The graduated consumption tax system would impose 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. According to its character, every consumable item would be placed somewhere along this continuum 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.²⁶ 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.²⁷

From the taxpayer's perspective, the graduated consumption tax would be less complicated than the income tax system. Even

²³ INST. ON TAXATION & ECON. POLICY, THE EFFECTS OF REPLACING MOST FEDERAL TAXES WITH A NATIONAL SALES TAX: A STATE-BY-STATE DISTRIBUTIONAL ANALYSIS 3 (Sept. 2004) [hereinafter ITEP]; DOUGLAS A. KAHN, FEDERAL INCOME TAX § 1.1000, at 3–4 (4th ed. 1999).

²⁴ Practically speaking, degree may be a function of character. For example, staple food items available at ordinary grocery stores should be subject to zero tax liability. Meanwhile, gourmet items less necessary would be assessed at the higher rates.

²⁵ 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. In other situations, however, assessment would prove more difficult. For example, it may be difficult to draw factual or otherwise principled distinctions between items of the same general description. While shoes are clearly a necessity, Manolo Blahniks clearly are not. Likewise, while houses may be necessary, mansions are not. Although 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.

²⁶ See *infra* notes 139–41 and accompanying text.

²⁷ See *infra* notes 143–48 and accompanying text. Cf. *infra* note 77 and accompanying text.

if the proposed system proves more administratively complicated, the burdens on individual taxpayers would be less. Individual taxpayers would not be responsible for filling out paperwork based on tens of thousands of pages of 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 burden on individual taxpayers would be paying that bill.²⁸

II

FRAMING THE GRADUATED CONSUMPTION TAX PROPOSAL

The income tax system encumbers all taxpayers with the responsibility of 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 on time.²⁹ As if calculating tax liability were not challenging enough, the government may impose severe penalties for failing to compute or file taxes correctly.³⁰ Of course, imposing such penalties assumes that

²⁸ 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 items they sell in order to give notice of the tax rate attached to the sale price.

²⁹ These responsibilities, which this Article refers to as the taxpayer's "filing burdens," are quite significant. In fact, the IRS estimates that the average taxpayer, using a tax software program, takes about forty hours to figure out taxes. David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens*, NTU POLICY PAPER 120 (Nat'l Taxpayers Union, Alexandria, Va.), 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 nonprofits [spent] an estimated 6 billion hours complying with the federal income tax code, with an estimated compliance cost of over \$265.1 billion." Moody et al., *supra* note 7, at 1. For a comprehensive discussion of the other various forms of income tax burdens, see generally JAMES L. PAYNE, *COSTLY RETURNS: THE BURDENS OF THE U.S. TAX SYSTEM* (1993) (pointing out, among other things, that it costs the government about \$65 to raise \$100 under the income tax system).

³⁰ *See, e.g.*, I.R.C. §§ 6651, 6662, 6702 (2006). In criminal tax cases, the prosecution must prove that the tax evasion was willful. *Cheek v. United States*, 498 U.S. 192, 201-02 (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

each taxpayer has the ability, the time, and the means to sift through the tens of thousands of pages of tax codes and filing instructions. Yet, flawless income tax computation requires a significant amount of skill that even tax experts may lack.³¹

Shouldering this monumental responsibility requires the taxpayer to become relatively well versed in tax law. But most taxpayers have not mastered over 60,000 pages of tax code and over 500 forms.³² Not surprisingly, many taxpayers delegate that responsibility to paid income tax professionals.³³ Meanwhile,

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.”).

³¹ 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. GOV'T ACCOUNTING OFFICE, GAO-06-563T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY, CHAIN PREPARERS MADE SERIOUS ERRORS 14 (2006) [hereinafter GAO, PAID TAX RETURN PREPARERS] (“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 consequences. Incorrectly reported refunds ranged from refunds overclaimed by nearly \$2000 to underclaims of over \$1700.”). See also Keating, *supra* note 29, at 120 (“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.”).

³² Absurdly, taxpayers are expected to know more about the over seven million words of tax rules than those who are paid to give tax advice at the IRS assistance centers. John Semmens, *Tax Filing Burden Continues to Grow*, HEARTLAND PERSP. (Heartland Inst., Chi., Ill.), 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 behind 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.”).

³³ According to the 2006 Tax Foundation Survey of U.S. Attitudes on Taxes and Wealth, 36 percent of those surveyed indicated they paid an outside tax professional to prepare their income taxes. 2006 SURVEY, *supra* note 4, at 5. This figure may be understated. A National Taxpayers Union policy paper written by David Keating, citing to the revised March 17, 2006, Taxpayer Usage Report of the IRS, indicates over 60 percent of tax returns have been signed by paid preparers since 2004. Keating, *supra* note 29, at 120. That figure jumps to an astounding 90 percent when including computer-prepared returns. *Id.* The policy paper also indicates that the average fee charged by H&R Block in 2006 for income tax preparation was around \$150. *Id.*

immediate and significant inequities reverberate as the government continues to force taxpayers to calculate their own tax liabilities.³⁴

As a result of its complexity, the income tax system creates unnecessary and often unintended tax breaks, or “loopholes.”³⁵ Of course, in order to take advantage of a loophole, a taxpayer must first know how to find one and properly utilize it. Accordingly, the benefits of these loopholes are enjoyed almost exclusively by the affluent or the well advised.³⁶ By successfully utilizing these loopholes,³⁷ taxpayers with the greatest tax burdens are able to shirk the full extent of their potential tax liability, thereby shifting a greater proportionate burden onto the backs of others. Unfortunately, taming the current income tax system has proven a Sisyphean task, as attempts to close loopholes often result in the creation of more loopholes.³⁸

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

Most Americans agree that a “fair” tax should generate sufficient government revenue while imposing minimum burdens

³⁴ The brunt of these inequities falls on 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 et al., *supra* note 7, at 1.

³⁵ For example, a recent clarification in tax law intended to benefit the poor inadvertently created a tax loophole for the rich. Mary Beth Franklin, *A Loophole is Born*, KIPLINGER.COM, Mar. 1, 2006, <http://www.kiplinger.com/magazine/archives/2006/03/loophole.html> (“Call it the law of unintended consequences at work. A new law designed to standardize the definition of who qualifies as a child for tax purposes has opened a gaping loophole that could be exploited by upper-income families with young children and older, ‘boomerang’ kids living at home.”).

³⁶ The irony is that many loopholes are the result of tax law designed to benefit the poor, who cannot afford to be well advised. *See, e.g., id.*

³⁷ 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 to achieve fairness, they have transformed common-sense income tax principles into a nonsensical, dizzying mess. *See infra* notes 39–44 and accompanying text.

³⁸ *See supra* notes 35–37 and accompanying text.

on the taxpayer.³⁹ What form best achieves those functions, however, is more controversial.⁴⁰ Indeed, disagreement existed even at the beginning of the twentieth century, when the income tax system was adopted in the United States.⁴¹

However the income tax may be characterized presently, it was not always considered draconian. In fact, the income tax was relatively well regarded until about the 1970s.⁴² Nevertheless, present frustration may have been unavoidable. The country's expanding economic complexity 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, 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 of some to admit that it is beyond repair.⁴⁴

The solutions presented to address the problems of the income tax system are as diverse as the problems themselves. The most widely recognized solutions suggest either broad

³⁹ Graetz, *supra* note 3, at 282 ("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.');" William G. Gale, *Tax Reform in the Real World*, 15 YALE J. ON REG. 387, 391 (1998) (reviewing MICHAEL 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.").

⁴⁰ Gale, *supra* note 39, at 391 ("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 against 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. See, e.g., 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 45 and accompanying text.

reform of the income tax system or scrapping the system altogether and starting from scratch.⁴⁵ Indeed, the idea of scrapping the current income tax system has tantalized taxpayers and economists for some time.⁴⁶ The most seriously considered alternatives include the value-added tax, the flat tax, the personal consumption tax, and the national retail sales tax.⁴⁷

1. *The Value-Added Tax*

The value-added tax (hereinafter “VAT”) has essentially two forms, the credit-invoice VAT and the subtraction VAT.⁴⁸ Both forms tax the value a business adds to a product at the time of sale.⁴⁹ 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.⁵⁰ Under the subtraction method, the tax is calculated by subtracting a business’s aggregate purchases of goods and services from the aggregate sales of its own goods and services.⁵¹

Tax liability is easier to verify under the credit-invoice VAT. 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,

⁴⁵ “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. See Keating, *supra* note 29, at 120 (“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 is incapable of any meaningful reform. See *supra* notes 35–38 and accompanying text.

⁴⁶ 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.”).

⁴⁷ See generally U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-98-37, TAX ADMINISTRATION: POTENTIAL IMPACT OF ALTERNATIVE TAXES ON TAXPAYERS AND ADMINISTRATORS 55–188 (1998) [hereinafter GAO, TAX ADMINISTRATION] (presenting analysis on the national sales tax model).

⁴⁸ *Id.* at 127.

⁴⁹ The value added to a product by a business equals the difference between the amount the business spent purchasing the product and the amount for which the same business sold that product. *Id.*

⁵⁰ *Id.* at 127, 133.

⁵¹ *Id.* at 127, 145.

including the retail level.⁵² Because of this inherent verifiability, the credit-invoice VAT could impose tax at multiple rates.⁵³

Conversely, tax liability under the subtraction VAT is difficult to verify because it is based solely upon the business's own records, which cannot be cross-referenced against the records of other businesses to verify their accuracy.⁵⁴ Accordingly, to minimize underreporting, the subtraction VAT should be assessed only at a single rate.⁵⁵

Both forms of the VAT eliminate the individual taxpayer's filing burden.⁵⁶ The VAT places that burden on businesses, requiring them to remit the difference between the taxes paid on their purchases of goods and services and the taxes received on the sales of their own goods and services.⁵⁷ Even though the burden of remitting taxes would be placed on businesses, the burden of ultimately paying the taxes is passed on to the individual taxpayer.⁵⁸

⁵² *Id.* at 136, 146. See also U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-86-91, TAX POLICY: CHOOSING AMONG CONSUMPTION TAXES 13 (1986) [hereinafter GAO, TAX POLICY] ("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.").

⁵³ The GAO notes that a single rate would be administratively more desirable. See GAO, TAX ADMINISTRATION, *supra* note 47, at 134.

⁵⁴ *Id.* at 146.

⁵⁵ *Id.*

⁵⁶ *Id.* at 127.

⁵⁷ *Id.*

⁵⁸ 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 [*sic*] 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

The credit-invoice VAT is commonly employed by many industrialized countries.⁵⁹ Yet often it is supplemented with some form of income tax because the system is unable to generate sufficient revenue due to its limited tax base.⁶⁰

(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 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 \$5 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.

GAO, TAX POLICY, *supra* note 52, 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. *See id.* In the end, since each business would receive its credit, the retail consumer ultimately would pay the entire amount of tax liability. *See id.*

⁵⁹ GAO, TAX ADMINISTRATION, *supra* note 47, 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).

⁶⁰ *Id.* at 131, 133. The tax base is limited because businesses end up passing the tax burden on to the individual taxpayer. *See supra* note 58 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 124 and accompanying text. Furthermore, given the constraints of the credit VAT, if it were “collected at the various stages of production and distribution (including retail), [and] 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.” GAO, TAX ADMINISTRATION, *supra* note 47, at 139. Given the comprehensive tax base of the graduated consumption tax, the average mean tax rate could be as low as 13 percent. *See infra* notes 139–47 and accompanying text.

2. *The Flat Tax*

The flat tax would attach a single rate of tax to the wages of all individuals and businesses, regardless of income level.⁶¹ Since it would tax only the accumulation of unsaved income, the flat tax technically is considered a consumption tax.⁶² Administratively, the flat tax would be 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 (“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.”⁶³

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 tax total taxpayer consumption rather than income.⁶⁴ Unlike the flat tax, the personal consumption tax would tax consumption at graduated rates based on income status.⁶⁵ But, like the flat tax, the personal consumption tax would not remove the individual taxpayer’s filing burdens. In fact, it would increase filing burdens by requiring taxpayers to add their income and deduct their savings to compute their tax liability.⁶⁶ Taxpayers not only would have to calculate their total income accurately, they would have to save all their receipts and calculate their expenses with equal precision.⁶⁷

⁶¹ The GAO’s analysis focused specifically on the Hall and Rabushka version of the flat tax. GAO, TAX ADMINISTRATION, *supra* note 47, at 157 (citing ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* (2nd ed. 1995)).

⁶² *Id.*

⁶³ *Id.* at 157, 162.

⁶⁴ *See 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.”).

⁶⁵ *See id.*

⁶⁶ *See id.*

⁶⁷ *See id.* at 178, 180.

4. *The National Sales Tax*

On January 4, 2005, Congress introduced “The Fair Tax Act of 2005”⁶⁸—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 proposed an initial fixed tax rate of 23 percent,⁷¹ the Institute on Taxation and Economic Policy⁷² concluded that the national sales tax program actually would require a single, fixed tax-exclusive rate⁷³ between 45 and 60 percent.⁷⁴ 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 low and middle-income households.⁷⁵ The Institute concluded

⁶⁸ The Act 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. The Fair Tax Act of 2005, H.R. 25, 109th Cong. (1st Sess. 2005).

⁶⁹ *Id.*

⁷⁰ *See id.* tit. 1, §§ 101, 201.

⁷¹ *Id.* tit. 2 § 201, ch. 1, § 101(b)(1). The 23 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*, BROOKINGS INST. (Aug. 12, 2004), available at <http://www.brookings.edu/views/papers/gale/20040812.htm>.

⁷² The Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research and education organization that works on government taxation and spending policy issues. ITEP’s unique resources and capabilities enable it to provide policymakers, advocates, and the public with accurate, useful, and timely information regarding state and federal tax systems and how they affect taxpayers at different income levels.

ITEP’s mission is to keep policymakers and the public informed of the effects of current and proposed tax policies on tax fairness, government budgets and sound economic policy.

About ITEP, <http://www.itepnet.org/itepdesc01.htm> (last visited Apr. 20, 2007).

⁷³ This Article uses the terms “tax exclusive” and “tax inclusive” when referring to tax rates. The term “tax inclusive” refers to the tax rate of the entire cost of purchasing an item, including the tax paid. The term “tax exclusive,” by comparison, refers to the tax rate of the purchase price of the item only, not including the tax paid. For example, assume an individual purchases an item priced at \$80. Assume also that the individual pays an additional \$20 in taxes. Thus, the entire cost of purchasing the item equals \$100. In this example, the tax-exclusive rate is 25 percent ($20 \div 80 \times 100$) while the tax-inclusive rate is only 20 percent ($20 \div 100 \times 100$). As illustrated by this example, failing to identify whether the rate is tax inclusive or tax exclusive could be misleading.

⁷⁴ *See* ITEP, *supra* note 23, at 2 (citing Gale, *supra* note 71).

⁷⁵ *Id.* at 3.

that “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.”⁷⁶

The national sales tax model presented several other potential problems. First, it purported to draw its revenue from a reduced tax base.⁷⁷ For example, business-to-business transactions would be exempted from taxation for fear of cascading tax upon tax.⁷⁸ Second, the national sales tax model’s refunds and credit programs could facilitate increased tax avoidance and evasion.⁷⁹ Finally, while the national sales tax would reduce the individual taxpayer’s filing burden, it would not eliminate that burden. Indeed, some taxpayer work would still be required. The poor, for example, would still be required to file forms to qualify for tax refunds or credits.⁸⁰

⁷⁶ *Id.*

⁷⁷ 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 broader tax base. *See infra* notes 139–47 and accompanying text. Perhaps the credit-invoice VAT or the national retail sales tax might work better if their respective tax bases were 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.

⁷⁸ *See* H.R. 25, 109th Cong. § 201, ch. 2 (1st Sess. 2005). *See also* William G. Gale, *The Required Tax Rate in a National Retail Sales Tax*, 52 NAT’L TAX J. 443, 445 (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 . . .”). However, the graduated consumption tax base is configured under a different theory of consumption. *See infra* note 123 and accompanying text.

⁷⁹ Gale, *supra* note 78, at 451 (warning that individuals might attempt to register as business entities to take advantage of the tax credits).

⁸⁰ 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 are built into the tax rate calculations themselves.

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

The graduated consumption tax is not the first scholastic attempt to reform the income tax system. In fact, several scholars already have proposed noteworthy income tax alternatives. 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 income taxes, payroll tax withholdings, and corporate taxes.⁸¹ The Graetz model, however, would not eliminate entirely the individual taxpayer's filing burdens.⁸² Moreover, administrative concerns aside, the graduated consumption tax presents a less complicated overall design than the Graetz model, which fuses several different tax structures into a single patchwork.⁸³

Also noteworthy is the "X-Tax." Designed by Professor David Bradford, the X-Tax essentially couples a business tax with a graduated tax on employment compensation.⁸⁴ Because of its complicated design, and since the X-tax is a form of subtraction VAT, administration of the tax may prove challenging.⁸⁵ Most significantly, however, the X-Tax would not relieve individual taxpayers' filing burdens, because it would complement, rather than replace, the present income tax system.⁸⁶

Perhaps the most practical solution to individual taxpayers' filing burdens is Professor Joseph Bankman's pilot program called "ReadyReturn."⁸⁷ The program would require California's Franchise Tax Board to complete the taxpayer's state income tax return using the wage data the Board already

⁸¹ Graetz, *supra* note 3, at 284–99.

⁸² *Id.* at 295 (explaining that, under his plan, "only about 25 million income tax returns would be filed each year").

⁸³ *See id.* at 284–99.

⁸⁴ David F. Bradford, *What are Consumption Taxes and Who Pays Them?*, 39 TAX NOTES 383, 384 (1988).

⁸⁵ *See id.* at 387; *cf.* GAO, TAX ADMINISTRATION, *supra* note 47, at 146.

⁸⁶ *See* Bradford, *supra* note 84, at 385 ("The X-Tax could be administered in conjunction with the existing income tax.").

⁸⁷ Joseph Bankman, *Simple Filing for Average Citizens: The California ReadyReturn*, 107 TAX NOTES 1431 (2005).

receives from employers.⁸⁸ Upon review, taxpayers can accept the government's work, make changes to it, or fill out and file a new return entirely on their own.⁸⁹

While the ReadyReturn program is a thoughtful and efficient approach to relieving the individual taxpayer's filing burdens,⁹⁰ it has its own shortcomings. First, the ReadyReturn program appears to be based on the ideal that there is one correct way, or at least one "most" correct way, for taxpayers to calculate their individual tax liabilities.⁹¹ Unfortunately, the reality is that the income tax's overwhelming complexity now allows for significant computational variance within individual tax returns.⁹² 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, hence, the most onerous filing burdens—no better off than they were before.⁹³

Moreover, the taxpayers who actually would benefit from the program might be overcharged by the government, as even tax experts seem incapable of taming the tax code's complexity.⁹⁴ 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,

⁸⁸ *See id.* at 1432.

⁸⁹ *Id.*

⁹⁰ To its credit, the ReadyReturn program achieves the same primary purpose of the graduated consumption tax model without requiring a complete change of the income tax system.

⁹¹ "The ReadyReturns stated the wage income reported to the state and the tentative tax liability produced by that wage income." *Id.* at 1432. 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.

⁹² *See supra* notes 31–32 and accompanying text.

⁹³ "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 Explanation, The California ReadyReturn Project*, <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 help less than 10 percent of Californians. *See* U.S. Census Bureau, State and County QuickFacts, California, <http://quickfacts.census.gov/qfd/states/06000.html> (last visited Aug. 3, 2006).

⁹⁴ *See supra* notes 31–32 and accompanying text.

using a software program or even submitting their returns to a tax preparer.⁹⁵

So, as thoughtful and efficient as the ReadyReturn program appears, it hardly can be considered a comprehensive solution when it seems that over 90 percent of taxpayers will be excluded from the program,⁹⁶ and when some of the participating taxpayers would do the work the ReadyReturn program was designed to eliminate anyway.⁹⁷ Administratively, fewer entities would be responsible for filing taxes under the graduated consumption tax model.⁹⁸ Indeed, Professor Bankman and Professor David A. Weisbach previously have argued that an ideal consumption tax is preferable to an ideal income tax.⁹⁹ For these reasons, the graduated consumption tax can achieve the goals of the ReadyReturn program with equal or better administration, equity, and economic efficiency.

III

THE GRADUATED CONSUMPTION TAX MODEL

While the graduated consumption tax is envisioned as a complete replacement to the income tax system, it also could function as an income tax supplement. In fact, the European VATs, as well as many other proposed income tax alternatives,

⁹⁵ “Some taxpayers would be thrilled to simply have a return to sign; others would want to show the ReadyReturn to their preparer, run the return through Turbo Tax or other software, or ‘manually’ double-check the State’s numbers.” Bankman, *supra* note 93.

⁹⁶ See *supra* note 93 and accompanying text.

⁹⁷ See *supra* note 95 and accompanying text.

⁹⁸ Under a credit-invoice VAT, only sellers—not consumers—would be responsible for filing taxes. See *supra* notes 56–58 and accompanying text.

⁹⁹ Professors Bankman and Weisbach provide many persuasive reasons for resetting some of the traditional notions that favor an income tax over a consumption tax. See generally Joseph Bankman & David A. Weisbach, *The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax*, 58 STAN. L. REV. 1413 (2006). For example, 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 182–90. Professors Bankman and Weisbach based their study on the assumption that a consumption tax should be neutral, or tax all consumption at the same rate. Bankman & Weisbach, *supra*, at 1414. Obviously, the graduated consumption tax does not follow the same assumption.

supplement, rather than replace, the income tax.¹⁰⁰ However, 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.¹⁰¹ Moreover, the primary goal of the graduated consumption tax is to remove all the individual taxpayer's filing burdens. Thus, there would be no reason to endure the administrative or economic headaches associated with keeping the income tax.

Accordingly, like the Fair Tax Act of 2005, the graduated consumption tax model would replace not only the income tax, but also the payroll and estate and gift taxes.¹⁰² In addition, since income would no longer be taxed, the repeal of the 16th Amendment would be appropriate. Excise taxes, however, should remain unchanged, as they have no effect on the individual taxpayer except to increase the tax base and, in turn, decrease tax rates.¹⁰³

Functionally, the graduated consumption tax would operate like a national sales tax at both the production and retail levels.¹⁰⁴ Unlike under the Fair Tax Act, tax rates under the graduated consumption tax model vary progressively in relation to the character of the specific item being consumed. Accordingly, credits, refunds, and allowances would be unnecessary because they would be built into the progressive nature of the tax rates themselves.¹⁰⁵ And, since there would be no exceptions or exemptions, all spending generated within the United States would be subject to taxation under the

¹⁰⁰ See GAO, TAX ADMINISTRATION, *supra* note 47, at 133; Graetz, *supra* note 3, at 285–99.

¹⁰¹ See *infra* notes 139–50 and accompanying text.

¹⁰² Cf. H.R. 25, 109th Cong. tit. 1, §§ 101–03 (1st Sess. 2005). In addition, the graduated consumption tax model may adopt the Congressional Findings related to the income, payroll, and estate and gift taxes as well. See H.R. 25 § 2(a)–(c).

¹⁰³ Cf. *id.* tit. 1, § 104.

¹⁰⁴ The graduated consumption tax model may incorporate some or all of Congress's findings relating to an administration of a national sales tax. The exception, of course, is 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 *id.* § 2(d), (e).

¹⁰⁵ Cf. *id.* tit. 2, § 201, chs. 2, 3.

appropriate classification,¹⁰⁶ including interstate and international purchases.¹⁰⁷

A. *The Characterization Model*

Like the income tax system,¹⁰⁸ the graduated consumption tax model is progressive.¹⁰⁹ Under the graduated consumption tax model, tax rates are organized into graduated tiers. The tax rates increase progressively from one tier to the next. An illustration of the tax rates¹¹⁰ under a graduated consumption tax model is provided below:

¹⁰⁶ All items consumed shall be subject to tax. While the purchase of homes would be subject to tax at the 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, rent should be subject to tax. Nevertheless, the tax rate associated with the rent would likely be de minimis, as the majority of rent probably would be characterized as a necessity.

¹⁰⁷ This policy would eliminate some of the benefits of offshore accounts. Since there would be no income tax advantage to holding assets outside of the United States, many of those assets might find their way back into the United States. Furthermore, since all 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 offshore entities.

¹⁰⁸ See KAHN, *supra* note 23, § 1.1000 at 3–4.

¹⁰⁹ 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 for 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 consumers. The most decadent consumers often are those with the greatest spending power. Thus, while the “progressive” nature of the consumption tax technically targets excessive consumption, the greatest tax burden would also be borne by the wealthiest taxpayers, as in the income tax system.

¹¹⁰ Here, the tax rates are 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 the government should broadcast its choice clearly to the public.

TABLE 1

Tax Tier	Tax Range
Fundamental Necessity	0% Sales Tax
Moderate Necessity	0–4% Sales Tax
Marginal Necessity	5–9% Sales Tax
Marginal Luxury	10–25% Sales Tax
Moderate Luxury	33–67% Sales Tax
Consummate Luxury	67%–100% Sales Tax

Each tier could be further subdivided into a specific number of steps, each with its own appropriate tax rates.

TABLE 2

Tier	Degree	Tax Rate
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: Consummate 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. The slowest rate increases are for more necessary items and the steepest rate increases are for the most luxurious items. The number of tiers, steps, and rates—even the category labels—are illustrative only. The actual number of tiers, steps, and rates must be calculated in a far less arbitrary manner.¹¹¹

Determining an item's character, or its degree of necessity or luxury, obviously requires the government to make certain value judgments. These value judgments must be made as objectively as possible. The legitimacy of the graduated consumption tax model depends largely on a classification system that is absolutely transparent. A transparent classification system would help guarantee against arbitrary assignments or political influence, which could discredit the system.¹¹²

No radical solution would be required to maintain transparency and legitimacy; our current system of checks and balances can 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,¹¹³ which would compile the various indexes, classification tables, and corresponding tax schedules. The work

¹¹¹ Given the low mean tax rates—a consequence of the comprehensive tax base—the differential tax rates conceivably could cover a substantially smaller range than provided in the above illustration. See *infra* notes 139–47 and accompanying text. Moreover, a two or three-tiered system that distinguishes only between necessities and luxuries, for example, could achieve the same goals, while posing simpler tax administration issues than the six-tiered model. In fact, similar models already have proven administratively possible, as most of the countries that employ a VAT system of taxation do so utilizing differential tax rates. GAO, TAX ADMINISTRATION, *supra* note 47, 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 theoretical completeness.

¹¹² A weakness in the graduated consumption tax model is that businesses likely would mount overwhelming lobbying efforts in an attempt to influence the characterization of their products and, hopefully, secure a lower tax rate. Of course, lobbying already affects the present tax code to some extent. Nevertheless, transparency would be critical to preserving the legitimacy of the graduated consumption tax model. Solutions may include prohibiting or restricting lobbying efforts or creating an administrative agency solely to regulate and scrutinize the characterization process.

¹¹³ See H.R. 25, 109th Cong. tit. 2, § 201, ch. 4 (1st Sess. 2005).

conducted by that agency, or any others, would be answerable to all three branches of government.

While preserving the progressiveness of the current income tax system, the consumption tax model reflects a different philosophy. Rather than tax income progressively, which some may characterize as “punishing” hard work, the graduated consumption tax model taxes spending progressively.¹¹⁴ The objective 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 would be subject to the same tax rates. The amount of taxes paid 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 be zero or some percentage close to it. Similarly, in the case of the manufacturer of luxury items, the raw materials consumed would have a significantly lower tax rate than the sale of the final manufactured product.¹¹⁵

The graduated consumption tax would apply to the purchase of all items, whether new or used, because the market automatically corrects for any discrepancies in value.¹¹⁶ Since the tax rate would be a percentage of the value, the actual amount of the tax would decline in proportion to the discounted

¹¹⁴ Some might characterize the graduated consumption tax model as one that “punishes” spending. Due to its progressive nature, however, it seems more accurate to characterize the model as one that “punishes” excessive and extravagant spending rather than spending in general.

¹¹⁵ Characterization of 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 objectively in terms of whether the item consumed, in abstraction, is something characteristically luxurious or necessary when compared to similar or like-kind materials, goods, or services.

¹¹⁶ As a matter of enforcement, distinguishing between the commercial seller of used goods and the one-time backyard seller might prove useful, as backyard sales are typically hard to track. *Cf. infra* note 127 and accompanying text.

value, if any, of the used item.¹¹⁷ Arguably, no consumption tax should attach to the sale of an unmodified,¹¹⁸ used product because it has not changed character and the seller already has been taxed once. Ultimately, as the next section illustrates, developing a sound theoretical basis for the graduated consumption tax is critical to its successful implementation.¹¹⁹

B. The Consumption Events Theory

Theoretically, consumption may be considered to occur exclusively outside the production cycle.¹²⁰ Under the traditional theory of consumption, 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 100 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. Many tax models, such as the VAT, operate under a version of this theory of consumption.¹²¹

Viewing consumption as occurring exclusively outside the production cycle, however, creates an overly broad distinction between producers and consumers.¹²² Under a consumption tax that taxes only consumers, the assumption is that only consumers

¹¹⁷ As a default, the character of the used item would be identical to when it was new. However, merchants or backyard sellers might request character reevaluations by the appropriate federal agency, to compensate for age, wear-and-tear, and similar considerations.

¹¹⁸ Theoretically, the example requires the product to be unmodified because the character of an item must be reevaluated once modified.

¹¹⁹ See *infra* note 124 and accompanying text.

¹²⁰ Some scholars note, however, that the line between consumption and production is not always clear. See Robin Cooper Feldman, *Consumption Taxes and the Theory of General and Individual Taxation*, 21 VA. TAX REV. 293, 316 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.”).

¹²¹ For an example of how this theory applies in the credit-invoice VAT context, see *supra* note 58 and accompanying text.

¹²² See Feldman, *supra* note 120, at 316 n.65.

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.¹²³ Therefore, the distinction should not be between producers and consumers as classes but between the individual events of production and consumption regardless of class.

Unlike the traditional theory of consumption, which assigns consumption tax liability to a broad class of end-market consumers, the “consumption events theory” determines when the consumption tax should apply based on individual events.¹²⁴ The consumption events theory distinguishes only between production and consumption events, taxing consumption at all levels—whether production, distribution, or retail. Once identified, each consumption event is treated as an isolated and complete consumption event.

Before a manufactured product can enter into the stream of commerce, the manufacturer must first transform raw materials into something novel. This transformative event is theoretically and operationally tax significant.¹²⁵ Once consumed, the old transforms into the new, and the finished product becomes something separate and distinct from the raw materials used to create it. The characterization of the new product is a reflection of that transformation. So the tax assessed to the consumption

¹²³ *See id.*

¹²⁴ 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 (Oxford Univ. 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 Commonwealth, [than] the other?”). For a discussion on the Hobbesian foundational tax theory, see Fried, *supra* note 46, 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 962.

¹²⁵ A bright-line transformative event test would avoid overcomplication of the characterization models. Only significant changes in the physical structure or overall design of the good or service should qualify for recharacterization. For example, if a retailer assembles a box of parts into a functioning bicycle, a significant change has occurred and recharacterization is appropriate. By contrast, if a retailer simply inserts a reflector in the spokes of a preassembled bicycle, a significant change has not occurred and recharacterization is inappropriate. For a brief consideration of the effect on middle merchants, see *infra* note 133 and accompanying text.

of raw materials under the consumption events theory corresponds to the complete consumption of those materials. Under this theory, once the new product assumes its new character, it then is ready for its own separate and complete consumption event.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 and complete consumption event. The sale of the unmodified, used item, however, requires additional considerations under 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 would generate no tax liability because its original consumption was considered complete. Because the item was unmodified, its character did not change. The second approach, conversely, views a subsequent sale as an indication that the item's original consumption was incomplete. Accordingly, the item would be subject to a subsequent consumption event because its resale would indicate some consumable value in the product was not exhausted by its original purchase. Thus, 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 does not cascade tax upon tax for manufacturers and distributors. By definition, cascading is not possible under the theory because each transaction along the chain of

¹²⁶ The consumption events theory is similar conceptually to the biological food chain. Once an item is consumed, the theory assumes it is removed completely 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 independently. 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.

¹²⁷ Ultimately, the approach adopted should not have a significant impact on revenue generation, 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.

production is a distinct and complete consumption event.¹²⁸ Moreover, the character of the item, and its corresponding tax rate, would depend on where the product is in the manufacturing process.¹²⁹ Manufacturing profitability, therefore, would be preserved because the earlier a product is in the manufacturing process, the more its character would be assessed as necessary at the time of consumption. Hence, a manufacturer consuming raw materials would pay little tax while the final consumer would pay the highest tax on that product.¹³⁰

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. 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 market readily has access to it. Accordingly, the finished character of the product should reflect this value added by the retailer or distributor.¹³³

¹²⁸ See *supra* note 124 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* notes 125–26 and accompanying text. The consumption events theory assumes that tax rates may be assessed in a way that does not significantly encourage businesses to consolidate vertically 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 The final, highest tax assessed on that product would depend ultimately on that finished product's final character. Moreover, this analysis ignores price increases along the chain of production, which would insulate further manufacturing profitability.

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

¹³² See *supra* note 20 and accompanying text.

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 that they were otherwise unable to increase the price of the item for sale. Nonetheless, such middle merchants subsist presently only at the expense of the consumer. Keeping prices competitive would provide previously exploited consumers with more money to spend on other products. This inherent prophylactic consequence of the graduated consumption tax model thus may benefit consumers and the economy.

IV

BENEFITS OF THE GRADUATED CONSUMPTION TAX MODEL

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 Eliminating the income tax system would also reduce the large drain on the economy attributed to the costs of complying with the April 15 filing deadline.¹³⁵

Another benefit of the graduated consumption tax system would be significantly greater participation from all consumers.¹³⁶ On February 14, 2006, the IRS announced that it

¹³⁴ See *supra* notes 28, 53–59 and accompanying text. Under the graduated consumption tax, 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 fall on businesses since the two models have similar administrative frameworks. See *supra* note 53–59 and accompanying text. Unfortunately, this burden is unavoidable, but businesses are better suited to bear this responsibility than 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, TAX ADMINISTRATION, *supra* note 47, 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 139–50 and accompanying text. Like the hypothetical U.S. VAT, the treatment of small businesses under the graduated consumption tax model should not be a problem either way. GAO, TAX ADMINISTRATION, *supra* note 47, at 136 (“For example . . . 96 percent of income year 1993 corporate revenues came from only 2 percent of the 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.”).

¹³⁵ 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 nonprofits. Moody et al., *supra* note 7, at 1. A similar study 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*, BACKGROUND PAPER NO. 35 (Tax Found., Wash. D.C.), Nov. 1, 2000, at 9 (Nov. 2000), available at <http://www.taxfoundation.org/files/7eb3ef27926cd164a33e6bf5a46372c8.pdf>. “Projections show that by 2015 the compliance cost will grow to \$482.7 billion.” Moody et al., *supra* note 7, at 1.

¹³⁶ Of course, tax evasion is a significant concern. Even so, participation under the graduated consumption tax model should exceed the current level under the income tax system. See *infra* notes 191–203 and accompanying text.

estimated a \$345 billion tax gap for the 2001 tax year.¹³⁷ Under the graduated 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 its fair share of the taxes.¹³⁸

Because all consumption events would be taxable,¹³⁹ the effective tax base would consist of personal consumption expenditures and government¹⁴⁰ and corporate expenditures, including employment compensation.¹⁴¹ Greater taxpayer participation¹⁴² would allow the government to generate tax revenue comparable to the income tax system without

¹³⁷ Press Release, Internal Revenue Service, IRS Updates Tax Gap Estimates, IR-2006-28 (Feb. 14, 2006), available at <http://www.irs.ustreas.gov/newsroom/article/0,,id=154496,00.html> (“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 billion.”).

¹³⁸ 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 191–203 and accompanying text. Since everyone must pay the tax on the items they consume, foreigners or undocumented workers spending time and money in the United States also must pay consumption taxes. Like everyone else, the amount of taxes they pay would correspond to the resources and governmental services they consume while in this country.

¹³⁹ See *supra* note 124 and accompanying text.

¹⁴⁰ Government spending would also be subject to tax. This would promote consistency and simplicity in the application of the tax, which limits alternate routes for avoidance and evasion. It also would 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.

¹⁴¹ Under the consumption events theory, employers consume 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 likely would be characterized 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.

¹⁴² Under the graduated consumption tax model, taxpayer participation includes undocumented workers and foreign visitors who 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 all items consumed in the United States. Although various trade and economic concerns should also be considered, a related question is whether purchases of products manufactured and sold outside of the United States by U.S. companies nevertheless should be subject to the consumption tax.

prohibitively increasing tax rates. As an example, compare the graduated consumption tax model to the income tax system in 2003.¹⁴³

For the 2003 tax year, the income tax system generated approximately \$1.953 trillion in total revenue.¹⁴⁴ The graduated consumption tax base in 2003 would have equaled about \$17.887 trillion.¹⁴⁵ In order to generate the same revenue as the income tax, the mean tax-exclusive rate under the graduated consumption tax model would have had to equal about 10.6 percent.¹⁴⁶ Even assuming 20 percent avoidance, evasion, and erosion of the tax base, the mean tax-exclusive rate would remain relatively low at about 13.3 percent.¹⁴⁷ By comparison, under the income tax system, the average tax rate for the individual taxpayer was also about 13 percent in 2003.¹⁴⁸ Thus, unlike the national sales tax,¹⁴⁹ the average tax rate would not

¹⁴³ The 2003 tax year is used as an example only because that year provides the most accessible data points.

¹⁴⁴ The figure drops to approximately \$1.9 trillion after subtracting the \$52.8 billion in the revenue generated from excise taxes. INTERNAL REVENUE SERV., 2003 DATA BOOK 8 (2003), available at <http://www.irs.ustreas.gov/pub/irs-soi/03databk.pdf>.

¹⁴⁵ 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 \$7.704 trillion in 2003. Government receipts totaled \$1.902 trillion and government expenditures totaled \$2.318 trillion in 2003, according to NIPA table 3.2, lines 36 and 39, respectively. Consumption of fixed capital plus adjustments totaled \$1.544 trillion in 2003, according to NIPA tables 7.5 and 7.6, line 1, and total compensation of employees private and public totaled \$6.325 trillion in 2003, according to NIPA table 6.2D, line 1. Accordingly, \$7.704 + \$2.318 + \$1.544 + \$6.325 = \$17.887 trillion.

¹⁴⁶ The figure was calculated in the following manner: \$1.902 trillion ÷ \$17.887 trillion = 10.6 percent.

¹⁴⁷ The figure was calculated in the following manner: \$17.887 x .8 = \$14.310 trillion; \$1.902 trillion ÷ \$14.310 trillion = 13.3 percent.

¹⁴⁸ Kyle Mudry & Michael Parisi, *Individual Tax Rates and Shares, 2003*, in SOI BULL., VOL. 25 NO. 3 (Internal Revenue Serv. ed., Winter 2005–06), available at <http://www.irs.gov/pub/irs-soi/06winbul.pdf>.

¹⁴⁹ Cf. *supra* note 77 and accompanying text. See also William G. Gale, *The National Retail Sales Tax: What Would the Rate Have to Be?*, 107 TAX NOTES 889, 898–99 (2005).

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

significantly increase under the graduated consumption tax model.¹⁵⁰

The graduated consumption tax model could also significantly reduce enforcement costs, especially if the cost associated with enforcing any other sales tax is a relevant indicator.¹⁵¹ The

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.

¹⁵⁰ Please note the formula is not intended as a proof, but as an indication that the graduated consumption tax is 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 40 percent figure, however, may be a more realistic tax base for the VAT. See *id.* (noting the 40 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 124, 139–49 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 that 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.

¹⁵¹ 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 J. 167, 168 (1997). Finishing the thought, attempts at evasion would rise in proportion to the increase in relative tax rate. Such a prediction is plausible and perhaps even probable. While the incentive for evasion under the graduated consumption tax model may be 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 a transaction along with stiff penalties, such as fines, liens, and prison time, seems an appropriate and significant disincentive for evasion to both seller and buyer alike. Furthermore, combined taxpayer avoidance and

government would not have to chase and prosecute as many taxpayers because taxpayer avoidance and evasion should occur less frequently.¹⁵²

The graduated consumption tax would not shift overall tax liability. The wealthy, who consume more luxurious items,¹⁵³ would continue to shoulder most of the tax burden. Conversely, the poor would live a 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 also would 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, taxpayers would know exactly how much they can afford to spend.¹⁵⁴ Thus, debt might be easier to avoid because the graduated consumption tax model encourages saving and responsible spending.¹⁵⁵

evasion should occur less than under the present income tax system. *See infra* notes 191–203 and accompanying text.

¹⁵² *See infra* notes 191–203 and accompanying text.

¹⁵³ *See infra* note 192 and accompanying text.

¹⁵⁴ At least taxpayers no longer would be able to blame debt on underestimated income tax liability. While debt still may be a problem under the graduated consumption tax model, the model would make debt easier for the responsible consumer to avoid. *See also infra* note 184 and accompanying text.

¹⁵⁵ Alan Greenspan remarked 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.” *Greenspan: Consumption Tax Could Help Economy*, FOXNEWS.COM, Mar. 3, 2005, <http://www.foxnews.com/story/0,2933,149298,00.html> [hereinafter *Greenspan*]. At the very least, a consumption tax would not punish those who save rather than spend their money. *See Bradford, supra* note 84, 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

In addition, since the consumption tax would be factored into the price of every item, taxpayers would be empowered with the ability to choose how and when to spend their tax dollars. This limited control may give taxpayers satisfaction that is not perceived under the present system.¹⁵⁶ Rather than simply paying taxes in abstraction, each tax payment under the graduated consumption tax model is factored directly into the purchase of a good or service. Since the graduated consumption tax would act like a sales tax, paying taxes would serve more than a purely abstract function, 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 and theory, to ascribe fair value judgments as to the necessity or luxury of different items. The answer depends on whether there is an economic model that can be implemented reliably to draw distinctions in inherent value.

The character of an item may be a function of a number of different factors, 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.¹⁵⁷ These factors may be weighted as variables in a mathematical equation formulated to derive a standardized ranking. An 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

responsible spending, however, does not mean that the graduated consumption tax model would exert control over consumer spending. *See infra* notes 182–87 and accompanying text.

¹⁵⁶ Although studies have indicated that taxpayers perceive little value from the government in exchange for their tax payments, this Article does not address how efficiently or effectively the government spends the taxes it collects. *See supra* note 5 and accompanying text.

¹⁵⁷ *See supra* note 20 and accompanying text.

be assigned to a range of numerical rankings. Once the standardized ranking of an item is calculated, the character, tier, and step of that item would correspond to the appropriate range. Consider the following table and example for illustrative purposes:

TABLE 3

Tier	Degree	Numerical Rank (Range)
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
	Third Step	473 through 784
	Fourth Step	785 through 1224 and so on . . .

Using the table,¹⁵⁸ an item with a standardized ranking of 562 would fall within the third step of the second tier. Using the tax rates from Table 2,¹⁵⁹ the tax on that item would equal 3 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.¹⁶⁰

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.¹⁶¹ Placing that power into the hands of an independent agency with government and public

¹⁵⁸ Once again, the table and its contents are included for illustrative purposes only.

¹⁵⁹ See *supra* note 110 and accompanying text and tables.

¹⁶⁰ 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.

¹⁶¹ Many state and local governments already make these value judgments in the application of sales taxes, without significant objection. For instance, many sales taxes exempt necessary items like certain types of food and medicine. See, e.g., CAL. REV. & TAX. CODE § 6369 (West 1998) (exempting certain medicines from sales tax).

oversight, however, seems the safer bet. The independent agency should consist of a nonpartisan panel of tax professionals, economists, and other specialists who would conduct transparent sessions and would be accountable to the government and the public.¹⁶² Government and public oversight and accountability would ensure that such experts would apply the appropriate equations to objectively calculate the right tax rates and item characterization.¹⁶³

A. *Administrative Concerns*

Even if item characterization is 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.¹⁶⁴ Regardless of which alternative tax methodology it studied, the GAO repeated one theme very clearly: multiple tax rates should be avoided because they would

¹⁶² Members may be appointed to the independent agency through Congressional committees, much like federal judicial appointments. The transparency and legitimacy of the system might be preserved by creating a special tax court whereby taxpayers may sue to challenge the characterization of any particular item.

¹⁶³ 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 via their own representatives, taxpayers may voice concerns or comments about the proposal for review by Congress. After public hearings, Congress would ultimately ratify, reject, or return the proposal 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 finally was ratified by Congress and enacted into law.

¹⁶⁴ GAO, TAX ADMINISTRATION, *supra* note 47, at 55–188.

be more difficult to administer.¹⁶⁵ A 1984 Treasury Report (the “Report”) put forth an identical sentiment.¹⁶⁶

Since the graduated consumption tax is structurally similar to the VAT or a national sales tax, it has similar administrative benefits.¹⁶⁷ 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.”¹⁶⁸ 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.”¹⁶⁹

Undoubtedly, the administration of multiple or differential tax rates would be more complicated than administering a single tax rate. But the increase in complexity should not automatically foreclose its consideration. In fact, dismissing alternative tax models that implement differential rates as administratively impractical is paradoxical given that the income

¹⁶⁵ 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 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.

¹⁶⁶ “To avoid unintended distortions in consumer behavior, a sales tax should constitute a uniform percentage of all consumption expenditures.” DEPT. OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT 216 (Nov. 1984) [hereinafter DEPT. OF THE TREASURY REPORT], available at <http://www.treas.gov/offices/tax-policy/library/tax-reform/tres84v1All.pdf>. The Report is emphasized because it explains why a multiple-rate VAT would raise significant administration concerns.

¹⁶⁷ See *supra* notes 21–22 and accompanying text.

¹⁶⁸ DEPT. OF THE TREASURY REPORT, *supra* note 166, at 217.

¹⁶⁹ *Id.*

tax system itself imposes differential rates.¹⁷⁰ In addition, such a dismissal sends the strange message that the ordinary taxpayer is better equipped to handle the challenge of multiple tax rates and exceptions than the government agencies that administer taxation.

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.¹⁷¹ Yet, this seems no more complicated than knowing which price tag to attach to each product. 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.”¹⁷²

While tax administration would be more challenging under a tax system with differential tax rates, the extent of the added complexity remains unknown. For example, technological advances could make the administrative complexities more manageable than in 1984.¹⁷³

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.”¹⁷⁴ Like administrative complexity, the potentially paternalistic economic impact of the graduated consumption tax system is a legitimate concern.

B. Equity Concerns

As a threshold matter, there is some question whether it is more fair to tax income or consumption. One reason to prefer

¹⁷⁰ 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.

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ In fact, administering a consumption tax at differential rates is already possible. See *supra* notes 59, 111 and accompanying text.

¹⁷⁴ In addition, the Report discourages assessing higher tax rates on luxuries than necessities. See DEPT. OF THE TREASURY REPORT, *supra* note 166, at 217.

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.” Put 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.¹⁷⁵

Pushing the policy to its logical conclusion, money and wealth are “bad” for society only when they are used “badly.” Assuming this is true, it makes little sense to tax income without reference to how the money is actually spent.¹⁷⁶ Accordingly, the graduated consumption tax operates under the policy that it is more fair to tax consumption than unspent income because taxing the former allows the rates to correspond with how the money is used.¹⁷⁷

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 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. Recent scholarship suggests that the most accurate way to test the inherent equity of a tax system is to compare the theoretical effects on similarly situated taxpayers.¹⁷⁸ Or, perhaps fairness is best measured by

¹⁷⁵ See I.R.C. § 170 (2006).

¹⁷⁶ Some may contend that money not spent is used “badly.” However, the graduated consumption tax encourages savings over consumption.

¹⁷⁷ An income tax and a consumption tax are similar in that they both impose a tax on labor earnings. See Bankman & Weisbach, *supra* note 99, at 1417–18. Yet income tax applies progressive rates according to the amount of earnings, while the graduated consumption tax model applies progressive rates according to the use of earnings.

¹⁷⁸ Professors Bankman and Weisbach, for instance, utilize intraclass comparisons when discussing comparative consumption tax and income tax net redistribution. *Id.* at 1440 (“[Under an ideal consumption tax], there is no net redistribution from one wage class to another. We do find intraclass redistribution:

balancing the theoretical consequences of each alternative tax policy for the same hypothetical taxpayer. The following example of the average wage-earning consumer demonstrates the inherent equity of the graduated consumption tax model.

Assume the average wage-earning consumer may be taxed with either a progressive income tax or a progressive consumption tax. 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 of overtime, promotions, or additional or alternative 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, 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 choice of consumption or the choice of labor.¹⁷⁹ Those accustomed to the income tax might resist the thought of attaching higher tax rates to a consumer's decision to buy a more luxurious item. But, attaching a higher rate of tax to the fruits of that person's decision to work more seems equally inappropriate.¹⁸⁰ The graduated consumption tax operates

the burden of the \$400,000-per-year wage earner 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.”).

Professors Bankman and Weisbach make another important point.

[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 . . . [i]f it is desirable to tax risk using graduated rates, both income and consumption taxes can do so.

Id. at 1440–41.

¹⁷⁹ This example assumes an average wage earner who is not seriously in debt. Not coincidentally, consumers seriously in debt may need some incentive to reexamine their spending.

¹⁸⁰ Some scholars have concluded that the income tax distorts both work effort and savings while a consumption tax would distort only work effort. See Bankman & Weisbach, *supra* note 99, at 1422–28. If the consumption tax distorts work effort

under the premise that it is fair—perhaps even virtuous—to encourage productivity while discouraging 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.¹⁸¹

C. Economic Efficiency

Some scholars have concluded that a consumption tax would promote economic efficiency when compared to an income tax.¹⁸² Yet, given the use of differential rates, a 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 reflect societal values and governmental processes.¹⁸³

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 chooses to work harder, as is the case under the income tax model. Instead, the individual is subject to the higher tax rate only when that person chooses to consume a more luxurious item.

¹⁸¹ Admittedly, the graduated consumption tax model reflects a conservationist attitude.

¹⁸² Bankman & Weisbach, *supra* note 99, at 1455 (finding that an ideal consumption tax “[would] generate efficiency gains”).

¹⁸³ *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, 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

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 benefit the economy if it encourages the taxpayer to spend within her or his own means. At the same time, however, encouraging taxpayers to spend within their 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 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 regarding their standard of living.

Encouraging consumers to spend within their means may seem paternalistic, but the influence might help the economy because, among other things, it could reduce debt.¹⁸⁴ Nevertheless, successfully reducing debt and encouraging consumer resourcefulness presupposes objective item characterization. And, since class stratification exists already under the income tax system, there are causes other than tax rates.

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 be regarded as an intrusion upon the economic free will of the consumer. After all, it is not the government's place to dictate how its citizens should

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.”).

¹⁸⁴ 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 caused by the bad decisions and poor spending habits of the individual consumer. *See supra* note 154 and accompanying text.

live.¹⁸⁵ Yet, to some extent, these concerns already exist given present interest rates and the income tax system.¹⁸⁶ The graduated consumption tax should have no significant impact on responsible spending other than, perhaps, to encourage more of it.¹⁸⁷

Manufacturers, particularly those that manufacture luxury items, undoubtedly would oppose a shift to a graduated consumption tax model. Manufacturers might argue that the graduated consumption tax model amounts to a disincentive to produce luxury goods because their high tax rate 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 evisceration of the income tax system. The absence of income tax would create sizable increases in disposable income that immediately would be perceptible because taxpayers would pocket all their paychecks.¹⁸⁸ The increase in taxpayers' take-home income could offset the disincentive to buy luxurious items.

Moreover, those wealthy enough to afford luxury items should not be hindered by the added consumption tax, especially since they would no longer be paying an 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

¹⁸⁵ For example, consider the low-income individual who wants to save up to buy a luxury item. The paternalism concern is that 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 ultimately might have some paternalistic impact on spending, it is not intended to serve as a system of control. To the contrary, the graduated consumption tax is designed to eliminate the individual taxpayer filing burden while preserving tax progressivity. *See supra* note 14 and accompanying text.

¹⁸⁶ *See supra* note 183 and accompanying text.

¹⁸⁷ *See supra* note 184 and accompanying text.

¹⁸⁸ Although this Article 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 would not stifle their economies.

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 reincentivizing luxurious consumption and reducing debt, a graduated consumption tax model that encourages taxpayers to save their money and spend within their means could promote economic efficiency.¹⁸⁹

Although excellent research already has been done on the efficiency gains of a consumption tax over an income tax,¹⁹⁰ further research is necessary to better predict the extent to which differential tax rates under a graduated consumption tax would affect overall economic efficiency. Certainly, a reliable prediction will depend on the actual tax rates, steps, and characterization models adopted for the graduated consumption tax.

D. Tax Avoidance and Evasion

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.¹⁹¹ Still, tax avoidance

¹⁸⁹ See *supra* notes 182–84 and accompanying text.

¹⁹⁰ See Bankman & Weisbach, *supra* note 99, 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.”).

¹⁹¹ See *supra* note 138 and accompanying text. While evasion and efficiency under a comprehensive tax base may generate unresolved empirical questions, 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 Coll. Law Sch., 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 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 because all items would be subject to tax and similar items consumed would be subject to the same tax. Accordingly, one 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 reclassification except by fraud. Fraudulent or otherwise illegal attempts to minimize or eliminate

would be possible. While the 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.¹⁹² 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.¹⁹³ So, under a policy to tax lavish consumption, even a wealthy person should enjoy the tax benefits of consuming less.¹⁹⁴ Indeed, such behavior probably should be encouraged in the interests of conservation, especially for those individuals or entities with an otherwise unchecked affinity or unlimited ability to consume natural resources without hesitation or restriction.

Conceivably, however, a wealthy person could consume excessive amounts of items characterized as necessary without enduring adverse tax consequences. For example, a wealthy person 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 generally may be characterized as necessary, certain food items—like champagne and caviar for instance—would be

tax liability are not tax avoidance, but tax evasion. *See id.* at 1 n.1. *See also infra* notes 196–203 and accompanying text.

¹⁹² 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, U.S. DEP'T OF LABOR, ISSUES IN LABOR STATISTICS, SUMMARY 06-02, COMPARING CHARACTERISTICS AND EXPENDITURES OF CONSUMER UNITS IN SELECTED INCOME RANGES (Jan. 2006), available at <http://www.bls.gov/opub/ils/pdf/opbils54.pdf>.

¹⁹³ *See supra* notes 114, 124 and accompanying text.

¹⁹⁴ Such a policy may indeed be Hobbesian. *See supra* note 114 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 155 and accompanying text.

characterized as more luxurious and taxed at significantly higher rates.¹⁹⁵

Although tax avoidance concerns may be minimal, tax evasion may be a more significant concern.¹⁹⁶ Even though regulating sellers to ensure the proper application of the tax program seems like a relatively straightforward task, William G. Gale expressed concerns about tax evasion in his analysis of the national sales tax.¹⁹⁷ While most of those concerns are particular to the national sales tax model,¹⁹⁸ some could apply to the graduated consumption tax model.¹⁹⁹

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.”²⁰⁰ This problem is significant under the national sales tax model because the sales

¹⁹⁵ Admittedly, the wealthy host could consume excessive amounts of food characterized as necessary without incurring significant tax liability.

¹⁹⁶ Professor Repetti concludes that tax evasion is an unresolved empirical question under a comprehensive income tax model. *See Repetti, supra* note 191, at 17. Although his conclusion also might apply to the graduated consumption tax model, his analysis must take into account that most tax evasion under the graduated consumption tax model would be more complicated, and perhaps more difficult, than simply failing to file a tax return. For instance, tax evasion might look as follows: 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 discount sufficient 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 latter scheme would allow the seller to sell an otherwise luxurious item at a lower price, therein undercutting the competition.

The exception is that businesses also could 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 challenge. *See GAO, TAX ADMINISTRATION, supra* note 47, 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”).

¹⁹⁷ *See Gale, supra* note 78, at 451–53.

¹⁹⁸ Exploitation of the \$2000 offshore credit under the national sales tax is one example. *Id.* at 452.

¹⁹⁹ *See id.* at 452–53.

²⁰⁰ *Id.* at 452.

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 these situations 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. Most of the small-scale services described would probably be assessed at marginal tax rates due to the necessary character of these services, for example, transportation, housing, maintenance, etc. Under contemporary evasion theory, a moderate tax rate would generate only moderate incentives for evasion.²⁰¹ Depending on the moderation of the assessed rate, the effect on revenue could be comparable to 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.²⁰² Without third-party reporting, commerce would be under the “honor system” where it would be far easier to cheat. Third-party reporting, however, exists under the graduated consumption tax model because, 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

²⁰¹ See *supra* note 151 and accompanying text.

²⁰² See Gale, *supra* note 78, 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 financing 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 151 and accompanying text.

involved at any point in the production, distribution, and retail chains.²⁰³

A low average tax rate, combined with regular auditing along all levels of the stream of commerce, and the imposition of stiff penalties and fines against offenders, may result in decreased tax evasion. 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 would be less than the combined avoidance and evasion that occurs presently.

E. Mortgage Interest, Investments, and Health Care

The current income tax system provides deductions that encourage home ownership.²⁰⁴ Perhaps the most significant is the deduction for mortgage interest.²⁰⁵ Mortgage payments are taxable 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.²⁰⁶ The borrower uses the money loaned to make the large purchase.²⁰⁷ 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.²⁰⁸ Accordingly, the entire repayment amount would be subject to consumption tax. Nevertheless, the amount of tax likely would be negligible for most taxpayers because home payments,

²⁰³ See *supra* notes 52–53. 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 196 and accompanying text.

²⁰⁴ I.R.C. § 163 (2006).

²⁰⁵ See *id.*

²⁰⁶ This analysis assumes a typical home owner.

²⁰⁷ As collateral, the lender attaches the item as security for the loan.

²⁰⁸ The lender may be ignored for consumption tax purposes because, by lending money, the lender technically is not consuming anything. For this reason, lending institutions may favor a graduated consumption tax model. This policy, however, may encourage lending institutions to loan money more generously, in turn helping consumers achieve certain benchmarks, such as home ownership.

principal and interest included, would be characterized as necessities in most cases.²⁰⁹

Investments, such as stocks and mutual funds, would be subject to 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 are not taxable; rather, only consumption events trigger tax liability. Similarly, aside from an incidental sales tax,²¹⁰ most taxpayers do not presently pay taxes on health care services. Under the graduated consumption tax model, however, the consumption of services is not 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 close to zero, because most health care services would be characterized as necessary.²¹¹

F. Inflation and Interest Rates

Inflation may increase significantly during the transition from the current income tax system to the graduated consumption tax model. Under the graduated consumption tax, however, manufacturers and sellers would no longer expend large amounts of money on income and payroll taxes. Accordingly, since these costs would not be incorporated into the price of the items sold, the pretax 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.

²⁰⁹ Of course, this would not be the case where a taxpayer purchases a luxury home. 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 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 present the assessing agency with evidence they believe is most relevant to characterization.

²¹⁰ There are, of course, the common exemptions. *See, e.g.*, CAL. REV. & TAX. CODE § 6369 (West 1998) (exempting certain medicines from sales tax).

²¹¹ Some health care services, such as those within the category of cosmetic surgery, would be classified as luxurious and subject to a higher tax rate.

Initially, higher prices might scare consumers into reduced spending.²¹² 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 have reset, requiring manufacturers and retailers to maintain the same high level of quality and service beyond the transitional period.

While inflation may increase during the transitional period, interest rates may nevertheless decline. Household and business savings would grow, as they would no longer be taxed, allowing for more spending and investment. Likewise, lending institutions would 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 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.²¹³

G. Miscellaneous Considerations

Although public tax professionals, such as those that work at the Internal Revenue Service, might oppose a shift to the graduated consumption tax model out of fear they may lose work, they 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 would require thousands of public tax professionals working in collaboration with other public and private sector experts to study, compute, recalculate, and implement periodic consumption tax rate indexes, schedules,

²¹² This would end when taxpayers learn to trust the permanency of the increased paychecks that would accompany the evisceration of the income tax.

²¹³ See *supra* note 107 and accompanying text.

and tables. Such an endeavor actually may generate more work for public tax professionals.²¹⁴

Private tax professionals would also voice concerns about a shift to the graduated consumption tax model. The shift would bring with it the obsolescence of individual income tax planning. However, the public benefit enjoyed by removing the individual taxpayer's filing burdens and liabilities would outweigh the loss of the tax professional's individual income tax planning. In fact, most taxpayers need tax assistance because the system is so complicated and difficult to understand.²¹⁵ For society as a whole, therefore, removing the need for tax assistance would be equitable given that 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 reevaluation.²¹⁶

Some taxpayers might oppose the shift to a graduated consumption tax model on the ground that it would reduce taxpayer control over computing taxes owed.²¹⁷ These taxpayers might contend that the income tax system allows for clever tax planning that can result in some level of tax avoidance. The concern, however, is a relatively weak one because preventing unequal access to tax breaks or other loopholes would be a net social benefit that greatly outweighs the individual taxpayer's benefits of tax avoidance.²¹⁸

In the end, although experts may support the implementation of some form of a consumption tax model, many suspect

²¹⁴ 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 alleviates the individual taxpayer's burden of computing tax liability by shifting that responsibility to the government. Removing the benefit of the free labor would create a gap in work that public tax professionals would fill. Shifting the labor burden onto the government could generate more jobs for public tax professionals.

²¹⁵ See *supra* notes 7–8, 31–33 and accompanying text.

²¹⁶ See, e.g., *supra* note 209 and accompanying text.

²¹⁷ 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.

²¹⁸ See *supra* notes 35–38 and accompanying text.

implementation of a consumption tax model may prove impracticable.²¹⁹ While the costs associated with transition should be considered, there also would be concerns about the fair treatment of taxpayers who relied upon the present tax system for long-term tax planning.²²⁰ While transition concerns are important, the degree of difficulty associated with transition is a subject of debate.²²¹ Some scholars surmise that the transition problem may not be as overwhelming as originally anticipated.²²² Regardless, transition issues probably are best resolved after the initial questions concerning the graduated consumption tax model are answered.

VI

CONSTITUTIONAL CONSIDERATIONS OF THE GRADUATED CONSUMPTION TAX MODEL

The Constitution presents no significant obstacle for the graduated consumption tax. Article I, Section 8 provides that “[t]he Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States. . . .”²²³ Nevertheless, Congress’s plenary power to tax is subject

²¹⁹ Alan Greenspan had indicated that:

[M]any 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.

Greenspan, supra note 155.

²²⁰ See *infra* notes 233–35 and accompanying text.

²²¹ See, e.g., Memorandum by David Burton and Dan Mastromarco, The Argus Group, to Laura Dale, Vice President, Dir. of Research, Am. for Fair Taxation 9 (Mar. 16, 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.fairtax.org/PDF/GaleRebuttal.pdf> (last visited June 2, 2006).

²²² See, e.g., Bankman & Weisbach, *supra* note 99, 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.”).

²²³ U.S. CONST. art. I, § 8, cl. 1.

to two important limitations.²²⁴ First, the tax must be applied uniformly throughout the states.²²⁵ Second, direct taxes must be apportioned.²²⁶ These limitations are mutually exclusive.²²⁷

A sales tax is “a classic indirect tax” because it does not tax individuals but rather the goods or services they decide to buy.²²⁸ Accordingly, a traditional sales tax is not subject to the apportionment limitation²²⁹ and is constitutional when applied uniformly throughout the states.²³⁰ Since imposing a national sales tax would be constitutional, imposing a graduated consumption tax likewise would be constitutional so long as it is applied uniformly.²³¹ Moreover, since the graduated consumption tax is not a tax on income, it would not implicate the Sixteenth Amendment.²³² Thus, the Sixteenth Amendment may be repealed upon implementation of the graduated consumption tax.

Although the graduated consumption tax may be constitutional itself, some constitutional questions might arise during the transition to its implementation.²³³ Specifically,

²²⁴ Erik M. Jensen, *The Apportionment of “Direct Taxes”: Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334, 2340 (1997).

²²⁵ *Id.* (citing *Knowlton v. Moore*, 178 U.S. 41, 83–106 (1900)).

²²⁶ *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, § 2).

²²⁷ *Id.* at 2341 (quoting 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 be outside the reach of the apportionment clause, it is within the reach of the uniformity clause.”).

²²⁸ Jensen, *supra* note 224, at 2405.

²²⁹ *See id.* at 2341, 2405.

²³⁰ *Id.* 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.”).

²³¹ *Id.*

²³² *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.”).

²³³ *See* Jensen, *supra* note 224, 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 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

transitional relief might be required to avoid double taxation of “old capital.”²³⁴ Such relief could amount to a direct tax, which would raise different constitutional considerations.²³⁵ Ultimately, the implications of granting potential transitional relief should not adversely affect the overall constitutionality of implementing the graduated consumption tax.²³⁶

CONCLUSION

Nothing in this world is perfect. Pointing out the problems of the income tax system is easy. The solution is not to find the perfect system, but to imagine a better one. And while imagining a graduated consumption tax model may be exciting, the model must not 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 incomplete without an equally competent economic model to assess appropriate tax rates. The model and its theory also must be tested to ensure reasonable administration as well as fair and practical application among taxpayers. And even if this is accomplished, a transitional plan must be engineered and executed.

Assuming the dream outlives this journey, this proposal’s transition to reality also would 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 statesman and philosophers and divines.”²³⁷ The graduated

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.”).

²³⁴ *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 99, at 1438.

²³⁵ *Id.* Such considerations are beyond the scope of this introductory Article.

²³⁶ *See supra* note 233 and accompanying text.

²³⁷ RALPH WALDO EMERSON, *SELF-RELIANCE* (1841), *reprinted in* 1 ANTHOLOGY OF AMERICAN LITERATURE: COLONIAL THROUGH ROMANTIC 871 (George McMichael et al. eds., 7th ed., Prentice Hall 2000) (1974).

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.