FLAT TAX, FAIR TAX: NEW HOPE FOR REFORMING THE INTERNAL REVENUE CODE

Although the idea of a flat-rate income tax is not new, until recently the idea seemed little more than an exercise in economic theory. The last few years, however, have witnessed an explosion of interest in major tax reform by prominent political figures of both parties.[1] The tax reform movement appeared to reach its zenith during the summer of 1982. At that time twelve bills had been introduced before the 97th Congress which called for a drastic revision of the Internal Revenue Code.[2]

The furor over tax reform has died down somewhat since 1982. But the perception on Capitol Hill that major reform is needed apparently has not. As of August, 1983, ten of the twelve tax-reform bills had been reintroduced into the 98th Congress.[3]

---

* James C. Murphy, third year student at Notre Dame Law School, provided research and assisted in writing the sections on objections to the present tax system, the possibility of reform, and tax reform and the deficit. Gregory S. Folley, third year student at Notre Dame Law School, researched the material for the sections on tax reform, the deficit, and the information on charitable and home mortgage interest deductions. The author wishes to express his gratitude for their contributions.

1. The sponsors of the tax bills currently before Congress, provided in note 6, *infra*, represent a wide portion of the political spectrum.
2. S. 2817, 97th Cong., 2d Sess., 128 CONG. REC. S9979 (daily ed. Aug. 5, 1982), introduced by Senator Bradley, D-N.J.; H.R. 6944, 97th Cong., 2d Sess., 128 CONG. REC. H5265 (daily ed. Aug. 5, 1982), introduced by Representative Gephardt, D-Mo.; S. 2887, 97th Cong., 2d Sess., 128 CONG. REC. S11206 (daily ed. Sept. 9, 1982), introduced by Senator Mitchell, D-Me.; S. 2557, 97th Cong., 2d Sess., 128 CONG. REC. S5717 (daily ed. May 20, 1982), introduced by Senator Quayle, R-Ind.; S. 2147, 97th Cong., 2d Sess., 128 CONG. REC. S1275 (daily ed. May 1, 1982), introduced by Senator DeConcini, D-Ariz.; H.R. 6628, 97th Cong., 2d Sess., 128 CONG. REC. H3666 (daily ed. June 17, 1982), introduced by Representative Dannemeyer, R-Cal.; H.R. 6070, 97th Cong., 2d Sess., 128 CONG. REC. H1427 (daily ed. April 5, 1982), introduced by Representative Panetta, D-Cal.; H.R. 4821, 97th Cong., 1st Sess., 127 CONG. REC. H7729 (daily ed. Oct. 22, 1981), introduced by Representative Hansen, R-Idaho; H.R. 6741, 97th Cong., 2d Sess., 128 CONG. REC. H4047 (daily ed. July 13, 1982), introduced by Representative Dreier, R-Cal.; H.R. 6352, 97th Cong., 2d Sess., 128 CONG. REC. H2048 (daily ed. May 11, 1982), introduced by Representative Paul, R-Tex.; S. 2200, 97th Cong., 2d Sess., 128 CONG. REC. S2088 (daily ed. Mar. 15, 1982), introduced by Senator Helms, R-N.C.; H.R. 5513, 97th Cong., 2d. Sess., 128 CONG. REC. H406 (daily ed. Feb. 10, 1982), introduced by Representative Crane, R-Ill.
3. S. 1421, 98th Cong., 1st Sess., 129 CONG. REC. S7838-45 (daily ed. June 8, 1983), introduced by Senator Bradley, D-N.J.; H.R. 3271, 98th Cong., 1st Sess., 129 CONG. REC. H3846 (daily ed. June 9, 1983), introduced by Representative Gephardt, D-Mo.; S. 1767, 98th Cong., 1st Sess., 129 CONG. REC. S11713 (daily ed. Aug. 4, 1983), introduced by Senator Mitchell, D-Me.; S. 1040, 98th Cong., 1st Sess., 129 CONG. REC. S4556 (daily ed. Apr. 13, 1983), introduced by Senator Quayle, R-Ind.; S. 557, 98th Cong., 1st Sess., 129 CONG. REC. S1509-10 (daily ed. Feb. 23, 1983), introduced by Senator DeConcini, D-Ariz.; H.R. 2520, 98th Cong., 1st Sess., 129 CONG. REC. H2077-79 (daily ed. Apr. 13, 1983), introduced by Representative Panetta, D-Cal.; H.R. 170, 98th Cong., 1st Sess., 129 CONG. REC. H44 (daily ed. Jan. 3, 1983), introduced by Representative Hansen, R-Idaho; H.R. 1770, 98th Cong., 1st Sess., 129 CONG. REC. H774 (daily ed. Mar. 2, 1983), introduced by Representative Dreier, R-Cal.; H.R. 2137, 98th Cong., 1st Sess., 129 CONG. REC. H1264 (daily ed. Mar. 16, 1983), intro-

This note will set forth the criticisms most commonly directed at the current tax code, delineate the major provisions of the two bills currently before Congress which have obtained the most support as viable alternatives to the present system, and analyze the obstacles presently facing each bill.

OBJECTIONS TO THE PRESENT TAX SYSTEM

Economic Inefficiency

A widely accepted goal for a tax system is economic efficiency. That is, the process of raising revenue should not interfere with the normal market incentives for engaging in business activity, except where Congress so intends.[4] Yet the combination of numerous deductions and a high marginal rate — fifty percent in the highest individual tax bracket — have unintentionally combined to create powerful incentives to allocate income to investments which shelter funds from taxation.[5] These incentives have the undesirable effect, first, of preventing the accumulation of savings, and second, of altering the allocation of resources which a free market would otherwise create.

Regardless of whether allowing the market to allocate resources is desirable, the current situation is not. The effect of the tax system on resource allocation not only interferes with the market, but it precludes rational congressional action to influence resource distribution, since any policy adopted must compete with the unintended incentives provided by the tax system.

The effect of high marginal tax rates also affects the labor supply, although that effect is debatable.[6] High tax rates may make work less attractive than leisure; yet, from another perspective, high tax rates require additional work to reach a particular income level. One recent study indicates that most male workers, given the opportunity, would choose to earn more income rather than increase their leisure.[7] In addition, recent falling levels of industrial productivity have also been

---

duced by Representative Paul, R-Tex.; H.R. 542, 98th Cong., 1st Sess., 129 CONG. REC. H93 (daily ed. Jan. 6, 1983), introduced by Representative Crane, R-Ill. Senator Helms and Representative Dannemeyer, as of August, 1983, had not reintroduced their bills.

4. STAFF OF JOINT COMMITTEE ON TAXATION, 97TH CONG., 2D SESS., ANALYSIS OF PROPOSALS RELATING TO BROADENING THE BASE AND LOWERING THE RATES OF THE INCOME TAX 5 (Jt. Comm. Print 1982) (hereinafter cited as STAFF OF JOINT COMMITTEE ON TAXATION).

5. Senator Bradley, D-N.J., observed:

> [W]hile we profess to believe in the free market system, section after section of the tax code tells new investors what lines of business to enter, tells existing corporations how to go about their work, and puts a heavy tax on the profits of successful and productive corporations.

Senator Bradley, Remarks to the National Press Club, *reprinted in* 129 CONG. REC. S7846 (daily ed. June 8, 1983).

6. CONGRESSIONAL BUDGET OFFICE, REVISING THE INDIVIDUAL INCOME TAX 32-33 (July 1983) [hereinafter cited as CONGRESSIONAL BUDGET OFFICE].

7. *Id.* at 33, citing Hausman, *Labor Supply*, in HOW TAXES AFFECT ECONOMIC BEHAVIOR 27-83 (H. Aaron & J. Pechman eds. 1981).

well documented.[8] During the years when America's marginal tax rates and tax code were growing most rapidly, the level of savings and investment had fallen far behind that of other major industrial countries.[9]

Complexity

The current Internal Revenue Code has also been accused of generating an entire industry devoted to tax shelters and tax services by lawyers and accountants.[10] A majority of taxpayers using a long-form return need help in preparing their tax returns,[11] while forty percent of all taxpayers using the short-form 1040A sought assistance in 1977.[12] The situation is even worse for businesses. Many businesses require expensive professional help to manage their tax affairs. Larger businesses must allocate hundreds of thousands of dollars to comply with Internal Revenue Code provisions.

Other costs must be added to the waste of resources, including the costs of administering, enforcing, and litigating the Internal Revenue Code, which at the present time comprises hundreds of pages, with hundreds more pages of interpretive regulations. Ridding the tax code of its "baroque complexity"[13] would "release the talents and energies that are now directed into figuring out tax avoidance schemes and counseling others in their use."[14]

Fairness

The current tax system fails a fundamental fairness test, that is, that equal incomes should be treated the same. A Harris Poll revealed that eighty-six percent of Americans believed that many people avoid paying their fair share of income tax.[15] The treatment of income under the Internal Revenue Code, with its vast number of deductions, credits, and exemptions, allows knowledgeable taxpayers to structure their transactions so as to benefit from tax preferences for certain kinds of income. Those who can afford to purchase homes may shelter from taxation the interest paid on their mortgages,[16] as well as, in many circumstances, capital gains incurred in selling a home;[17] those who

8. SIMON, REFORMING THE INCOME TAX SYSTEM 4 (1981).
9. *Id.* at 3.
10. HALL AND RABUSHKA, LOW TAX, FLAT TAX, SIMPLE TAX 13 (1983); SIMON, REFORMING THE INCOME TAX SYSTEM 23 (1981).
11. *Flat Rate Tax: Hearings Before the Senate Committee on Finance*, 97th Cong., 2d Sess., pt. 1, 222 (statement of Senator Domenici, R-N.M.) [hereinafter cited as *Hearings*).
12. SIMON, *supra* note 8, at 23.
13. *See* Washington Post, June 3, 1982, at A18, col. 1.
14. *Id.*
15. *A Loss of Faith in the Progressive Tax*, BUS. WK. 15, Sept. 6, 1982. The article included a Harris Poll revealing that American people have lost faith in the ability of the tax system to operate equitably.
16. I.R.C. § 163 (CCH 1983).
17. *Id.* § 1034(a).

choose to or must rent have no such advantage. Investors in state and local bonds are not taxed on the interest income received;[18] investors in most other securities must pay tax on their interest income.[19] Those who can persuade their employers to compensate them with fringe benefits may pay little or no tax on these benefits, although they are clearly a form of compensation.[20] Even the tax enforcement system discriminates. Capital gains are not subject to withholding, thus such gains have greater potential to unlawfully avoid taxation, whereas wage and salary income is subject to withholding automatically.[21]

Tax Evasion

Even if sound policy reasons justify the tax preferences cited above, a widespread perception of unfairness may be driving an increasingly large portion of the economy underground. Studies estimate that anywhere from $100 billion to $250 billion of income escapes taxation annually.[22] Among farmers, professionals, and other self-employed groups, unreported income is estimated to be extraordinarily high.[23] Many observers believe that perceived unfairness and cheating are rising together, threatening the very basis of the nation's voluntary, self-assessing tax system.[24] Apparently, those who have the ability to avoid taxes legally, through "loopholes," do so. Some who cannot afford the services of lawyers and accountants, or lack the income to benefit from those services, increasingly escape taxation by cheating.

The Tax Code and Social Policy

Conservatives have long deplored the use of the tax code as a tool of social policy, pointing out that its primary function is to raise revenue.[25] Since 1913, however, when passage of the sixteenth amendment[26] authorized the income tax, increased use of the tax code to implement social policy has paralleled the increased role of government in managing the nation's economic and social welfare. The Internal Revenue Code for 1984 contains hundreds of pages of complex rules that seek to encourage particular activities. The disparities in the

18. *Id.* § 103.
19. *Id.* § 61(a)(4).
20. Gross income includes income realized in any form. Treas. Reg. § 1.61-1(a) (CCH 1983).
21. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 6, at 24.
22. *See, e.g.*, INTERNAL REVENUE SERVICE, DEP'T OF TREASURY, ESTIMATES OF INCOME UNREPORTED ON INDIVIDUAL INCOME TAX RETURNS, (1979) (hereinafter cited as INTERNAL REVENUE SERVICE); Gutmann, *The Subterranean Economy*, FIN. ANALYSIS J. 26 (Nov.-Dec. 1977).
23. *See* INTERNAL REVENUE SERVICE, *supra* note 22, at 96.
24. *See, e.g.*, *Hearings*, *supra* note 11, pt. 2, at 131 (testimony of Fred Wertheimer, President of Common Cause), pt. 1, at 222 (testimony of Sen. Domenici, R-N.M.). *See also* HALL AND RABUSHKA, *supra* note 10, at 10.
25. *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 174 (1962). Friedman argued against the use of the tax code to redistribute income and advocated a flat-rate tax scheme very similar to that put forth by Hall and Rabushka.
26. U.S. CONST. amend. XVI.

treatment of income attempt to accomplish ostensibly legitimate objectives,[27] yet the accumulation of preferential tax provisions has resulted in the inefficiences and unfairness of the current system.

William E. Simon has argued:

> A far better mechanism for promoting economic and social objectives, is to do so explicitly through the expenditure side of the budget. Here such support would be more visible and under closer scrutiny. It could thus be channeled more directly to the targeted areas. To attempt to achieve the same end with the tax system is to adopt a shotgun approach. Benefits flow willy-nilly to those who need them as well as to those who do not. The costs of such tax manipulations, in terms of forgone revenues and misallocated resources, may exceed the value of their benefits.[28]

Although subsidies would require costly administrative agencies for disbursement, whereas tax expenditures utilize the established tax code,[29] the Senate Finance Committee Hearings revealed widespread acceptance of Simon's views. All of the tax-reform bills were discussed and a majority of the witnesses reached substantial agreement on two points: the need to broaden the base of taxpayers and the need to lower the tax rate.[30] Significantly, these propositions received support not only from conservatives, but also from witnesses such as Joseph A. Pechman of the Brookings Institution, who testified that "the source of the complexity is the attempt by Congress and most administrations to do too much with the income tax",[31] and by Fred Wertheimer, president of Common Cause, who testified that "continued support [for worthy purposes] can be provided in more direct forms, if warranted, such as through grants or loans."[32]

THE POSSIBILITY OF REFORM

Three goals for a new tax system emerged from the Senate Finance Committee Hearings: first, taxes should distort economic activity as little as possible; second, the cost and complexity of complying with the current tax code must be reduced; and third, similarly situated taxpayers should shoulder a similar and fair portion of the tax burden.[33] While these goals are far from novel, they do provide a common ground from which to evaluate alternative tax systems.

Two of the ten bills before the 98th Congress have emerged as the most detailed, discussed, and heavily promoted. One, the Fair Tax Act of 1983,[34] is co-sponsored by Senator Bill Bradley (D-N.J.) and Repre-

27. For example, promoting home ownership or financing local government.
28. SIMON, *supra* note 8, at 15.
29. *See* STAFF OF JOINT COMMITTEE ON TAXATION, *supra* note 4, at 7.
30. *Id.* at 8.
31. *Hearings*, *supra* note 11, pt. 2, at 5.
32. *Id.* at 137.
33. *See* STAFF OF JOINT COMMITTEE ON TAXATION, *supra* note 4, at 3-7.
34. S. 1421 and H.R. 3271, *supra* note 3.

sentative Richard Gephardt (D-Mo.) and the other, a flat-tax plan,[35] was formulated by Robert Hall and Alvin Rabushka of the Hoover Institution, and is sponsored by Senator Dennis DeConcini (D-Ariz.).

The principal differences between the Bradley-Gephardt and Hall-Rabushka proposals are the deductions allowed and rate structures imposed. The Hall-Rabushka proposal eliminates virtually all current deductions, credits, and exemptions, except for a personal allowance, while the Bradley-Gephardt proposal retains a significant number of popular deductions. The Hall-Rabushka bill imposes a single "flat" rate on all income, whereas the Bradley-Gephardt bill uses a graduated rate structure for personal income and a separate tax on corporate income. A summary of the essential provisions of each bill follows.

The Bradley-Gephardt Bill[36]

Under this bill, taxpayers with incomes below $25,000, or joint incomes below $40,000, would pay a tax of 14% on taxable income. Income between $25,000 and $37,500, or joint income between $40,000 and $65,000, would be subject to a 12% surtax, resulting in an effective rate of 26%. Income above $37,500, or above $65,000 on a joint return, would carry a 16% surtax, for an effective rate of 30%. Married persons filing separately would pay one half the joint return amount.

The Bradley-Gephardt proposal allows personal exemptions including $1,600 for a single taxpayer, $3,200 for joint taxpayers, and $1,800 for a single head of household. The bill also grants exemptions of $1,000 for each dependent, for each blind taxpayer, and for each elderly taxpayer. Individuals do not pay tax on their first $3,000 of income if they file singly, or the first $6,000 if they file jointly.

The Bradley-Gephardt plan would tax corporations with a flat thirty percent rate. The bill would repeal the minimum corporate tax.

The plan would eliminate a large number of deductions, credits, and exclusions. Several would remain, however, including deductions for home mortgage interest, charitable contributions, state and local income and real property taxes, payments to IRA's and Keogh plans, and employee business expenses. The bill would also exclude from income veterans' benefits, Social Security benefits, and interest on general obligation bonds.

The Bradley-Gephardt proposal would implement a new depreciation method whereby plant and equipment would be placed into one of

35. S. 557, *supra* note 3.
36. S. 1421 and H.R. 3271, *supra* note 3.

six classes. The depreciation ratio[37] is designed so that "the present value of depreciation deductions is approximately equal to the present value of economic depreciation at a 10% discount rate."[38]

The Hall-Rabushka Bill[39]

Doctors Hall and Rabushka believe raising revenue through taxes should be uncomplicated. Thus, their bill contains few provisions. Under their flat-rate plan, a nineteen percent tax would apply to all individual and corporate income. Dividends and capital gains from investments generally would not be taxable, thereby eliminating double taxation of corporate profits.

The only deductions from gross income that the Hall-Rabushka proposal retains would be personal allowances, whereby individual taxpayers could deduct $3,800, joint filers $6,200, and single heads of households $5,000. Each dependent would entitle a taxpayer to a $750 deduction.

The flat-rate bill would tax businesses separately, and would allow a deduction only for the costs of doing business, including purchases of goods and services and compensation to employees. In addition, capital costs for plant and new equipment may be written off against gross income in the year of purchase. Net losses may be carried forward and applied to the following year's taxable income.

Hall and Rabushka's plan punctuates its simplicity by requiring business and individual taxpayers to file on postcard-size forms.[40]

ANALYSIS OF THE BRADLEY-GEPHARDT AND HALL-RABUSHKA PROPOSALS

The Hall-Rabushka and Bradley-Gephardt proposals both have equitable, economic, and political rough spots reflecting upon their feasibility. The heart of the debate between advocates of the Hall-Rabushka and Bradley-Gephardt bills is whether tax reforms should strive to achieve fairness.

Not all tax-reform supporters agree that equity or fairness is a tax-

37. The asset classes and depreciation rates for equipment are as follows:

ADR Midpoint	Class Life
Under 5	4
5.0 to 8.5	6
9.0 to 14.5	10
15 to 24	18
25 to 35	28
Over 35 and Structures	40

Office of Senator Bradley, D-N.J., Press Release (April 14, 1983) [hereinafter cited as Bradley Press Release]. *See also* S. 1421, *supra* note 3, § 168; H.R. 3271, *supra* note 3, § 168.

38. *Id.*

39. S. 557, *supra* note 3.

40. The postcard-size form would be approximately the size as reprinted below. An individual would file a form similar to the following:

reform issue.[41] Norman B. Ture, former Under Secretary of the Treasury Department for Tax and Economic Affairs, believes that equity is "an elusive and non-productive" approach to tax reform.[42] He argues that neutrality should take priority over the various goals of tax propos-

HALL-RABUSHKA SIMPLIFIED FLAT-RATE TAX FORM

Form 1	**Individual Compensation Tax**	**1982**
Your first name and initial (if joint return, also give spouse's name and initial)	Last name	Your social security number
Present home address (Number and street, including apartment number, or rural route)		Spouse's social security no.
City, town or post office, State and ZIP code	Your occupation ► Spouse's occupation ►	

1 Compensation as reported by employer	1	
2 Other wage income, including pensions	2	
3 Total compensation *(line 1 plus line 2)*	3	
4 Personal allowance		
(a) ☐ $6200 for married filing jointly	4(a)	
(b) ☐ $3800 for single	4(b)	
(c) ☐ $5600 for single head of household	4(c)	
5 Number of dependents, not including spouse	5	
6 Personal allowances for dependents *(line 5 multiplied by $750)*	6	
7 Total personal allowances *(line 4 plus line 6)*	7	
8 Taxable compensation *(line 3 less line 7)*	8	
9 Tax *(19% of line 8)*	9	
10 Tax withheld by employer	10	
11 Tax due *(line 9 less line 10, if positive)*	11	
12 Refund due *(line 10 less line 9, if positive)*	12	

On the other side of the postcard, a business entity would file a form similar to the one reprinted below.

Form 2	**Business Tax**	**1982**
Business Name		Employer Identification Number
Street Address		County
City, State, and ZIP Code		Principal Product

1 Gross revenue from sales	1	
2 Allowable costs		
(a) Purchases of goods, services, and materials	2(a)	
(b) Wages, salaries, and pensions	2(b)	
(c) Purchases of capital equipment, structures, and land	2(c)	
3 Total allowable costs *(sum of lines 2(a), 2(b), 2(c)*	3	
4 Taxable income *(line 1 less line 3)*	4	
5 Tax *(19% of line 4)*	5	
6 Carry-forward from 1981	6	
7 Interest on carry-forward *(14% of line 6)*	7	
8 Carry-forward into 1982 *(line 6 plus line 7)*	8	
9 Tax due *(line 5 less line 8, if positive)*	9	
10 Carry-forward to 1983 *(line 8 less line 5, if positive)*	10	

41. For example, a National Taxpayer Union spokesman declared that "equity is a matter of opinion." Fessler, *Flat-Rate Tax Advanced as Radical Cure for Problems of Existing Revenue System*, CONG. Q. 1333 (June 5, 1982).
42. TURE, *The Flat Tax Challenge* 4 (The Heritage Foundation Backgrounder Monograph No. 212, Sept. 21, 1982).

als.[43] Other tax policy analysts note that fairness underlies the deeply engrained tax concept of vertical equity, that is, the concept that taxpayers in higher income groups should pay a proportionately greater share of their income in taxes.[44] The progressive rate structure of the current income tax code purports to embody this long-held principle.[45] A Congressional Research Service (CRS) economic analyst agrees that vertical equity is a subjective concept,[46] and that many tax experts consider such a fairness standard too arbitrary to form the basis of a tax structure.[47] But while flat-rate tax proponents believe that tax policy decisions based on equity entail imprecise judgments, the CRS analyst contends that the flat-rate tax argument in favor of proportional tax rates, rather than progressive rates, also stems from arbitrary assumptions about vertical equity.[48] Ultimately, which bill one supports seems to depend upon whether one believes vertical equity should influence tax reform.[49] A discussion of the Bradley-Gephardt bill's adoption and the Hall-Rabushka bill's exclusion of progressive rates can explain what role the fairness issue plays in either bill.

Flat Versus Progressive Rates

While testifying before the Senate Finance Committee, Fred Wertheimer, president of Common Cause, emphasized that progressivity is

---

43. Mr. Ture states:

> [N]o one would design an unfair tax. Even with the best intent and greatest effort to produce the fairest possible tax, however, there is likely to be little confirmation of success. If for no other reason than that we do not know what tax fairness really is it should take a back seat to other criteria, principally neutrality, in the design of a flat-rate, broad based tax.

Id. at 10.

44. Esenwein, *An Overview of the Issues Concerning a Flat-Rate Income Tax*, TAX NOTES 950 (June 21, 1982).
45. *See* I.R.C. § 1 (CCH 1983).
46. Esenwein, *supra* note 44.

> [V]ertical equity is a highly subjective concept because it is based on the assumption of declining marginal utility of income. That is, a dollar of income is considered to be more valuable to a lower income individual (who's more likely to spend it on necessities) than it is to an upper income individual (who is more likely to spend it on nonnecessities).

47. *Id.*
48. Tannenwald, *Progressivity in Income Taxation: A Pro-Con Discussion,* CONGRESSIONAL RESEARCH SERVICE 3 (Dec. 28, 1976).
49. Fred Wertheimer of Common Cause before the Senate Finance Committee stressed the need for fairness in reforming the tax system. *Hearings*, *supra* note 11, pt. 2, at 131. Dr. Alvin Rabushka believes that: "[p]eople outside the 'Hill' don't care nearly as much about distribution shifts as they do about simplicity and the knowledge that their neighbor pays the same in taxes for the same amount of income." Interview with Dr. Alvin Rabushka, Senior Fellow, Hoover Institution, at Notre Dame Law School (Nov. 8, 1983).

Representative Gephardt, on the other hand, has complained that increasingly casting the tax reform debate in terms of the effect on the distribution of the tax burden, rather than in terms of reform and fairness, would make tax reform impossible. Bernick, *Reagan Asks Treasury to Study Tax Simplification*, TAX NOTES 78 (Oct. 4, 1982). Louis Alan Talley, CRS research analyst in taxation, said "the 'proper' amount of progressivity an income tax should entail is a judgment which depends upon personal notions regarding equity and social utility." Talley, *Estimates of Flat Income Tax Rates Using Various Tax Bases*, TAX NOTES 956 (June 21, 1982).

a fundamental element of fairness in a tax system.[50] Common Cause, a middle-income taxpayers' lobbying group, finds flat-rate tax systems inherently unfair.[51] Wertheimer says that a graduated rate structure can solve the flat-rate's unfairness.[52] Common Cause supports the Bradley-Gephardt bill,[53] with minor adjustments.[54]

Citizens for Tax Justice's director for federal tax policy, Robert McIntyre, perceives that this country's capitalism rests on the underlying assumption that "winners and losers" inevitably result in society.[55] To lessen the impact on those who lose, McIntyre suggests that the American system should maintain "a tax approach that tells the winners they have to pay more to support the system under which they have done so well."[56]

Common Cause and Citizens for Tax Justice, as well as other interest groups,[57] agree that progressivity plays a crucial role in a tax system's perceived fairness.[58] These groups support the Bradley-Gephardt proposal, or favor it over a flat-rate tax, because of its four-bracket, graduated rates. The concept of "ability to pay" runs throughout arguments supporting the fair tax.[59] Senator Bradley (D-N.J.) explained that "[w]e have taken the progressive route because we believe that someone who has benefitted substantially from our economic system

---

50. Common Cause defines progressivity in generally accepted terms: higher income taxpayers should pay a higher percentage of their income in taxes. This is also known as the ability to pay principal. *Hearings*, *supra* note 11, pt. 2, at 135-36.
51. *Id.* at 141.
52. *Id.*
53. *Id.* at 142. The Bradley-Gephardt bill maintains progressivity with its two-tier rate structure, whereby allowable deductions and exemptions affect only the 14% bracket. Income which exceeds that bracket's income limit and falls into the higher brackets is not subject to the deductions. According to Wertheimer, "this further adds to their system's fairness by ensuring that a dollar of deductible expense has the same value for all taxpayers, regardless of income level." *Id.*
54. Common Cause notes that the Bradley-Gephardt bill hopes to maintain the degree of progressivity in the current code, which includes the 1981 tax cuts. Because Common Cause believes that the 1981 cuts gave "disproportionate benefits to upper-income taxpayers," the organization advocates using the pre-1981 progression and tax liability distribution as standards. *Id.*
55. McIntyre, *Flat-Rate Talk*, THE NEW REPUBLIC 21 (July 19-26, 1982). Citizens for Tax Justice is a public interest group representing labor, lower-income, and middle-income groups.
56. *Id.* McIntyre continues that "free-market liberals" believe progressive rates can help "mitigate the concentration of wealth and power which, unless kept in check, undercuts the basic rationale for the capitalist system."
57. The AFL-CIO, for example, argues that "fundamental tax justice requires the retention of a progressive income tax rate schedule." AFL-CIO, *Issue Alert!: The Flat-Rate Tax Hoax* 2 (March 3, 1983) (fact sheet 98-10). The national labor organization goes so far as to take the position on the Bradley-Gephardt bill that "although this proposal is less damaging than the flat-rate tax, it too moves away from the principle of progressive taxation which, without its loopholes, is far preferable to either of these two proposals." *Id.* The AFL-CIO believes that the key to tax reform is not lowering the rates, which they perceive as a wealthy taxpayer boon and broadening the base, but eliminating certain loopholes and arbitrary tax preferences. *Id.* *See also* Fessler, *supra* note 41, in which former IRS Commissioner Jerome Kurtz argues that those who earn more can afford to pay a greater share of their income in taxes because those extra dollars are not being used for food, clothing, and shelter.
58. *See* Hitchner, *Memorandum for Governing Board: Reforming the Federal Income Tax System*, COMMON CAUSE (July 1982).
59. *Hearings*, *supra* note 11, pt. 2, at 135-36.

should give back a little more than people who are struggling from paycheck to paycheck. That is a longstanding policy in America . . . ."[60] Advocates of the Bradley-Gephardt bill fear that elimination of progressive tax rates under a flat-rate proposal would cause a major shift in the tax burden distribution, thereby decreasing the burden on the wealthy and increasing it on middle-income taxpayers.[61] Others dispute whether flat-rate tax systems, specifically the Hall-Rabushka proposal, eliminate progressivity in the tax structure. Also, some commentators disagree that progressivity is as cherished as advocates of the Bradley-Gephardt bill contend.

Progressivity and the Hall-Rabushka Proposal

Doctors Hall and Rabushka point out that their flat-rate tax proposal maintains progressivity as long as that term refers to higher-income taxpayers paying proportionately larger shares of their incomes in taxes.[62] Although the Hall-Rabushka bill seems to do away with progressivity because it applies the same tax rate to all income groups, the bill's authors contend that in comparison to how the current tax system actually operates, with all of its deductions and exceptions, their flat tax is more progressive.[63] Ultimately, they say, the Hall-Rabushka proposal achieves a progressive result. Some analysts dispute that a truly progressive tax system can result from the adoption of any flat-rate tax.[64]

Robert Tannenwald, tax analyst at the CRS, recounts a slightly different argument made by flat-tax advocates. According to Tannenwald, these "flat-raters" imply that the current tax system sets the

60. 129 CONG. REC. S7846 (daily ed. June 8, 1983). S. 1421, *supra* note 3, at 7836.

61. *See, e.g.*, *Hearings*, *supra* note 11, pt. 2, at 135; AFL-CIO, *supra* note 57; McIntyre, *supra* note 55.

62. HALL AND RABUSHKA, *supra* note 10, at 84. Dr. Rabushka prefers the term "graduated" over "progressive" to describe a rate structure that has increasing tax rates throughout several income brackets. Interview with Dr. Alvin Rabushka, *supra* note 49.

63. HALL AND RABUSHKA, *supra* note 10, at 84-85. The authors illustrate the progressivity of their flat-rate tax proposal:

Income	Effective Tax Rate as A Percentage of Income (19% Flat-Rate Tax)
$10,000	4.4%
15,500	9.2
20,000	11.7
30,000	14.1
40,000	15.2
50,000	16.1

Id. at 85. Because of the personal exemptions and dependency deductions, the effective rate of tax rises and approaches 19% as income increases.

64. Gregg Esenwein, an economic analyst at the Congressional Research Service, states:

> Hence, a flat-rate tax coupled with an income exemption is not incompatible with the concept of progressivity. However, regardless of the particular provision for exemptions, adoption of a flat-rate tax would in all probability reduce progressivity when compared to the current income tax system and hence could result in an overall tax burden that is regressive.

Esenwein, *supra* note 44, at 950.

guidelines for future tax rate structures. In operation, the current system provides little or no progression. Therefore, the argument concludes, a flat-rate tax reflects reality, offers an "outright recognition of proportionality," while avoiding the morass of multiple brackets and numerous deductions.[65] This argument highlights the current Internal Revenue Code's inadequate implementation of progressivity and assumes that if taxpayers want the present progressivity, they will have it under a flat-rate tax regardless of its non-progressive label.[66]

Should a Tax System Include Progressivity?

Not all tax reformers believe the tax structure should be progressive. In fact, some reformers vehemently oppose the concept as unfair and confiscatory.[67] For example, the National Taxpayers Union (NTU) believes the current progressive rates penalize those who earn more money by assessing a higher tax rate against additional dollars earned. This conservative lobbying organization claims the progressive rate penalty discourages productivity and work effort, and NTU blames it in part for the recent economic slump.[68]

Senator DeConcini (D-Ariz.) has said that a low, flat-rate structure would not suppress the incentive to produce as taxpayers moved up the income scale. DeConcini believes that the progressive marginal rates of the current tax code inhibit workers to produce and earn more.[69]

Additionally, a recent Harris Poll showed that some taxpayers have lost faith in the progressive tax system because of the deductions and exclusions available to those who could afford tax lawyers and accountants.[70] The poll indicated that many taxpayers want tax reform, but with the reservation that reform should stop where it begins taking away one's own available tax preferences.[71] The ambivalence exhib-

65. Tannenwald, *supra* note 48, at 3-4.
66. Some analysts do not agree that the current code is not progressive in effect. Tannenwald cites a study by Richard A. and Peggy B. Musgrave, which determined that in 1968 the effective individual income tax rates ranged from two percent for people with incomes under $4,000 to 18.5% for taxpayers with $92,000 plus incomes. *Id.*
67. Edwin Meese has said that "the progressive rate structure is immoral." Fessler, *supra* note 41.
68. *Id.*
69. Senator DeConcini's comments originated from his impressions of a film produced by Dr. Rabushka on Hong Kong's economic system. Senator DeConcini explains that Hong Kong's low, nearly flat tax rates which removed an impediment to productivity stimulated his interest in implementing a similar rate structure in the U.S. tax system.

    Dr. Rabushka has remarked that by removing the penalty for earning extra money, people would work more and have more money to save and invest. After the elimination of most deductions and loopholes, people would invest in productive areas of our economy rather than in nonproductive tax avoidance schemes. HALL AND RABUSHKA, *supra* note 10, at 94.
70. The survey then asked if every taxpayer should pay the same percentage of income in taxes. Forty-eight percent of those polled favored the same rate for all, 42% opposed the proposition. The lowest income group polled narrowly favored retaining the present system. *A Loss of Faith in the Progressive Tax*, *supra* note 15.
71. According to the poll, 62% of those surveyed favor a single 14% tax rate for everyone, along with elimination of nearly all deductions, while 25% opposed such a measure. However, "when it comes to giving up treasured tax breaks, Americans change their tune drastically.

ited in the poll and the divergent treatment of progressivity in both the Bradley-Gephardt and Hall-Rubushka proposals underscore the value-oriented nature of tax reform. As Tannenwald stated "[o]ne's beliefs concerning the appropriate degree of progressivity in federal income taxation are important components of his image of a just society. The issue of progressivity ultimately must be resolved on the basis of value judgments, not on deductions based on objective laws."[72]

Distribution of the Tax Burden

The Bradley-Gephardt and Hall-Rabushka bills differ significantly in their effects on distribution of the tax burden. Many predictions about either bill's effects on specific income groups stem from speculative income projections. The Hall-Rabushka proposal has undergone more critical analysis than the Bradley-Gephardt bill concerning its shift of tax burden from the upper- to middle-income class. The perceived inequity of the redistribution is the strongest objection to a flat-rate tax; thus, this issue merits considerable discussion under both the Hall-Rabushka and Bradley-Gephardt bills.

The Bradley-Gephardt Bill

An advocate of the Bradley-Gephardt proposal, Common Cause, suggests that tax reform analysis should focus on how proposed systems will affect the distribution of tax liabilities among individuals in different income classes, as well as among the income classes.[73] Senator Bradley (D-N.J.) explains that "throughout [our] bill, the changes are designed . . . to raise approximately the same revenues now expected [in 1985] under existing law and all of this would be done without changing the tax burden for any income group."[74] Common Cause cites figures which show that the Bradley-Gephardt proposal will not significantly change the proportionate burden of the total federal income tax per income group.[75] Common Cause refers to these figures as tentative "preliminary estimates."[76]

For example, more than 70% of the people polled want to keep the mortgage interest deduction." *Id.*

72. Tannenwald, *supra* note 48, at 25.
73. *Hearings*, *supra* note 11, pt. 2, at 135.
74. Bradley Press Release, *supra* note 37, at 4. Representative Gephardt adds: "[o]ur plan does nothing to change the tax obligations of various income groups." Address by Richard Gephardt, U.S. Representative, National Press Club, in Washington, D.C. (April 14, 1983).
75. COMMON CAUSE, *Resolution on Federal Tax Reform* 18 (July 31, 1982). The figures below project the tax distribution for 1985 if Bradley and Gephardt's Fair Tax is enacted:

Expanded Income	Percentage of Total Federal Income Taxes
$5,000-10,000	1.6 current law
	1.5 Fair Tax
40,000-50,000	13.7 current law
	14.2 Fair Tax
1,000,000 +	1.7 current law
	2.0 Fair Tax

76. *Id.*

The Bradley-Gephardt proposal purports to distribute the tax burden in the same way as the current tax law, while closing many loopholes and eliminating preferred tax treatment such as the capital gains deduction. The bill also promises to raise the same amount of tax revenue.[77] These provisions would shift the tax burden among taxpayers within the same income group.[78] Under the Bradley-Gephardt bill those taxpayers who benefitted most from exclusions, deductions, exemptions, and credits under the current law would experience the largest tax increase.[79] Those taxpayers who do not currently take many deductions will pay less taxes. Senator Bradley estimates that the latter group totals approximately seventy percent of all taxpayers.[80]

Advocates of the Bradley-Gephardt proposal have not presented facts concerning how many people within each income level will have gains or losses.[81] United States Chamber of Commerce tax policy analyst Kenneth D. Simonson determined that most taxpayers would pay Bradley-Gephardt's fourteen percent bottom rate, which is less than what most of those people now pay in taxes. Lower-income workers, however, will have to pay higher payroll taxes because the Bradley-Gephardt bill eliminates employer-provided health and insurance plan income exclusions.[82] Ironically, the Bradley-Gephardt proposal, intended to alleviate the income tax burden of lower income workers, may result in higher taxes for that group.

The Hall-Rabushka Bill

Congressional Budget Office tax analyst Joseph Minarik summarizes the distribution problem with the Hall-Rabushka proposal: a flat-rate tax must set a low enough rate to encourage wealthy taxpayers to forego their deductions and other tax preferences. Most flat-tax plans, such as the Hall-Rabushka bill, increase the existing personal exemptions to prevent the poor from having to pay taxes. Thus, with tax revenues lost at the upper and lower end of the income scale, "it is the

---

77. Bradley Press Release, *supra* note 37, at 4.
78. Hitchner, *Reforming the Federal Income Tax System*, 18, 19 (Common Cause Internal Memorandum) (July 1982).
79. *Id.*
80. Bradley Press Release, *supra* note 37, at 5.
81. Before Senator Bradley and Representative Gephardt revised their bill to arrive at the "Fair Tax Act of 1983," the U.S. Chamber of Commerce noted that the bill's sponsors did not provide firm data on how the tax burden distribution would remain unchanged among income groups. Simonson, Director of Federal Budget Policy, *The Bradley-Gephardt "Fair Tax,"* at 2.
82. *Id.*

middle that is left holding the bag."[83] Minarik demonstrates that a flat-rate system would shift a major share of the tax burden from the $50,000-plus income taxpayers to the $10,000-$50,000 income group.[84]

Tax distribution figures show that the 1979 median income per tax return was approximately $12,000.[85] Assuming a 14.5% flat-rate tax in that year, taxpayers below the median income level would have borne 18% of the total individual tax paid, compared with the 6.9% of the total that they actually paid.[86] According to Gregg Esenwein of the CRS, any flat-rate tax proposal would result in a redistribution similar to those figures.[87] "[U]nless some form of low to middle income relief were included (say an exemption of a portion of income or a tax credit) a flat-rate income tax would produce a tax burden which would fall more heavily on lower to middle income taxpayers than the present system."[88] The Hall-Rabushka plan provides no tax credits, and aims its exemptions at the poor. The Chamber of Commerce declares that the Hall-Rabushka proposal's "basic exemption level would help out taxpayers at the bottom, but necessarily increases the burden on the middle still further."[89] Finally, many of the largest deductions frequently used by the middle class would be eliminated by the Hall-Rabushka plan. Loss of these deductions adds to the total percentage of income a middle-income taxpayer would pay in taxes.[90]

Hall and Rabushka frankly admit that their plan would increase many people's taxes.[91] They emphasize, however, that "quickly everyone will benefit from the increased economic activity that will accompany a dramatic improvement in the incentives facing the most critical

83. Fessler, *supra* note 41, at 1333. Similarly, Common Cause complains: "[t]he most important fact to recognize about the flat-rate tax proposals . . . is that they would redistribute the tax burden away from the high-income taxpayers and onto the middle class." *Hearings*, *supra* note 11, pt. 2, at 140.

84. Hitchner, *supra* note 78, at 19-20. Moreover, taxpayers with $15,000-$20,000 incomes would experience a tax increase of 7.7% compared with the current law's liability, and those in the $20,000-$30,000 income group would have an increase of 9.3%. At the same time, $200,000-plus-income taxpayers would save 27.7% in taxes under the flat rate. These percentage increases and decreases are in comparison with the current law. *Id.*

85. *The First-Rate Tax: An Old Idea with New Appeal*, Bus. Wk., July 19, 1982, at 130-31.

86. *Id.*

87. Esenwein, *supra* note 44, at 974.

88. *Id.* Because the current tax system is slightly progressive, Esenwein concludes that the overall tax burden could be regressive after implementing a flat rate. *Id.* at 950.

89. *Hearings*, *supra* note 11, pt. 2, at 214 (statement of Kenneth Simonson, Senior Tax Economist, United States Chamber of Commerce).

90. *Id.* Simonson notes that taxpayers in the $15,000-$50,000 income range send in 75% of all tax returns that itemize deductions, even though that income group constitutes only 43% of all returns.

91. Hall and Rabuska, *supra* note 10, at 93. Hall and Rabushka have tabulated the tax burden shift by income groups:

participants in our economy."[92] Dr. Rabushka feels that citizens outside Capitol Hill care more about simplicity than about tax burden shifts, and he also feels they demand that equal-income taxpayers should pay equal taxes.[93] Because he believes that a taxpayer's real disposable income will increase under the Hall-Rabushka bill, and because the penalty of higher tax rates for extra dollars earned will disappear, Rabushka thinks people "will spend less time worrying about the tax consequences of their actions and will concentrate instead on earning higher incomes."[94]

Other flat-rate advocates contend that "the question of who would pay more under a flat-rate system is trivial next to the question of who loses now under the current system."[95] Norman B. Ture believes that tax policy should treat all taxpayers the same, "which calls for offending everyone when taxes must be raised."[96] Ture believes that marginally progressive tax rates purport to partially equalize the distribution of wealth.[97] He contends that the current code fails this purpose, and argues that if a tax system attempts to redistribute income, the best approach calls for effectively graduated rates.[98] Therefore, Ture argues in favor of a flat-rate tax with personal exemptions and a standard deduction because such a system would actually achieve progressivity.[99] Ture concludes that "there clearly is no objection on grounds of fairness or income distribution against a flat or single marginal rate."[100]

Augmented Income	Current Tax	Simple Tax (19% Flat Rate)	Changes as a % of Income
$ 5,687	$ 247	$ 440	3.4%
•	•	•	•
11,635	905	1,494	5.1
•	•	•	•
17,629	1,726	2,535	4.6
21,244	2,446	3,166	4.3
•	•	•	•
33,505	4,286	5,404	3.3
44,196	6,532	7,417	2.0
58,753	10,333	10,182	−0.3
88,750	18,640	15,879	−3.1
•	•	•	•
251,870	67,973	46,870	−8.4
691,239	202,384	130,382	−10.4
1,792,476	577,080	339,652	−13.2

Id. at 125.

92. *Id.* at 93. The authors of LOW TAX continue: "[w]ithin seven years, we foresee a 9% increase in real incomes on account of the simple tax, almost double its immediate tax increase for any group." *Id.*
93. Interview with Dr. Alvin Rabushka, *supra* note 49.
94. HALL AND RABUSHKA, *A Simple Income Tax with Low Marginal Rates*, 17-18 (1982).
95. Lee, *Rating the Flat-Rate Tax*, Wall St. J., June 30, 1982, at 22, col. 4. The writer concludes that the "loser" under the current system is the nation's economy, "meaning all of us."
96. Ture, *supra* note 42, at 6.
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*

Technical Problems

Both the Bradley-Gephardt and Hall-Rabushka proposals have other controversial effects that the authors may or may not have intended. Although these effects arise from technical aspects, they have serious political ramifications.

First, the Bradley-Gephardt proposal does not index to inflation.[101] Kenneth Simonson states that the Bradley-Gephardt bill's "repeal of indexing means that individual income taxes would rise faster than under present law."[102] Opponents of the bill argue that the supposed eighty percent of all taxpayers who would start out paying the fourteen percent tax rate under the Bradley-Gephardt bill would soon have to pay the top rate of thirty percent due to inflation.[103]

Second, the Bradley-Gephardt bill does not integrate personal and corporate income taxes. The bill's failure to integrate these income taxes illustrates that not all tax reformers believe, as Hall and Rabushka do, that income should be taxed only once.[104] Flat-rate advocates emphasize that double taxation under the Bradley-Gephardt proposal could possibly result in a fifty-one percent tax rate on corporate profits.[105] Rabushka asserts that this feature provides a disincentive to investors.[106]

The United States Chamber of Commerce contends that double taxation distorts business decisions by forcing businesses to consider tax consequences in deciding whether or not to incorporate.[107] While the Chamber of Commerce advocates taxing income only once, it cautions that "achieving integration of corporate and individual taxation is not a straightforward task."[108]

Third, the Hall-Rabushka bill eliminates home mortgage interest and charitable deductions. This elimination has raised significant objection to the Hall-Rabushka proposal because so many taxpayers presently benefit from the write-offs.[109] To allay the fears of homeowners and other debtors, Hall and Rabushka argue that interest rates will

101. S. 1421, *supra* note 3, at 7839.

102. *Hearings*, *supra* note 11, pt. 2, at 3. Simonson adds that income taxes under the Bradley-Gephardt bill would not rise as fast as under the current rate structure if the present system was not indexed to inflation because the broader fair tax brackets lessen "bracket creep." *Id.*

103. Interview with Dr. Alvin Rabushka, *supra* note 49.

104. Rabushka says that separate corporate and personal income tax systems perpetuate double taxation, whereby income is taxed once as corporate profit, and a second time in the shareholders' hands as a dividend. *Id.*

105. The fair tax applies a 30% rate to corporate profits. If the corporation distributed the 70% income remaining to a shareholder in the top 30% bracket, the I.R.S. would collect another 21% of the original corporate profit. *Id.*

106. *Id.*

107. *Hearings*, *supra* note 89, at 212.

108. *Id.* Mr. Simonson, of the Chamber of Commerce, argues that increasing the $100 dividend exclusion would alleviate the present code's double taxation. "Congress should not adopt a tax plan which eliminates this exclusion unless it provides other relief from double taxation of corporate income." *Id.*

109. HALL AND RABUSHKA, *supra* note 10, at 60-66.

drop as a result of their bill.[110] They believe that the current deduction for interest paid and the tax on interest earned sustains today's high interest rates. Enactment of their plan would mean that borrowers would no longer tolerate high interest payments and lenders would have to lower their interest rates to attract borrowers. When interest deductions no longer offset the cost of owning a home, purchase prices will stabilize for prospective home buyers.[111] Current homeowners who would lose the substantial interest deduction for their fixed interest payments would find little comfort in lower future rates. Rabushka admits this inequity and concedes that current homeowners with high interest payments would join the few but inevitable losers among the many winners of a new tax system.[112]

The Hall-Rabushka proposal would also exclude charitable contribution deductions. Hall and Rabushka argue that the charitable deduction should not enjoy the preferred status afforded by the Bradley-Gephardt proposal. They point out that the current deduction does not motivate the bulk of charitable contributions.[113] Hall and Rabushka also assert that public subsidy for certain organizations should depend on the intrinsic merit of such groups, not on the deductibility of contributions to them.[114] For example, in 1979, charitable contributions of cash and volunteer work totalled ninety-four billion dollars.[115] Charitable contribution deductions for that year amounted to only twenty-four billion dollars.[116] Hall and Rabushka therefore conclude that, even without a charitable deduction in 1979, seventy billion dollars of contributions would have been made.[117]

The charitable deduction is one of the most difficult deductions to judge on its merits.[118] Rudolph G. Penner, economist and tax analyst for the American Enterprise Institute who supports the flat-rate tax, stated that because of public sentiment, "whatever happens to the rest of the tax system, the charitable deduction is likely to remain."[119]

Fourth, the Hall-Rabushka bill's first-year investment write-off for businesses applies only to new assets. The bill has caused a stir among small businessmen who often cannot afford to buy new plant facilities and machinery. Small businesses and other purchasers of used goods

110. *Id. See also* Jacobs, *A Flat Tax Can Help Growth Firms*, Wall St. J., July 12, 1983, at 38, col. 4.
111. HALL AND RABUSHKA, *supra* note 10, at 62-66. *See also* Everett, *Flattening the Personal Income Tax*, CHASE ECONOMIC OBSERVER 3-5 (Mar.-Apr. 1983). Everett writes that the loss of a deduction sustained by homeowners will engender a potent source of political resistance.
112. Debate between Dr. Alvin Rabushka and Dean David T. Link of the Notre Dame Law School, *The Flat-Rate Tax*, Notre Dame Law School (Nov. 3, 1983).
113. HALL AND RABUSHKA, *supra* note 10, at 66.
114. *Id.* at 78.
115. *Id.* at 66.
116. *Id.*
117. *Id.*
118. *Hearings*, *supra* note 11, pt. 2, at 33 (statement by Rudolph G. Penner, American Enterprise Institute).
119. *Id.*

would have to bear the cost of replacing declining assets without a corresponding deduction. To explain why they limit the write-off, Hall claims that purchases of old equipment often result in "financial manipulations" rather than additions to capital stock.[120] Under the Hall-Rabushka plan, an asset's first owner would have already taken a write-off against income.[121] Such an explanation does little to comfort small businesmen who would not be able to expand their business through capital stock purchases without a corresponding tax write-off.

The Uphill Political Battle

The fundamental question concerning the future of the Hall-Rabushka and Bradley-Gephardt plans is whether Congress will seriously consider installing a new tax system. Realistically, neither tax-reform proposal has overwhelming taxpayer support, even though most people agree that major tax reform is overdue.

Some analysts feel that the current tax system holds too much complexity for anyone to accurately forecast the effects of a major revision. Additionally, the costs associated with tax reform generally fall on identifiable groups, some of which have committed themselves to fight tax reforms with uncertain and intangible benefits.[122] As an advocate of the Bradley-Gephardt plan, Common Cause recognizes these hurdles: "[u]nder normal circumstances, the Bradley-Gephardt proposal would have no chance of passage. The question is whether the present circumstances are normal."[123]

Although the Reagan Administration philosophically believes the flat-rate tax has merit, the White House has not spent much time considering tax reform.[124] The administration strongly supports lower tax rates and a simpler tax code, but because of the politically powerful interests enjoying and lobbying for preferred tax status today, administration officials consider a flat-rate tax "practically impossible" to enact.[125]

Similarly, after counting 110 tax expenditures in the present code, the Congressional Budget Office (CBO) reported that "[t]he biggest obstacle to any simplified tax system is that it, quite simply, goes against the grain of a Congress that has found it irresistible to use the tax code to dole out favors and to implement new programs without direct spending."[126] The home mortgage interest and charitable deductions represent particularly difficult tax preferences to eliminate. Because the Bradley-Gephardt bill retains these deductions, as well as other de-

120. Brimelow, *Get Rid of the Creep*, Barron's, April 12, 1982, at 9.
121. *Id.*
122. Hitchner, *supra* note 78, at 25.
123. *Id.*
124. Telephone interview with Ed Dale, Assistant Director for Public Affairs of the White House (Aug. 26, 1983).
125. *Id.*
126. Fessler, *supra* note 41, at 1334.

ductions commonly used by taxpayers, the bill may be politically easier to pass than the Hall-Rabushka proposal.

On the other hand, because the Bradley-Gephardt plan retains certain tax expenditures, other interest groups may try to add to the preference list in favor of themselves, only to return the tax system to its present complexity.[127] The Hall-Rabushka bill adopts an absolute stance by not allowing any deductions except for the personal exemption, dependency deduction, and zero bracket amounts. According to Herman Kahn, chairman of the Hudson Insitute, a plan with no exceptions results in wholesale tax reform.[128] Kahn believes that fewer special preferences helps Congress combat special interests.[129] The Hall-Rabushka bill, however, carries the political liability of significant changes in tax distribution.

Simply passing a flat-rate tax over the resistance of special interests may not reduce the pressures for tax breaks.[130] The reality of our special-interest-laden tax code prompts Common Cause to declare that "equity in the current code is more theoretical than real. In practice, it distributes tax liabilities more in accordance with the political strength of special interests than with a rational conception of equity."[131] The Bradley-Gephardt and Hall-Rabushka bills purport to eliminate political favoritism in varying degrees by laying to rest certain deductions, exclusions, and exceptions. By doing so, both bills boldly challenge the benefactors of tax preferences while urging the benefactors' support for a more broadly-based tax system. For example, the Hall-Rabushka bill may result in significant tax burden increases to large, defined income groups, as well as elimination of most deductions, exclusions, and exceptions. Economist Rudolph Penner remarked that "[u]nder any flat-rate system, what you find is that a very large number of people would pay a bit more, and a very small number would pay radically less. That's not a good formula politically."[132]

Tax Reform and the Deficit

Counterbalancing the political infeasibility of major tax reform is the potential the Bradley-Gephardt and Hall-Rabushka proposals have for significantly reducing or perhaps even eliminating the huge federal budget deficits,[133] which are perceived by many analysts to be the

---

127. *See id.*

128. *Id.*

129. Herman Kahn urges: "[t]his is going to have to be a fight of the whole country vs. the special interests." *Id.*

130. McIntyre, *supra* note 55. For example, McIntyre notes that "corporate tax breaks are the fastest growing item in the Reagan budget . . . and will double between 1981 and 1985." *Id.*

131. Hitchner, *supra* note 78, at 23.

132. *The Flat-Rate Tax: an Old Idea with New Appeal*, BUS. WK., July 19, 1982, at 130.

133. The deficit for fiscal year 1983 was approximately $200 billion. *Budget Solution*, Wall St. J., Sept. 14, 1983, at 33, col. 1. Office of Management and Budget Director David Stockman has

greatest single threat to continuing economic recovery.[134] The Joint Committee on Taxation has concluded that a flat-rate tax similar to that proposed by Hall and Rabushka would expand the tax base approximately sixty percent[135] by eliminating all deductions, credits, and exclusions, except for strictly defined business and occupational expenses.[136] Many observers believe that such a set-up would be "a budget balancer's paradise."[137] According to Joseph J. Minarik, a flat rate of twelve percent applied to the expanded tax base described above in fiscal year 1983 would have produced revenues roughly equivalent to those collected under the present tax structure, and that an eighteen percent flat rate would have balanced the budget.[138] Slightly less optimistic are the estimates of Hall and Rabushka themselves, who projected that a simple across-the-board rate of nineteen percent would have shrunk the deficit to $29 billion in fiscal year 1984 and virtually wiped out the deficit by 1985.[139]

The Bradley-Gephardt proposal is intended by its sponsors to be revenue-neutral;[140] nonetheless, adjustments in the proposed tax rates could be made to accommodate the goals of a balanced budget without doing violence to the base-broadening and rate-reducing objectives of the bill.[141]

Given congressional reluctance to make additional spending cuts, the prospect of increasingly large, recovery-threatening deficits, and the fact that no one wants to raise tax rates to balance the budget, influential officials such as CBO director Alice Rivlin have concluded that "a

---

been quoted as projecting $200 billion deficits "as far as the eye can see." Jones, *Single-Minded Devotion to Tax Reductions Courts Disaster*, Wall St. J., Sept. 23, 1983, at 31, col. 1.

134. *See* Jones, *supra* note 133, for an even more dire view of the danger of budget deficits. *But see Budget Solution*, *supra* note 133; Ture, *What Really Does the Crowding Out*, Wall St. J., Sept. 14, 1983, at 33, at col. 4, which expresses the point of view that current budget deficits are not as yet a substantial threat to economic recovery.

135. *See* STAFF OF JOINT COMMITTEE ON TAXATION, *supra* note 4. *See also* HALL AND RABUSHKA, *supra* note 10, at 14-15.

136. S. 557, *supra* note 3.

137. *See generally* Wilson, *Flat Tax Fever*, DUN'S BUSINESS MONTH, November 1982, at 34-35.

138. *Id.*

139. HALL AND RABUSHKA, *supra* note 10, at 126-27. Their projections are based on the President's February 1982, budget estimates. Even under the more pessimistic projection of expenditures included in the 1982 Congressional Budget Office (CBO) baseline budget report, Hall and Rabushka's 19% flat rate would bring the budget deficit down to well below $100 billion by fiscal year 1987, as opposed to the CBO's projection of a nearly $250 billion shortfall.

140. *See* Bradley Press Release, *supra* note 37.

141. The Joint Committee on Taxation explained this adjustment process as follows:

> One of the key decisions which must be made in analyzing or designing a comprehensive tax proposal is the choice of a revenue target. Clearly, if there is substantial base broadening with no changes in marginal tax rates, total revenue will be increased, and if marginal tax rates are lowered without changing the tax base, total revenue will be reduced. Several of the proposals appear to be designed so that the new combination of tax rates and tax base would produce approximately the same revenue as is expected under present law for either 1983 or 1984. However, if a judgment is made that this level is either too low or too high, base broadening and tax rate decisions can be adjusted accordingly.

STAFF OF JOINT COMMITTEE ON TAXATION, *supra* note 4.

broad-based, low-rate income tax has the potential to provide badly needed tax revenue."[142] If this line of reasoning is valid, then the pressures of enormous budget deficits and the unpleasantness of the alternatives may lead many members of Congress and officials within the executive branch to take a much closer look at the Bradley-Gephardt and Hall-Rabushka bills as possible vehicles for bringing the deficit problem under control.

CONCLUSION

The *Wall Street Journal* commented after President Reagan's 1984 State of the Union Address that the current tax code will grow even more complex before Congress enacts any serious measures to simplify taxes.[143] In response, Dr. Rabushka predicted that "you can expect lots of tax-simplification studies, lots of talk and no action this year or next."[144] Rabushka's outlook for tax reform in the coming months feeds his conviction that our tax system needs a complete overhaul, not just simplification.[145]

Although the Hall-Rabushka and Bradley-Gephardt bills contain significant differences, a coalition of both bills' sponsors can speed the process toward a tax system overhaul. Dr. Rabushka has stated that he certainly favors the Bradley-Gephardt plan over the current Internal Revenue Code, and would indeed support it for the immediate future if the sponsors change certain provisions.[146] First, Rabushka would require that the Bradley-Gephardt bill index its rate brackets to inflation; second, the bill must integrate the corporate and individual taxes to eliminate double taxation; and finally, the Bradley-Gephardt proposal must reinstate capital gains treatment to avoid a disincentive to saving and investment.[147] Rabushka predicts that once taxpayers realize the economic boom from such a tax system they will want to lower rates further and broaden the tax base even more.[148] Consequently, Congress could smoothly usher in a flat-rate tax like the Hall-Rabushka bill, thus completing the metamorphosis of the tax system.[149]

Congress can no longer avoid overhauling the tax system simply because it threatens special-interest constituencies. The Bradley-Gephardt bill, with adjustments suggested by Dr. Rabushka, represents the most feasible plan of tax reform. The integration of certain provisions from the two bills may encourage the sponsors of other tax reform bills to band together behind the Bradley-Gephardt/Hall-Rabushka hybrid. Meaningful tax reform will be accomplished expeditiously

142. Wilson, *supra* note 137, at 34-35.
143. *Tax Report*, Wall St. J., Feb. 1, 1984, at 1, col. 5.
144. *Id.*
145. *Id.*
146. Interview with Dr. Alvin Rabushka, *supra* note 49.
147. *Id.*
148. *Id.*
149. *Id.*

only if reform-minded groups cooperate and contribute their support and ideas toward a common tax overhaul goal, rather than diffuse their efforts by advocating their own individual bills.

Dr. Rabushka's prediction that no significant tax reform steps will be taken this year or next seems almost certain to come true due to the upcoming elections.[150] Although Congress may not soon enact any tax proposal, the Hall-Rabushka and Bradley-Gephardt bills will have "performed a useful service for the economy and for tax fairness"[151] if they can focus national attention on the need to purge the tax code of arbitrary loopholes and preferences.

*Michael G. Oddo**

150. Since Dr. Rabushka's statements on the future of tax changes, however, another proposal has emerged, even though it has not yet been introduced into Congress. On March 2, 1984, Representative Jack Kemp, R-N.Y., and Senator Robert Kasten, R-Wis., announced that they have collaborated on a tax-reform package with a twenty-five percent top rate. Kemp unveiled the plan to the Conservative Political Action Committee in Washington, D.C. A copy of their proposal was not available in time for consideration in this note. The Kemp-Kasten proposal resembles the Bradley-Gephardt bill in that it retains a progressive rate structure and purports to maintain the current tax-burden distribution by income group. Unlike the Bradley-Gephardt bill, Kemp and Kasten's tax plan would index its brackets to inflation, which is significant in light of the author's support for Rabushka's adjustments to the Fair Tax. *See Bradley-Kemp-Reagan?*, Wall St. J., March 5, 1984, at 30, col. 1.

151. McIntyre, *supra* note 55.

* B.A., St. Mary's University of San Antonio, 1980; J.D. Candidate, Notre Dame Law School, 1984.