

INTRODUCTION

Time for a Change

"Taxes," said rich dad. "You're taxed when you earn. You're taxed when you spend. You're taxed when you save. You're taxed when you die."

"Why do people let the government do that to them?"

"The rich don't," said rich dad with a smile. "The poor and the middle class do. I'll bet you that I earn more than your dad, yet he pays more in taxes."

"How can that be?" I asked. As a 9-year-old boy, that made no sense to me.

—Robert T. Kiyosaki (with Sharon L. Lechter), *Rich Dad, Poor Dad*

I BEGIN WITH TWO FACTS ABOUT AMERICA TODAY. ONE, our tax system is a disgrace, and has been so for decades. The way we tax is complicated, inefficient, and unfair. Yet whenever elected officials in Washington actually try to do something about tax, they tinker at best. At worst, they make the system even more annoying. We need fundamental, comprehensive tax reform, not ad hoc tinkering.

Two, there is a widening gap between the rich and the not-rich in this country.

It may surprise many readers to learn that there is a deep connection between these two facts. Tax as it is today is a cause of the wealth gap. Tax as it could be tomorrow would narrow it. That's what this book is about: a proposal to make the tax system better

and fairer so that we can get to a model of class teamwork, not class conflict, in this great nation. Right now we're a long way from realizing that goal.

This is not a tax-planning book. It is a book about change—long overdue change. The problem can be simply stated: Under the current American tax system, if you have wealth, you don't need to pay tax anymore; taxes have become voluntary. But if you are like most ordinary wage earners laboring to earn their keep, you have precious little choice but to pay your distant Uncle Sam first before you get money for your daily bread. Tax is a nightmare from which you cannot escape.

Tax today is fundamentally set against work and savings: it makes it hard for people to build up wealth in the first place. Yet once you have wealth, whether you earned it or were given it, you are home—and tax—free. Life on top is very good, with ever new and ever more expensive luxuries for you to enjoy. And with very basic tax planning, you need never pay tax on your lavish lifestyle. But if you are not rich, these are difficult times. Life is stressful as you live from paycheck to paycheck, never seeming to get ahead. And yet you are taxed at every turn.

Books like the best-seller *Rich Dad, Poor Dad* chronicle the divide between the rich and the not-rich and give advice—often not very good advice—about how individuals can bridge the gap and get to the promised land of riches without taxation. This book takes a different tack. It proceeds from the premise that something is wrong with the picture. I will explain why that picture needs to be fixed and how it can be—for all Americans. I will answer the question the nine-year-old boy posed to Rich Dad, about how it has come to be that under our federal system tax falls on wage earners but not on wealth holders. And I will recommend fundamental changes in order to get tax right.

TROUBLE IN RIVER CITY

The American tax system, including all federal, state, and local taxes, is huge. It takes in over one-third of all dollars produced in this country each year. But the size of the tax burden is not my complaint, nor, by and large, is it that of the American people, who understand

ON RICH DAD, POOR DAD AND OTHER BEST-SELLERS

In text boxes throughout this book, I use fictional characters, real-life stories, and contemporary best-sellers to illustrate ideas in the main text. I also begin many of the chapters with quotations from popular business books. These volumes give an interesting perspective on contemporary America. They reflect the general state of knowledge about financial facts of life, and they capture many of our common hopes and dreams.

The best-selling *Rich Dad, Poor Dad: What the Rich Teach Their Kids about Money—That the Poor and Middle Class Do Not!* by Robert T. Kiyosaki with Sharon Lechter is typical of this genre. At times condescending in its attitude toward the “poor and middle class,” more often vague—and occasionally wrong—in its basic financial advice, *Rich Dad, Poor Dad* nonetheless conveys two vital truths about economic life in the United States today. One, there are many ways that the rich can get richer. Two, the poor and middle class must labor away just to hold steady and pay their bills. Kiyosaki’s aim is to advise his readers on how to get rich so that they can win under the existing rules. My aim is to recommend a change in those rules to make it easier for the poor and middle classes to become rich in the first place, and to make it harder for the rich to avoid being taxed as they live a lavish lifestyle in the second place.

full well that taxes pay for important public goods and services, including Social Security, Medicare, schools, police, roads, national defense, and so on. There’s more to talk about with regard to a tax system than its size. Whatever level of taxation we have, there are important questions about the way we tax.

Trouble is, the way we tax today is complicated, inefficient, and, most importantly, unfair. *Rich Dad* points to the starkest aspect of our tax system’s unfairness: the surprisingly obscure fact that paying tax has become virtually voluntary for the growing number of Americans who have made a fortune for themselves and can comfortably live out the rest of their days on the yield from their property holdings. Meanwhile, workers—lower-, middle-, and upper-middle-

class citizens—are taxed on all sides, often at combined rates of 50 percent or higher, with nowhere to hide. America has developed an onerous wage-tax system with massive holes when it comes to taxing wealth and its products. That shouldn't make sense to any of us.

What makes even less sense is the fact that things are staying the way they are. It isn't all that difficult, conceptually, to fix the system—to make tax simpler, fairer, and more efficient. My aim in this book is to explain how to get tax right. It's surprisingly simple.

PLENTY OF BLAME TO GO AROUND

There are plenty of reasons for the mess we're in. To begin with, it's not practical to change a large and important system like tax without popular support. But it's hard to gain that support when so few Americans understand the deep incoherence of tax today. The basic form of the tax system has become mind-numbingly difficult to discern. It's hard even to sense the existing problems. Popular understanding of tax looks to statistics that feature only reported income and therefore hide the root problem: the ability of the wealthy to easily, and perfectly legally, live off the fruits of *unreported* income.

People need help to understand tax. But no one seems ready, willing, or able to help them. The media lack the time and resources to figure it all out. And academics, who do have the time and talent, haven't been much help. Consider some basic facts. The largest overall tax in America, and the focus of most academic analysis, is the federal personal income tax. Yet most Americans pay more in payroll taxes than they do in income taxes. Further, what we call an income tax isn't really an income tax at all. An income tax is supposed to tax income, whatever its source: whether it comes from wages or as a return on investments. But our so-called income tax is extremely inconsistent when it comes to taxing the latter type of income. The "income" tax is in fact far closer to a wage tax, one that taxes labor earnings alone. Rich people don't have to report their increases in wealth to the federal tax collector, yet they can borrow against their wealth and spend away. Meanwhile, wage earners see both income and payroll taxes come out of their paychecks before the checks can

be cashed. That's reality today for most of us. Still, academics continue to debate the relative merits of income versus consumption taxes, oblivious to the fact that what we have is an incoherent mixture of the two. Scholars rarely comment on how bad the status quo is or support sensible changes to it; they often fail even to note the growing role of the payroll tax in the bigger picture of tax. Many academics are quicker to point out the many difficulties of change—any change—than the deep structural problems in the way things are. Few try to explain to ordinary people the basic flaws of the tax system or sensible alternatives to it.

Wealthy people and their well-paid tax advisors are even less help. These fortunate few are doing just fine under the status quo. They have no interest in change. Most people who know enough about tax to see its deep flaws are making a good living by exploiting those flaws. Tax is simply too important to leave to the few people who already happen to understand it.

Politicians seem particularly unable or unwilling to fix the mess. Whenever they have the chance, politicians do things to help their favored constituencies. Republicans aim to cut taxes for the wealthiest few, helping the rich to get richer. Democrats aim to do as little about taxes as possible, preferring continued spending programs and minor complicating changes to fundamental reform. It's difficult to get anywhere with the inside-the-beltway crowd, because what they want is out of step with what the average American citizen needs and deserves: a better, simpler, fairer tax system.

ME AND MY BOOK

As a tax lawyer, an economist, and a professor, I have been thinking, writing, testifying, and lecturing about tax reform for more than a decade. My mission is to help make the tax laws more sensible and fair for ordinary Americans. My ideas have helped to further public discussion about the "marriage penalty" and about the ills of the so-called death tax. But I have been frustrated with what politicians have and have not done with my ideas: they're interested in sound bites, not real reform.

Hope exists; mine persists. There is a better way to tax. I believe

that America should have a progressive consumption tax, one that falls consistently on spending, not on work or savings. There is no reason to tax work and savings directly. Nor is there any reason to raise taxes for the middle class in order to pay for tax reductions for the rich, as the common flat-tax plans would do. America should have a tax system whose basic principles we can all understand: a fair not flat one.

I did not write this book for politicians, academics, or the wealthy. Instead I am taking my ideas straight to the people. I wrote this book to answer the nine-year-old's question in *Rich Dad, Poor Dad*, to explain how tax today works and why it is badly wrong. And I wrote it to propose a simpler, fairer tax system.

THE BASIC PLAN

My proposal is simple:

- change the inconsistent income tax to a consistent spending tax by granting an unlimited deduction for savings and making other logical corrections
- repeal the so-called death tax
- keep tax rates progressive
- reduce the paperwork burden that most Americans now face

The result is, in essence, a progressive national sales tax. I call it the Fair Not Flat Tax.

The Fair Not Flat Tax can take several different forms. I will emphasize one that features a broad consumption tax such as a sales or value-added tax with a rebate for low-end spenders and a supplemental personal consumption tax for high-end ones. Roughly speaking, a family of four will pay no tax on its first \$20,000 of spending and a 10 percent tax on its next \$60,000. Only a minority of families, those that spend more than \$80,000 a year on themselves, will have to fill out tax forms and pay higher rates under the supplemental consumption tax.

I readily admit that my numbers are illustrative and are only estimates. I mean this book to be general and highly readable. I will not engage in long, technical discussions about precise rates and numbers, adding fuel to think-tank fires. Complexity can wait. The devil

may indeed dwell in the details, but we first need to find an angel or two in the abstractions that govern tax. It's time to get the basic principles of tax down right.

WHY THE PLAN IS FAIR

The Fair Not Flat Tax is fair because it rests on a simple and consistent principle: tax people on what they spend, not on what they earn or save. The Fair Not Flat Tax sticks to this principle. It does not contain a death tax for the simple reason that dead people don't spend. The Fair Not Flat Tax instead taxes heirs when they spend inherited wealth. It is a far better, far more consistent tax on the wealthy, of both the first and later generations, than the ineffective system we now have.

The Fair Not Flat Tax is fair because it assigns a lower rate of tax to spending on life's necessities—like food, clothing, shelter, medical care, and education—than to spending on life's ordinary pleasures, and it assigns the highest tax rate to spending on life's luxuries.

The Fair Not Flat Tax is fair because, unlike most of the common flat-tax plans, it does not raise tax rates on the middle class to pay for tax reductions for the rich.

The Fair Not Flat Tax is fair because it does not require most Americans to fill out complicated and intimidating tax forms every year.

And, finally, the Fair Not Flat Tax is fair because it represents the best practical expression of current American attitudes toward tax and wealth. Or so I aim to convince you.

A NOTE TO READERS

I have tried to write a simple book about a complex subject. I have skipped the usual academic devices of footnotes and such, and I have deliberately kept my text and examples simple and straightforward. I know from experience that many questions and objections will come up in your mind as you read. To help answer these, I have gathered up many and put them in a Questions and Comments section at the end. This has its own table of contents that you can browse

to find the topic you have in mind. I have also included a glossary of key technical terms and a guide to other books on tax policy that you might find of interest.

I hope you will enjoy this book. More important, I hope you will get motivated to help fix the mess we've gotten ourselves into. Tax needs your help.