

BOOKSHELF: Consumed by a Taxing Question

FAIR NOT FLAT

By Edward J. McCaffery

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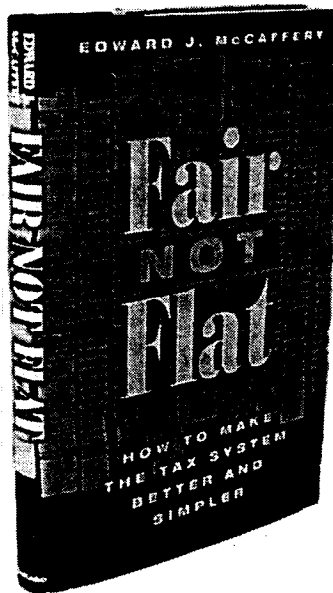
By BRUCE BARTLETT

EDWARD J. McCAFFERY believes that the rich are undertaxed on what they spend. Since unrealized capital gains are never taxed and because borrowing is not taxed as income, the wealthy can live lavishly, waste money on luxuries, shamelessly flaunt their wealth and pay few taxes.

By contrast, those in the middle class, struggling to save a few dollars for retirement or a child's education, are taxed mercilessly. Their wages are so heavily taxed by income and payroll taxes that they have precious little left to save after paying for the necessities of life. And when they do save, they are taxed again on the return, making it extremely difficult to build even a modest nest egg.

What to do? In "Fair Not Flat," Mr. McCaffery lays out the case for a consumption tax. He does so in a reader-friendly way, presenting his argument with very few footnotes, equations or technical terms. The consumption of the book, so to speak, is not at all taxing. And its argument is well worth pondering.

Under Mr. McCaffery's plan, all saving would be treated like Individual Retirement Accounts—that is, sheltered from taxation—but unlimited contributions and withdrawals would be allowed. The former would be fully free from the IRS and the latter fully taxed. The restrictions that now vex various tax shelters—concerning age, invest-



Under this plan, Bill Gates could escape taxation by saving all his money.

ment choices, the use of withdrawals—would be abolished.

If saving is exempted from tax, consumption cannot be, since there are only two things one can do with money—save it or spend it. Mr. McCaffery would tax consumption at progressive rates: The effect would be to lower taxes on the middle class and raise them on the wealthy.

To be sure, even Bill Gates could still escape taxation by saving all his money.

But then he would have to live in the style of an ordinary American. Mr. McCaffery says that if this is what he wants to do, then that is OK—he can earn millions of dollars and pay no tax as long as he saves all of it. On the other hand, if people want to borrow, splurge and live for today, they should pay a tax penalty for doing so.

Mr. McCaffery believes his plan makes more sense than the flat-rate idea that has dominated tax reform thinking for the last 20 years. In effect, he is saying that the tax base—what is taxed and when—is more important than rates. He also argues that the experience of the Tax Reform Act of 1986 shows that flat-rate systems are politically unstable. That legislation got the top rate down to just 28%, but within a decade it was back up to 40%. In short, Congress can tinker this way or that with rates, depending on the political climate, but the base is less susceptible to change.

Of course that is also part of the challenge for anyone who wants to replace an income tax with a consumption one. It is here that Mr. McCaffery's credentials will help. He is a University of Southern California law professor whose political ideas tilt left in eccentric ways. A law review article he wrote on why liberals should support repeal of the estate tax was influential in Congress, and an earlier book of his made the case for the abolition of the marriage penalty on feminist grounds. If anyone can rally a spirit of bipartisanship to the whole rancorous debate about taxes, it is Mr. McCaffery.

Naturally, because he is writing a popular book, he must gloss over a great many details. Most important, he does not discuss the corporate income tax or business taxation generally in "Fair, Not Flat." If he wants to be consistent, the corporate income tax would effectively have to end along with the personal. But that would make the consumption tax a harder sell on the Democratic side of the aisle.

As for the Republican side: Flat taxers will take issue with Mr. McCaffery's endorsement of progressivity. But I think he is right to emphasize the much greater importance of getting savings out of the tax base than flattening the rate structure. This one action will greatly improve fairness, simplify the Tax Code and increase economic growth, since more savings would translate into more investment. Giving up on a single rate seems to me a reasonable trade-off, especially given that a flat tax is probably impossible to achieve anyway.

In Mr. McCaffery's ideal world, around this time of year Americans would be thinking about how best to save their money instead of feeling penalized for earning it. Doesn't sound so bad.

Leisure & Arts



Simple, sane and progressive aren't usually words associated with the tax code. They should be, says University of Southern California law professor Edward J. McCaffery. His solution in a new book, "Fair, Not Flat."

Mr. Bartlett is a senior fellow at the National Center for Policy Analysis.