Consumption Tax:
An Idea Whose Time Is Coming

Special Report from the Tax Foundation
Tax Foundation, Incorporated, founded in 1937, is a nonprofit organization engaged in nonpartisan research and public education on the fiscal and management aspects of government. Its purpose, characterized by the motto "Toward Better Government Through Citizen Understanding," is to aid in the development of more efficient and economical government. It also serves as a national information agency for individuals and organizations concerned with government expenditures, taxation, and debt.

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Tax Foundation, Incorporated
1875 Connecticut Avenue, N.W.
Washington, DC 20009
(202) 328-4500
Price: $5.00 Per Copy
"Reagan Studying Taxing Income That Is Spent, Not Saved" —
"Administration Weighs Shift to Consumption Tax: 'Reform' Would End Income Levy"—

So went news headlines last January when the idea of a "consumption tax" became a hot number in Washington's tax reform follies of 1983.

What explains the revived interest in a tax proposal that was considered and rejected more than 40 years ago, in 1942, as a World War II financing measure?

The basic impetus springs from the seemingly unstoppable rise in government spending. That spawns added demand for government revenue, which can be met only by higher taxes in one form or another. At the same time, the present tax system—wonder of the world for so many decades—shows signs of strain and maybe terminal illness.

In this situation, politicians of both major political parties and all shades of opinion, from Far Right to Far Left, are casting about for new ways to raise revenue. And a consumption-based tax, which could stimulate savings and investment—the vital medicine for long-range economic health—is in the spotlight for congressional study and maybe a trial run, some day.
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Hobbes to Kaldor

“For what reason is there, that he which laboureth much, and sparing the fruits of his labor, consumeth little, should be more charged taxed, than he that living idely getteth little, and spendeth all he gets: seeing the one hath no more protection from the Commonwealth than the other?”

The quote above, from Leviathan by Thomas Hobbes, the 17th century English thinker, is often cited as the birth cry of the consumption tax theory. It states the basic justification for a tax on consumption rather than savings in a way scarcely improved upon to this day.

The Hobbes thought was carried forward, 200 years later, by John Stuart Mill, classical English philosopher of the 19th century, who stated that the only “perfectly unexceptionable and just principle of income tax” is to “exempt all savings.”

These early backers of taxing consumption instead of savings rested their case primarily on the notion that such a tax would encourage thrift, and the resultant savings would stimulate investment in wealth-producing equipment and facilities, thus promoting the best interests of all.

Irving Fisher, a leading American economic theorist, was a convert. He and others, in the 1930s and 1940s, stressed the argument that the straight income tax was flawed because it imposed double taxation on savings, since it first applies to wages and other income from services and then again to any income, including interest and dividends, that savings earn.

With Fisher’s endorsement, and in a search for new ways to finance World War II, the U.S. Treasury became interested and sent a proposal for a “spendings tax” (another name for a tax on consumption) to Congress in 1942. The political leaders of the day gave it little serious consideration, and a national consumption tax dropped from public view in the United States and most of the rest of the world. But the idea stayed alive in economics textbooks and continued to attract support from heavy hitters among economic theorists, including Nicholas Kaldor.

That eminent British economist “wrote the book” on consumption tax
theory and its practical application and impact so far as they can be determined short of an actual program. Kaldor's treatise, An Expenditure Tax, was published in 1955 by London's George Allen & Unwin publishing company. The book is considered must reading for students of the consumption-based income tax, and some of its wording has a timely, even prophetic, tone in 1983, when the U.S. Congress is embarking on a search for alternatives to the present tax system.

Kaldor believed that a tax based on personal expenditure could be only a supplement to the personal income tax, rather than a complete replacement. He also stressed that the new tax, if adopted, should be "moderate" in rates, and then wrote this warning:

"We have travelled so far down the path of decadent tax systems—the path of charging more and more on less and less—that it requires a great effort of imagination to turn back... Taxation can be a powerful instrument of social progress but it cannot be made into an engine of social revolution. The noble experiment of gradually building a society that is both free and just through progressive taxation is bound to fail unless we recognize that fact."

Despite the appeal of a consumption tax to economic theorists for more than 300 years, the idea has never been tried on a significant scale—that is, as a stand-alone system replacing other taxes—in a modern industrial nation. The closest to a test came in limited experiments in India and Sri Lanka with a consumption tax applying only to the higher income groups. Those experiments ended in the mid-1960s. Yet important moves toward the concept of consumption taxation have surfaced in recent years in the United States, Europe, and Japan—although the term "consumption tax" is rarely tied to these tax initiatives.

And Now: Ronald Reagan and Martin Feldstein

As 1983 began, President Ronald Reagan's Administration lit a fuse for the consumption tax that is still burning. Martin Feldstein, Chairman of the President's Council of Economic Advisers (CEA), devoted seven pages in a major Washington address on January 19, 1983, to a description of the consumption tax. Emphasizing that it was only an idea "being considered," Feldstein went on to explain "why this is a very attractive approach to tax reform." From available records, this marked the strongest public endorsement of the consumption tax by a top government official while in office—and the beginning of a national debate over a tax issue that has been discussed mostly in academic circles up to now.
Consumption-Based Income Tax Explained

How It Differs from Other Consumption Taxes

The present U.S. tax system already incorporates a number of consumption taxes at all levels, Federal, state, and local. Sales, excises, and customs levies—and even elements of the present income tax—are forms of consumption taxation, in that their burden is distributed to some extent in proportion to consumption expenditures.

To qualify as a true consumption levy, a tax must be imposed so that the exact amount of the tax is shifted forward to consumers. This requirement is not fulfilled by the present consumption-like taxes.

For one thing, even the most broadly based of these taxes—general sales taxes extensively used by states and increasingly by localities—are not universal in scope, typically leaving untaxed large elements of consumer spending, much housing, and most other services. For another, the taxes are not generally confined solely to consumption goods since they may be levied on the manufacturer, wholesaler, or retailer; inevitably, business purchases are subject to some of the tax. The tax may thus pyramid as merchants apply percentage markups on the way to the final consumer. But that is not entirely the case.

The "wide world" list of taxes on page 6 gives the picture of government levies in their various forms as of 1983. Not shown by the figures, however, is the emergence of the consumption tax approach in the form of special allowances that shield some income—as long as it is saved or invested—from taxation, until the money is drawn out and spent or passed on to heirs.

These features of a genuine consumption-based tax approach, like shoots of springtime grass in the landscape of Federal taxes, include Individual Retirement Accounts (IRAs).

IRAs offer taxpayers the chance to deduct money set aside in such accounts from taxable income and thus are the clearest example of recent steps toward a consumption-based income tax. First authorized in 1974, IRAs were...
preceded by a whole family of similar tax-deferred savings allowances centering on pensions, and ranging from huge company and union funds to modest KEOGH plans (named for the U.S. Representative who proposed the concept) for the self-employed.

Other savings/investment arrangements with tax-deferral features include ESOPs (Employee Stock Ownership Plans); employee health and life insurance plans; and tax-sheltered investments in housing, other real estate, and gas and oil ventures.

All these devices go partway toward a consumption tax system. Yet some of them represent a significant departure from the traditional notion of consumption taxation that is exemplified by general sales taxes (levied on wholesale and retail purchases) and excises (levied on selected products and services at the producer level).

The simplicity of sales taxes is appealing to politicians, who see them as easy to collect, easy to increase, and easy for voters to forget when tacked onto or folded into prices. On the other hand, critics regard sales taxes as regressive.

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**EASY GUIDE TO TAX TERMS**

- **Progressive income tax.** Rates go up as taxable income rises. Levied on personal and corporate income. This is present U.S. Federal income tax system, with many complex calculations and deductions that reduce the tax base—the income subject to tax.
- **Flat rate income tax.** Suggested substitute for progressive tax. All would pay the same rate on taxable income.
- **Comprehensive income tax.** Broad-based tax applying to as many forms of income and wealth-gains as practical, including pensions, fringe benefits, capital gains, etc. Tax rate flat, or progressive.
- **Consumption tax.** Also known as Expenditure Tax; Spendings Tax; Cash-Flow Tax. Would replace present income tax, and apply instead to “consumption income” (the difference between all cash received and all savings). Tax rate flat, or progressive.
- **Sales tax.** Usually a percentage of the selling price on a product, collected from manufacturers, wholesalers, or retailers, who may add the tax to the consumer’s price.
- **Excise tax.** Usually a percentage of the selling price on selected products, collected from producers or distributors, who may add the tax to the retail price.
- **Tariff.** Also known as Customs Duty. Paid, as percentage of value or price, by exporter or importer on goods going out of or coming into a country.
- **Estate tax.** Also known as Death Tax. Paid by the deceased’s estate as percentage of value of the wealth (in property, money, jewelry, art, etc.) owned by the person at the time of death.
—taxing a larger share of income from poorer people than from those who are better off.

The upshot is that most observers of the political scene predict that Congress will go very slowly along the path toward a consumption income tax, preferring instead to put patches on the present hybrid system that combines both income and consumption levies.

If Congress did surprise everybody and go the whole route to revolutionary tax reform, junking the present individual and corporate income taxes—a step viewed as unlikely before the 1990s at the earliest—the present system could be replaced by what economists call the “consumption-based income tax,” or “expenditure tax,” or “consumed-income tax”—three terms for the same concept.

All the ins and outs of such a theoretical system have not been outlined beyond the details in Kaldor’s 1955 treatise and similar, though less well-known, studies. The main thrust from the individual taxpayer’s viewpoint has been delineated in studies by Treasury Department analysts and others.

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**YOU NEED TO KNOW**

- **Inheritance tax.** Tied in with Gift Tax in the United States. Paid by the heir or other giftee as percentage of value of property, money, etc., received from another. Also tied in with the Estate Tax in many states.

- **Value-added tax.** A form of consumption tax, paid at a number of points in the production and distribution chain (from iron mine to automobile, for example). The tax is a percentage of the “value added” at each stage, and usually is added to the price paid by the next producer or distributor in the chain. So the final price to the consumer includes the total VAT, but often it is not stated separately in contrast to the typical retail sales tax.

- **User charge.** Paid by the public for services (sewers, water, trash pickup, etc.); facilities (parks, marinas, parking spaces, waterways, toll roads and bridges, libraries, etc.); permits (drivers’ licenses, auto tags, fishing and hunting licenses, business operation permits, etc.). A growing revenue source for Federal, state, and local governments and quasi-governmental agencies such as park boards, thoroughway authorities, and so forth.

- **Payroll tax.** Levied on wages and salaries, collected by employer. Most common examples are Social Security and Unemployment Compensation taxes.

- **Severance tax.** Paid on removal of natural products, e.g., oil, gas, and timber, and measured by value or quantity of products removed.

- **Property tax.** Taxes conditioned on ownership of property and measured by its value.
Treasury's Model for a Consumed-Income Tax

John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy, described the main outlines of a tax on consumed income in testimony before the Senate Finance Committee on September 28, 1982, indicating how the Treasury would like some features of the tax to be set up. This was a follow-up on a 1977 Treasury study entitled Blueprints for Basic Tax Reform, which discussed the consumption tax idea under the label of "cash flow tax."

The way such a tax would apply to individuals is outlined by the "5-Step Tax" and the "Annual Return" illustrated on pages 15 and 16.

Taxpayers would report all cash income and all net borrowings: the excess of borrowed funds over loan repayments, as on a home mortgage, on an annual return very similar to the present Form 1040; they would then subtract purchases in excess of sales of income-earning assets and net deposits in interest-bearing accounts. The resulting balance would be the "cons-

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THE WIDE WORLD

Percent of GNP Taken By —

Governments at all levels—Federal, state, and local—now take 31 percent, nearly one-third, of the nation's Gross National Product (value of all goods and services) in taxes and fees paid by people and businesses.

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<th>19.4%</th>
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<td>Excludes</td>
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<td>non-tax revenues</td>
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4.9% Local governments

6.7% States

"The Feds"

Percent of Total Government Revenues

Most present taxes fall on incomes and payrolls. But sales and excise levies and user charges—forms of "consumption taxes"—are levied extensively.

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<thead>
<tr>
<th>Other licenses, etc.</th>
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<td>10.8 User charges (tolls, etc.)</td>
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<td>12.8 Sales taxes, excises, tariffs</td>
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<td>Property taxes</td>
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sumered income” for the year, and it would be taxed at whatever rate or rates Congress decreed. There would be no tax credits or exclusions, in contrast to present income tax law.

What about corporations? Assistant Secretary Chapoton said this: “Because only individuals consume, there would be no separate corporation tax nor any need to integrate personal and corporate earnings. Taxable income of an individual would include distributions from corporations and individuals’ sales of corporate shares. In effect, corporate income would be taxed when it found its way into individual consumption.”

To put it another way: Dividends would be reported as taxable income; proceeds from the sale of stock also would be included in taxable income; but gains and losses on stock transactions would not be reported as such and thus would have no tax consequences.

The Treasury’s studies are specific evidence of how far the theory of a consumed-income tax system has advanced, down to the details of how such

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**D OF U.S. TAXES**

**15 Ways Americans Pay Taxes**

<table>
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<th>Percent of Total Government Revenues</th>
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<tr>
<td>1. Federal income tax ................ 27.6%</td>
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<tr>
<td>2. State income taxes ............... 5.5%</td>
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<td>3. Local (city, county) income taxes .0.5%</td>
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<tr>
<td>4. Federal payroll taxes (Social Security, Unemployment) 16.5%</td>
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<tr>
<td>5. State payroll taxes (Unemployment) 1.3%</td>
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<tr>
<td>6. State property taxes ............ 0.3%</td>
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<td>7. Local (city, county) property taxes 7.5%</td>
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<tr>
<td>8. Federal excises, customs duties ... 4.0%</td>
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<tr>
<td>9. State sales taxes ............... 7.5%</td>
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<tr>
<td>10. Local (city, county) sales taxes 1.4%</td>
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<tr>
<td>11. Federal user charges ........... 4.5%</td>
</tr>
<tr>
<td>12. State user charges ............. 2.7%</td>
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<tr>
<td>13. Local (city, county) user charges 3.6%</td>
</tr>
<tr>
<td>14. Federal death and gift taxes ... 0.5%</td>
</tr>
<tr>
<td>15. State death and gift taxes .... 0.2%</td>
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<tr>
<td>Other (licenses, etc.) ............ 1.9%</td>
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(Excludes non-tax revenues)

Why a Consumption Tax Looks More and More Appealing

- Demand for revenue by Washington is rising as spending climbs.
- Present tax system is complicated, taxes savings too heavily and impedes capital formation.

RESULT:
Political and business leaders are discussing the need for a simpler, more efficient tax system — such as a consumption tax could provide.

a system could work. But important questions remain.

Could a consumption income tax raise enough revenue to keep the gigantic Federal bills paid each year? Would such a tax place an unfair burden on lower-income taxpayers? Would it give an unjust tax break to the wealthy? And, in practical terms, does a consumed-income tax have any real future? Could it ever get approved by Congress?
As this report went to press in the early spring of 1983, no member of Congress had introduced a specific legislative proposal for a consumption-based income tax. The general feeling in the capital was that a lull in tax reform was to be expected until after the 1984 presidential and congressional elections.

Offstage, however, in committee hearings and staff talks, the search was pressed for a long-range answer to the basic tax riddle: How can the United States raise the trillions of dollars government units are committed to spend in the decades ahead, without destroying individuals' and businesses' incentives to work, save, and invest in the country's future?

The squeeze on taxpayers already has produced revolts at the polls, and arbitrary limits on certain taxes, at local and state levels—starting in California in the late 1970s and spreading across the nation to Massachusetts by the early 1980s. This groundswell of taxpayer resentment at ever higher tax bills did not go unnoticed in Washington. It paved the way for the largest tax reductions in years at the national level, culminating in the Economic Recovery Tax Act of 1981. Congress took back part of the reductions in the following year, with the Tax Equity and Fiscal Responsibility Act of 1982. But that tax-raising measure only spurred new interest in finding alternatives to the present income tax with its built-in bias against savings and investment.

The guiding thought among those seeking structural change in the tax system itself is this: If Congress refuses to cut spending and thereby makes continuation of high taxes inevitable, the best practical response is to shift more of the tax burden to transactions, products, and services—i.e., to adopt some form of consumption (expenditure) taxes. This is a controversial idea, to put it mildly.

Critics of the consumption tax approach fall mainly into two groups: those who agree that the present tax system needs to be replaced or radically...
altered: and those who think the system needs only to be tightened up, made simpler, and applied more broadly.

In the latter group are advocates of "comprehensive flat-rate" tax proposals. They would keep the present income tax setup but end all, or nearly all, deductions and apply the same rate to all taxable income, or provide only two or three successively higher rates as income rises, instead of the present graduated steps rising from 12 up to 50 percent.

Backers see this approach as curing most tax ills, making the income tax simpler, eliminating unfair loopholes, and treating all taxpayers alike when they have enough income to be subject to tax.

At least a dozen "tax simplification" bills were introduced in the 97th Congress, including those by Senators Bill Bradley (D-N.J), Dennis DeConcini (D-Ariz.), Jesse Helms (R-N.C.), George Mitchell (D-Me.), and Dan Quayle (R-Ind.); and by Representatives Philip Crane (R-Ill), William Dannemeyer (R-Cal), Richard Gephardt (D-Mo), Leon Panetta (D-Cal) and Ron Paul (R-Tex). Many of those same bills may turn up again in the 98th Congress.

Reagan Administration Attitude

The Reagan Administration, as this report went to press, had stated publicly only that it was "considering" a plan to replace income taxes with a consumption tax at some unspecified future time.

President Reagan was asked this question in a Business Week magazine interview published in the February 14, 1983, issue: "Are you leaning toward a flat-rate tax or a consumption tax?" His reply: "My mind is really open on this. All I ask is that we find a way to simplify the tax system. I used to fill out my own tax form, even when I was receiving some of that make-believe money in Hollywood. But I was unable to do it when my tax forms were sent to me here in the White House last year. I could not understand them. I wonder why the government has to have a tax system so complicated that people have to seek professional advice."

Earlier, CEA Chairman Feldstein had written favorably and at length about a consumption-income tax. But the Administration's specific tax legislation proposals for 1983 were limited to a plan for a "stand-by" tax, consisting of a 5 percent surcharge on income tax bills and a $5-per-barrel excise tax on oil, to take effect in the year starting October 1, 1985, if Federal deficits appeared unacceptably high and if Congress had met Reagan spending restraints.

The initial reaction in Congress was hostile to the notion of any kind of contingency tax, primarily because of the uncertainty it would introduce into the already complex equations of tax planning. By contrast, the idea of a consumption-based income tax seemed to intrigue Capitol Hill, at least as a topic for serious study and long-range consideration.
Arguments For ... And Against

One big hurdle for the consumed-income tax is its name. Politicians fear that voters are so unfamiliar with the terms and concepts of a "consumption tax" that they will tune it out and automatically reject the idea before learning much about it.

That problem may be overcome in time, through an educational national debate on the pros and cons of this type of taxation. Such a debate is already underway among tax authorities in and out of government. One key issue is the extent to which a consumed-income tax would be too regressive (hitting hardest on those least able to pay). Another issue is whether the amount of income a person gets is the best measure of ability to pay, rather than the amount of income spent by that person.

On the "too regressive" issue, Tax Foundation analysts note that a consumed-income tax can be as progressive as the present income tax, by making its rates go up as the amount of consumption (expenditure) rises; that many state sales taxes in the United States exempt certain products and services such as rents, food, and medicine, to ease their impact on low-income families; and that European value-added taxes, another form of consumption taxation, apply higher rates to luxuries, lower rates to necessities.

On the "measure of ability to pay" issue, economists' opinions vary greatly and arguments get highly technical. Here's a sampling of the points made by various tax thinkers in recent months —

Former Congressman Al Ullman, Chairman of the House Ways and Means Committee, 1975-80, told a Tax Foundation Conference in New York City last December: "After years of struggling with an eroding tax system, it is my judgment that balanced growth in our economy cannot be achieved without a new revenue system that produces adequate revenue to pay for government and also turns around the incentives — toward savings, investment, work and productivity. But that can be achieved only by a shift away from the income side toward the products and consumption side. The rational application would be on transactions — the buying and selling of goods and services. To avoid pyramiding it should be applied on the basis of added value, at each step in the production and distribution process."

Richard Goode, former Director of Fiscal Affairs, International Monetary Fund, criticized the consumption tax at a Washington conference last January, concluding that "a more comprehensive income tax, with lower nominal rates,
is a far more attractive route to tax reform than pursuit of either a flat-rate tax on income or an expenditure tax.*

Norman B. Ture, while he was Under Secretary of the Treasury for Tax and Economic Affairs, supported an expenditure tax in testimony before the Joint Economic Committee of Congress in 1981, declaring: "It is certainly true that the expenditure tax would shift tax liabilities between those who would and those who would not save, compared to the distribution of liabilities under present law. It is also highly likely that those few people in the upper end of the income scale save more of their income than those at the bottom. But this is a minor matter. Individuals at the bottom or lower end of the income scale can be substantially relieved of most tax liability under a really flat-rate expenditure tax by an adequate zero-rate bracket. Those at the top will reduce their tax liabilities only insofar as they continue to be big savers, with beneficial effects for the entire economy."

**Antidote for Keynesianism**

Martin Feldstein sees a consumption tax as an antidote for 50 years of misapplied "Keynesian fear of saving." In a major address on tax policy in Washington last January, the Reagan Administration's top economist noted that both the United States and Britain have been dominated for five decades by Keynes's theory that the depression of the 1930s was due to "inadequate spending or, equivalently, to excessive saving" — and this led to economic, monetary, and social policies favoring spending over saving.

In contrast, most of Europe and Japan, spurred by the urgent need to replace capital destroyed in World War II, adopted policies encouraging saving and investment. The result: The United States and Britain have had the lowest saving rates in the industrial world during the past two decades.

Feldstein believes, "All that began to change a few years ago. The Reagan Administration and many leading members of Congress in both parties have come to recognize that a permanently higher saving rate would be a good thing for the American economy." He cited the 1981 Tax Act and the growth of Individual Retirement Accounts as moves in the right direction, and noted that the Administration was considering "a major tax reform initiative" where "one of the approaches that we have been discussing is to move from the existing income tax to a tax on consumption...an approach that could guide decisions of a full-scale redesign of our tax system or of more modest piecemeal reform."
As part of its research for this study the Tax Foundation asked a few Washington-based tax authorities for their reaction to the 1983 revival of interest in the consumed-income taxation idea.

Senator Russell Long, (D-La.), ranking minority member of the Senate Finance Committee, responded as follows: "Since this type of tax could take many different forms, I would have to carefully examine a specific proposal before I could determine whether or not to support it. If the Administration were to come forth with a consumption tax proposal, I assure you that I would give it careful study."

Treasury Secretary Donald T. Regan's answer was given by Assistant Secretary Chapoton, in this statement to the Tax Foundation: "A tax system based on consumed income, rather than on all income earned, would eliminate the bias against saving in the current tax system and would allow considerable simplification of the tax system by eliminating the need for depreciation rules, rules for defining asset basis, and many other provisions required to measure the income from assets. However, a consumption tax may be regarded as inequitable by those who believe that accumulation of wealth itself confers tax-paying ability, even if the wealth is not spent. In addition, there would be difficult problems of transition in replacing the current tax system with a consumption base. As part of our continuing interest in improving the tax system, the Department of the Treasury is planning to study the issues involved in replacing the current tax base with a tax on consumed income. Since this review has not been completed, the Secretary is not able to provide an evaluation of the consumption tax idea at this time. However, we do believe that the consumed income concept has sufficient merit to warrant a careful study of the practicality of such a tax system."

While Chairman Paul A. Volcker of the Federal Reserve Board declined comment, Assistant to the Board Joseph R. Coyne said this: "I can appreciate your interest in obtaining a statement from the Chairman on this type of tax but it has long been his policy not to recommend specific tax programs to the Congress. He has made one exception in the current environment and that was to recommend some energy taxes as one way to promote conservation and help reduce the Federal deficit. Since we have no direct responsibility at the Federal Reserve for tax matters, it would be appropriate for the Chairman to 'pass' on this one."
An Ugly Duckling?

Even the most stalwart backer of the consumption tax idea has to admit that it is a confusing concept, compared with the straightforward populist appeal of the "sock it to the rich" income tax.

The name "consumption tax" would make a marketing expert turn pale. The fact that there are at least two other competing names meaning the same thing—"consumed income tax" and "expenditure tax"—adds to the fog and thus the difficulty of winning public acceptance for a complicated theory.

And yet, the consumption tax or an approximation of it may turn out to be an ugly duckling of tax theory that overcomes its handicaps and becomes, if not a swan, at least a useful influence in American tax policy of the future.

Its chance will come because a new and more efficient way of raising revenue is badly needed. The present crazy-quilt of taxes is full of holes and can't be stretched much further. Yet governments' demands for money are unlikely to be cut back, despite the wishes of millions of voters and gales of political promises for less spending. So there is a serious hunt underway for alternatives to higher income, property, and sales taxes.

Horace Busby, editor and publisher of "The Busby Papers"—periodic political analyses with a wide following in business circles—told a Tax Council luncheon in Washington on April 13 that he is convinced the days of the present income tax system are numbered, because it no longer fits the national economy and society. He recommended formation of a high-level commission, patterned after the commission that came up with the Social Security rescue plan, to explore alternative taxes including consumption taxation.

As debate over tax policy rises, some authorities are citing a fact of American history that has tended to be forgotten in this era of ever bigger government. That fact is that the United States did not adopt an income tax until 1913 (excluding a temporary levy adopted by the Union government during the Civil War). In its first 137 years—1776 to 1913—Federal revenues were mostly from customs duties, one of the oldest forms of a consumption tax.

A final point: The Tax Foundation hopes this report will be a contribution to public understanding of underlying tax issues facing the nation in the 1980s. Congress is once again focusing on short-term measures such as sharply higher energy taxes. But structural reform, embodied in the consumed-income tax, the value-added tax, and similar proposals, cannot be postponed forever.
A 5-Step “Personal Consumption” Tax

Step 1  Add up all the cash received in a year including wages; salary; tips; net business income (if self-employed); gifts and inheritances; rental income; interest and dividends; proceeds from the sale of stock and other assets; proceeds of loans used to purchase certain short-lived consumer goods and services such as vacation trips and recreation equipment, for example (excluding loans for buying a home and other lasting assets). The total is “Cash Receipts” for the year.

Step 2  Add up all savings for the year, including increases in checking and savings accounts and money market funds; payments on a home mortgage or for purchases of stock, rental real estate, and other assets; amounts invested in a farm or business; repayments on earlier borrowings. The total is “Savings” for the year.

Step 3  Subtract “Savings” from “Cash Receipts.” The result is “Total Consumption-Income” for the year.

Step 4  Subtract from “Consumption-Income” an allowance for personal exemptions, plus a basic living allowance, plus other deductions such as charitable contributions that would be part of any likely tax system. The result is “Taxable Consumption-Income.”

Step 5  Pay the tax on this “Taxable Consumption-Income,” at either a flat rate applying to everyone, or a progressive tax rate that increases as the amount of “Consumption-Income” rises.
# A CONSUMPTION TAX ANNUAL RETURN (Illustrative Example)

**CT Form 000**

## INDIVIDUAL CONSUMPTION TAX 1983

<table>
<thead>
<tr>
<th>First Name/Initial</th>
<th>Last Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>(if filing jointly, give spouse's name)</td>
<td></td>
</tr>
</tbody>
</table>

**Present Home Address**

<table>
<thead>
<tr>
<th>Street</th>
<th>City</th>
<th>State</th>
<th>Zip Code</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Social Security Numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yours</td>
</tr>
</tbody>
</table>

### 1. Filing Status (check one)
- a. Single
- b. Married filing jointly
- c. Unmarried head of household
- d. Married filing separately

### 2. Exemptions
- a. Self
- b. Spouse
- c. Number of dependent children
- d. Other dependents
- e. Total exemptions

### 3. Receipts
- a. Wages, salaries, tips of all wage earners in family (attach W-2s)
- b. Gross business receipts (if self-employed)
- c. Gross distributions from partnerships
- d. Distributions from pension funds, Social Security benefits
- e. Gifts and inheritances received
- f. Receipts from interest, dividends, and sale of any asset
- g. Alimony received
- h. Disability pay, unemployment pay, workmen's compensation, sick pay, public assistance (welfare) aid, food stamps, fellowships, other cash stipends
- i. Total Cash Receipts (3a-h inclusive)

### 4. Deductions
- a. Gross business expenses if self-employed
- b. Contributions to partnerships
- c. Contributions to trusts
- d. Addition to savings, including purchase of stocks, bonds, and other assets
- e. Other allowable deductions, as determined by law, such as taxes or charitable contributions
- f. Total Deductions (4a-e inclusive)

### 5. Computation of Tax
- a. Cash flow (consumption) subject to tax (subtract 4-f from 3-i)
- b. Personal exemptions
- c. Taxable cash flow (consumption-income) (subtract 5b from 5a)
- d. Tax liability (from table showing tax rates for different levels of consumption-income)
- e. Federal consumption-income tax withheld by employer(s)
- f. Payments of estimated tax in quarterly installments
- g. Total tax prepayments (5e plus 5f)
- h. If amount on line 5d is greater than 5g, enter BALANCE DUE
- i. If amount on line 5g is greater than 5d, enter REFUND DUE

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**Note:** Based in part on sample tax form for "cash flow tax" in Blueprints for Basic Tax Reform, U.S. Treasury Department, January 17, 1977.
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