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Among the many attractive proposals for reforming the federal tax structure, the Nunn-Domenici USA Tax is unique: it alone promotes economic growth and simplification without sacrificing fairness. While each analyst and taxpayer may give different weight to these and other values, it is instructive to analyze the alternatives in the light of a standard set of goals.

In carrying out this objective, this paper contains three sections: (1) a description of the USA Tax Plan, (2) an analysis of its effects in terms of growth, simplification, and fairness, and (3) a comparison with alternative reforms.

Highlights of the Nunn-Domenici Proposal

The Nunn-Domenici USA Tax Plan consists of two parts: a revised individual income tax and a new business tax. The latter replaces the existing corporate tax as well as the individual tax treatment of unincorporated businesses. The combined structure is designed to be "revenue neutral" in that it raises the same amount of revenue as the existing tax system. (This is so, at least initially, in its static form. In a dynamic sense, the future revenue flow is likely to be higher than what the current tax law generates because of the positive effects on the economy, as explained later.)

The Tax on Individuals and Families

The USA individual income tax is a progressive tax with an unlimited deduction for saving. The term USA refers to this latter feature as an "Unlimited Savings Allowance."

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Progressivity is achieved through a progressive rate table plus an enlarged zero bracket/family allowance and expanded use of earned income credits. Simplicity is attained by eliminating a great variety of special treatments to certain transactions and taxpayers.

In contrast to the current individual income tax, the USA version possesses the following characteristics:

- It permits a full and unlimited deferral on the portion of income that is saved. The tax is paid only when the principal and earnings are withdrawn from savings and devoted to consumption.
- It treats all income equally for tax purposes. The distinction drawn is not on the source of income, but between the portion consumed and the part saved.
- It allows wage earners a full credit for the 7.65 percent FICA payroll tax (the employee portion of the social security and medicare taxes).
- It exempts from taxation the consumption out of previously taxed savings (these funds have already been included in taxable income). Thus, a retiree who is drawing down previously taxed savings, accumulated prior to the USA Tax Plan, can draw down and live on that savings tax free.

In addition, individuals with less than $50,000 of previously taxed savings can elect to deduct these amounts against taxable income. This special, transitional deduction is allowed in equal parts over three years.

A fuller view of the revised individual income tax can be gained by showing how the tax is calculated. The following four steps contain the essence of the plan:

Step 1. Calculate Gross Income

Gross income is the sum of wages and salaries plus financial income such as interest, dividends, and amounts received from sales of stocks, bonds, and other assets. This step is similar to the current procedure.

Step 2. Subtract Deductions

Step 2A. Deduct Exemptions

First deduct a family allowance, which ranges from $4,400 for a single individual to $7,400 for a married couple filing jointly. Second, deduct $2,550 each for the taxpayer, spouse, and each dependent. Conceptually, this is similar to the current procedure. In practice, the deductions are more generous. For a family of four, the total exemption comes to $17,600.

Step 2B. Subtract Unlimited Savings Allowance

Deduct the total amount of income saved during the year. Include deposits in savings accounts, purchases of stocks and bonds, and start-up capital contributed to one's own small business. This step, in effect, constitutes the creation of a universal and unlimited Individual Retirement Account, without the current paperwork and restrictions.

Step 2C. Subtract Higher Education Deduction

Deduct up to $2,000 each for the taxpayer, the spouse, and up to two dependents for college tuition and similar vocational education. The deduction is also allowed for remedial education of students under 18 years of age. This is an extremely innovative reform, acknowledging the importance of investments in "human capital."

Step 2D. Subtract Three Existing Deductions

Continue to deduct home mortgage interest, charitable contributions, and alimony paid. All other current deductions are eliminated, including state and local taxes.

Step 3. Calculate Initial Tax Liability

After making all the subtractions allowed from gross income to compute taxable income, the taxpayer applies a new rate table (see Table 1) to compute the initial liability. The rates are designed to maintain roughly the same tax burden in each income class as is imposed by the current system. Within each class, however, the high savers experience a lower tax and the low savers a higher tax.

Table 1

**Initial Federal Individual Income Tax Schedule
Under Nunn-Domenici**

Taxable Income — Single	*Federal Tax Rate*
$0-$3,200	19%
$3,200-$4,400	27%
$14,400 and over	40%
Taxable Income — Head of Household	
$0-$4,750	19%
$4,750-$21,100	27%
$21,100 and over	40%
Taxable Income — Married	
0-$5,400	19%
$5,400-$24,000	27%
$24,000 and over	40%

Note: In three subsequent years, the rates for the first two brackets are reduced to cover the transition from the current tax on saving plus consumption to the new tax base on consumption alone.

Step 4. Calculate Net Tax Liability

Finally, the total amount of social security and medicare tax paid on wages and salaries (subject to a cap) is deducted from the initial tax liability to compute the taxpayer's net tax liability, the amount owed to the Treasury. This last deduction eliminates the most regressive feature of the existing federal revenue system. If the social security and medicare tax exceeds the initial income tax liability, the excess will be refunded to the taxpayer. So will the Earned Income Tax Credit for the working poor, which is maintained and expanded.

The Tax on Businesses

In the Nunn-Domenici USA Tax Plan, all businesses, whether incorporated or not, are taxed at the same flat rate of 11 percent on their annual gross profit. There is no tax advantage from shifting to or from the corporate form or any special version (such as subchapter S corporations).

In calculating its gross profit, a business starts with its total revenues from the sale of goods and services in the United States. It then subtracts the amount paid to other firms for the goods and services bought from them, including plant and equipment as well as inventory, parts, supplies, outside services, and utilities (see Table 2).

Immediate expensing of all investments in capital equipment is a tremendous simplification compared to the current system, and it also encourages investment in durable business assets. Coupled with the new saving incentive contained in the individual income tax, the result is a substantial boost to the entire capital formation process.

Financial transactions are excluded from the calculation of gross profits. The business neither includes interest and dividends received nor deducts interest and dividends paid. Furthermore, compensation of employees is not deductible from sales revenues. However, a credit is allowed for the 7.65 percent employer FICA payroll tax that businesses must pay on the wages paid to employees.

This new type of cash-flow tax on gross profits is superficially similar to a VAT: both use a tax base of sales minus purchases. However, the business cash-flow tax differs from the VAT in several important respects. First, the tax is intended as a replacement of the corporate income tax, not as an additional sales tax. Second, the cash-flow tax lacks the administrative complexities of a VAT, which requires firms to track on an invoice-to-invoice basis the amount of tax attributable to each transaction.

Indeed, the Nunn-Domenici cash-flow tax drastically simplifies the current business tax structure. Firms will devote fewer resources to complying with tax regulations (and to devising creative methods to minimize their tax burden), and more resources to productivity increasing

Table 2

Calculating the Business Tax Under Nunn-Domenici

	Gross Revenues from Sales of Goods and Services
-	Export Sales
=	Sales in the United States
-	Cost of Equipment and Services (purchased from other businesses)
-	Cost of Inventory
=	Taxable Gross Receipts
x	Tax Rate of 11%
=	Gross Tax Bill
-	7.65% Payroll Tax Paid
=	Tax Liability

investment. For example, the Nunn-Domenici business tax eliminates bizarre, complicated tax provisions such as the "amortization of intangible expenditures," a procedure that depreciates purchases of patents, licenses, and other intangibles. Such complicated law contributes to the high costs of tax compliance: the Tax Foundation estimates that business tax compliance costs in 1990 totaled $112 billion, a sum nearly equal to 75 percent of federal corporate income tax collections. The simplifications would particularly aid small business.

The USA Tax Plan also introduces a new tax treatment of international trade. Amounts received from exports (sales of goods and services to a purchaser outside the United States) are excluded from the calculation of gross profit. Correspondingly, a special 11 percent import tax is imposed on the sale in the United States of goods and services from abroad. Thus, a foreign business that manufactures outside the United States but sells its products in the U.S. market will pay the 11 percent tax.

In tax parlance, the USA business tax is territorial. Businesses do not include in gross profits the proceeds from sales made or services provided outside the United States and they cannot subtract amounts paid for the purchase of goods or the provision of services outside the United States. Nor will businesses be taxed on dividends paid by foreign subsidiaries. Foreign businesses include in reportable gross profit only the amounts they receive for goods and services provided in the United States.

Table 3 compares the key elements of the new business tax with the existing corporate income tax.

Analysis of Impacts

Encouraging Saving and Investment

A major objective in designing the Nunn-Domenici USA Tax is to reduce the tax burden on saving and investment. The intent is to encourage a higher rate of capital formation. This, in turn, will lead to a more rapidly growing economy and an improved standard of living for the American people.

In addition, public finance economists over the years have offered several basic justifications for shifting the primary base of taxation from income to consumption in an effort to achieve greater equity as well as economic efficiency. Consumption-based taxes put the fiscal burden on what people take from society — the goods and services they consume — rather than on what they contribute by working and saving, as do income taxes. Thus, under a consumption-based tax system, saving — and long-term investment — is encouraged at the expense of current consumption. Over a period of time, society is likely to achieve higher levels of both saving and consumption because the added investment, by generating a faster growing economy, will lead to a bigger income "pie" to be divided among the various participants in economic activity.

Table 3

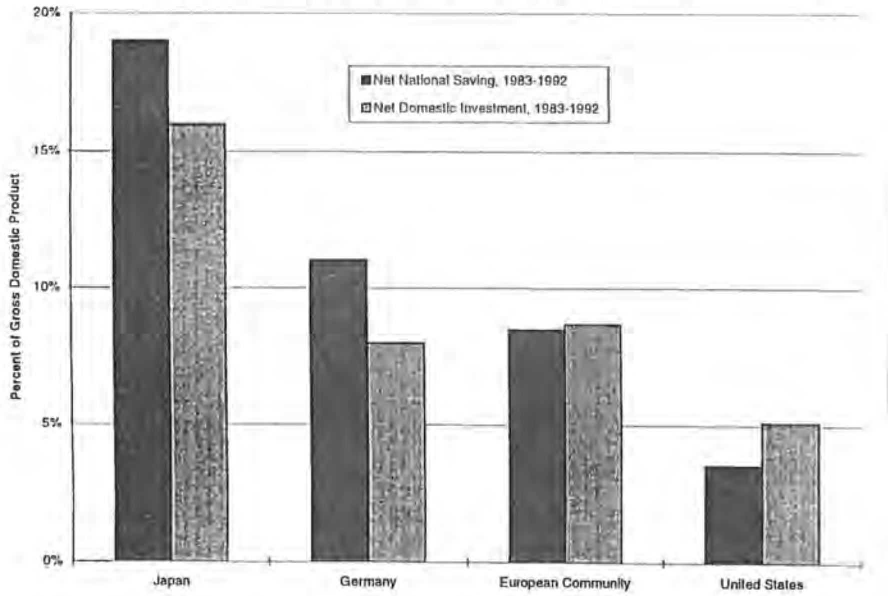
Comparison of USA Business Tax With Existing Corporate Income Tax

Item	USA Business Tax	Current Corporate Income Tax
Rate	11%	35%
Cost of Plant and Equipment	Expensed	Depreciated Over Years
Export Sales	Excluded; Not Taxed	Generally Included and Taxed
Directly Competing in Foreign Markets	Not Taxed	Taxed
Dividends Paid for Services of Capital	Not Deducted	Not Deducted
Interest Paid for Services of Debt Capital	Not Deducted	Deducted
Wages and Salaries Paid for Services of Employees	Not Deducted	Deducted
Employer Payroll Tax on Wages Paid	Yes	Yes
Credit for Employer Payroll Tax on Wages Paid for Services of Employees	Full Credit Allowed	No Credit

This argument becomes more compelling when we examine the historical record. The data convincingly show that the United States consistently devotes a smaller fraction of its national output to saving and investment than do the other major industrial nations (see Figure 1). In addition, the correlation between the investment share of gross domestic product and the growth rate of the national economy is striking and positive. The skeptic is referred to Figure 2 which shows the close relationship between these two key economic variables for the major

Figure 1

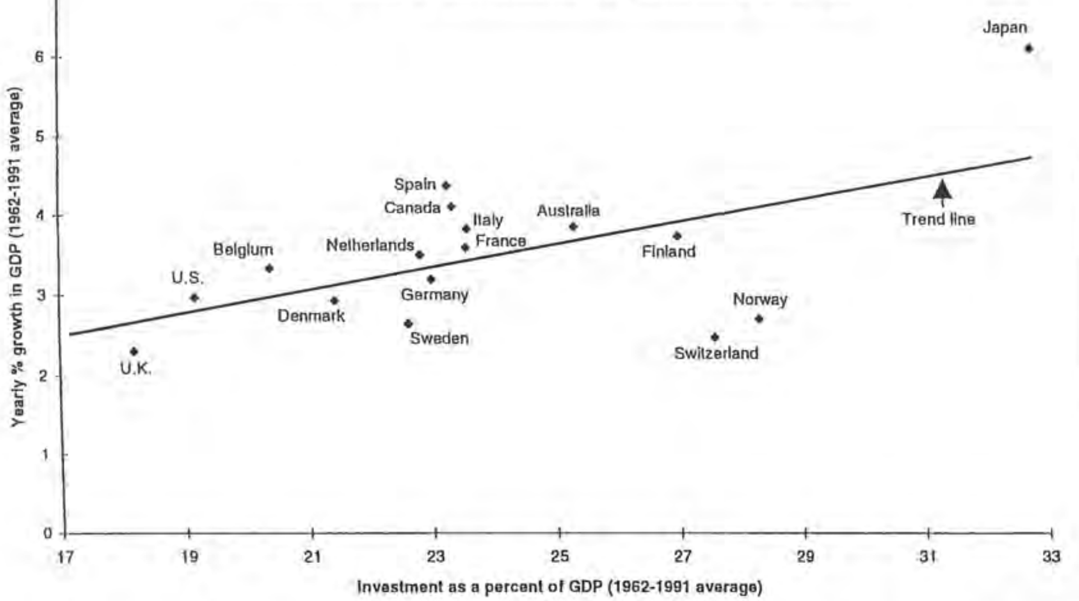
International Comparisons of Saving and Investment



Source: Bipartisan Commission on Entitlement and Tax Reform, Interim Report to the President, August 1994.

Figure 2

Relationship of Investment to Economic Growth



Source: International Monetary Fund, *International Financial Statistics Yearbook*, 1993. The trend was obtained by performing an ordinary least squares regression of GDP on investment. The slope coefficient of 0.14 is significant at the 5 percent level.

member nations of the Organization for Economic Cooperation and Development (OECD) over the past three decades.

The Nunn-Domenici tax plan responds to this situation directly. Under this reform, individual and family taxpayers (who do the great bulk of net saving) deduct *all* of their saving from their income in deriving their tax base.

Under this approach, the basic way for taxpayers to reduce their tax liability — legally — is for individuals and families to save more and for companies to invest more. In contrast, to minimize tax liability under the existing tax system, taxpayers have to earn less, reducing the incentives to work, save, and invest. By increasing the amounts saved and invested, the proposed tax system augments the forces that create the formation of capital. Moreover, there is considerable support in economic theory for the proposition that a consumption-based measure may better reflect the lifetime ability of households to pay taxes than a measure based on annual income.

It is useful to note what is absent from the Nunn-Domenici proposal. It does not select any specific sector of the economy to receive especially favorable tax treatment through traditional loopholes nor does it discourage any category of activity through tax penalties. Thus, the proposed tax code is far more neutral than the present system or any other in modern times. An added benefit is the simplicity of the resultant tax system, a subject dealt with in the following section.

This paper does not include any computations of the precise statistical effects that the enactment of Nunn-Domenici will have on the U.S. economy. That is a task best left to econometricians who can examine the details in the light of their macroeconomic models. Yet, there is no need to yield too much on that score. Surely, the direction of change is favorable. Eliminating the federal tax burden on saving encourages the formation of a larger pool of potential investment capital. Reducing the tax burden on investment likewise encourages the investment of that pool of saving.

The result, under most reasonable circumstances, is a faster rate of economic growth with an accompanying rise in employment and living standards. That highly desirable outcome, in turn, generates two favorable budgetary consequences. First, it enlarges the tax base without any change in the tax groundrules. This creates a faster flow of revenue into the Treasury reducing the government's need to borrow. Likewise, a stronger economy means lower payments for unemployment benefits, welfare, and other transfer payments. The process just described is the most painless way of bringing down those continually high budget deficits.

Promoting Simplification

Economist — and tax reform skeptic — Robert Eisner of Northwestern University has provided the appropriate introduction to the subject of tax simplification:

> I am happy to stipulate that we waste many, many billions of person-hours and hundreds of billions of dollars in administering, complying with and seeking to avoid or evade current income taxes.

Empirical studies provide statistical support for Eisner's sweeping statement. The current individual tax code alone is estimated to cost taxpayers $50 billion in compliance costs. We may never again achieve the level of simplicity offered by the original 1913 income tax. Its 1040 form was three pages long and accompanied by one page of instructions. It was filed by only one percent of the population. In this spirit, the Nunn-Domenici plan eliminates about four-fifths of the current income tax provisions in the Internal Revenue Code. The resultant simplification of the federal tax system would be evident in many ways. The several thousands of pages of the tax code would be reduced to approximately three hundred.

By making saving generally deductible from gross income, there is no need for the paperwork and other overhead expenses now required to establish and maintain IRAs, Keoghs, SEPs, and other "tax favored" accounts. Nor need the taxpayer be concerned with staying within the arbitrary limits now required under these specialized savings incentives. Moreover, consumption-type taxes do not require complicated corrections for inflation because the tax base is inherently based on current cash flows.

Similarly, by expensing all real investment, the taxpayer no longer has to estimate the useful life of assets nor choose from an array of complicated depreciation systems. Also, there is little incentive to fuss with the conversion of ordinary income into capital gains because only the income actually consumed winds up in the tax base. Tax is deferred on capital gains, dividends, interest, and other forms of income that remain in the pool of savings.

Because all businesses — whether they are incorporated or not — are subject to one and the same tax system — there is no longer any incentive to go through the expense and bother of repeatedly changing the legal form of the enterprise merely to take advantage of shifting differentials between individual and corporate income taxes.

Likewise, because interest and dividends are subject to the same tax treatment, there is no longer any tax incentive to leverage a company's financial structure or to convert dividend payments into interest payments. The result will not be an end to the current merger and acquisition boom. Rather, business decisionmakers will make such choices on the basis of underlying economic advantage rather than responding to tax considerations.

However, this report does not deal with the many transitional effects that result whenever any major change is made in the tax system. A common example is the effects on the value of assets purchased under the assumption that they will be subject to the "old" tax system. Dealing with these important but usually limited concerns almost invariably requires some significant but usually temporary movement away from simplification.

Maintaining Fairness

The fairness of a tax system, like beauty, is mainly in the eye of the beholder. Economists tend to view the subject in terms of horizontal equity and vertical equity. Horizontal equity is simply our jargon for "equal treatment of equals." The idea is that taxpayers with similar incomes should generally pay the same tax. Inevitably, qualifications are added when dealing with taxpayers in special circumstances. This, of course, opens the door to the introduction of all sorts of loopholes into the revenue structure.

The Nunn-Domenici USA Tax Plan moves to greater horizontal equity in many ways. For individual and family taxpayers, virtually all types of income are treated the same. Likewise, virtually all forms of saving are treated identically. This is even more apparent in the case of businesses, where all enterprises — corporations, partnerships, and individual proprietorships — become subject to a single tax system. Likewise, virtually all capital investment is treated equally, as is the return on financial investment (e.g., interest versus dividends).

As for vertical equity, a progressive rate structure is usually — but not universally — chosen as the appropriate instrument for achieving this aspect of fairness. Some fairly esoteric assumptions underlie the proposition that it is fair for taxpayers with higher incomes to pay a higher *percentage* of their income than do those with lower incomes. A considerable literature is devoted to such questions as the diminishing marginal utility of income as the individual ascends the income scale and the difficulties in making interpersonal utility comparisons.

A significant number of public finance specialists, however, has concluded that the case for a progressive income tax structure is questionable or "uneasy." That line of reasoning supports a proportional tax system, whereby the government assesses all taxpayers the same percentage of their income. To my knowledge, there is no professional support for the adoption of a regressive tax structure — whereby the upper brackets pay a smaller percentage than the lower brackets. If the case for progressive taxation is "uneasy," surely the case against regressive taxation remains "easy." In practice, of course, there are taxes that are regressive in terms of their effects.

As for the Nunn-Domenici proposals, the rate structure is clearly progressive. As noted earlier, the USA Tax Plan contains three rates — 19 percent, 27 percent, and 40 percent. The designers of the Plan have calculated the change in tax burdens by income class from the current tax structure. As can be seen in Table 4, the tax liability declines substantially for the

Table 4

Comparison of Nunn-Domenici With the Status Quo (Estimated Change in the Federal Income Tax Burden)

Family Income Class (dollars)	Percent Change in Tax Liability
0-10,000	-75%
10,000-20,000	-9
20,000-30,000	-14
30,000-50,000	-5
50,000-75,000	-
75,000-100,000	-
100,000-200,000	+3
Over 200,000	+4

lowest income group, is stable for the middle of the income distribution, and rises somewhat for the top brackets. The calculations underlying the table are based on the concept of "expanded family income." This notion is broader than the measure used by the Internal Revenue Service. For example, it includes transfer payments.

Comparison of Alternatives

The Nunn-Domenici USA Tax Plan is one of an array of proposed reforms of the U.S. Internal Revenue Code currently under serious consideration. How does the USA Tax Plan compare with those other tax proposals? The most popular alternative is Representative Dick Armey's flat tax, which is based on the scholarly work of Robert Hall and Alvin Rabushka of Stanford University's Hoover Institution (referred to here as Armey H/R). Other proposals under serious consideration include a national retail sales tax and a value-added tax (VAT).

Nunn-Domenici and Armey-Hall/Rabushka

Although it is fashionable to focus on the important differences between Nunn-Domenici and Armey/HR, the careful reader is struck by their basic similarities. Both proposals promote economic growth by putting more of the tax burden on consumption, and lightening it on saving and investment. Both simplify the tax system very substantially. Neither requires an additional record-keeping apparatus or enforcement system because neither creates a new tax. Moreover, by avoiding the form of a sales tax or VAT, neither is regressive or inflationary. Thus, it is not difficult to conclude that either would be a very substantial improvement over the status quo.

There is a problem, however, with attempting to label the flat tax a progressive consumption tax, as do Hall and Rabushka. First of all, judging by Congressman Armey's version, the base of the flat tax is not consumption, but wage and salary income — not all of which is consumed. Furthermore, the presence of a zero rate is not persuasive in addressing equity concerns. That common characteristic of all income taxes does not provide the graduation or progression from lower to higher rates that is the essence of a progressive structure.

Table 5 is a crude attempt to compare the progressivity of different federal income tax structures. The ratios are based on the formal rate tables and do not take account of the many special provisions imbedded in the Internal Revenue Code (the public finance literature contains more sophisticated measures requiring information not available to the author).

It can be seen that most of the move from a highly progressive rate structure to a flat tax already has occurred. For example, in 1980, the top rate of 70 percent was exactly five times as high as the bottom rate of 14 percent, indicating a rather progressive tax structure. By 1985, as a result of the enactment of the initial Reagan tax program, the ratio of the top rate to the bottom rate had declined very modestly from 5.0 to 4.5. Following subsequent tax reform, by 1987 the ratio was down to 3.5 and by 1994 it fell to 2.6.

Table 5

Comparison of Federal Income Tax Rate Structures

Year or Proposal	Top Rate	Bottom Rate	Ratio of Top Rate to Bottom Rate
1980 (pre-Reagan)	70%	14%	5.0
1985 (mid-Reagan)	50%	11%	4.5
1987 (late Reagan)	38.5%	11%	3.5
1994 (current)	39.6%	15%	2.6
Nunn-Domenici	40%	19%	2.1
Armey H/R	19%	19%	1.0

Under Nunn-Domenici, this rough measurement of tax progressivity drops further to 2.1. In comparison, the ratio under the flat tax is 1.0, indicating a truly proportional tax structure for all income above the baseline deduction.

Sales Taxes and the VAT

Sales taxes and value-added taxes (VAT) represent a very different approach to raising revenue than Nunn-Domenici or Armey/HR. While the latter two proposals reform and simplify the existing income tax system, a national sales tax or VAT require a new and very different form of revenue collection at the federal level.

The basis of income taxes paid by individuals and organizations is an annual return which lists a variety of financial data and facilitates computations of tax liability. Sales taxes and VATs, in contrast, are levied on the value of individual purchases of goods and services. As a result, both a national sales tax and a value-added tax would require a new record-keeping apparatus for business and a new collection system for government.

Furthermore, because both the retail sales tax and the VAT are levied on individual transactions and, hence, included in the price of the good or service, the introduction of either one would trigger an upward movement in the consumer price index and other measures of inflation. So does any future increase in the rates of either tax. Secondary inflationary effects would result from the operation of escalator clauses in wage and supply agreements.

Sales taxes and VATs also alter the tax burden of varying income classes, raising equity concerns (Table 6 outlines the impacts of various tax plans for a typical middle class family). Because consumption is a declining function of income (as people's income rises, they devote smaller proportions to consumption), both proportional rate sales taxes and VATs are inherently regressive. Efforts to soften this regressivity require all sorts of complicated adjustments and may provide unintended loopholes to some taxpayers. For example, the common practice of exempting food, clothing, and medicine provides a windfall to many upper income groups. Such exceptions also require that a higher rate be levied on the remaining tax base, introducing further distortions in consumer purchasing patterns.

There are important differences, of course, between general sales taxes and value-added taxes. Essentially, they involve a trade-off between simplicity (favoring the sales tax) and economic efficiency (favoring the VAT).

Perhaps of greatest impact substantively is the concern that enactment of either a national sales tax or a VAT would promote the expansion of the public sector. That is likely to occur as a result of giving the federal government an additional revenue source. Assurance to the contrary — that the new tax would merely replace a portion of the income tax — is not comforting. Based on historical experience, pressure would rise over the years to push up the rates of both the income tax and the sales tax (or VAT).

The proponents of a VAT point to its widespread use overseas. However, unlike current proposals in the United States, the adoption of a tax on value-added was true structural reform in Western Europe. The VAT typically replaced an extremely inefficient form of consumption tax that was already in place, a cascading sales or turnover revenue system.

Table 6

Tax Consequences of the Alternative Reform Proposals for the Jones Family

Current Law, 1994		*Armey Flat Tax*		*USA Tax System*		*National Retail Sales Tax*	
Income:		**Income:**		**Income:**		**Income:**	
Wage and Salary	$47,066	Wage and Salary	$47,066	Wage and Salary	$47,066	Wage and Salary	$47,066
Interest	67			Interest	67	Interest	67
Capital Gains	(1,960)			Capital Gains	*a*	Capital Gains	(1,960)
Dividends	303			Dividends	303	Dividends	303
Gross Income	45,476			Gross Income	47,436	Gross Income	45,476
Less:		**Less:**		**Less:**		**Less:**	
Standard Deduction	6,350	Personal Allowances	26,200	Family Allowance	7,400	Payroll Taxes	3,630
Exemptions	7,350	Dependent Exemption	5,300	Exemptions	7,650	Property Tax	698
Taxable Income:	31,776	**Taxable Income:**	15,566	Previously Taxed Savings[a]	653	Mortgage Interest	4,250
				Mortgage Interest	4,250	Charity	240
Tax (15% bracket)	5,736	**Tax Liability (19% rate)**	**$2,958**	Charity	240	Saving	3,600
Child Care Credit	480			Savings Allowance	3,600	Other Government Fees	150
				Taxable Income:	23,643	Estimated Nontaxable "Expenditures"	12,568
Tax Liability	**$4,286**						
				Tax (19% on first $5,400); 27% on Difference)	5,952	Estimated Taxable Expenditures[b]	32,908
				Refundable Credit for Payroll Tax	3,630	**Tax Liability (17% rate)**	**$5,594**
				Tax Liability	**$2,322**		

[a]Most taxpayers will be able to amortize over a three-year period previously taxed basis of savings assets acquired prior to the USA Tax. The $653 (one-third of $1,960) previously tax savings deduction assumes that the Jones family had a previously taxed savings basis of $1,960 — the value of their capital losses for the year. Since the Jones family appears to have a history of saving, its deduction for previously taxed savings is probably understated.

[b]Assumes the broadest possible tax base. No goods and services are excluded.

Source: Tax Foundation; author

Those latter taxes applied to the total amount of a firm's sales rather than only to its value-added. Thus, sales taxes were paid over and over again on the same items as they move from firm to firm in the various stages of the production and distribution process, from raw material supplier to manufacturer to wholesaler to retailer to final customer. Such cascade-type taxes favored integrated firms, that could legally avoid one or more stages of the tax. However, they severely discriminated against independent companies, each of which operated at only one phase of the production process.

Despite these advantages over a national sales tax, the collection of the VAT is not simple. Exemptions are no minor matter in terms of the administrative complexity that they generate. In France, a long and extensive debate occurred over whether or not Head and Shoulders anti-dandruff shampoo was a tax-exempt medicine or a cosmetic subject to the full VAT.

Conclusion

Among the different approaches to fundamental tax reform currently under consideration, the Nunn-Domenici USA Tax is the most attractive because its structure provides the most favorable combination of simplification, economic incentive, and fairness.

The Armey H/R Tax provides a greater degree of simplification at the expense of some loss of fairness (as measured by progressivity or vertical equity). In their fundamentals, Nunn-Domenici and Armey are closely related because both soften the current progressive nature of the federal income tax, promote capital formation and economic growth, and move toward greater simplification of the tax system.

In contrast, value-added or sales taxes generate a new array of problems, ranging from increasing inflation to new paperwork requirements to a regressive tax structure.

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