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Federal Tax Reform
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COMMENTS

06-10-05 - Martin B. Tittle from Michigan

Subject: Argument against Prof. Michael Graetz's Proposal

Comments: On May 11, Professor Michael Graetz of the Yale Law School told the Advisory Panel that his proposed income/value-added tax plan would "avoid the difficult issues of transition to an entirely new system that have haunted other proposals to move completely away from the income tax." That is just not true; at least, not unless the United States intends to double-tax the current after-tax savings of all Americans, including the amounts in their Roth IRA accounts.

Those savings have been fully taxed under the current system, and yet if Prof. Graetz's plan were adopted, they would be taxed a second time by the federal value-added tax when they were spent. Former Federal Reserve Board member H. Robert Heller noted this kind of double-taxation as a problem with the proposed FairTax in a March 16 letter to the Wall Street Journal. It is no less a problem with Prof. Graetz's proposal.

Avoiding double-taxation would require some kind of transition regime -- for instance, a system of capital reporting that establishes the level of pre-consumption-tax capital for each taxpayer and then allows refunds for consumption taxes that are properly allocated to pre-enactment capital.

Implementing any transition system would necessarily make the tax system more complex, at least for a time. However, without some form of transition relief, Prof. Graetz's proposal would unfairly penalize all Americans who have after-tax savings, and that is simply too high a price to pay for any advantages his plan offers.