Overview: Issues in Tax Policy

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Overview: Issues In Tax Policy

Introduction

Borris I. Bittker*

If there was any doubt before, the Yale Law and Policy Review has made it official: 1985 is the Year of Tax Reform. If only one word of the Internal Revenue Code is blotted out for every journalistic appeal for legislative action, we will not only be able to file our tax returns on postal cards, but there will be room left over to decorate the margins with an illuminated version of the renovated Code. If, on the other hand, Congress is inspired by the journalists to add so much as one new word for every thousand of theirs, we will assuredly yearn for the Code of yesteryear.

I am no political prophet, but I foresee neither an earthly Heaven, nor an earthly Hell. I suggest instead that every careful analysis of the flat tax movement, like Professor Graetz’s and Ms. McDowell’s, increases the odds that whatever may be enacted will bear little resemblance to the proposals now on the table. Their sponsors, however, will be entitled to credit for having gotten the ball rolling, and even if they don’t like the outcome and hence spurn the credit, they will have achieved a secondary gain. As Graetz and McDowell note, "the most important development to date [of the flat tax movement] is the bipartisan rejection of a consumption tax as a replacement for the income tax." It is no mean achievement for one unenacted bill to bury another.

Senator Bradley and Congressman Gephardt present, in succinct and lucid form, the case for their Fair Tax—designed to “fundamen-

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tally restructure our income tax, to make it fairer, simpler, less economically distorting, and more conducive to work and productive investment.” This statement of their objectives would probably be endorsed by the sponsors of the many other flat tax proposals; but, as shown by a Treasury comparison of the 6 leading proposals (Bradley-Gephart, Kemp-Kasten, Treasury, and three others), there are numerous differences in detail among them. On running through the Treasury's summary of the treatment accorded by each of the six to 144 provisions of existing law, I found unanimity on only 3 proposed changes.

To be sure, many of the differences can be described as minor, at least by an outsider, to whom each bill looks more like a laundry list than an aesthetically integrated collage; but I am far from confident that their authors would agree with this assessment, or that they readily coalesce on a single compromise proposal. As their article indicates, Senator Bradley and Congressman Gephardt have given serious attention to each of the changes they propose, and while they do not assert that their bill is carved in stone, neither do they suggest that it is as malleable as a floppy disc. But unless the flat tax movement's intramural differences can be reconciled, it is not likely to make much headway in an outside world that is full of skeptics and enemies.

As Mr. Rosow's contribution to this symposium indicates, critics of the flat tax movement are not all lovers of the status quo. Rosow denounces today's income tax as vigorously as anyone, but he is equally repelled by the Treasury's reform proposals because they "replace one set of subsidies, preferences and political biases with another." Although this verdict applies explicitly only to the Treasury's modified flat tax, Rosow's strictures would evidently apply with substantially equal force to most if not all of the other products of the flat tax movement.

II

Professor Graetz and Ms. McDowell argue that the features of today's income tax that are most in need of restructuring are (1) its special exclusions, deductions, deferrals and credits — enacted "to encourage particular economic activities or to benefit particular categories of taxpayers" (so-called tax expenditures); (2) its failure to respond adequately to the impact of inflation on the measurement of income; (3) the lack of a coherent relationship between the corporate and individual income taxes, and the desuetude of the corpo-
rate tax as a result of excessively generous depreciation deductions and investment credits; (4) the Code’s sluggish response to sophisticated tax shelters and other tax arbitrage schemes; and (5) the low level of enforcement. If I read them right, Graetz & McDowell credit the flat tax movement with good intentions with respect to all five of their criteria for tax reform, but conclude that the proposals as a group grapple effectively with only the first of the five.

If I were not acting as the impartial chairman of this symposium, I would want to add three questions about the flat tax movement’s announced objective of achieving “economic neutrality” for the income tax by purging it of provisions that interfere with the economic choices that taxpayers would make if they lived in a “tax-free world.” First, if the legislative decision to tax income rather than consumption or some other event is itself based on judgments about such controversial social and economic values (e.g., distributive justice and encouragement of entrepreneurial initiative), is it realistic to think that the chosen fiscal instrument can be kept free, at the operational level, of more judgments of the same type, whether intended to strengthen or restrain the tax on its appointed rounds? Second, if the income tax inevitably falls more heavily on some events than on others (e.g., on labor but not on leisure), do provisions mitigating this tendency (e.g., deductions for contributions to pension plans) undermine—or contribute to—“economic neutrality”? Finally, if economic neutrality is fostered by imposing the same burden on all taxpayers who are “similarly situated,” should the sources of their incomes and their expenditures be disregarded, or instead be taken into account? For example, is a taxpayer with an annual salary of $20,000 “similarly situated” vis-a-vis a taxpayer receiving $20,000 from a trust fund or a portfolio of marketable securities? Are two employees “similarly situated” if their salaries and family responsibilities are identical, but one spends $5,000 on doctors’ bills or to replace a car wrecked in a collision? Mindful of my assigned role, I am of course scrupulously neutral, and hence I refrain from answering these questions, leaving them instead to the reader. If by any rhetorical slip of my pen, my questions seem to lead the witness, I beg to be forgiven.

III

At first blush, one might think that Professor Stephan’s analysis of the right of nontaxpayers to litigate the income tax obligations of their fellow citizens would be rendered moot by the enactment of a
flat tax. The leading flat tax proposals, however, leave many areas of the tax law virtually untouched—for example, the non-recognition rules, the relationship between shareholders and corporations, the status of nonprofit organizations, and the assignment of income doctrine. This means that there will be plenty of room for nontaxpayer litigation, if allowed by the courts, even if the Code is radically reformed. If we add to these residual sources of litigation the grandfather and transitional clauses that would almost certainly be included in any flat tax that was actually enacted—and that might be almost as numerous as the repealed old provisions—the issue of nontaxpayer litigation would remain on the judicial agenda even if the most utopian of the flat tax movement's aspirations were realized. By itself, the extension of *jus tertii* standing to income taxation is quite appealing: we are hurt if our fellow citizens don't file proper Forms 1040, since what they don't pay, we must—in future taxes, in interest on the national debt, or in lost federal benefits. But, as Stephan urges, the subject warrants closer attention; and this will be true whether Congress chooses to enact a flat tax or to stick with the status quo. It would be ironic if any gains achieved by simplifying the Code's substantive provisions applicable to *taxpayers* were outweighed by administrative complexities and delays resulting from an avalanche of *nontaxpayer* litigation.