A "COMPREHENSIVE TAX BASE" AS A GOAL OF INCOME TAX REFORM

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Taking issue with those who contend that the income on which taxes are paid should be the same as what an economist would consider "net income," Professor Bittker urges that a neutral, scientific measure of taxable income is a mirage. In many of the vexed areas of income definition, the concept of economic income yields no help; in others, it implies results from which even its proponents would recoil. There is no touchstone for tax reform: proposals must be considered provision by provision and policy by policy, on their particular merits.

SINCE World War II, our ablest commentators on federal income taxation have repeatedly attacked the "exceptions," "preferences," "loopholes," and "leakages" in the income tax provisions of the Internal Revenue Code and have called upon Congress to reverse the "erosion of the income tax base" caused by these "special provisions." It is no exaggeration to say that a "comprehensive tax base" (hereafter CTB) has come to be the major organizing concept in most serious discussions of our federal income tax structure. This theme dominated the Tax Revision Compendium published in 1959 by the House Committee on Ways and Means and the hearings based on this collection of papers; it inspired the "optional simplified method" recently proposed by Senator Long; its exploration is a major task of the Special Committee on Substantive Tax Reform of the ABA's Tax Section; it was a major Leitmotiv in the responses of economists and others when the Joint Economic Committee in 1965 asked them to comment on the "fiscal policy issues of the coming decade"; and discussions of federal income taxation written for, or by, the nonexpert but interested citizen have brought it to the attention of a wider public.1

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I am very grateful for the comments and criticisms of Alan R. Bromberg, Marvin Chirelstein, and Joseph A. Pechman, who read a draft of this article.

1 House Committee on Ways and Means, 86th Cong., 1st Sess., Tax Re-
Some of this discontent with "preferences" and "leakages" has focused on the economic or social shortcomings of the particular provision under discussion; but increasingly a different line of argument has become popular. This approach accepts the rationale advanced in defense of the "preference," at least arguendo, but goes on to assert that equally persuasive arguments may be offered in support of virtually all other "preferences," including many that are still embryonic. Moreover, it is argued, a tax concession is a poor way to distribute a government bounty or to encourage activities that are in the public interest: the value of the concession varies with the beneficiary's tax status, the impact of the program may be erratic and unpredictable, its cost cannot be accurately estimated or budgeted in advance, and its operation is covert rather than open to public inspection and criticism. The only road to a simplified and improved tax structure, it is contended, is to eliminate "preferences" ruthlessly, no matter how persuasive or seductive their individual appeals may be, and to impose the tax on the resulting CTB. The broader base will per-


An offsetting advantage of tax concessions is that they leave taxpayers with greater freedom than some governmental programs; it was this, I take it, that led some advocates of a CTB in 1962 to favor the investment credit rather than a subsidy as a means of encouraging economic growth. Another premise that seems to be buried in the CTB approach is that "preferences" are not nullified by the market; a corollary is that the revenue gain to be achieved by eliminating preferences can be estimated without adjusting for changes in the pretax income to be received under the new tax structure.

It is odd that so many economists are advocating a "neutral" income tax base in the classroom at the same time that they are striving to persuade Congress that the income tax should be used as a flexible fiscal tool. This is not entirely a paradox; something can be said for the view that fiscal ends are best accomplished by changing the rate structure rather than the tax base. In the end, however, this effort to distinguish between legitimate and illegitimate fiscal uses of the tax system is likely to founder. Indeed, the 1962 depreciation guidelines and investment credit have been hailed as triumphs of a discretionary fiscal policy, though neither changed the rate structure. See Statement of Gardner Ackley, Chairman, Council of Economic Advisers, in Hearings on Fiscal Policy Issues of the Coming Decade Before the Subcommittee on Fiscal Policy of the Joint Economic Committee, 89th Cong., 1st Sess., at 3 (1965).
mit rates to be reduced, and with lower rates the benefit to be reaped by the restoration of any one “preference” will be lessened; this will let some of the steam out of efforts to renew the process of “eroding” the base. Alternatively, Congress could tax the augmented base at rates that will produce additional revenue, using the surplus to finance directly the programs that are now covertly financed by tax concessions. In either event, Congress will be willing and able (it is argued) to resist attempts to “erode” the new tax base since it will be armed with an argument — “one exception inevitably breeds another” — that now lacks persuasive force because today’s Code is already riddled with “preferences” and “exceptions.”

The aim, in short, is a reformed Internal Revenue Code with a “correct” tax base, to which all men of good will can and will rally when it is threatened by “exceptions,” “special provisions,” “preferences,” “loopholes,” and “leakages.”

In trying to come to grips with the CTB approach to income taxation, I have encountered a distressing vagueness in the use of terms like “preference.” Sometimes we are offered a goal no more precise than “an income-tax system which refuses special benefits to some taxpayers because their income comes from particular sources, and which taxes alike all dollars of income.” Of the more elaborate conceptual frameworks, the following are a fair sampling:

“[S]pecial Tax Provisions” . . . means any and all provisions of tax law which are designed to afford significant preferential treatment within each of the normal basic taxpayer categories.

. . . .

Thus, this runs the whole gamut of taxpayer differentiation affected by type of entity, size of income, time and nature of receipts and

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3 See Blum, *Federal Income Tax Reform—Twenty Questions*, 41 TAxes 672, 679 (1963): There is nothing about the combination of rate reduction and base broadening which dictates that all preferential provisions be eliminated, but there are potent reasons for leaning over backwards before allowing any of them to remain . . . . [T]he existence of any one special dispensation makes it easier to argue on behalf of others. . . . [T]he fewer gaps left in the base, the more rates can be cut without affecting revenue yields. . . . [A] Spartan attitude toward defending the integrity of the base will aid in creating the impression that the reform plan is intended to improve the system as a whole, with the chips falling as they may, and is not calculated to benefit certain identifiable groups possessing political strength.

expenses, geographical location, age, state of health, and family status.\textsuperscript{5}

While theorists may argue about what constitutes preferential treatment, sophisticated taxpayers have not experienced a similar difficulty. Instead they have been guided by this single principle: It is more advantageous to accumulate wealth or enjoy personal consumption in ways calling for the payment of less total income tax than if the savings and consumption were financed only by money received in the form of ordinary income and if that money were spent on consumption or saved only in ways which did not give rise to deductions for tax purposes. There is no reason why we should depart from this realistic principle. Legislation is preferential to the extent it allows any taxpayer to accumulate wealth or enjoy personal consumption without paying the full tax. And the full tax is that which would be due if all of the taxpayer's economic enhancement were financed by cash received as ordinary income and if he did not qualify for any non-business deductions or extraordinary exemptions or credits in the course of saving or spending his income.

The wholly nonpreferred taxpayer thus is the man who receives everything in fully taxable forms, who satisfies his personal consumption and accomplishes his savings in nondeductible ways, and who does not otherwise qualify for special exemptions or credits. To the extent that any taxpayer fares better than this yardstick he is being preferred.\textsuperscript{6}

Reference to a tax provision as "preferential" or "special" does not connote opposition to the social or economic objective which Congress has used the tax law to support. It does mean the provision deviates from a norm. Implicit in the reference is the idea that the income tax has an essential integrity; that there is a fundamental standard for determining the tax base and the applicable rates; that maintenance of the standard (restoration where it has been eroded) is important to society, high on its scale of values; that the proponent of a measure which deviates—which creates a preference—has a burden of proof which goes as much to the use of the tax system as the means of accomplishment as to the measure's specific social or economic objective.\textsuperscript{7}

\textsuperscript{5} Atkeson, \textit{The Economic Cost of Administering Special Tax Provisions}, in 1955 Compendium 276, 279.

\textsuperscript{6} Blum, \textit{The Effects of Special Provisions in the Income Tax on Taxpayer Morale}, in id. at 251–52.

To determine the extent of erosion, we must first have some notion as to what the tax system ought to be. Since this is to a large extent a matter of equity, and since equity judgments are highly personal, no single standard will meet everybody's approval. Economists have defined the term "income" as consumption plus (or minus) the net increase (or decrease) in value of an individual's assets during the taxable period. I propose to use this definition with two modifications: First, capital gains will be included in income when realized or when transferred to others through gifts or bequests; second, gifts and inheritances are to be excluded from income. The first of these modifications is made because it is probably impractical to include capital gains in income until they are realized or transferred. The second accepts the present status of estate and gift taxation as separate from income taxation. As a working approximation, this concept of income is equivalent to gross receipts in cash and in kind (other than gifts and inheritances) received by the taxpayer during the taxable period less the expenses necessary for the production of such receipts, plus the net rental value of owner-occupied homes and net capital gains transferred at gift or death.8

Most provisions leading to erosion [of the corporate income tax base] . . . represent favorable treatment granted with the intention of promoting objectives deemed to be more important than revenue and equity considerations. The dominant consideration may be to provide an incentive to some highly desirable activity such as defense-plant expansion, to relieve a depressed area or industry such as coal, to help small business, or to remove existing discrimination by extending special tax treatment to comparable industries or types of income. . . .

Two standards are used in this paper to identify preferential provisions. First, taxes should be neutral between different types of economic activity. Tax neutrality is used here in the sense that taxes be levied without discrimination and without favor between different forms of income, between different categories of expenditure, and between different industries. . . .

Secondly, taxable income in most cases should correspond to commonly accepted business measures of net income consistently followed.9

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9 Hallmuth, The Corporate Income Tax Base, in id. at 283, 284, 285, 286.
Some briefer statements are quoted below.\textsuperscript{10}

When writers turn to the task of listing the sources of "erosion," the bill of particulars almost always begins with such exclusions as state and municipal bond interest, sick pay, foreign source income earned by citizens abroad, and social security payments. As the extracts set out above suggest, however, their authors are not exclusively concerned with items that are totally excluded from the tax base. Thus, the concept of "erosion" embraces deductions (percentage depletion), differential tax rates (the long-term capital gain rate),\textsuperscript{11} rules relating to timing (postponement by qualified pension plans), and other provisions, regardless of the technical form in which they appear in the Code.

So far as I know, however, no one has attempted to list all the sources of "erosion" to be found in existing law,\textsuperscript{12} although the

\textsuperscript{10} Brazer, in 1959 Panel Discussion 201: "[I]ncome is essentially equal to the value of rights exercised in consumption expenditure plus the change in one's capital position over the course of the year. Now, you have a loophole under this definition if you allow a deduction or an exclusion that is not justified under the terms of this definition." Sneed, in id. at 12: "[E]ach dollar of income to a taxpayer should be fully included in the tax base, irrespective of its source, except where administrative convenience requires otherwise. The Simons definition of income should be used as the ideal." For other statements see Surrey, The Congress and the Tax Lobbyist — How Special Tax Provisions Get Enacted, 70 Harv. L. Rev. 1145, 1146-48 (1957); Blum, Tax Policy and Preferential Provisions in the Income Tax Base, in 1 1959 Compendium 77, 84; see Ture, The Costs of Income Tax Mitigation, 49 Nat'l Tax Ass'n Proceedings 51, 52 (1956); note 86 infra.

\textsuperscript{11} The relationship of the CTB movement to differential rates is puzzling. Although the tax base might initially be regarded as independent of the rate structure, excluding an item is in effect interchangeable with putting a zero rate on it; and the capital gain provisions disclose a similar link between deductions and special rates. Percentage depletion can also be regarded as a device to moderate the tax rate applicable to a specified type of income. The advocates of a CTB regularly describe the capital gain provisions as a source of "erosion" that must be closed to achieve a CTB, and they sometimes apply the same label to the special rates applicable to joint returns. However, Pechman, supra note 8, at 276, calculates the yield of a comprehensive income tax both with and without income-splitting, asserting that this rate issue involves a value judgment that "cannot be resolved on a priori grounds." This may imply that some (but not all) special rates are inconsistent, on definitional grounds, with a CTB, for instance those that differentiate on the basis of the source of income, such as the capital gain provisions and the rate reduction applicable to Western Hemisphere Trade Corporations.

\textsuperscript{12} The most extensive examination seems to be R. Goode, The Individual Income Tax 99-152 (1964). In my opinion, as will be seen, Goode's list is not exhaustive. In Pechman's estimates, the references to "all" eroding features were probably intended to refer only to those "leakages" that he was able to quantify. Erosion of the Individual Income Tax, 10 Nat'l Tax J. 1, 2 (1957); What Would a Comprehensive Individual Income Tax Yield?, in 1 1959 Compendium 251; see p. 929 supra for his definitions. Surrey has compiled a list of "principal income exclusions and preferences," but some of its inclusions are as surprising as some of its omissions, and I do not know how vigorously he would defend it. Thus, the ex-
philosophy of "treating all income alike" in order to achieve a CTB, with no seeds from which new "exceptions" can grow, is premised on our ability to identify the provisions to be eliminated. For this task we need more than a compilation of everyone's favorite complaints.13

From the rhetoric of the broad base approach to tax reform,14 one might get the impression that its advocates (or at least the lawyers among them) would compute the taxpayer's gross income by using section 61(a) as a starting point, discarding as exclusion of the income of state and local governments is cited, but not the exclusion accorded to the income of tax-exempt institutions. Surrey, The Federal Income Tax Base for Individuals, in 1 1959 Compendium 1, 15. Heller acknowledges that "a consensus on a detailed definition may be difficult to achieve" and addresses himself only to provisions or omissions "which have received considerable attention as inroads on the equity of the income tax." He does not disclose whose blackballs were counted in this election, or how they were weighted; but I judge from his list that the criterion was not one-man, one-vote. Heller, Limitations of the Federal Individual Income Tax, 7 J. Finance 185, 192–93 & n.14 (1952).

Efforts to compute "effective" income tax rates, as distinguished from nominal rates, are necessarily premised on an "adjusted" taxable income figure, and thus require the author to offer his alternative to the Code's version of "taxable income." Here again, however, I know of no alternative definition that purports to eliminate all "preferences." See, e.g., Musgrave, The Incidence of the Tax Structure and Its Effects on Consumption, in 1955 Compendium 96. For macroeconomic analysis, Musgrave's adjusted "broader income concept" may be adequate, but it would hardly qualify as a no-preference base for taxing purposes. See also Musgrave, How Progressive is the Income Tax?, in 3 1959 Compendium 223; White & White, Horizontal Inequality in the Federal Income Tax Treatment of Homeowners and Tenants, 18 Nat'l Tax J. 225 (1965). Attempts by welfare economists to measure "income inequality" also require the scholar to devise an adjusted income base if he thinks that taxable income is a misleading or inadequate concept. See Staff of Joint Economic Committee, 88th Cong., 2d Sess., The Distribution of Personal Income 106 (Comm. Print 1964); J. Morgan et al., Income and Welfare in the United States ch. 20 (1962); Lampman, The American Tax System and Equalization of Income, 49 Nat'l Tax Ass'n Proceedings 271, 277–78 (1956).

13 See Blum, Federal Income Tax Reform—Twenty Questions, 41 Taxes 672, 691 (1963): "So long as comprehensive reform is only a slogan, referring generally to rate reduction and base broadening, and not a concrete program for action, an assessment of its chances is premature. . . . Until a specific program has been developed, we cannot expect that the merits of the idea will get an adequate airing."

14 In the absence of an authoritative membership list, I have treated all who profess faith in a CTB as though they were full-fledged members of the club, although I recognize that they may not feel this way about each other. My concern is not to measure degrees of loyalty to the CTB rhetoric, but to see what it means and where it leads. The scholar whose professional work focuses on taxation may brush the rhetoric aside as a crude label for a program, the details of which he can consider on their individual merits. As the no-preference, comprehensive tax base concept moves into the larger world, however, it is bound to lose some of the qualifications that the experts tucked away in footnotes and appendices; and a fortiori it will lack those that were never made explicit.
a "preference" any provision which alters the result that would be reached if section 61(a) stood alone, whether it does so by excluding an item from gross income, by assigning it to a different year or to a different person, or otherwise. Having computed gross income by looking solely to section 61(a), we would then convert it into taxable income by deducting the expenses, losses, bad debts, and depreciation incurred in the taxpayer's business or profit-motivated transactions — but nothing else. A rigorous application of the "comprehensive base" approach, then, seems to imply that sections 61(a), 162, 165, 166, 167, and 212 are the only operative provisions needed for an ideal computation of taxable income.

Another answer to the same question — how can we arrive at a comprehensive base, devoid of all "preferences"? — that is suggested or implied by the commentators, especially the economists, is use of the Haig-Simons definition of income as the touchstone. Haig defined personal income as "the money value of the net accretion to one's economic power between two points of time," a formulation that was intended to include the taxpayer's consumption, and that was thought by Simons to be interchangeable with his own: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." 16

At times, the "broad base" commentators seem to imply that a "true" or rigorous CTB would be achieved if Congress enacted the Haig-Simons formulation. It is always admitted, to be sure, that valuation difficulties or administrative problems require some departures from the ideal (for example, with respect to unrealized appreciation, imputed income from assets, and domestic services by the taxpayer or his wife); but I take it that these concessions assume that the departure is a preference, albeit an unavoidable one. Such concessions, in other words, are adjustments to practicality, rather than an integral part of the definition. 18

15 THE FEDERAL INCOME TAX 7 (R. Haig ed. 1921), reprinted, READINGS IN THE ECONOMICS OF TAXATION 54 (R. Musgrave & C. Shoup eds. 1959) (emphasis omitted); H. SIMONS, PERSONAL INCOME TAXATION 61-62, 206 (1938). When it came to a program for action, Simons was more latitudinarian than his definition; indeed, he said: "If one accepts our definition of income, one may be surprised that it has ever been proposed seriously as a basis for taxation." Id. at 103.

18 If a concession to practicality is thought to be unavoidable, is it quibbling to call it a "preference" rather than a definitional criterion? I think not, for two reasons: (1) Whether practicality requires the concession is always a matter of
Still another criterion that has been tendered as the starting point in achieving a CTB, especially in the last few years, is the concept of personal income as employed by the National Income Division of the Department of Commerce in its national income statistics. Comparisons between the amount of taxable income as reported on tax returns and personal income as computed by the NID are sometimes efforts to estimate the amount of illicit underreporting of items that may be more accurately estimated by the NID than by taxpayers' admissions on tax returns. I detect, however, an incipient tendency to move beyond this use of the NID's conceptual framework, and to hold it up (with some modifications, primarily the inclusion of capital gains and losses and personal contributions for social insurance) as a normative model.\(^7\)

I do not suggest that the advocates of the "broad base" approach have explicitly asserted that the way to extirpate all "preferences" and thus to "restore" the tax base is to repeal all substantive parts of existing law except section 61(a) and the business expense and loss provisions, or to enact the Haig-Simons or National Income Division definition. These seem to me the directions in which they point, however, and I have found in their writings no other standards by which "preferences" can infallibly identified.

Against this background, I have set for myself the task of ex-judgment; thus, to admit that the item is "income" within the Haig-Simons definition invites debate on the possibility of solving the practical problem—a debate which a whole-hearted supporter of a CTB ought to enter with an eagerness to be shown that inclusion is feasible. If the concession is buried in the definition, on the other hand, this debate is foreclosed. (\(x\)) As I will suggest later, one who thinks the item ought to be (but for practical reasons cannot be) included in income may want to make other adjustments in the tax base to counterbalance this unavoidable departure from principle.

\(^7\) For the use of NID statistics as a test of underreporting see Holland & Kahn, *Comparison of Personal and Taxable Income*, in 1955 *Compendium* 313. For their normative use (explicitly or implicitly) see, e.g., Surrey, *supra* note 12, at 16-17; Cohen, *Substantive Federal Tax Reform*, U. So. Cal. 1964 Tax Inst. 711, 716; Galvin, *supra* note 1, at 3-4; *Resolutions on Substantive Tax Reform*, Bull. ABA Section of Taxation, July 1963 (Annual Report), at 4, 10 ("it may be that as a matter of equity the spread [between NID personal income and IRC taxable income] should be severely narrowed"); R. Goode, *The Individual Income Tax* 6 (1964) (supporters of income tax "are disturbed by special provisions allowing much income to escape taxation, the ingenuity of taxpayers in finding loopholes, the reluctance of Congress to repair the erosion of the tax base, and incomplete compliance with the law. In 1960, for example, the amount of income actually taxed equaled only about two-fifths of total personal income . . . ").
amining the major substantive areas of income tax law to see what changes would be required if our overriding legislative aim is to be a CTB without "preferences," "exceptions," or "special provisions." In some of these areas, CTB commentators have already specified a number of provisions that in their view constitute "preferences," and I have sought by extrapolation from these certified items to identify provisions that are equally deserving of the same label. In other areas, I have had to strike out largely on my own, since the possibility that "preferences" exist in these areas seems to have gone unnoticed.

For reasons that will be set out in more detail hereafter, I have concluded that a systematic and rigorous application of the "no preference" or CTB approach would require many more sweeping changes in the existing tax structure than have been acknowledged. I also believe that many of these changes would be quite unacceptable, despite their conformity to the Haig-Simons definition, to many of those who are attracted, in the abstract, by the idea of a CTB. At the same time, there are in my view many more ambiguities in the concept than have been acknowledged, and at these points it sheds less light than some of its supporters seem to claim. Some alleged "preferences," in other words, are as compatible with the Haig-Simons definition as their elimination would be. Finally, those who continue, in defiance of all experience, to hope for a simplified tax structure in a complex society are doubly deluded, in my view, if they believe that a CTB will make a significant contribution to simplification. Most of our troublesome complexities concern issues that are either independent of the definitional criteria or unavoidable once we accept the departures that even the most committed believers in a CTB accept as desirable or necessary.

I. Exclusions from Gross Income

Because tax differentials among taxpayers based on the source of their income are inconsistent with the Haig-Simons emphasis on consumption and net accretions to wealth as the proper measures of income, lists of "preferences" almost invariably begin with items that are now excluded from gross income, such as interest on tax-exempt bonds and social security payments. Indeed, although the concept of "erosion" takes in such tax concessions as deductions, credits, and differential rates, it has at its very core the idea that many items properly belonging in the income tax
base have been excluded from it by statutory or administrative fiat. It is appropriate, therefore, to begin with the statutory and other exclusions from gross income in analyzing the implications of a CTB.

A. Social Security, Welfare, and Other Public Transfer Payments

An important theme in the literature of "erosion" is that social security payments are earned by the taxpayer's personal services and increase his wealth just as much as receipts from traditionally taxable sources. Since these payments are not geared to the taxpayer's financial needs, it is argued that their exclusion from gross income is a poor way to protect a minimum subsistence level and that direct public aid to the poor would insure that any given amount of governmental assistance would reach those who deserve it, rather than being wasted on less needy claimants. Including social security payments in gross income (with an adjustment to permit the taxpayer to recover his contributions\(^\text{18}\)) along with analogous benefits like railroad retirement and veterans' pensions, therefore, has been a favorite way of "restoring" the tax base.

Social security, railroad retirement, and veterans' benefits are nominated for inclusion in the proposed CTB because they increase the taxpayer's net worth in the Haig-Simons sense and because if excluded they will have a differential value depending on his tax bracket and will not be openly reflected in the federal budget-making process. These characteristics are shared, however, by many other federal, state, and local government benefits, such as soil conservation and reforestation grants, subsidies to attract industrial plants, scholarships and fellowships, aid to the blind and other disabled persons, meals, clothing, and shelter supplied to patients and inmates of hospitals, prisons, and other public institutions, veterans' readjustment allowances, Medicare protection, and unemployment compensation. Some advocates of a CTB are prepared to tax these benefits (and those who eschew this responsibility impair their credentials as consistent enemies of "preferences"); but it must be noted that this route soon

\(^{18}\) The employee's contributions — his tax payments — amount on the average to 10–20% of benefits, and a similar share comes from his employer's tax payments. See Deran, Income Redistribution Under the Social Security System, 19 Nat'l Tax J. 276, 281 (1966). The balance is often described as a gift from the Government. As suggested below, however, if gifts from private persons are to be excluded from the CTB, it is not clear why the exclusion of gifts from the public would be a "preference."
brings one face to face with the fact that every modern nation—even if it does not call itself a welfare state or a Great Society—provides its citizens with a variety of benefits through programs that involve no transfer of cash or identifiable "property." This means that the "comprehensive tax base" must either measure the benefit derived by the taxpayer from all governmental services, or grant a "preference" to those who benefit from indirect government programs.

Thus, to tax the student who receives a federal or state scholarship, while exempting the one who can attend a public institution without charge, is a "preference"—as that term is used by the advocates of a CTB—to the latter; and the same can be said of an exemption for the businessman whose plant is made more accessible and valuable by public improvements while his competitor is taxed on a grant of land which was given him to induce a change of location; of an exemption for the farmer who benefits from a flood control project while his neighbor is taxed when a public agency plants trees on his land to check erosion; and of rental allowances vis-à-vis public or subsidized housing. Other troublesome areas are the services of welfare workers, county agricultural agents, and the like; the net deficit of the postal service; and government guarantees of loans to homeowners and businessmen. Even if we look only to public programs providing benefits that are susceptible to valuation and can be accepted or refused at the recipient's option, a policy of rigorously taxing direct grants would inevitably discriminate in favor of indirect benefits.

To be sure, a decision to tax all direct grants while exempting indirect benefits in order to avoid a valuation quagmire is not

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10 Federal subsidy programs aggregating $8.5 billion (excluding veterans' benefits, public assistance, public health and school lunch grants, and aid to Indians) for fiscal 1967 are listed in U.S. Bureau of the Census, Statistical Abstract of the United States 394 (1966), many of them providing indirect rather than direct benefits to individuals and business firms. Cf. R. Tittmuss, Essays on "The Welfare State" 44 (1959), arguing that state intervention in the economy in the interest of social policy did not commence in Britain with the "welfare state" of 1948, but with the introduction of progressive taxation in 1907.

unreasonable; but it would require an admission that the aim of "taxing all income alike" and extirpating all "preferences" had been compromised. And once this is acknowledged, it is only a short step to the conclusion that public policy is not necessarily served by a single-minded effort to tax all grants that can be measured, and that it might be better to decide, program by program, which should be taxed and which should be exempt. To take just three examples, the exclusions granted by existing law to combat pay, unemployment compensation, and prizes for notable public achievement may reflect an intuitive sense of fairness or public pride. Assuming the irrationality of this feeling, what is gained by including these items in a tax base that will inevitably exclude a host of noncash benefits under public programs?

For a fully committed enemy of "preferences," governmental benefits belong in the CTB even if the recipient must pass a means test to qualify; thus, the exclusion allowed by existing law for public assistance is a hidden subsidy to local welfare programs, and it creates geographical disparities since it is worth more to the residents of a city that is generous in its welfare allowances or lenient in disregarding outside earnings than to those whose city is more strict in these respects. Pechman, for example, would include such payments in the tax base, relying on the personal exemptions (raised above the existing level, if necessary) and on increases in the welfare payments themselves to prevent the income tax from encroaching on the taxpayer's ability to feed, clothe, and house himself. 21 Even if every welfare recipient received a federal subvention precisely equal to the tax burden resulting from including his welfare payments in his gross income, I presume that this reform would be viewed as an improvement over existing law by a thoroughgoing enemy of "preferences" because it would bring the federal grant into the open and compel it to pass through the budgetary process. Some advocates of the CTB may falter at this point, 22 opening themselves to the charge of being "soft on preferences"; but even they, presumably, would favor including welfare payments in gross income if, as with social security payments, the recipient is not subjected to a means test. If so, they

may reach the same practical result as Pechman (despite their rejection of his logical rigor) as the means test comes increasingly to be rejected as degrading and self-defeating in the administration of welfare programs.

In the foregoing discussion, I have accepted arguendo the theory that public assistance, veterans’ benefits, scholarships and free tuition at public educational institutions, and the like are “subsidies” in their entirety and that social security payments are “subsidies” to the extent that they exceed the recipient’s OASI payments. This premise is not unassailable, however; its validity depends upon the kind of cost accounting one chooses to use. If we take account of all taxes paid by the recipients of these public programs over their lifetime, it may be that they pay in full for what they get. Another possibility is that the price they pay cannot be estimated with reasonable accuracy; and that the case for excluding the benefits from income in order to make sure that the recipients are not taxed on a return of their contributions is as good as the case for treating the benefits as “subsidies.” The CTB is to take no account of police, fire, and military protection, I assume, because there is no feasible way of comparing the taxpayer’s benefits with his payments. In the case of public assistance and social security, the cash receipts can be measured, but it takes an act of faith to come to a firm conclusion about the amount paid by the recipient for these benefits. Perhaps the exclusion of these items does not “erode” the base after all.

B. Charity and Other Private Transfer Payments

Government agencies were not the first to distribute welfare benefits, nor have they yet preempted the field. If grants from the public treasury to needy persons are to be included in gross income, is there any justification for permitting gifts by charitable institutions (which, in any case, are increasingly viewed as having a quasi-public status) to be excluded? If veterans are to be taxed on their G.I. benefits, can an exclusion be justified for scholarships

Perhaps the rationale is that the “recipient” of police, fire, and military protection is society, not its individual members. In the case of public elementary and secondary school education, it might again be argued that the “recipients” of the expenditures are not the school children or their parents but society as a whole. (But Gillespie, supra note 20, at 146, allocates expenditures for education to school children.) Perhaps the same can be said of free college and university education. If so, what is the predicate for the conclusion that welfare, unemployment compensation, and social security programs provide individual, rather than social, benefits?

23 Perhaps the rationale is that the “recipient” of police, fire, and military protection is society, not its individual members. In the case of public elementary and secondary school education, it might again be argued that the “recipients” of the expenditures are not the school children or their parents but society as a whole. (But Gillespie, supra note 20, at 146, allocates expenditures for education to school children.) Perhaps the same can be said of free college and university education. If so, what is the predicate for the conclusion that welfare, unemployment compensation, and social security programs provide individual, rather than social, benefits?
A COMPREHENSIVE TAX BASE

and fellowships awarded by Harvard or the Ford Foundation? If welfare checks are to be included in income, why not the amounts received by the New York Times's Hundred Neediest Cases or the beggar on the streets? I presume that the CTB is to include charitable grants of all types in gross income, but I do not recall any explicit discussion of the issue; and I suspect that some who are attracted by the CTB concept will not be happy if it taxes private charity along with public transfer payments.

Workmen's compensation, military disability benefits, and sick pay, which are included in Pechman's list of unwarranted welfare-oriented exclusions, substitute for or supplement the taxpayer's wages when his earning capacity has been impaired by illness or accident; but these are not the only sources of such assistance. Existing law also excludes amounts received as damages for personal injuries in automobile and industrial accidents, payments under accident and health policies, and similar receipts. The ABA Committee on Substantive Tax Reform (in conjunction with its study of proposals to "broaden the tax base" by "including in gross income items not now included") recently asked the Treasury to estimate the revenue effect of including items of this type in gross income "to the extent that such amounts are in the nature of replacement of income rather than recovery of capital, with provision, however, for tax free recovery of cost of such items." The terms of this inquiry imply that such receipts might continue to enjoy an exemption if they compensate the taxpayer for medical expenses, pain and suffering, and loss of limb or bodily function but not if they compensate him for loss of earnings or, perhaps, for a diminution in his earning capacity.

Aside from difficulties in administering this distinction, especially as respects lump-sum settlements of tort claims, it cannot be easily reconciled with a "no-preference" tax base. If the deduction for extraordinary medical expenses in existing law is a "preference," why is not the proposed tax-free recovery of medical expenses from a tortfeasor also a "preference"? In the same vein, if existing law is "eroded" by the extra 600 dollar exemption for the blind (and if, as argued, it would be preferable to bring assistance to the blind out into the open by direct government subsidies to those who need financial aid), is it not equally a "preference" to exempt the damages received by a blind taxpayer from the tortfeasor who caused his misfortune? If the pain

of daily labor and the exhaustion of the taxpayer's body during his occupational career are not to be reflected in any tax concession, is it not a "preference" to exempt the compensation he may receive for pain and suffering or permanent injury caused by an automobile or industrial accident? The ABA Committee's request for a Treasury estimate does not mention the miscellaneous personal injury recoveries that are excluded by administrative practice or case law rather than by explicit statutory provisions (for instance, damages for libel of personal reputation); but a rigorous attack on "erosion" would, I presume, nullify these exclusions as well.

Here again, I suggest that a CTB devoid of "preferences" has ramifications that have seldom been explicitly acknowledged and that will be repellent to many persons who are attracted by the rhetoric of the broad base approach.

C. Personal and Dependency Exemptions

Although conditioned on the taxpayer's family status rather than on the source of his income, the personal and dependency exemptions "erode" the tax base on a grand scale. The 64 million individual income tax returns filed for 1963 claimed 183.5 million exemptions, removing 110 billion dollars from taxable income and thus reducing tax revenue by about 18.8 billion dollars.25 If the purpose of the exemptions is to protect a minimum level of subsistence against income taxation, the unvarying allowance of 600 dollars for the taxpayer, his spouse, and each dependent is objectionable because much of the benefit goes to persons who are above the specified plateau. A "vanishing" exemption — diminishing rapidly for income above the subsistence level — or a credit of a fixed amount would be free of this defect; 26 but even a vanishing exemption or a credit would perpetuate another feature of the personal exemption: it is "inefficient" by welfare standards because it can be claimed by wealthy persons who are only temporarily in low brackets, as well as by the children and other dependents of high bracket taxpayers.27

27 Perhaps an averaging system could be devised to prevent wealthy taxpayers with fluctuating incomes from getting "unnecessary" exemptions, but this would take some ingenuity. As to children and other dependents of high bracket taxpayers.
Since the advocates of a CTB argue that a direct government subsidy to the needy is preferable to the tax concessions of current law for taxpayers who are blind or over sixty-five, receive social security payments, or incur extraordinary medical expenses or casualty losses, one would expect them to ask that the personal and dependency exemptions also give way to federal public assistance to qualified persons. This expectation is borne out by their criticism of the extra exemptions allowed taxpayers who are over sixty-five or blind; but they appear to accept the personal and dependency exemptions as an appropriate way of preserving a minimum level of income from encroachment by the tax. Yet if we convert the 183.5 million personal and dependency exemptions claimed for 1963 into a hypothetical federal subsidy of 18.8 billion dollars, it can hardly be disputed that the circle of persons to whom Congress would be prepared to allocate this subsidy would overlap only in part the circle of taxpayers claiming the exemptions.

For this reason, one might have expected the advocates of the CTB to argue that it is inconsistent with their approach to exempt entirely a family with three children having 3,699 dollars of income, if indigent families of this size are getting only (say) 2,500 dollars of public assistance. Why not tax the first family, and let Congress appropriate — as part of the open budgetary process — such “subsidies” as are appropriate to aid all needy families (including the 3,699 dollar family, if the imposition of an income tax pushes it below the subsistence level)? The arguments that taxpayers, exemptions could be denied to them if we taxed family units as aggregates; but unless this (or the abolition of all personal exemptions) is a necessary concomitant of a CTB, it seems to follow that the CTB is thought by its supporters to be compatible with these “unnecessary” exemptions.

28 E.g., Shere, supra note 22, at 9, Hearings, supra note 22, at 429:

Unfortunately the blind are only one of many disability groups that suffer from handicaps in life. Chronological age is not a satisfactory measure of fitness, and fitness is not an acceptable measure of taxable capacity under the income tax. . . . The benefits under . . . [the social security] system can be better adjusted to meet some rational standard than can the hidden benefits under the graduated income tax which are progressively scaled to income. The public would be in a better position to evaluate the sum total of benefits that are desirable for older and disabled persons if they were kept together in one place under the social security system . . . .

Pechman, supra note 21, at 79, adduces a different objection to these exemptions: “The aged and the blind would have a valid claim for an additional exemption if it could be shown that they are required to spend more out of a given income than other taxpayers. There are no data on the expenditures of the blind, but the available evidence indicates that a family headed by an individual over 65 years of age does not on the average spend more than other families in the same income group.”
are adduced against the exclusion of public assistance from gross income seem to me equally applicable to the exemptions. Conversely, if the welfare function of the personal and dependency exemptions is compatible with a comprehensive tax base even though their benefits are "inefficiently" distributed, other welfare-motivated tax allowances (like the exclusion of unemployment compensation and social security benefits) can hardly be opposed on the ground that the tax law is the wrong forum for advancing social ends. Here again, I do not suggest that all preferences must be preserved if any are preserved, but only that we will not make much headway by unwarranted claims of logical rigor.

The exemptions are sometimes defended as devices for keeping unproductive tax returns off the administrative rolls, rather than for protecting a minimum subsistence level from taxation. This aim might account for the taxpayer's own exemption, but it does not explain those allowed for his wife and dependents; and it would suggest a "vanishing" exemption or credit rather than a constant amount that can be claimed even though the return is above the nuisance level and must be filed and audited in any event. Moreover, with the advent of the withholding system, administrative convenience became a less tenable ground for exemptions of any kind. Many taxpayers whose taxable income is completely offset by their exemptions must file returns to obtain refunds of withheld taxes; and these unproductive returns are thus part of the administrative load in any event. And now that we have automatic data processing, it may be less costly and troublesome to keep all potential taxpayers on the rolls at all times than to search annually for nonfilers to make sure that they are not subject to tax.

Another rationale for the exemptions is that they adjust the tax burden to the taxpayer's familial responsibilities. (They do this only at low levels of income, of course; for taxpayers in the middle or upper reaches, the 600 dollar exemption bears no sensible relationship to the cost of maintaining a wife, child, or other dependent.) But if the reduced rates applicable to taxpayers filing joint, head-of-household, and surviving spouse returns are objectionable because family expenses are costs of living that should be defrayed from after-tax income—as contended by some proponents of a CTB—the exemptions allowed for the taxpayer's spouse and dependents would seem objectionable for the same reason.

Finally, exemptions are the principal source of progressivity at
low brackets and can be viewed as the equivalent of a zero rate of tax on the bottom bracket. So viewed, are exemptions consistent with a CTB? In one sense, yes; one might rationally argue for a CTB coupled with a rate schedule that (for example) imposed a zero rate on the first 25,000 dollars of income and a fifty percent rate on amounts above that level. But when a zero rate is imposed on amounts that vary with the size of the family and that are regularly discussed in terms of subsistence-protection (sometimes by advocates of the CTB themselves, in proposing an increase in exemptions to offset the burden resulting from taxing welfare and other transfer payments\(^{29}\)), it seems to me that the “welfare” function of the exemptions is paramount. If so, the “nonbudgeted subsidy” argument of the CTB enthusiasts is not easily reconciled with preservation of the personal exemptions.

**D. Proceeds of Life Insurance**

If the war on preferences compels us to include in gross income the amounts received by a deceased wage-earner’s family under the federal social security system, I suppose it also requires us to tax anything the family may receive from a tortfeasor for their decedent’s wrongful death: in both cases, the payments increase the family’s net worth and replace wages that would have been taxed as earned. At this point, however, consistency requires the advocates of a CTB to reconsider their apparent tolerance of section 101(a)(1), which excludes the proceeds of life insurance paid on the death of the insured. This is no doubt an unpalatable suggestion, but there is unfortunately no way to be comprehensive except by being comprehensive.

Death benefits of 4 to 5 billion dollars are received annually by the beneficiaries of life insurance policies, and almost all of this amount “leaks” from the income tax base through the exclusion of section 101(a)(1), although it comes within the Haig-Simons concept of income. To the extent of the policy’s cash surrender value (if any), this “preference” bears a resemblance to the exclusion of gifts and bequests from gross income; but the theory that the income tax exclusion merely compensates for a federal

\(^{29}\) See Pechman, *supra* note 8, at 267:

The exemptions in effect provide a zero rate for that part of an individual’s income which is below the minimum levels. Apart from the obvious humanitarian reasons, this zero rate is supported on the ground that taxation below the minimum levels will reduce the health and efficiency of the lowest income strata of the community and will eventually result in lower economic vitality, less production, and possibly higher Government expenditures for social welfare purposes.
The inclusion of life insurance savings (imputed interest on the terminal reserve or increases in the cash surrender value) in gross income would be a palliative but not a corrective, since it would not affect pure term insurance, payments under double indemnity and other accidental death clauses, or mortality "gains" resulting from early death. These payments (for instance, death benefits of 50,000 dollars under flight insurance purchased for a few dollars at an airport) are similar to gambling profits: without making the nation richer, they transfer wealth from long-lived insureds to the beneficiaries of short-lived insureds.

Let me make clear that I am not advocating the inclusion of life insurance proceeds in taxable income. I am simply recording my conviction that the exclusion of these receipts is a "preference" as that term is used by the advocates of a CTB, that it may promote the purchase of life insurance just as percentage depletion encourages the discovery and draining of oil wells, and that it invites the exclusion of other items that are functional substitutes for insurance. If I am wrong in thinking that the war on preferences requires repeal of section 101(a)(i), however, why do its com-

30 Life insurance included in 1963 taxable returns totaled $680 million; death benefits paid in 1961 and 1962, the years of death for estate tax returns filed in 1963, were $3,381 and $3,878 million respectively. U.S. INTERNAL REVENUE SERVICE, STATISTICS OF INCOME—1962: FIDUCIARY, GIFT, AND ESTATE TAX RETURNS 51 (1965); INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 1966, at 37. Part of the amount included as "life insurance" in tax returns no doubt represents values other than death benefits (policy dividends, cash surrender values of insurance on persons other than the decedent, and so on); if these were taken into account, the proportion of death benefits included in taxable estates to aggregate benefits paid would be even smaller than 18%.

31 A good deal of attention has been devoted to the "interest" component of life insurance, of course, but the beneficiary's tax-free receipt of the proceeds has elicited less criticism. See, e.g., Irenas, Life Insurance Interest Income Under the Federal Income Tax, 21 TAX L. REV. 297, 314–18 (1966); Goode, Policyholders' Interest Income from Life Insurance Under the Income Tax, 16 VAND. L. REV. 33 (1963). Vickrey argues that it would be "theoretically correct" to require the beneficiary to report "that part of the benefit which consists of insurance proper, but not that part which is paid from the reserve," the latter being excluded, evidently, as a gift from the policyholder. W. VICKREY, AGENDA FOR PROGRESSIVE TAXATION 66 (1947).
manding generals have so much enthusiasm for repealing section 101(b) (the 5,000 dollar employee death benefit) and for taxing death benefits paid under the social security system?

E. Gifts and Bequests

Both Haig and Simons, who might be regarded as the spiritual forefathers of the CTB, believed that gifts and bequests constituted "income" as they defined the term. The theory that these items should be excluded from gross income because we have separate transfer taxes on gifts and bequests—which take no account of the recipient's other income—was characterized by Simons as "one of the most spurious and naïve types of argument in the literature." To his rebuttal at the theoretical level one might add that only about one-eighth of inherited property finds its way into the taxable estates of decedents subject to the federal estate tax. Most amounts received by bequest, in other words, bear no federal estate tax burden; and for those that do, the death tax burden is often less than the income tax that would be imposed on the recipient if this "leakage" were eliminated. As to gifts, the existence of a federal gift tax is an even weaker reason for excluding them from a CTB. The statistics on inter vivos transfers are fragmentary, but experience tells us that the donor who pays a gift tax is a rara avis.

Although advocates of a CTB sometimes call attention to this issue, the dominant mood is acquiescence in existing law. I do not know whether they have steered clear of section 102 (excluding gifts and bequests from gross income) because they think it is a "good" preference or out of political realism. Bunching of income would be a problem, of course, if section 102 were repealed; but the advocates of a CTB almost always favor income averaging rather than an exclusion as the appropriate remedy for this

33 In the absence of a more authoritative estimate, I offer the following computation. R. Lampman, The Share of Top Wealth-Holders in National Wealth 1922-56, at 23 (1962), estimates that about 30% of "personal sector wealth" was held in 1953 by "top wealth-holders" (persons with gross estates of $60,000 or more). Let us assume that the wealth owned by top wealth-holders who died in 1953 was 30% of the wealth owned by all 1953 decedents. Federal estate tax returns filed in 1954 reported net estates of $7 billion ($74 gross, less debts of $04). U.S. Internal Revenue Service, Statistics of Income — 1962: Fiduciary, Gift, and Estate Tax Returns 81 (1965). If these returns reflected 30% of the wealth owned by all 1953 decedents, the aggregate wealth transferred by death in 1953 was $23.3 billion (109/30 times $7 billion). Taxable estates aggregated $3 billion, or 13% of the aggregate amount transferred by death.
phenomenon, and sometimes they promise rates so low that timing will be unimportant. There are other reasons for excluding gifts and bequests from the income tax base, such as the distortions in family transfer patterns that would result from efforts to bypass as many generations or intermediate donees as possible, and the difficulties in taxing the beneficiaries of discretionary trusts. These, however, are no more self-evident or compelling — to me, at any rate — than the reasons that led Congress to enact many of the other "preferences" of existing law. Nor can gifts and bequests be excluded from gross income without inviting the exclusion of many other items that share some of their characteristics — scholarships and fellowships, prizes, some employee death benefits, life insurance proceeds, public assistance, social security payments, unemployment compensation, and so on.

F. Support, Dower, and Similar Rights

If a gold digger strikes it rich, would a CTB require the present value of her right to be supported by her wealthy husband to be included in her taxable income in the year of marriage, along with the estimated value of her dower rights? If this mode of improving one's economic status is to be granted a "preference" by being excluded from gross income because of valuation difficulties, should the amount actually spent by the husband on his wife's support be reported by her annually during the continuation of the marriage? As to wives, this refinement would be of little significance if the husband were allowed to deduct the amounts included in the wife's tax base (as with periodic alimony under existing law) and if the joint return of existing law were preserved in the reformed tax structure; but if support payments "belong" in a CTB, they ought to be accounted for by children as well as by the wife. Absent a "family" return aggregating the income of parents and children, however, the tax structure would be much altered by including support in the taxable base of children and other dependents. And even as to the wife, the advocates of a CTB ordinarily assert that family responsibilities are merely a form of personal consumption that are not legitimately reflected in a tax base — an approach implying that the husband should not be permitted to deduct the expense of maintaining his wife even if she is required to account for the support in her income.

A committee of the ABA Tax Section recently recommended that the Internal Revenue Code be amended to provide explicitly that the wife does not realize taxable income "from the acquisition
of support rights or dower rights either on marriage, or annually thereafter." Although this proposal merely codifies the administrative practice of the day, it implies that section 61(a) of existing law is broad enough, at least in theory, to require these items to be included in taxable income. Is the ABA proposal one of those "special exceptions" that would "erode" the tax law, to be resisted at all cost lest it serve as a precedent for more "preferences"? I put the question not entirely in a spirit of Schadenfreude, because genuine problems do arise if support is excluded from a CTB. Support is a next door neighbor of gifts and bequests; if wives and children are not taxed on the support they receive from the head of the family but are required to include gifts and bequests from him in their taxable income, some mighty fine distinctions will have to be drawn. This painful task may be avoided by excluding gifts and bequests, support payments, and life insurance death benefits from the proposed CTB. But the resulting disloyalty to the Haig-Simons definition will then be so monumental that I am baffled by professions of faith in that touchstone when the issue is the proper treatment of other types of transfer payments by individuals, private institutions, and public agencies.

G. Imputed Income from Taxpayer's Assets

The exclusion from gross income, as presently defined, of the net rental value of owner-occupied residences has been a common target of commentators, and some have also criticized the failure to tax imputed income from other assets, for example, the net rental value of household furnishings and the value of bank services provided in lieu of interest on idle balances in checking accounts.\(^\text{35}\) Acknowledging that it would not be easy to value these

\(^{34}\) Bull. ABA Section of Taxation, July 1965 (Annual Report), at 59. Thus far, the ABA Tax Section has not turned its attention to another danger that looms on the horizon if the tax base is broadened to take all economic enhancement into account. I mean the possibility that a wealthy bachelor may realize income on marriage equal to the present value of the tax savings resulting from filing joint returns until his death or divorce. For a calculation of this increase in his net worth see Hellborn, Uncle Sam's Dowry, 44 Nat'l Tax Ass'n Proceedings 310 (1951).

\(^{35}\) It has been reported that a private bank proposes to provide its depositors with "a highly trained staff that will translate letters and documents, carry out personal secretarial assignments, get theater tickets and travel reservations and advise on investments," in the manner of "an exclusive private club where privileges and services will be extended only to properly sponsored and approved members." The bank would require minimum balances of $25,000 in personal checking accounts and $50,000 in business accounts. N.Y. Times, Aug. 12, 1965, at 29, col. 1.
economic advantages or to enforce compliance, most advocates of a CTB would evidently be satisfied with taxing the imputed rent of owner-occupied residences and willing to exempt imputed income from other assets. I presume that they would agree, however, that this tolerance, even if impelled by the pain and suffering that consistency would require, would "erode" the tax base.\textsuperscript{36} I do not know the order of magnitude of the "special exception" that is thus to be granted to the owners of personal property, but it must be at least as substantial as many "preferences" that we are asked to nullify.

\textbf{H. Income from Vicarious Enjoyment}

Under existing law, the income from property transferred by gift is ordinarily taxable to the donee, not to the donor; but in some circumstances (as with so-called grantor or Clifford trusts), the income is imputed to the donor on the ground that he continues to enjoy it, though vicariously. It is often suggested that the tax base is "eroded" by excessive concessions to donors, and that the income thrown off by transferred property, family partnerships, and the like should be taxed to the donors whenever they vicariously enjoy it, not merely in the limited circumstances defined by existing law.\textsuperscript{37} As the expression of an attitude, this is all very well; but it hardly constitutes a program for reform. Is it proposed that a taxpayer who makes a gift of stock to his ten year-old son be taxed on the dividends even if they are accumulated in a bank account rather than spent currently? — even if the parents are divorced and the mother rather than the taxpayer gets custody of the child? — even after the child reaches his majority? If the CTB requires inclusion in all these circumstances, what of the income generated by stock (or the reinvested proceeds thereof) that is donated by the taxpayer to adult children, friends, and charitable institutions?

The Haig-Simons definition seems to seize upon \textit{legal} rights rather than vicarious enjoyment as the measure of income; but, as is true whenever we encounter an issue that is worth arguing about, it is sufficiently flexible, or ambiguous, to support either approach.\textsuperscript{38}

\textsuperscript{36} See note 16 \textit{supra}.

\textsuperscript{37} Of course, the income generated by donated property, transfers in trust, and family partnerships is taxed to \textit{someone}; it does not drop out of the income tax base entirely. Hence the claim that these income-splitting arrangements conflict with a CTB implies that the CTB concept dictates, or helps to determine, the taxpayer by whom a given item of income should be reported. This is, at best, a debatable theory. See pp. 974-77 \textit{infra}.
If the CTB is to look solely to the taxpayer's legal rights, it will achieve consistency at the expense of realism, while if it accepts vicarious enjoyment as a determinant of income, it will plunge us into the same morass that the income-splitting practices of existing law create. Unless all donors are taxed on all income from property transferred by gift, distinctions will have to be based — just as under existing law — on the relationship between the donor and donee, the character of the property, the mode of transfer, and other factors thought to be relevant. No matter where these lines are drawn, they will grant "preferences" to those on the non-taxable side. Here again, there is no formula that will give us a tax base devoid of "exceptions," "loopholes," and "leakages."

I. Miscellaneous Exclusions

If the aim is to eliminate all exclusions of existing law so that all income is included in the CTB, what are we to do about such tax-exempt persons and institutions as the British ambassador, the Girl Scouts, the local Baptist church, the City of Boston, the Port of New York Authority, the Benevolent and Protective Order of Elks, the Teamsters, the Yale Club of New York City, and so on? There are occasional intimations that some of these exemptions are "preferences," but I know of no authoritative list of those marked for extinction; and I suspect that even the most hardy advocates of a CTB will find reasons for keeping the list rather short. Still, as Blum says, one preference leads to another; there is surely no magic in the line drawn by existing law between exempt and taxable institutions. Conversely, if we can have a CTB even though churches, universities, labor unions, and other socially useful institutions are tax-exempt, I do not see why the CTB is not also consistent with the partial tax-exemption, special deductions, or special rates that are available to cooperative societies, mutual savings banks, insurance companies, Western Hemisphere Trade Corporations, and other organizations. Once these provisions are accepted, in turn, it is but a small

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38 As pointed out in note 12 supra, Surrey's list of exclusions and preferences includes § 115, exempting the income of state and local governments. Hellmuth, supra note 9, at 312–13, says that "the possibility of including net income of Government-owned commercial enterprises, such as electric powerplants, could be raised." I do not know whether the question to be raised is whether the existing exclusion is a "preference," or whether the "preference" should be eliminated. If the exemption of governmental revenue is threatened by a CTB, I suppose that a fortiori § 501(c) is in jeopardy.

39 See note 3 supra.
step to many other "preferences" that we are asked to eliminate in order to achieve a CTB. Thus, if Harvard's investment income is to be exempt from income tax because its activities are socially useful, is it persuasive to assert that a deduction must be denied to contributors to Harvard in order to keep the income tax structure "neutral"? Conversely, if the exemption of state and municipal bond interest is an illegitimate, because hidden, federal "subsidy," what is the proper label for section 115, exempting all income derived by a state or political subdivision from operating a public utility or exercising an essential governmental function? No doubt many if not most of our tax-exempt institutions operate at a loss, but some do not. For these, an exempt status can be predicated only on value judgments of the type that the CTB is supposed to avoid.

II. Personal Deductions

Advocates of a CTB are ordinarily hostile in theory to the personal deductions of existing law, arguing that the taxpayer's disposable income is the ideal tax base no matter how he may choose to spend it. But they do not cleave consistently to this theory. Thus, Pechman would preserve the deductibility of state income taxes to encourage use of these taxes at the state level and to minimize interstate tax differentials, and he favors or would accept deductions for large charitable contributions, extraordinary medical expenses, and major casualty losses. Senator Long's "optional simplified tax method" is more hostile than Pechman's proposal to personal deductions, rejecting all of the "preferences" that Pechman favors or is willing to accept; but it makes its own "exceptions" to the tax base: alimony, bad debts, and section 212(3) expenses. Galvin would preserve the same personal deductions as Pechman (charitable contributions, medical expenses, and casualties) and would add the interest deduction to this list of acceptable "preferences," but only to the extent that these items amount in the aggregate to more than twenty percent of the taxpayer's adjusted gross income. Some other enemies of "prefer-

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40 Cf. the suggestion that inclusion of interest from state and municipal bonds in the federal income tax base might cause the states to rely more heavily on regressive taxes, in Bronfenbrenner, Economic Effects of the Taxation of Government Securities, 35 Ill. L. Rev. 253, 305-07 (1940).
41 Pechman, supra note 8, at 273-74.
ences" find virtually all of the personal deductions acceptable, but want dollar or percentage floors to be established so only extraordinary amounts will qualify; in some cases, they also favor the imposition of ceilings to insure that extraordinary amounts will not qualify if they are too extraordinary.

I think it is fair to say of these proposals that they cannot be reconciled with the generalization ("no preferences") that we are often urged to accept as the prime criterion of a sound tax structure. They can be reconciled with other criteria, however, which might be verbalized as follows: The base to which the tax rates are to be applied should take account of costly catastrophes in the taxpayer's personal life and should offer him an incentive to make charitable contributions. It should also (some would say) allow him to deduct state income taxes in order to encourage, or refrain from discouraging, the levy of this type of tax by the states. Some other items such as interest and bad debts should be deductible to avoid the abrasive administrative burden of separating those that are business-oriented from those that serve only a personal purpose. Finally, the difficulty of verifying claims for personal expenditures and the fact that all taxpayers incur some items of this type as part of the normal cost of living, justify the imposition of a nondeductible floor on these expenses.

The principles that govern — as distinguished from those that are said to govern — the tax programs offered to us by their authors strike me as (a) sensible, and (b) familiar. I describe these principles as sensible because they involve an examination of each deduction to see what can be said for and against it, and as familiar because they do not depart in any significant sense from the principles embodied in every revenue act since 1913. Many of the proposed changes seem meritorious to me, but they stem from relatively minor differences in judgment; and they do not begin to resemble the dramatic leaning over backward against "exceptions" and "preferences" that is prescribed by Blum as the only posture capable of protecting the tax system against further "erosion." 44 In short, the proposals summarized above would invite — precisely as existing law invites — the proliferation of other personal deductions on the ground that they too deserve a boost from the tax structure or result from unexpected or catastrophic events in the taxpayer's personal life; and they also would invite the same process of refining, elaborating, and individualizing the concept of a "proper" deduction that has resulted in the

44 See note 3 supra.
preposterous detail of the charitable contribution and medical expense provisions of existing law. On balance, however, I would prefer to amend or even to retain the personal deductions and face the troubles they inevitably spawn rather than abolish them. Evidently the enemies of "preferences" have come to the same conclusion.

III. THE PERSONAL-BUSINESS BORDERLINE

Since the ideal of the advocates of a CTB is a tax on "net" income, they retain the distinction between the cost of living, which is not to be deductible, and the cost of earning a living. They cannot be blamed for the haziness of this distinction, of course, but they have blithely bestowed the pejorative terms "preference," "erosion," and "special exceptions" in the erroneous belief that the CTB concept is a useful tool of analysis in this area. In point of fact, however, it is of no assistance in separating personal from business expenditures, or in deciding whether or how to allocate the cost of items that inextricably confer personal benefits on the taxpayer at the same time that they serve his business purposes.

Thus: should taxpayers be allowed to deduct the expense of driving to and from work, of clothing or grooming themselves in the manner required by or suited to their jobs, of liberal or professional education,\footnote{See Goode, Tax Treatment of Individual Expenditures for Education and Research, 56 Am. Econ. Rev. 208 (1966).} of moving to new business locations, of curing or insuring against occupational diseases or job-related injuries, of entertaining customers and other business associates, or of maintaining themselves on business trips? The deduction of travel and entertainment expenses is so frequently denounced as a "preference" as to imply that the proposed CTB is not to make allowances for any borderline expenditures; but perhaps this hostility to "T & E" is an ad hoc or moral judgment that does not apply to moving expenses, work clothes, or accident insurance. Similarly, the ability of business executives and self-employed professionals to squeeze a variety of personal benefits out of their deductible expenditures — the lawyer who can use his secretary on personal errands; the physician who reads the National Geographic before putting it in his waiting room; the executive whose family occupies empty seats on a company plane — is often cited as a source of "erosion" in the tax base; but here again we are
assailed by labels rather than offered an analysis. Like it or not, our lives are not so compartmentalized that these borderline items can be readily classified.

The child care deduction of existing law, section 214, is a good example of this troubled area, and it nicely illustrates the irrelevance of the CTB concept to the problem of borderline expenditures. If the mother of small children takes a job outside the home, she may have to hire a nurse or baby-sitter; thus, section 214 is a plausible way to reflect the fact that the working mother's salary is not all gravy. But if section 214 is not a "preference" and does not "erode" the tax base, would it deserve these pejoratives if it were amended (a) to eliminate the family income limit of section 214 (b)(2)(B), thus permitting upper bracket families to qualify; (b) to permit all two-job families to deduct the increase in their living expenses resulting from the housewife's absence from the home (such as the extra cost of cleaning the house and of preparing meals or eating in restaurants); or (c) to permit bachelors to deduct the extra cost of living alone? Finally, what is the difference — so far as the concept of a CTB is concerned — between allowing the working mother to deduct her child care expenses and allowing the business executive to deduct the extra cost of custom-tailored clothing? If the answer is that the business man works in order to be able to live well, rather than the reverse, it is also true that some mothers do not hire a nursemaid in order to work, but work in order to hire a nursemaid.

A ground for eliminating provisions like section 214, and resisting the enactment of others, is that the business necessity of borderline expenditures is hard to prove or disprove, while their personal component is usually clear, with the result that deductions in this area cannot be adequately policed and will therefore breed exaggeration, fraud, and public discontent. This is a plausible reason for restricting such deductions, but it is different from one-dimensional insistence on a CTB. Moreover, it leaves

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46 I have heard no clarion call for denying the academic community the right to deduct living expenses incurred while teaching away from home for the summer or traveling on sabbatical leave, or for taking into income such fringe benefits as free tuition for faculty children and personal use of university facilities; but perhaps these "preferences" are "desirable as means of carrying out supervening economic and social policy" rather than tainted by "mere submission to private interest groups and political expediency" (to use Heller's dichotomy, supra note 12, at 193).

47 On the possibility of allocating such expenses see Klein, The Deductibility of Transportation Expenses of a Combination Business and Pleasure Trip — A Conceptual Analysis, 18 Stan. L. Rev. 1099 (1966).
room for deciding that some borderline expenditures should qualify for deduction because their business function can be either established with reasonable certainty or properly assumed without proof, or because the personal benefit they confer is usually modest. In an analogous area—interest and bad debts—some advocates of a CTB, acknowledging that it may be difficult to say whether the taxpayer's payment or loss is personal or profit-oriented, have favored an unlimited deduction rather than an attempt to separate the business items from the personal ones or a Draconic denial of any deductions for interest and bad debts. This is a plausible approach (and it can with equal plausibility be applied to the business-personal expenditure area), but it is a judgment that derives no support from, because it is irrelevant to, the CTB concept.

IV. BUSINESS DEDUCTIONS

If there is such a thing as a "classic" preference, percentage depletion heads so many lists that it surely qualifies for this accolade. In allowing the taxpayer to deduct more than his financial outlay in the interest of stimulating investment, however, percentage depletion has much in common with the investment credit. The former is more selective, to be sure, because limited to the mineral industries; but the investment credit is by no means "neutral" either. It is intended to prefer investment over consumption, and it distinguishes among competing investment opportunities: foreign investment, short-lived and nondepreciable assets, and most buildings do not qualify, and public utilities are treated less generously than other taxpayers.

I assume, therefore, that the investment credit has been less frequently described as a source of "erosion" only because it was unveiled too late to be included in most lists of "special provisions," not because it is consistent with a "no preference" tax system. This impression is strengthened by the fact that percentage depletion and the investment credit were evidently bracketed by the ABA Committee on Substantive Tax Reform when it requested Treasury estimates of the impact on revenue of a variety of tax reforms, since one of its assumptions was that business and investment outlays would be capitalized and "the basis of such assets [would be recovered] over the useful life of

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48 Some proponents of a CTB no doubt regard the credit as a "good" preference because of the contribution it makes to economic growth.
the assets in accordance with any one of several methods of capital recovery used by the business and investor community." 49 This statement eschews explicit mention of percentage depletion, but it seems (and was understood) to be a roundabout way of asking the Treasury to assume that depletion deductions would be restricted to the taxpayer's cost; and it also seems to exclude the investment credit from the hypothetical tax structure whose revenue results were to be estimated by the Treasury.

In contemplating the depreciation or amortization of business assets by "any one of several methods of capital recovery used by the business and investor community," moreover, the ABA committee may also have been implying that a CTB is inconsistent with the recent statutory trend toward speeding up the write-off of a wide range of expenditures that under conventional accounting principles would either be written off more slowly or be held in abeyance and applied to reduce taxable income only on a sale or abandonment of the asset. These statutory provisions, some of them inspired by the allowance of accelerated amortization for wartime productive facilities, include: section 169 (grain storage facilities); section 173 (newspaper and magazine circulation expenditures); section 174 (research and experimental expenditures); sections 175, 180, and 182 (expenditures by farmers for soil and water conservation and for clearing and fertilizing land); section 177 (trademark and trade name expenditures); section 179 (additional first-year depreciation deduction for small business); section 248 (corporate organizational expenditures); and sections 263(c), 615, and 616 (expenditures for exploring, drilling, and developing mineral properties). To these statutory "preferences," we might add the administrative practice of allowing the taxpayer to deduct the cost of small tools and institutional advertising, when capitalizing these expenditures would be more appropriate, 50 as well as the 1962 depreciation guidelines, to the extent that they permit the taxpayer to assign shorter useful lives to his assets than an independent examination of his business practice would warrant. 51

49 Report, supra note 24, at 294.

50 For 1964, it is estimated that $7.4 billion of "producers' durable equipment" (primarily tools) was charged to current expense. U.S. DEP'T OF COMMERCE, SURVEY OF CURRENT BUSINESS, Aug. 1965, at 12.

51 Double declining balance depreciation was proposed as a practical substitute for "correctly-computed realistic depreciation" by G. Terborg, Realistic Depreciation Policy 149 (1954), but empirical evidence on loss of value through time (which should be controlling to those who hold to the Haig-Simons defini-
Such statutory and administrative provisions for the "expensing" or rapid amortization of capital outlays are usually proposed either as incentives to investment or as devices to avoid difficulties in allocating the expenditures in question to specific years; but voices are also sometimes raised in favor of allowing all capital outlays to be deducted in computing taxable income when incurred or over whatever period of time the businessman chooses to designate. One such proposal is based on the claim that existing practices sanction the current write-off of virtually all expenditures for intangible assets even though they have a protracted useful life, so that it is pointless to blow the whistle on outlays for tangible property. This suggestion might be regarded as a "no-preference" approach to the write-off of capital investments.\textsuperscript{2}

It is also argued that technological developments in a dynamic economy "make any capital expenditure of certain benefit only for the present accounting period,"\textsuperscript{3} so that expensing such outlays (with the exception, perhaps, of real estate improvements) would accurately reflect economic reality.\textsuperscript{5} Though it may appeal to our vision of an America on the move, this theory cannot be reconciled with the fact that the average attained age of business equipment in use today is about ten years, a figure that has not varied more than a year or two in either direction for any year since 1920, and that is, of course, less than the anticipated useful life of the equipment. Moreover, equipment with an average attained life of five years or less accounted for about thirty-five percent of all business equipment in 1920 and for about the same percentage in 1965. As for business plant, as distinguished from equipment, its average attained age in our "dynamic" society is about twenty-four years, while it was only about twenty years in the period 1920–1930.\textsuperscript{54} These macroeconomic estimates are confirmed by experience: few taxpayers have attempted to prove useful lives for their equipment shorter than those in the 1962

\footnote{2}{Dean, \textit{Four Ways To Write Off Capital Expenditures — Can We Let Management Choose?}, in 1955 \textsc{Compendium} 504, 509–11; Dean, \textit{Capital Wastage Allowances}, in \textsc{2 1959 Compendium} 813.}

\footnote{3}{Galvin, \textit{supra} note 43, at 220. This argument implies that published financial statements overstate income on a monumental scale.}

\footnote{4}{See \textit{Capital Goods Rev.}, Sept. 1964 (Machinery & Allied Prods. Inst.).}
“guidelines”; and the vigorous complaints that we hear about the reserve ratio test stem from the fact that equipment is not being replaced at the rate implied by the 1962 guidelines, let alone at the rate that would be implied by a general expensing policy.

When all is said and done, then, statutory provisions and administrative practices that permit capital outlays to be deducted when incurred, or over periods shorter than their useful lives, are properly seen as “preferences” by the taxpayer who must depreciate his productive facilities over their useful economic lives and who cannot amortize any part of his investment in land, goodwill, and similar assets because their economic life is not reasonably predictable. Since they take no account of the taxpayer’s net worth, such provisions are not easily reconciled with the Haig-Simons definition.

Indeed, one who is seeking to eliminate all “preferences” cannot avoid questioning the propriety— from the point of view of “treating all income alike”—of the rapid methods of depreciation that entered the Code in 1954 or that were approved earlier by administrative practice. The statutory methods are not permissible for used or short-lived assets; these limitations acknowledge an intent to stimulate investment rather than to “clearly reflect income,” and this nonrevenue purpose would presumably require their ouster from a purified tax system. Finally, one might go so far as to ask whether straight-line depreciation, though sanctioned by long usage, would be consistent with the CTB or would accurately reflect “the taxpayer’s economic enhancement” unless limited to the annual decline in the market value of the depreciable property. We are told, to be sure, that depreciation “is a process of allocation, not valuation,” but if there is no decline in value, what is there to allocate?

It is obvious that these implications of a systematic program

55 The debate among accountants and security analysts over the proper way—"flow-through" or "normalization"—to reflect the tax savings generated by the investment credit, the 1962 depreciation guidelines, and the 1954 accelerated depreciation methods springs from a candid acknowledgment that these write-offs are less "realistic" than the depreciation deducted for financial statement purposes.

56 See p. 928 & note 6 supra.

57 American Institute of Certified Public Accountants, Accounting Terminology Bulletin No. 43, at 76 (1961). But see Detroit Edison Co. v. Commissioner, 370 U.S. 98, 101 (1962): "The end and purpose of it all [depreciation accounting] is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets" (emphasis added).
to “treat all income alike” would be highly unpalatable to many who profess to be attracted by the principle of eliminating “preferences” of every variety. In an effort to avoid these implications, they are likely to urge that tax “incentives” to invest in productive facilities will pay us dividends in increasing output, an improved growth rate, and less unemployment — forgetting that whole-hearted devotion to a CTB leaves no room for such “special provisions.” They may even argue that the CTB is compatible with the expensing or “fast” depreciation of capital outlays because these are mere matters of timing — forgetting that they have insisted on the importance of “mere timing” in criticizing other “preferences.”

V. PROBLEMS OF TIMING

The Simons definition of income does not specify the period of time to which it is to be applied: that is left to the person who uses the definition, which refers only to “the beginning and end of the period in question.” Similarly, Haig’s definition refers to the accretion in the taxpayer’s economic power “between two points of time.” Simons himself was not much concerned with the problems of the taxable period, or with the effect on the Treasury of moving income from one taxable period to another; and he had little patience for “those who persist in deploring long postponement of tax payment and the consequent interest cost to the Treasury,” referring to the issue as “this mosquito argu-

58 See p. 932 supra.
59 H. SIMONS, FEDERAL TAX REFORM 127 (1950); see id. at 155. Simons argued that the elimination of the special rate for capital gains, coupled with realization at death, would make the income tax virtually independent of time; taxpayers could then be allowed to depreciate assets at their discretion, to deduct losses on “wash sales,” and so on. Id. at 44–52. But if time really does not matter, a carryover of basis generation after generation would be as satisfactory as realization at death, except for transfers to tax-exempt institutions. It would be interesting to know if Simons was so tolerant of postponement that he would have accepted “Yankee storekeeper” accounting: deduct inventory costs when incurred, but take sales into account only when the customer pays. For a proposal along this line see Carson, An Investment-Recovery-First Concept of Taxable Profit, 26 ACCOUNTING REV. 456 (1951).

Simons’s tolerance of tax postponement was not a peripheral aspect of his tax theory. The taxing system, he argued, “must not require or presuppose sharp allocations of income among short accounting periods . . . tax legislation calling for definitive annual determinations means awful complexity, difficult administration, expensive compliance, endless litigation, and bad taxpayer and Bureau morale,” as well as — perhaps this was the worst of all — a “pestilential multiplication” of tax lawyers. “Income taxation has simply never faced squarely the axiom that an-
ment." His disciples, however, have not inherited his insouciance; they have condemned devices by which taxpayers can postpone the recognition of taxable income from one taxable year to another as "preferences" that are inconsistent with a CTB. Since these items do not drop out of the tax base entirely, the assertion that these "preferences" have the effect of "eroding" the tax base must mean that a CTB is a function of time, as well as of scope. Even if the tax base includes all appropriate items, then, it is not "comprehensive" if some of the items are included in the "wrong" period. As will be seen, however, this concern with timing is not pursued consistently; if it were, it would require changes in the existing structure of a far more sweeping character than has been acknowledged or, perhaps, recognized.

Before we proceed, however, a curious aspect of this area should be noted. The achievement of a CTB, it is often argued, is desirable because it will afford an opportunity to reduce the upper bracket rates and thereby mitigate the degree of progression. And one of the virtues claimed for a less progressive rate structure, in turn, is that it will reduce the importance of timing. The chain of reasoning seems to amount to this: postponement devices must be eliminated in order to create a CTB, which will in turn make possible a rate structure under which postponement devices will be innocuous. Notwithstanding this involuted way of returning to Simons's view that objections to the postponement of income are no more bothersome than mosquitoes, I intend in the discussion that follows to accept the contrary premise that timing is important.

The postponement of tax liabilities by the astute selection of an accounting method, contractual arrangement, or other device is often analogized to an interest free loan by the Government to the taxpayer. Translated into dollars, the value of postponing for five, ten, or twenty years the payment of a liability of $1,000 dollars is set out in the following table, depending upon whether the taxpayer discounts the future at five, ten, fifteen, or twenty percent:

<table>
<thead>
<tr>
<th>Years</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>$216</td>
<td>$379</td>
<td>$503</td>
<td>$598</td>
</tr>
<tr>
<td>10</td>
<td>386</td>
<td>614</td>
<td>753</td>
<td>838</td>
</tr>
<tr>
<td>20</td>
<td>623</td>
<td>851</td>
<td>939</td>
<td>974</td>
</tr>
</tbody>
</table>

Annual-income accounting is and should be tentative and provisional." H. Simons, supra at 58-60. The trouble with this line of argument is that no foreseeable income tax rate structure or general interest rate will make the timing of tax liabilities irrelevant or unimportant.
It is often argued that the same aggregate tax burden should be imposed over a period of time whether income is realized early or late in the period selected; and proposals have been made to neutralize the taxpayer's time preference by averaging income over the period and imputing interest on early tax payments. This would reduce the importance of timing, but postponement would retain some of its charms if the interest rate were inadequate in the eyes of the individual taxpayer. A rate of five percent, for example, might seem satisfactory to a conservative fiduciary or to a public utility; but for many businessmen, a rate of ten or fifteen percent would be required to take the advantage out of postponement. And for taxpayers — there must be millions of them — who are perpetually in debt to personal finance companies, a rate of twenty-four or thirty percent might be necessary to achieve the desired result. On the other hand, a rate that is tailored to the needy or leverage-minded taxpayer would be so high that other taxpayers would be tempted to adopt devices to accelerate the realization of income. And if an average rate were to be selected, the Government would be “borrowing” from some taxpayers (those who accelerate their liabilities) at too high a rate, at the same time that it was “lending” to others (those who postpone their liabilities) at too low a rate. I do not mean to suggest that averaging coupled with interest on early payments would not mitigate the importance of timing, but I do assert that the issue would continue to be of major importance. I see no possibility, with high income tax rates, of reducing the issue to the mosquito level to which Simons thought it belonged.

The continued importance of timing, even with averaging and imputed interest on early payments, is further assured because the “loan” that is obtained by postponing a tax liability has features that are overlooked by the academician but critical to the businessman. Loans from banks and other nongovernmental lenders can be procured only if the lender is satisfied with the debtor's financial ability, and are often accompanied by restrictions on the borrower’s freedom; in the case of loans to corporations, for example, the salaries to be paid to shareholder-employees may be limited, dividends may be restricted beyond the limits imposed by state law, and the major shareholders may be required to

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60 E.g., W. Vickrey, supra note 31, at 164–97.
61 For some accounting ramifications of the phenomenon of “prepaid” federal income taxes see H.A. Black, Interperiod Allocation of Corporate Income Taxes 72–74 (1966).
endorse the corporation’s notes. The loan that results from a post-
ponement of tax liabilities, by contrast, is obtainable at the bor-
rower’s will, regardless of his financial condition, and entails no
restrictions on his freedom. Moreover, it does not appear on his
balance sheet as a liability, and hence does not reduce his power
to get other loans. Finally, an ordinary loan carries a fixed ma-
turity date, imposed by the lender, and is subject to extension
only at his sufferance. Postponed tax liabilities, on the other
hand, become “due” only if the taxpayer takes whatever step
(sale of property, reduction of inventory, change of accounting
method, withdrawal of funds, or liquidation) is required to rea-
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lize the income in question. Thus, even if interest is imputed on
early tax payments at the same rate that would be paid by the tax-
payer for a commercial loan, he would be well advised to “borrow”
from the Government by postponing his tax liability whenever
possible rather than to borrow from a private lender.62

A. The Taxable Period

Income must be measured chronologically. The unit of time
selected by the Internal Revenue Code is the twelve month tax-
able year, not the month, triennium, or decade; and this decision,
though conforming to business custom, is by no means neutral
in its impact, since tax rates are progressive and taxpayers have
a variety of earning cycles. Although the twelve month taxable
year is controlling for most purposes, it is modified by a variety
of carryover provisions, which in turn specify their own chrono-
logical limits. These include section 170(b)(5) (five year carry-
forward of individual taxpayer’s excess charitable contributions),
section 172 (three year carryback and five year carryforward of
net operating loss), and section 122(b) (unlimited carryforward
of individual’s capital loss).63

62 One can usefully compare the wide-open “loan” that is obtained by post-
poning the realization of income with the more conventional terms that will be
imposed on a taxpayer by the Collection Division of the IRS if he has incurred a
tax liability but wishes to pay it in installments or at a later time. It is also
instructive to note the extent to which financially pressed businessmen are tempted
to “borrow” government funds by failing to pay over taxes withheld from their
employees’ wages on the due date, despite the severe penalty on this practice. See
1964 Tax Inst. 657.

63 Income averaging under §§ 1301-05 is another exception to the annual ac-
counting principle. For the differential advantages to various categories of tax-
payers resulting from averaging see Steger, Averaging Income for Income Tax
I do not recall any suggestion that these modifications of the twelve month taxable year are "preferences," but I am not sure why they have escaped these labels. Can it be that existing law—so deficient, we are told, in so many other ways—has somehow succeeded in defining the taxable period in a way that is consistent in every respect with a CTB? Or are we to conclude that the concept of a CTB is independent of time, and that (as Simons argued) it requires only that all items of income be taken into account at some time or other, no matter when? If so, what are we to make of the assertion that the employee who recognizes income from a qualified pension plan at retirement rather than when his employer makes contributions is receiving a "preference"?

Perhaps the advocates of a CTB object to the delayed recognition of income from qualified pension plans only because it seems inconsistent with the twelve month taxable period that usually controls in computing taxable income. If the accretion in the taxpayer's economic power (Haig's criterion of income) is normally measured by comparing his wealth on December 31 with his wealth on January 1 of the same year, it may be asserted that the same two points in time ought to be used in measuring the economic growth resulting from his participation in a qualified pension plan. This is a persuasive, though perhaps not irrefutable, argument; but it would carry the advocates of a CTB into territory that they have hitherto not attempted to invade. Our network of statutory rules governing tax-free exchanges, as well as the statutory and nonstatutory rules of "tax accounting," will require agonizing reappraisal— as I will show in a moment—if consistency in applying the twelve month taxable period is a prerequisite to achieving a CTB. Moreover, the many carryovers and other exceptions to the twelve month taxable period that are to be found in existing law are not easily reconciled with the notion that the same two points in time must invariably be used in measuring the accretion in economic power that is to be the new measure of taxable income.

B. Averaging

The effect of the twelve month taxable period may be modified in the case of income that was earned or accrued over a longer period of time (as with back pay awards under section 1303 of pre-1964 law) or that substantially exceeds the taxpayer's average income during a specified base period (as with sections 1301-05
of existing law). If the averaging device applies only to a limited category of income, however, it is not easily squared with the demand, frequently voiced by advocates of a CTB, that income be taxed "without regard to its source." The "preference" accorded to capital gains is a rough and ready kind of averaging; neither the deduction allowed by section 1202 nor the alternative special tax rate takes account directly of the tax that would have been paid had the appreciation been measured and taxed in the earlier years, to be sure, but they are often defended as a simple way of mitigating the effect of bunching. This claim would be strengthened if the holding period were longer, as it was before 1942. By contrast, the income averaging provisions of current law do not even purport to deal with slowly maturing income, and they resemble the capital gain provisions in modifying the tax rate applicable to the computation year without regard to the tax that would have been payable if the averageable income had been received during the base period.

I have seen no analysis of the implications of the Haig-Simons definition for income averaging. In the case of income that is earned over a period of time, there may be a corresponding increase in the taxpayer's net worth to be accounted for annually under the definition; but if the accretion cannot be measured or is dependent upon successful completion of the project, the income would not be reflected in the taxpayer's net worth until the final year. Tempering the rate of tax in that year to take account of the income-maturing process seems consistent with the Haig-Simons formulation (indeed, it might be regarded as an optional retroactive adoption of accrual accounting), but only if all forms of slowly maturing income are entitled to this benefit. I am not sure, however, whether the averaging contemplated by some advocates of a CTB is to apply to all slowly maturing income regardless of its source, or only to capital gains.

Averaging that takes account of the income-maturing process does not necessarily do anything for the taxpayer with fluctuating income, since an "abnormal" amount of income in a given year may reflect nothing more than that year's activities. A reduction in the tax rate to mitigate this kind of "bunching" may be consistent with the Haig-Simons definition, but here again it would seem to be a "preference"—as that term is used by advocates of a CTB—if only a limited category of income qualifies for the rate reduction. The income averaging rules of the current Code (sections 1301–05) are not applicable to capital gains or to in-
come from property received by gift or bequest during the com-
putation year or base period. Perhaps these disqualifications can
be excused as atoning in some measure for the "preferences" ac-
corded to these types of income; otherwise, they would seem to be
objectionable because they turn on the "source" of the taxpayer's
income.

C. Accounting Methods

Aside from a few peripheral issues, the advocates of a compre-
hensive tax base have not directed their attention to accounting
methods, possibly on the assumption that "exceptions" and "pref-
erences" are not to be found in this area. In point of fact, how-
ever, accounting methods are composed of conventions, primarily
governing the time when items are to be taken into account, that
are often indistinguishable from "substantive" statutory provi-
sions that are thought to deserve pejorative labels. The cash
receipts and disbursements, accrual, installment, completed con-
tract, and percentage of completion methods of reporting income
can produce very different results in any given taxable period, and
these divergencies may continue for many years—possibly for
the full span of the taxpayer's natural or business life.

To illustrate the impact of accounting methods on the CTB
concept, one example will suffice. The installment method of ac-
counting (section 453) permits the taxpayer's gain on a sale of
property to be spread out over the period of collection, even if
the buyer is highly solvent and his obligation to pay is evidenced
by promissory notes or other negotiable instruments. The ration-
ale of this method of accounting, which an authoritative com-
mittee of the American Accounting Association considers too mis-
leading for financial statement purposes,64 was recently explained
as follows by the Internal Revenue Service: 65

The method of reporting income on the installment basis was
enacted by Congress as a relief measure, the idea being that it
would enable merchants to actually receive in cash the profit aris-
ing out of each installment before the tax was paid. In other words,
the tax could be paid from the proceeds collected rather than be

64 Committee on Concepts and Standards Underlying Corporate Financial
Statements, American Accounting Association, *Accounting Principles and Taxable
Income*, 27 *Accounting Rev.* 427, 429 (1952); see SEC Securities Act Release
No. 4811, 3 CCH Fed. Sec. L. Rep. ¶ 72,124 (Dec. 7, 1965) (proper reporting of
deferred income tax liability resulting from use of installment basis of computing
income).

advanced by the taxpayer. . . . It is this "ability to pay" concept which underlies the privilege of reporting income on the installment basis.

If the cash flow theory that underlies this method is acceptable to the proponents of a CTB, why is it a "preference" to permit employees to exclude from their gross income the contributions made by an employer to a qualified pension plan that will not pay any benefits in cash for many years? If all income is to be treated "alike," I see no escape from either repealing the installment method of accounting or extending it to all taxpayers.66

The installment method of section 453 is by no means the only accounting method that permits the taxpayer to reflect income in a later year than would be required by a consistent application of the Haig-Simons principle for measuring the taxpayer's economic gain, or that is available to some taxpayers but denied to others similarly situated. The completed contract and percentage of completion methods of reporting income can be used, under section 1.451-3(a) of the Regulations, only for building, installation, and construction contracts. Surely the systematic elimination of "preferences" would require either the abandonment of these accounting methods or their extension to all contracts taking more than one year to complete.

Even more basic is the fact that the cash receipts and disbursements method of accounting permits the taxpayer to control the timing of income by accelerating or postponing the receipt and payment of many items. Deferred compensation arrangements have been criticized by proponents of a CTB, who recommend that cash basis taxpayers be put on an accrual basis in this limited area; but a consistent application of this approach (which also underlies proposals to include the interest component of life insurance savings in the CTB as it accrues) would collide on a grand scale with the assumptions of cash basis accounting. Deferred compensation arrangements are a dramatic illustration of the "creative" use of cash basis accounting principles by the tax planner, but they do not begin to exhaust the possibilities.67

66 For its limited applicability to income from personal services see W.W. Pope, 34 P-H Tax Ct. Mem. 1198 (1965) (carpenter-dealer allowed to use installment method for houses built and sold by him).

67 See Goetz, The Myth of Special Tax Concessions for Qualified Pension Plans, 51 IOWA L. REV. 561 (1966), arguing that the cash method of accounting, rather than "special" legislation, is responsible for the exclusion from the employee's current income of employer contributions to qualified pension plans and of the investment income thereon. Compare the right of cash basis taxpayers to exclude the
Indeed, a rigorous application of accrual accounting principles would require some items and transactions to be taken into account even earlier than the advocates of a CTB have proposed in their war on "preferences." For example, if social security benefits are to be stripped of their tax immunity, why wait until benefits are paid to the employee before requiring him to take them into account? If his employer bought an annuity for him, the contribution would be taxable when made under existing law, and we are asked to extend this rule to qualified pension plans as well. If this extension is required to achieve a "no preference" tax base, should not the employee be required to report, when earned, the present discounted value of social security benefits to be paid in the future? If Medicare benefits are to lose their immunity, should not the taxpayer be required to report annually the value of the protection that is conferred on him, just as he would be taxed if his employer bought him an accident and health policy as compensation? There are, to be sure, reasons for not imposing the tax at this time, but they are not easily squared with the "no preference" approach.

Not even the pitiless suppression of all accounting methods other than accrual accounting, however, would give us a tax system devoid of "preferences" and "exceptions." In support of this dismal conclusion, let me simply remind the reader of the many variations of accrual accounting that are to be found in the Treasury Regulations, rulings, and judicial decisions. Which ones are the interest component of U.S. savings bonds until redemption or maturity, despite the annual increase in redemption value.

Of course, the scale of benefits might be revised later, but that can be taken into account when it occurs; surely few would contend that a downward adjustment of benefits is so likely that the fully insured employee has not experienced an accretion in net worth. The Tax Adjustment Act of 1966, § 302(a), 42 U.S.C.A. § 428 (Supp. July 1966), provides that persons previously outside the social security system are to receive monthly benefits of thirty-five dollars for life on reaching the age of seventy-two. Would a CTB require such a person to include in income the fair market value of a comparable annuity (about $5,000) as soon as he qualifies? See United States v. Drescher, 179 F.2d 863 (2d Cir.), cert. denied, 340 U.S. 821 (1950) (employee must include in gross income the present value to him of a nonassignable annuity contract purchased and held for him by his employer).

Consider, for instance, the pricing of inventories. LIFO was used in valuing 20% of total closing inventories on tax returns filed for fiscal 1963. 25 J. TAXATION 267 (1966). If it is a "preference" that ought to be purged from the comprehensive tax base (as Hellmuth, The Corporate Income Tax Base, in The Compendium 283, 312, suggests), it would broaden the base far more than many targets that are frequently mentioned. Other ambiguities in the term "accrual accounting" are reflected by the recent debates regarding prepaid income, reserves for estimated expenses, accrual of vacation pay, dealers' reserves, and disputed liabilities.
“exceptions,” and to what general rule, I leave to scholars more skilled than I in this type of taxonomy.

One final thought: if for some reason that escapes me we can achieve a tax base that is devoid of preferences without hacking away at accounting methods, it will be necessary to define just what it is that is to enjoy this immunity from reform. The difficulty, of course, is that many statutory provisions that bear on the timing of income could be dressed up as “accounting methods” and transferred to Subchapter E (Accounting Periods and Methods of Accounting). Among these are most if not all of the business deductions mentioned earlier (research and development expenses, depreciation, and so on), the nonrecognition provisions discussed below, and such more esoteric provisions as section 77 (commodity loans), section 165(h) (disaster losses), and section 165(e) (theft losses).70

D. Unrealized Appreciation

Appreciation in the value of the taxpayer’s assets is not included in gross income under existing law until it has been “realized” by sale or other disposition. None of the proponents of a CTB, so far as I know, wants to substitute an annual net worth computation to take account each year of the taxpayer’s increase or decrease in wealth.71 I do not quarrel with this exemption of unrealized appreciation, but it unquestionably tolerates a “preference” and is inconsistent with the hope of achieving a tax base unsullied by human compromises. Although Henry Simons acknowledged that a yearly computation of the taxpayer’s net worth was implied by his definition of income, and called the realization concept a “professional conspiracy against truth,”72 he thought that

70 Compare the problem of distinguishing among “accounting method,” “accounting practice,” and “error” under sections 446 and 481. See Boughner, Change in Accounting Method, Practice, or Correction of Error? The IRS Position, 23 J. Taxation 264 (1965).

71 In 1937, however, an eminent committee that included the president of Equitable Life Assurance Society and a partner of Sullivan and Cromwell recommended an annual accrual of capital gains and losses; curiously, only the former chairman of the National Labor Relations Board objected to the taxation of “paper profits.” Twentieth Century Fund, Inc., COMM. ON TAXATION, FACING THE TAX PROBLEM 476 n.15, 477, 490 (C. Shoup ed. 1937). Compare the stress on “realizable profits” and “realized cost savings” in E. Edwards & P. Bell, The Theory and Measurement of Business Income (1961).

72 H. Seltons, Personal Income Taxation §1 (1938). Referring to Seligman’s insistence on realization as a condition to recognizing income while simultaneously favoring depreciation deductions (to which inventory write-downs and bad debt reserves might have been added), Simons said: “Surely no definition of income
no "workable scheme" could be devised to reach the theoretically correct result. He was not explicit about his reason for this conclusion, however, except for the statement that income taxation "simply must follow, in the main, the established procedures of accounting practice."73

Perhaps this source of "erosion" in the CTB is to be tolerated because of the difficulty of valuing the taxpayer's assets each year. In point of fact, of course, we somehow manage to value assets of almost every description in computing the gain or loss on taxable in-kind exchanges and in applying gift and death taxes; and Simons, like many other advocates of a CTB, wanted transfers by gift and at death to be treated as taxable realizations of gain, thus accepting the responsibility of valuing the assets at that

which admits 'mere value changes' only in one direction can well escape the fate of appearing ridiculous." Id. at 88. As to the phrase "inchoate income," coined by Seligman as a label for unrealized appreciation, Simons said that it "deserves prominent place among the curiosities of economic terminology." Id. at 87.

73 Id. at 208. Thus, Simons in the end joined the "professional conspiracy against truth," or at least abdicated in favor of accounting procedures that he profoundly distrusted: "The reputable accountant never loses sight of the fact that his income statements are influential in matters of dividend policy. Income, for him, is perhaps only what may be reported safely to unsophisticated directors as income. He aims, it would seem, never to ascertain what income is, in any really definable sense, but rather to devise rules of calculation which will make the result a minimum or at least give large answers only in the future." Id. at 81. In point of fact, although some accountants may try to protect "unsophisticated directors" by refusing to count chickens before they are grandparents, others are told by their clients whether an optimistic or pessimistic income statement is wanted. See Briloff, Needed: A Revolution in the Determination and Application of Accounting Principles, 39 Accounting Rev. 12 (1964); Cohen, Accounting for Taxes, Finance, and Regulatory Purposes—Are Variances Necessary?, 44 Taxes 780 (1966). Accounting principles often come in pairs or sets, from which management can select those that will yield the most useful financial statements. Consistency from year to year is about all that can be expected, and even this is not essential if the inconsistency is disclosed in a footnote.

As to the treatment of unrealized appreciation by accountants, it is interesting to compare the vigorous assertion that appreciation and depreciation in market values must be recognized in order to measure net revenue in W. Paton & R. Stevenson, Principles of Accounting 238-43, 451-69 (1918), with Paton's equally firm assertion twenty years later that "appreciation in its various forms is not income." W. Paton & A. Littleton, An Introduction to Corporate Accounting Standards 46, 62-63 (American Accounting Ass'n Monograph No. 3, 1940); see Income Measurement in a Dynamic Economy, in Five Monographs on Business Income 57 (S. Alexander ed. 1950) ("the accountant's use of realized rather than accrued gain is based principally on convenience"); Litherland, Fixed Asset Replacement a Half Century Ago, 26 Accounting Rev. 475 (1951); AIA, Study Group on Business Income, Changing Concepts of Business Income 23-24 (1952). For a contemporary proposal to take unrealized appreciation into account currently see E. Edwards & P. Bell, supra note 71, at 276-77.
Moreover, once the giant step of taxing unrealized appreciation was taken for the first year, it would produce a grand list of values, and later changes in value might be satisfactorily approximated by index figures based on economic trends (subject to rebuttal evidence at the taxpayer's option). The first year, in other words, would be the hardest. At the very least, before accepting the "special exception" or "loophole" that is created by the exclusion of unrealized appreciation from gross income, the advocates of a CTB might be expected to examine the possibility of applying to this area the principle used elsewhere in the tax field: value those assets that do have an ascertainable market value, and hold the others in abeyance until valuation becomes feasible. This is what the proposed taxation of life insurance savings by requiring the annual increase in the policy's terminal reserve or cash surrender value to be reported would amount to. If the exclusion of this type of unrealized appreciation erodes the tax base, what is the rationale for excluding other readily measurable appreciation?

Perhaps unrealized appreciation is to be excluded from the proposed CTB not because of anticipated difficulty in valuing assets but because "paper profits" produce no cash to pay the tax and may be wiped out in a later year. These are not untenable grounds for exempting unrealized appreciation, but they furnish equally persuasive support for other exclusions as well. One example: employees get no ready cash when their employer contributes on their behalf to a qualified pension or profit-sharing plan, and they will be involuntarily at the risk of the market until the benefits are paid in cash. Why not, then, preserve the employee's right under existing law to exclude the employer's contribution from gross income; it is a "preference," to be sure, but so is the exclusion of unrealized appreciation. Indeed, if lack of cash and continued risk of the market are legitimate grounds for taking appreciation into income only when it is realized, why should we not amend existing law to allow employees to deduct or exclude from gross income their contributions to pension plans and their social security taxes? The employee's claim is not properly answered by the assertion that he wants a "prefer-
ence” while the investor is getting only what natural law requires. The employee, in fact, is in the usual case asking only for postponement; under existing law, the investor's unrealized appreciation will be excluded from income permanently if he holds the property until death.

E. Realization of Gain or Loss on Transfer at Death or by Gift

Advocates of a CTB ordinarily propose to take account of unrealized appreciation and depreciation when property is transferred by gift or at death. In this way, they would convert the outright exemption enjoyed by such appreciation under existing law into a postponement provision. For a taxpayer who is fifty years old, a current increase in net worth would not be reported for twenty-four years if his life conforms to the 1958 Standard Ordinary Mortality Table; for thirty-five and sixty-five year-old taxpayers, the corresponding figures are thirty-seven and thirteen years. The value of postponing payment of a tax liability of $1,000 dollars for these periods of time, assuming various interest rates, is set out in the following table:

<table>
<thead>
<tr>
<th>Years</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
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<tbody>
<tr>
<td>13</td>
<td>$470</td>
<td>$710</td>
<td>$838</td>
<td>$906</td>
</tr>
<tr>
<td>24</td>
<td>690</td>
<td>898</td>
<td>965</td>
<td>988</td>
</tr>
<tr>
<td>37</td>
<td>836</td>
<td>971</td>
<td>994</td>
<td>999</td>
</tr>
</tbody>
</table>

If it is an unwarranted “preference” to allow employees to postpone the recognition of currently earned pensions and annuities until they start to receive payments on retiring from active service, realization at death also deserves the label “preference” even though it would constitute an important reform of existing law.

One need hardly add that the only version of realization at death that has been so far unveiled—the 1963 proposal of the Kennedy Administration—was a mere sieve when measured by the criterion of “treating all income alike.” 77 Even this proposal,

77 Some property was excluded entirely and granted a basis equal to its fair market value at death (personal residence and household effects); a carryover basis was provided for one-half the assets transferred to a surviving spouse; life insurance was not included; no provision was made for recapturing percentage depletion deductions in excess of the property's basis; and there was a minimum exemption (with a stepped-up basis) for $15,000 of unrealized appreciation. Hearings on the President's 1963 Tax Message Before the House Committee on Ways and Means, 88th Cong., 1st Sess., pt. 1, at 128-40 (1963). I do not quarrel with these ex-
however, encountered such heavy weather that it was replaced by a plan for a carryover of the decedent's basis, so that the gain would go untaxed until the taxpayer's heirs sold or exchanged the property in a market transaction. This modest suggestion—a "preference" proposed as a substitute for a "preference" that in turn would have only diluted a more formidable "preference"—also failed to survive the House Ways and Means Committee's examination. Resistance to change in this area is so great that any reform, even a carryover of basis for inherited property, may be seen as a victory for the CTB ideal, justifying a ruthless elimination of "preferences" in other areas. A clear-eyed view of the landscape, however, would disclose that neither a carryover of basis nor realization at death would be more than a halfway house on the road to a truly comprehensive base.

F. Tax-Free Exchanges and Similar Transactions

In addition to exempting appreciation in the value of the taxpayer's property from his gross income if it is not realized by a sale or other disposition, existing law is riddled with provisions for the nonrecognition of the gain even if it is realized. These non-recognition provisions, which may be regarded as "exceptions" in the sense that their repeal would result in taxability of the taxpayer's realized gain under section 61(a), are usually mandatory, but some are optional with the taxpayer. Among the most important are the following:

1. section 351 (transfer of property to a controlled corporation);
2. section 354 (exchange of stock or securities in a corporate reorganization, such as a merger or stock-for-stock acquisition);
3. section 1031 (exchange of business or of investment property other than stock, securities, or inventory assets for other property "of a like kind," e.g., an exchange of industrial equipment or of investment real estate);
4. section 1033 (replacement of property lost by "involuntary conversion," such as condemnation or fire, with other property "similar or related in service or use"); and

emptions, but I should think they would be intolerable to anyone who worries about the erosion of the tax base resulting from the exclusion of welfare payments.

78 Although it has been asserted that a carryover of basis "would accomplish the same result" as constructive realization at death, Somers, The Case for a Capital Gain Tax at Death, 52 A.B.A.J. 346, 347 (1966), they can be regarded as equivalents only if one assumes with Simons, see p. 958 & note 59 supra, that timing does not matter.
(5) section 1034 (sale of the taxpayer's principal residence at a gain if another residence is acquired within one year).

In addition to nonrecognition provisions, of which the foregoing are merely a sample, the Code contains a number of other provisions that operate similarly, though not under the same technical label. Examples are section 305, excluding stock dividends from gross income, and section 108, permitting the taxpayer to exclude income realized on the cancellation of his indebtedness for less than its face amount if he agrees to reduce the tax basis of his assets.

The policy underpinnings of these provisions are several in number, and they overlap in part. Some nonrecognition transactions are forced on the taxpayer, and some of these he may regard as misfortunes rather than profitable events. Whether the transaction is voluntary or not, he ordinarily either receives no cash or promptly uses any cash received to replace the assets that were disposed of, so that the imposition of a tax might compel him to sell other assets, to borrow, or to take some other inconvenient or uneconomic step. Often he does not wholly liquidate his economic interest in the assets given up, or he acquires an interest in similar property, so his profit is arguably a paper one. Another rationale for the nonrecognition provisions is a Congressional intent to encourage, or to eliminate barriers to, business adjustments, labor mobility, or other economic or personal behavior.

These all strike me as legitimate reasons for the nonrecognition provisions, and as to some transactions I find them persuasive or conclusive; but to those who envision a tax base without "preferences" or "exceptions," this attitude must seem fuzzy-minded if not downright pusillanimous. To be sure, the taxpayer's gain usually goes unrecognized only at the expense of a carryover of his basis, so that the unrecognized gain will be taken into account if he disposes of the property in a taxable transaction at a later date; but this postponement of income is itself a "preference." Moreover, nonrecognition in today's tax structure often leads to the exclusion of gain by reason of the stepped-up basis conferred on the property at death. Even if this "super-preference" were eliminated by a watertight requirement of realization of gain at death, however, the nonrecognition provisions would remain as an important source of "erosion."

Curiously, however, the nonrecognition provisions have been
little assailed by the advocates of a CTB. Criticism of details has been plentiful, but there has been no parallel in this area to the vigorous and nearly unanimous assault on such "preferences" as the exclusion of wage supplements or social security benefits. The economists, viewing the nonrecognition provisions from macro-economic heights, may have thought them of minor importance; but it can be confidently predicted that their repeal would be as unpopular as restricting percentage depletion.\footnote{Since the average holding period for capital assets is probably longer for high bracket taxpayers, L. Selzer, The Nature and Tax Treatment of Capital Gains and Losses 142-44 (1951) (1934-1937 statistics), the value of the realization concept, tax-free exchange provisions, and other postponement opportunities no doubt increase as we go up the economic ladder.} Even if the tax base were expanded by rules for realization of gain at death, the nonrecognition provisions would surely retain much of their appeal; indeed, given a choice, many individual taxpayers (as well as corporations and trusts) would undoubtedly prefer realization at death to a repeal of the nonrecognition provisions.

VI. THE TAXABLE UNIT

Before we can measure the "economic accretion" to which the "broad base" income tax is to be applied, we must specify the taxpaying unit whose economic betterment we want to measure. The "individual" income tax of existing law is not quite what its name implies; it is imposed on some income of trusts and estates, as well as on the income of individuals. Moreover, of the 64 million "individual" returns filed during 1965, 38 million were joint returns of married persons reporting their combined incomes.

For some purposes, the taxpayer is regarded by existing law as an isolated unit; thus, he must report gain realized on a sale of property even if the buyer is his wife or child. For other purposes, however, account is taken of the taxpayer's marital and family relationships: witness the separate rate structures for married couples, surviving spouses with dependent children, and heads of households; the dependency exemptions; the deductions allowed for medical expenses of the taxpayer's dependents and for alimony payments; the disallowance of losses on intrafamily transactions; and the effect of marriage on the numerous dollar and percentage limitations on deductions and other allowances. Our tax structure is similarly ambivalent as regards relations between the taxpayer and business or other economic entities in which he is financially interested. Sometimes the income of such entities is im-
puted to the individual, sometimes his income and the entity's are computed as though they had nothing to do with each other, and sometimes there are separate computations that partially reflect an identity of economic interest. Although statutory provisions taking account of, or disregarding, family or economic relationships are sometimes said to "erode" the tax base, I think these claims stem from an inadequate analysis of the problem and that in reality the concept of a CTB is quite independent of the choice of taxpaying units.

A. Family Relationships

To begin with, I find nothing in the CTB concept that leads inexorably, or even points vaguely, to the conclusion that the income of individuals should be taxed, rather than the income of married couples, families, or households, or that tells us anything about the extent to which tax rates should take account of marriage bonds or family responsibilities. Since the tax base could be enlarged to include every item that constitutes "income" under the Haig-Simons definition even though the rate structure differentiated between single persons and married couples, why is the income-splitting joint return of existing law classified as a "leakage" or source of "erosion" by some advocates of a CTB? 80

80 E.g., Pechman, Erosion of the Individual Income Tax, 10 Nat'l Tax J. 1, 27 (1957); Heller, The Federal Income Tax and the Working Man, in CIO Conference on Taxation 21, 23 (1953). Pechman, however, points out that the income-splitting issue "cannot be resolved on a priori grounds," and hence offers alternative calculations of the revenue yield obtainable by eliminating leakages, dependent on whether income-splitting is permitted or not. What Would a Comprehensive Individual Income Tax Yield?, in 1 1959 Compendium 251, 276. As pointed out in the text, however, an admission that the Haig-Simons definition is compatible with a structure that reduces the tax liability when a wealthy bachelor gets married is a dangerous concession for the advocates of a CTB. It clearly implies that the Haig-Simons definition is equally compatible with other adjustments of the tax liability to the taxpayer's marital or family status.

Simons himself was ambivalent on this issue. He asserted that "it would be hard to maintain that the raising of children is not a form of consumption on the part of parents" and that consequently no more should be allowed than "small, fixed credits" for minor children and other dependents who are incapable of self-support. H. Simons, supra note 72, at 140, 141. At the same time, however, he conceded, id. at 137–38, that:

It seems reasonable enough that the credits for, at least, minor dependents should vary directly with the family income. This might be arranged—as indeed was done under the German Reichseinkommensteuer—by providing minimum and maximum credits per child, together with a credit expressed as a percentage of income between those limits. It may also seem reasonable that adult members of a taxpayer's household should be taxed with respect to that part of the joint consumption expenses attributable to them (less contributions by them), with deduction of the amounts so imputed in determining the taxable income of the householder. Consistency, of course, would
Although they are not as explicit on this point as one would wish, their objection to income-splitting evidently is that it violates their theory that the income tax should not take account of the way taxpayers choose to spend their income. In this view, I take it, a single man’s tax should not be reduced by his acquisition of a wife any more than by his acquisition of a yacht.

This is one way of looking at life, of course, but it is surely not the only one, and others might conclude that tax distinctions based on marriage or other family responsibilities are of a different order from those based on the taxpayer’s other expenditure choices. And if it be admitted that a CTB does not forbid taking account of family responsibilities by variations in the rate structure, I perceive no reason why a CTB is not equally consistent with the use of exclusions, deductions, or credits as the means of achieving the desired differentials.

In fact, even those who find it difficult or impossible to distinguish between the taxpayer’s support of his wife and children and his other “personal” expenditures should not, in my opinion, move directly to the conclusion that all tax variations based on family responsibilities must be extirpated. An intervening question must be answered: whose income is being used for the “consumption” we are talking about? It is at least arguable that what we choose to call the husband’s income is not “his” to the extent that he is required by law to use it for the support of his wife or children — that he is merely a conduit pro tanto, so that this portion of his earnings should be reported by, and taxed to, the wife or child. If married couples think of themselves as equally entitled to their combined income, how do the tax rates applicable to joint returns “erode” the tax base? If the husband’s income is $25,000 dollars and the wife’s zero, their tax on a joint return is less than a single person must pay on $25,000 dollars; but it is the same as the tax on two single persons with $12,500 dollars of income each.

Some commentators compare the husband with $25,000 dollars of income to the bachelor with the same income, saying that they have merely chosen to spend their money in different ways, and that their choices are irrelevant to a tax on disposable income. Others may find it more persuasive to compare the married couple to two unmarried persons with $12,500 dollars of income each; whether the couple resides in a community property state or not,
marriage creates emotional, social, and legal claims so that the husband's salary is not "his" in the same sense that the salary of an unmarried taxpayer with no close relatives belongs to him. On this theory, if there are children, part of the husband's income "belongs" to them, not to him. Laymen are usually more legalistic than lawyers, and this bias may lead them to emphasize the husband's "right" to his salary and other income; but the insights of domestic life ought to dispel this preoccupation with legal concepts.

So far as I can tell, its advocates think that a CTB is consistent with allowing alimony to be deducted by the husband and reported by the ex-wife. If this is not a "leakage," would it be equally consistent with the Haig-Simons definition to allow a taxpayer to deduct amounts paid for the support of his wife and children, provided these amounts were reported by the recipient? Like alimony, these obligations stem from the fateful, but voluntary, decision to marry; and in both cases the taxpayer may have married in haste only to repent at leisure. Perhaps the tolerance shown toward alimony reflects the fact that the amount to be paid—the cost of support—has been fixed by an arm's-length agreement or by a court, while there is no such reliable basis for allocating a part of the husband's income to his wife or children during the pendency of the marriage; this ground would imply that some of the husband's income ought to be deductible by him and taxed to his wife or children, if only a satisfactory measure of the obligation of support were at hand. If so, it might be better to do what we can to allocate something (whether by a formal deduction coupled with inclusion in the recipient's income, as with alimony, or by some other means, such as a manipulation of the rate structure, exemption, or credit) rather than do nothing at all. In any event, tolerance of the alimony deduction suggests a sound, if unacknowledged, lack of assurance in the family-as-consumption theory—an implicit admission that support of one's family, though undertaken voluntarily, should not be classed with the taxpayer's other consumption expenditures.

I do not mean to suggest that the joint return rate schedule, the dependency exemption, or any other structural provision of this area is immune to criticism or preferable to alternatives. What I do assert, however, is that the concept of a CTB is of no assistance in selecting the taxpaying unit. A decision to include every dollar

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81 It might also be noted here that a legal duty of support may devolve involuntarily on the taxpayer, for example in the case of indigent parents.
of economic betterment in someone's gross income does not help us to designate the appropriate someone. And a statutory provision can be an "exception" or a "preference" only if we have an agreed-upon standard.

B. Partnerships, Corporations, and Trusts

The ambiguity of the term "income" is encountered again when we ask if a taxpayer enjoys a "net accretion to" his "economic power" (Haig's formulation) when a partnership, trust, corporation, or other entity in which he is financially interested engages in profitable transactions. In the case of partnerships, the Internal Revenue Code requires each partner to report his share of the firm's profits, whether it is distributed to him or not. Ordinarily, of course, he has the legal right to compel a distribution, but an exercise of this right would often disrupt the business and his relations with his partners; and sometimes the partnership agreement permits a distribution of profits only by majority or unanimous vote of the partners. Since the Internal Revenue Code takes no account of practical or legal restrictions on the partner's right to withdraw his share of the firm's income, he is in effect taxed on "economic enhancement" rather than on the amount available to him for personal expenditures.

A shareholder of a corporation, however, is not taxed on its income until it is distributed to him, and this means no tax at all at the shareholder level if he holds the stock until death. (The corporation, of course, is taxed on its income as realized; but the aggregate burden of a corporate tax on the corporation's income and a personal tax on such gains as are distributed or otherwise realized by the shareholder may exceed or fall short of, but will almost certainly not correspond to, the tax that would have been paid if the same income had been realized by a partnership or individual proprietorship.) In contrast to the partnership, then, the corporation shields the shareholder against the individual income tax so long as the income is accumulated. And it does this even if the shareholder owns all of the stock and can withdraw the profits at will; spendable receipts are what count, not economic enhancement or even legal control over the profits. Natural law does not dictate this distinction between partnerships and corporations; in the case of two categories of corporations—foreign personal holding companies and foreign corporations realizing Subpart F income—the shareholder is taxed on his share of the corporation's undistributed income. Moreover, the existence of section
is a constant reminder of the intimate relationship between a corporation's profits and the tax status of its shareholders.

Trusts and estates fall between partnerships and corporations as respects the tax treatment of accumulated income: sometimes it is taxed to the beneficiaries even though not distributed to them (as with partners), but sometimes it is not taxed to them until distribution (as with shareholders). There are also circumstances in which trust income is taxed to the grantor of the trust, even though it cannot be distributed to him, because of the "non-economic" satisfactions he obtains by dedicating the income to the beneficiaries of the trust.82

In short, in its treatment of the taxpayer's financial interest in business and other entities, existing law wobbles between spendable receipts and economic enhancement as the criterion of income, and occasionally it fixes instead on vicarious enjoyment as controlling. We are sometimes told that some minor threads in this tangled web of rules are "preferences" that "erode" the tax base, the implicit premise being that the CTB concept implies a set of rules governing the attribution of entity income to the persons beneficially interested. Despite these fragmentary announcements, I know of no attempt to explain why a CTB is consistent with some attribution rules and not with others, nor any effort to spin out the implications that are thought to reside in this concept by systematically identifying the provisions in today's tax law that would have to be changed to achieve a CTB.

If corporate stock owned by the taxpayer were to be valued at the beginning and end of each taxable period in order to take the net accretion in unrealized gain or loss into account, as the Haig-Simons formulation seems to require, no other steps to reflect the taxpayer's interest in the corporation would be required. If unrealized appreciation or depreciation is to be disregarded, however, we might expect the advocates of a CTB to explore the milder measure of imputing the realized corporate income to the shareholders. There are obstacles in the way of doing so, of course, and the separate corporate tax may be viewed as rough compensation for failing to tax the shareholders; but this apology is just another way of saying that a CTB can be no more than a faintly flickering, far-off ideal. As to trusts, I presume (in the absence of an unequivocal statement by the CTB experts) that beneficiaries are to be taxed on income that is allocated to them, whether distributed or not. The status of the undistributed income of dis-

82 See pp. 946-47 supra on the relationship of vicarious enjoyment to a CTB.
cretionary trusts, under the Haig-Simons formulation, is less clear. Perhaps it is income without a taxpayer, to be held in abeyance until the beneficiary who will receive it can be identified and taxed. There is little justification for taxing it to the fiduciary except as an interim measure, to be followed by an adjustment (additional tax or refund) when the real party in interest becomes identifiable. To the economists, this may seem obvious enough; but I suspect that the ABA Tax Section's Committee on Substantive Tax Reform will not be very comfortable with this application of the principle of "taxing all income equally."

Without claiming prescience, I venture to predict that many advocates of a CTB will draw back from the logical consequences of the idea that "economic enhancement" should be taxed wherever it can be identified, and will propose or acquiesce in an exception for the undistributed income of corporations and trusts. The justification that is likely to be offered for this exception is that the undistributed income of these entities is not presently available for expenditure by their shareholders or beneficiaries (except by selling or borrowing against their interests), and that it may never be distributed to them because it remains at the risk of the entity's activities. Fair enough. But cannot the same be said of the employer's contribution to a qualified pension plan, or even of the employee's own contribution if it is mandatory? And would the enemies of preferences be equally complacent if the personal holding company provisions were amended to permit the personal service income of movie stars — or of law professors and factory workers — to be accumulated in a corporation free of the individual income tax? My bones are not sensitive to the threat of rainy weather, but they tell me that this proposal would "erode" the tax base. But why would it, if an incorporated storekeeper is not taxed on his corporation's earnings until they are distributed to him?

Although the CTB concept thus implies a group of changes in the individual tax structure that are much more far-reaching than its advocates have acknowledged, it leaves us without guidance in a closely related area of the "taxable unit" problem, the separate corporation income tax. Just as the Haig-Simons formulation requires the taxable period to be specified without shedding any light on the criteria to be used in fixing a period, so it seems to require the taxable unit whose economic accretion is at stake to be prescribed by criteria that are not part of the definition of income. If the unit is selected on the basis of such "outside"
criteria, however, it evidently follows that we can have a CTB whether corporations are taxed as separate entities or not. If so, the assertion that the dividends-received exclusion erodes the tax base \(^{83}\) is puzzling: why is it not a partial nullification of a separate corporate tax that was not a necessary part of a CTB to begin with?

More important, is the tax base “eroded” if corporations are classified into categories (ordinary business corporations, personal holding companies, insurance companies, commercial banks, and so on) with the income of each category being computed and taxed in a manner — and at a rate — thought to be suited to its function in the nation’s economy? If all incorporated taxpayers must be treated alike in order to achieve a CTB, today’s rules will have to be drastically reformed at a variety of points that have not yet been identified for us by the CTB advocates. If, on the other hand, the aim of “taxing all income alike” is compatible with separate taxing systems or separate rate structures for insurance companies, personal holding companies, mutual savings banks, and commercial banks, I do not see why this aim is not equally consistent with taxing mining corporations differently from manufacturers, business executives differently from ministers, and married persons differently from bachelors.

VII. CONCLUSIONS

This attempt to work out the implications of the “no preference, comprehensive base” approach in a systematic way, and thus to ascertain where it would take us if it were converted from a slogan into a program for action, has led me to these conclusions:

(1) The systematic elimination of “preferences” in order to achieve a truly “comprehensive” base would require many more fundamental changes in existing law than are usually acknowledged. Among the areas that would be drastically affected by a whole-hearted use of the Haig-Simons definition are: mortality gains on life insurance; governmental benefits furnished in kind or in services; recoveries in suits for personal injury or death; charitable gifts to individuals; personal and dependency exemptions; tax-exempt organizations; the investment credit; deduction or rapid amortization of business assets; depreciation below

\(^{83}\) E.g., Pechman, Erosion of the Individual Income Tax, 10 Nat’l Tax J. 1, 12 (1957). I mean to imply not that the dividend exclusion is a desirable provision, but that the CTB concept sheds no light on the issue.
market values; inventory pricing; accounting methods; and tax-free exchanges. Some of these areas seem to have been disregarded by the proponents of the CTB, and others have not received the attention their importance deserves.

(2) At many points, the most enthusiastic proponents of a CTB have drawn back from its implications: they almost always advocate the exclusion from gross income of unrealized annual net worth increases, gifts and bequests, and imputed income from personal services, and support allowances for such personal expenditures as charitable contributions and medical care; and some also favor provisions to encourage investment, such as the investment credit or rapid depreciation. Their reasons for departing from the Haig-Simons definition are, in my opinion, no different from the reasons that are offered in support of all of the "preferences" of existing law: the necessity or desirability of avoiding difficulties in valuation or enforcement, of stimulating economic growth, of encouraging behavior thought to be socially useful, of alleviating economic hardship, of retaining the freedom of choice that results from use of tax concessions rather than some other governmental mechanism, or of pursuing other social policies. I dare say that they would give similar reasons for favoring perpetuation of many other preferences of existing law if they were required to express an opinion on all of those mentioned in this article. In short, they harbor, in my opinion, the same attitude


Scholars who are hot for certainties . . . . must have answers if they are to be happy, and the answers must derive from some uniform standard which is objectively applied. Besides, the term "loophole" has become too charged with emotional overtones for the staid world of tax scholarship . . . . And so the scholars have turned to other words that are supposedly less partial and hence more informative.

There are enough words to please everybody who wishes to appear impersonal and detached. Instead of loopholes the enlightened now speak of "erosions" of the tax base. Or they refer to special treatments and special provisions, special deductions and special exclusions, special exceptions and special accommodations, differentials and preferentials, discrepancies and discriminations, openings and leakages, tax shelters and tax havens, tax favors and tax advantages, tax mitigations and tax concessions. All these words, as well as others now in fashion, disclose a marked capacity for devising polite synonyms. They produce an air of impartial judgment. To call percentage depletion a loophole is to indulge in a personal prejudice. To call it an erosion is to make an objective appraisal . . . .

My inquiry into loopholes confirms anew a familiar truth. Better answers require wiser questions. Ultimately dispensations for certain taxpayers are condemned, not because they conform to some definition of a loophole, but because they are considered undesirable for various reasons . . . . We cannot learn very much by asking what is a loophole. The only meaningful questions are those which focus on the precise purposes and effects of a dispensation. Of course, the answers will vary, for they will reflect different standards of good and evil . . . . No larger wisdom is discernible.

The following extract from Report Supporting Resolutions on Substantive Tax
toward the Haig-Simons definition of income that Congress is said to exhibit toward our progressive rate schedule: a declaration of faith, combined with advocacy or tolerance of numerous exceptions, each of which inures to the benefit of a "special" group of taxpayers.

(3) If I am right in asserting that most professed supporters of the CTB concept favor a host of important departures from the Haig-Simons standard, there ought to be an equally drastic revision of their rhetoric, including a renunciation of the claim that we can or should eliminate all, or even most, "preferences" and "special provisions" from the Internal Revenue Code. This means not that all provisions of existing law are equally good, but rather that we cannot avoid an examination of each one on its merits in a discouragingly inconclusive process that can derive no significant assistance from a "no preference" presumption that would at best be applied only on a wholly selective basis. Put another way, there are "preferences" and "preferences"; some are objectionable, some are tolerable, some are unavoidable, and some are indispensable. A truly "comprehensive" base, in short, would be a disaster.

It may be argued that the rhetoric of the CTB approach does not matter; we are used to political slogans and exhortations that contain a kernel of truth and do no harm even though they promise more than they can deliver. What concerns me is that the rhetoric

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Reform, Bull. ABA Section of Taxation, July 1963 (Annual Report), at 5, 12–13, would have been admirable grist for Eisenstein's mill:

There can be no wavering from a resolute determination that what is really income must be taxed without exception. Once there is a compromise with principle or a yielding to pressure to admit a special exception, the hole in the dike widens. All efforts at real reform go for naught. Having stated this broad proposition, however, one should note certain possible exceptions: for example, certain tax exempt organizations could continue their exempt status as under present rules; there could be a deferment of recognition of income in certain exchanges and corporate reorganizations; and such deferment might be extended to cover sales of property followed by reinvestment in comparable property.

I suspect that much of the enthusiasm for rigorous "broad base" reform among academicians would prove equally evanescent if subjected to cross-examination. Take, for example, these recommendations in Joint Economic Committee, 89th Cong., 1st Sess., Fiscal Policy Issues of the Coming Decade (Comm. Print 1965): "broad-based, flat tax on all gross income" (Brown, in id. at 11, 14); "an adjusted gross income tax if possible" (Buchanan, in id. at 19, 21); "a general broadening of the tax base to include all forms of income" (Eisner, in id. at 42, 44); "[a tax] preferably on adjusted gross income with minor exemptions" (Groves, in id. at 61). I suggest that these shorthand expressions would, if expanded, translate into a somewhat broader tax base than we now have, but with a host of major and minor exclusions and deductions retained, rather than into a rigorous application of the Haig-Simons definition.
A COMPREHENSIVE TAX BASE

will foster changes in the tax structure not because they are desirable in themselves, but merely because they will broaden the base. Since I am convinced that a full-fledged CTB will, and should, remain miles away, I see no automatic advantage in moving a few feet in its direction. It is a truism that existing law bears more heavily on earned income than on income from investments, and I venture the judgment that the base-broadening provisions that are most likely to be enacted in the pursuit of a CTB would enlarge rather than narrow this disparity.

(4) To the extent that a departure from the Haig-Simons definition is compelled by administrative difficulties (valuation, enforcement, and the like) rather than by its contribution to a social or economic goal, the advocates of the CTB have given too little attention to the paradox of the "second best." 85 I take it that one of the virtues they see in the Haig-Simons definition is that its rigorous application would lead to an "ideal" distribution of the tax burden, by measuring the ability to pay that arises from "income" in the most accurate way. 86 If this is their view, it would be appropriate to quantify the tax burden distribution that would result from a rigorous application of the definition by taking into account, at the best estimates available, such difficult items as annual increases in net worth, imputed income from personal assets, housewives' services, and gifts and bequests. Even if the valuation problems are too formidable to justify inclusion of these items in the tax structure itself on a taxpayer-by-taxpayer basis, a rough and ready estimate would be better than nothing


86 See H. SIMONS, supra note 72, at 105-05: "Since the devices of accounting and tax legislation contemplate only very rough approximation to income, it is decisively important to see behind these methods of calculation an 'ideal income,' calculable by different and less practicable methods. Only on the basis of some broader conception is it possible to criticize and evaluate merely practicable procedures and to consider fruitfully the problem of bettering the system of presumptions." Accord, R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 165 (1959). (But Musgrave, id. at 165, refers to the "excellent analysis" of the income concept in N. KALDOR, AN EXPENDITURE TAX (1955), which concludes, at 70, that "the problem of defining individual income, quite apart from any problem of practical measurement, appears in principle insoluble.") See White, Consistent Treatment of Items Excluded and Omitted from the Individual Income Tax Base, in 1 1959 COMpendium 377 ("Aside from practical difficulties in administration, the base of the individual income tax ought never, or hardly ever, to be determined on any criterion other than that of consistency with the economic [Simons] definition of personal income"); H. BRAZER, A PROGRAM FOR FEDERAL TAX REVISION 7 (1960); Blum, Federal Income Tax Reform—Twenty Questions, 41 TAXES 672, 680 (1963); authorities cited note 10 supra.
for the kind of macroeconomic model that I am suggesting. Having worked out in this way an approximation of the "ideal" distribution of the tax burden, it would be possible to test alternative reform programs to see which comes closest to the "ideal." The "best" practical program, on this theory, would not be the one that eliminated the most "preferences," but the one whose tax burden distribution was closest to the ideal.

This method of judging the proximity of a proposal to the professed ideal would recognize that unavoidable preferences (those compelled by limitations in valuation techniques, anticipated problems in compliance, and similar factors) might be offset by deliberately preserving (or even creating) other preferences. It has often been pointed out that the elimination of an exclusion would serve no purpose if it is so equally distributed that the tax burden would be unaffected by the tidier system resulting from the change. I am suggesting nothing more than a generalized application of this well-known principle. If the tax base is to continue to exclude gifts and bequests, annual net worth increases, and imputed income from personal property, for example, the continued exclusion of unemployment compensation, social security payments, and similar items may distribute the tax burden more equitably (using the Haig-Simons definition as the touchstone) than a reform program that adds the latter category of items to the base.

Such a study would employ the computer techniques pioneered by J. Pechman and described in his *A New Tax Model for Revenue Estimating* (1965), and applied in B. Okner, *Income Distribution and the Federal Income Tax* (1966). The study proposed by the ABA Committee on Substantive Tax Reform of the Section of Taxation, 90 ABA Rep. 289, 295 (1965), will be a step in the right direction if it is rigorous enough in its conception of a "broad income tax base." The proposed study ought to examine the effect of "preferences" on both "horizontal" and "vertical" equity (that is, within each income bracket and as among brackets, respectively). There may be "preferences" that, taken in combination, produce a distribution of tax liabilities within certain brackets comparable to the burden that would result from a more rigorous application of the Haig-Simons definition; and other combinations of "preferences" may have a similar effect as among income brackets. Finally, there may be more elaborate combinations that would perform the same function simultaneously for both the horizontal and vertical planes.

I do not wish to minimize the difficulties; to satisfy everyone, the study would have to offer a series of "ideal" distributions of the tax burden, each based on its own assumptions about the proper way to resolve the definitional issues in the concept of income. Moreover, since we lack information on the size and distribution of many items that are not now reflected on tax returns, a good deal of estimating ingenuity would be required. One of the dangers, of course, in the availability of some information in a form that permits easy computer use is that items that are not "machine-handleable" will be disregarded. See Spengler, *Machine-Made Justice: Some Implications*, 28 Law & Contemp. Prob. 36, 44-45 (1963).
There are many problem areas in which the search for "preferences" is doomed to fail because we cannot confidently say which provisions are "rules" and which are "exceptions." In these areas, we cannot comply with Blum's advice to "lean over backward" to avoid "preferences" because, in the absence of a generally acceptable or scientifically determinable vertical, we cannot know whether we are leaning forward or backward. The central source of difficulty is the fact that the income tax structure cannot be discovered, but must be constructed; it is the final result of a multitude of debatable judgments.

If we were dealing not with an income tax but with a tax whose label described its reach with greater precision, an "exception" would be easier to identify. For example, in constructing a poll tax, we would have at the outset a consensus on what constitutes a natural person whose "head" is to be taxed. To be sure, even here there would be marginal cases — conceived but unborn children, persons who have been legally declared dead but who reappear, Siamese twins, and so on. These peripheral cases aside, a consensus on the base to which the tax is to be applied would be feasible, and it would warrant the use of terms like "exception" and "preference" to describe proposals to exempt from the tax such persons as children, foreign tourists and diplomats, or incompetents. And one could say of proposals to exempt soldiers on combat duty, Boy Scout leaders, or persons over the age of sixty-five or blind that, however meritorious such "preferences" might be when considered individually, there would be no satisfactory criteria for exempting one group of meritorious persons while refusing to exempt other persons such as Peace Corps workers, nurses, or the unemployed. Under these circumstances, it could be persuasively argued that a "pure" tax base would be a fortress that could be effectively defended against all comers, no matter how appealing their claims. When we turn to the field of income taxation, however, we do not begin with a consensus on the meaning of income, but with a myriad of arguments about what should be taxed, when, and to whom. The CTB concept is simply irrelevant to many of these issues — the taxable unit, the taxable period, the personal-business borderline, and others — and hence, notwithstanding the contrary assumption of some commentators, it can make no contribution to the elimination of "preferences" from these areas.

See note 3 supra.